



The Institute of
Chartered Accountants
of Sri Lanka

- Guidance for Directors of Banks, Licensed Finance Companies and Finance Leasing Companies on the Directors' Statement on Internal Control
- Sri Lanka Standard on Assurance Engagements 3050 – Assurance Report for Banks on Directors' Statement on Internal Control (SLSAE – 3050)
- Sri Lanka Related Services Practice Statement 4750 – Engagements to report on the compliance with the corporate governance directive issued by the Central Bank of Sri Lanka (SLRSPS – 4750)

ISSUED BY

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

FOREWORD

The Central Bank of Sri Lanka (CBSL) in pursuance to the role as the regulator of financial institutions in Sri Lanka, has issued the Banking Act direction No. 11 of 2007 on corporate governance and internal controls to licensed commercial banks, in order to enhance and build the confidence in these key entities.

In order to assist the bankers and practitioners to comply with this direction, at the request of CBSL, the Institute of Chartered Accountants of Sri Lanka (ICASL) appointed a consultative committee under the Chairmanship of Mr. Asite Talwatte, Chairman – Corporate governance committee, to discuss and deliberate the practical approach and implementation of requirements of the direction by banks and practicing firms. The consultative committee consists of the following representatives from banks and partners of practicing firms;

No.	Name	Designation	Company/ Firm
1	Mr. Nandika Buddhipala	Chief Financial Officer	Commercial Bank of Ceylon PLC
2	Mr. Channa De Silva	Director General	Securities & Exchange Commission of Sri Lanka
3	Mr. Nihal Fonseka	General Manager/CEO	DFCC Bank
4	Mr. Amitha Gooneratne	Managing Director	Commercial Bank of Ceylon Ltd.
5	Mr. Ajanta De Vas Gunasekara	Asst. General Manager	HNB Assurance PLC
6	Mr. Ravidu Gunasekera	Partner	PricewaterhouseCoopers
7	Mr. Su-ayid Ismail	Partner	Ernst & Young
8	Mr. Manil Jayasinghe	Partner	Ernst & Young
9	Ms. Ranjani Joseph	Partner	KPMG Ford Rhodes Thornton & Co.
10	Mr. Sujeewa Mudalige	Partner	PricewaterhouseCoopers
11	Mr. P R A L Paranavithana	Senior Assistant Director	Central Bank of Sri Lanka
12	Mr. Jagath Perera	Partner	KPMG Ford Rhodes Thornton & Co.
13	Mr. Suren Rajakarier	Partner	KPMG Ford Rhodes Thornton & Co.
14	Mr. Sujeewa Rajapakse	Partner	BDO Partners
15	Mr. G A J C Reny	Senior Assistant Director	Central Bank of Sri Lanka
16	Mr. Asoka Rupasinghe	Chief Financial Officer	Bank of Ceylon
17	Mrs. N H E R Siriwardane	Additional Director - Non-Bank Supervision Dept.	Central Bank of Sri Lanka
18	Mr. Yohan Soza	Head of Finance	People's Bank
19	Mr. S Swarnajothy	Auditor General	Auditor General's Dept.
20	Mr. Asite Talwatte	Partner	Ernst & Young

After several discussions of the consultative committee to interpret the directions from our application perspective to benchmark and develop guidelines, a technical committee was appointed to research best practices available internationally to comply with the said regulations. The technical committee consisting of senior partners of firms and the technical directorate of ICASL after a process of rigorous review of available international pronouncements recommended the following standards for adoption by the Statutory Accounting Standards Committee and subsequently by the Council of ICASL.

