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Dear Sir,

## **Management's Report on Internal Control over Financial Reporting**

The management of Deutsche Bank AG, Colombo Branch ("Branch") is responsible for establishing and maintaining adequate internal control over financial reporting. Branch's internal control system is designed to provide reasonable assurance to management regarding the preparation and fair presentation of published financial statements in accordance with generally accepted accounting principles. All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

The Management has established an ongoing process for identifying, evaluating and managing the significant risks faced by the Branch and this process includes enhancing the system of internal controls as and when there are changes to business environment or regulatory guidelines. The process is regularly reviewed by the management and accords with the guidance for directors of Banks on the Directors' Statement of Internal Control issued by the Institute of Chartered Accountants of Sri Lanka.

To the best of our knowledge, we did not identify any material deficiencies or weaknesses, in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Branch's ability to record, process, summarize and report financial data. Based on our understanding, there has been no fraud that involves management or other employees who have a significant role in the Branch's internal controls over financial reporting which requires disclosure.

The Branch management assessed the effectiveness of Branch's internal control over financial reporting as of December 31, 2018 based on the guidelines issued by the Institute of Chartered Accountants of Sri Lanka in relation to statement of internal control. Based on this assessment,



management believes that, as of December 31, 2018, Branch's internal control over financial reporting is effective.

## **Internal Control Governance**

The key processes that have been established in reviewing the adequacy and integrity of the system of internal controls and governance of the Branch include the following:

- The Committees are established by the Management in ensuring the effectiveness of the Branch's daily operations and that the Branch's operations are in accordance with the corporate objectives, strategies and the annual budget as well as the policies and business directions that have been approved.
- In accordance with the requirement of CBSL, Group Audit (GA) conducts an annual audit of DB AG Colombo branch using a risk-based audit approach as outlined in GA policy and GA manual. The methodology enables GA to increase transparency of audit coverage, refine the Risk Assessment (RA) approach, better align risk and resources, and exercise greater judgment in audit coverage. The RA process is fundamental to GA's understanding of the Bank's strategy, plans and objectives and is used to develop an audit plan focused on the most relevant areas in any plan year. The RA is the primary instrument for documenting the assessment of Inherent Risk (IR) and the Control Environment Indicator (CEI) for all applicable risk categories, including fraud risk. The RA results in an overall score for each Auditable Area (AA) in the Audit Universe (AU), which drives the cycle of audit coverage, to a maximum of 5 years. GA also adds coverage based on regulatory requirements and override the risk-based cycle either for all or parts of the AA. Group Audit APAC is primarily responsible for audit coverage in Sri Lanka and, where necessary, is assisted by global teams.
- Operational committees have also been established with appropriate empowerment to ensure effective management and supervision of the Branch's core areas of business operations. The committees established locally are the Branch Management Board and Asset and Liability Committee. Branch also comes under the purview of the following Global Committees:
  - Audit Committee
  - Risk Committee
  - Integrity Committee
  - Compensation Control Committee
  - Technology, Data and Innovation Committee

In assessing the internal control system, Branch relies on documented procedures and controls that are connected with significant accounts and disclosures of the financial statements of the Branch. These are under the overall purview of the above committees and Group Audit for suitability of design and effectiveness on an ongoing basis.

## **Adoption of Sri Lanka Accounting Standards – SLFRS 9 – Financial Instruments and SLFRS 15 Revenue from Contract with Customers**

The Branch first time adopted SLFRS 9 and SLFRS 15 from 1 January 2018 and due to the transition method chosen by the Branch in applying SLFRS 9 comparative information throughout the financial statements have not been restated to reflect its requirements.



The adoption of SLFRS 15 did not impact the timing or amount of fee and commission income from contracts with customers and the related assets and liabilities recognised by the Branch.

SLFRS 9 sets out requirements for recognising and measuring financial assets & financial liabilities and has replaced LKAS 39 Financial Instruments: Recognition and Measurement. The requirements of SLFRS 9 represent a significant change from LKAS 39 and has brought fundamental changes to the accounting for financial assets and to certain aspects of the accounting for financial liabilities.

The Branch has made an assessment of the objective of the business model at the group level in which an asset is held at a portfolio level prior to concluding on the classification of the assets as it best reflects the way the business is managed and information is provided to management.

The concept of “Incurred loss” used under LKAS 39 has been replaced with, “expected credit loss” under SLFRS 9. The Branch’s models to calculate Expected Credit Losses (ECLs) are inherently complex and judgment is applied in determining the correct construct of the models. There are also a number of key assumptions made by the Branch in applying the requirements of SLFRS 9 to the models including selection and input of forward looking information. These models have been developed by the Group and the information relating to Branch have also been considered at the Group level. The key assumptions and appropriateness of forward looking information underlying the models have been reviewed by independent consultants and tested by the Group auditors. The relevant information and documentation have been shared with the auditors of the Branch.

The ECL from loans and receivables have been computed at Group level and the entries relating to the Branch have been centrally processed into the local general ledger. The involvement of local management in the process of ECL computation was minimal.

Comments made by the external auditors, in connection with internal control system will be dealt with in the future.

## **Confirmation**

Based on the above processes, the Management confirms that:

- The financial reporting system of the Branch has been designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes has been done in accordance with Sri Lanka Financial Reporting Standards and regulatory requirements of the Central Bank of Sri Lanka.
- There was no material change in internal control over financial reporting that occurred during the period covered by the report that has materially affected, or is reasonably likely to materially affect internal control over financial reporting, including any corrective actions with regard to significant deficiencies and material weaknesses.

## **Review of the Statement by External Auditors**

The external auditors have reviewed the above Management’s Statement on Internal Controls for the year ended 31 December 2018 and reported to the Management that nothing has come to their attention that causes them to believe that the statement is inconsistent with their understanding of



the process adopted by the Management in the review of the design and effectiveness of the internal control system of the Branch.

*Aarti Gulati*  
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Deutsche Bank AG