This publication covers a guidance for directors of banks, Licensed Finance Companies and Finance leasing Companies and two new standards issued under “Sri Lanka Standards on Assurance Engagements” (SLSAE) and “Sri Lanka Related Services Practice Statement” (SLRSPS) in the conduct of this specialised and related services and broadly could be categorized as follows:

- Guidance for Directors of Banks, Licensed Finance Companies and Finance leasing Companies on the Directors’ Statement on Internal Control
- Sri Lanka Standard on Assurance Engagements 3050 – Assurance Report for Banks on Directors’ Statement on Internal Control (SLSAE – 3050)
- Sri Lanka Related Services Practice Statement 4750 – Engagements to report on the compliance with the corporate governance directive issued by the Central Bank of Sri Lanka (SLRSPS – 4750)

The guidance and SLSAE 3050 are for the purpose of compliance with the sections 3(8)(ii)(b) and 3(8)(ii)(c) of the Banking Act Direction and SLRSPS 4750 is in compliance with the section 3(8)(ii)(g) of the Banking Act Direction.

The practitioners, banking personnel and users of this publication should be aware and consider the appropriate Standards / Practice Statement applicable to the engagement.

On behalf of the special consultative committee, I take this opportunity to thank the consultative and technical committee members for their valuable feedback, and the staff of the Technical Division, Ms. Chamila Cooray – Head of Technical, Mr. Kamal Saseedaran – Quality Assurance Manager and Ms. Anushka Madurasinghe – Technical Manager for having, researched, and edited this publication contributing immensely to its content.

Asite Talwatte
Chairman
Corporate Governance Committee

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**GUIDANCE FOR DIRECTORS OF BANKS, LICENSED FINANCE
COMPANIES AND FINANCE LEASING COMPANIES**

ON

THE DIRECTORS' STATEMENT ON INTERNAL CONTROL

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Introduction

- 1 The Central Bank of Sri Lanka issued directions on Corporate Governance for Licensed Commercial Banks and Licensed Specialized Banks in Sri Lanka. These directions require the Board of such institutes to present a report on the bank's internal control mechanism that confirms that the financial reporting system 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 relevant accounting principles and regulatory requirements.
- 2 The Institute of Chartered Accountants of Sri Lanka (ICASL) was requested by the Central Bank of Sri Lanka (CBSL) to develop guidance for directors of banks, Licensed Finance Companies and Finance leasing Companies in complying with the directions. ICASL considered the recognized principles for the assessment of internal control systems elaborated in the "Framework for Internal Control Systems in Banking Organizations" issued by the Basel Committee on Banking Supervision in September 1998 as more relevant and appropriate for this specific requirement.
- 3 ICASL believes that the principles presented in paragraphs 4-15 will provide a useful framework for the effective assessment of internal control. This guidance also illustrates the responsibilities of directors in fulfilling the requirements enunciated by the principles. In addition, an illustration of how to document control activities is annexed to this guidance, enumerating significant processes and significant accounts to assist the directors in reporting requirements.

Principles for the Assessment of Internal Control System

Management oversight and control culture

Principle 1:

- 4 The Board of Directors should have responsibility for approving and periodically reviewing the overall business strategies and significant policies of the bank; understanding the major risks run by the bank, setting acceptable levels for these risks and ensuring that senior management takes the steps necessary to identify, measure, monitor and control these risks; approving the organizational structure; and ensuring that senior management is monitoring the effectiveness of the internal control system. The Board of Directors is ultimately responsible for ensuring that an adequate and effective system of internal control is established and maintained.

Principle 2:

- 5 Senior management should have responsibility for implementing strategies and policies approved by the Board; developing processes that identify, measure, monitor and control risks incurred by the bank; maintaining an organizational structure that clearly assigns responsibility, authority and reporting relationships; ensuring that

delegated responsibilities are effectively carried out; setting appropriate internal control policies; and monitoring the adequacy and the effectiveness of the internal control system.

Principle 3:

- 6 The Board of Directors and senior management are responsible for promoting high ethical and integrity standards, and for establishing a culture within the organization that emphasizes and demonstrates to all levels of personnel the importance of internal control. All personnel at a banking organization need to understand their role in the internal Control process and be fully engaged in the process.

Risk recognition and assessment

Principle 4:

- 7 An effective internal control system requires that the material risks that could adversely affect the achievement of the bank's goals are being recognized and continually assessed. This assessment should cover all risks facing the bank and the consolidated banking organization (that is, credit risk, country and transfer risk, market risk, interest rate risk, liquidity risk, operational risk, legal risk and reputational risk). Internal controls may need to be revised to appropriately address any new or previously uncontrolled risks.

Control activities and segregation of duties

Principle 5:

- 8 Control activities should be an integral part of the daily activities of a bank. An effective internal control system requires that an appropriate control structure is set up, with control activities defined at every business level. These should include; top level reviews; appropriate activity controls for different departments or divisions; physical controls; checking for compliance with exposure limits and follow-up on non-compliance; a system of approvals and authorizations; and, a system of verification and reconciliation.

Principle 6:

- 9 An effective internal control system requires that there is appropriate segregation of duties and those personnel are not assigned conflicting responsibilities. Areas of potential conflicts of interest should be identified, minimized and subject to careful, independent monitoring.

Information and communication

Principle 7:

- 10 An effective internal control system requires that there are adequate and comprehensive internal financial, operational and compliance data, as well as external market information about events and conditions that are relevant to decision making. Information should be reliable, timely, and accessible and provided in a consistent format.

Principle 8:

- 11 An effective internal control system requires that there are reliable information systems in place that cover all significant activities of the bank. These systems, including those that hold and use data in an electronic form, must be secure, monitored independently and supported by adequate contingency arrangements.

Principle 9:

- 12 An effective internal control system requires effective channels of communication to ensure that all staff fully understand and adhere to policies and procedures affecting their duties and responsibilities and that other relevant information is reaching the appropriate personnel.

Monitoring activities and correcting deficiencies

Principle 10:

- 13 The overall effectiveness of the bank's internal controls should be monitored on an ongoing basis. Monitoring of key risks should be part of the daily activities of the bank as well as periodic evaluations by the business lines and internal audit.

Principle 11:

- 14 There should be an effective and comprehensive internal audit of the internal control system carried out by operationally independent, appropriately trained and competent staff. The internal audit function, as part of the monitoring of the system of internal controls, should report directly to the Board of Directors or its audit committee, and to senior management.

Principle 12:

- 15 Internal control deficiencies, whether identified by business line, internal audit or other control personnel, should be reported in a timely manner to the appropriate management level and addressed promptly. Material internal control deficiencies should be reported to senior management and the Board of Directors.

- 16 The responsibilities of Directors in maintaining a sound system of internal control, in accordance with the principles for the assessment of internal control systems are enumerated in paragraphs 17 – 28.

The Responsibilities of Directors in Maintaining a Sound System of Internal Control

- 17 Maintaining sound system of internal controls to safeguard shareholders' investment and the bank's assets is the responsibility of the Board and top management.
- 18 The Board should identify principal risks on an ongoing basis and ensuring the implementation of appropriate systems to evaluate and manage these risks by considering the following factors.
- (a) The adequacy of the whole risk management framework of the bank
 - (b) The nature and extent of risks facing the bank
 - (c) The extent and categories of risk which it regards as acceptable for the bank to bear
 - (d) The likelihood of the risks concerned materializing
 - (e) The bank's ability to reduce the incidence of risks that do materialize and their impact on the business
 - (f) The costs of operating particular controls relative to the benefit thereby obtained in managing the related risks.

It is the role of management to implement Board policies on risk and control. In fulfilling its responsibilities, management should identify and evaluate the risks faced by the bank for consideration by the Board and design, operate and monitor a suitable system of internal control which implements the policies adopted by the Board.

- 19 The Board and top management should establish an appropriate control environment which includes;
- (a) Written communication of bank values, the code of conduct, policies and procedures
 - (b) The functions of the Board of Directors and its committees
 - (c) Management's philosophy and operating style
 - (d) The bank's organizational structure and methods of assigning authority and responsibility
 - (e) Clearly defined authorities and responsibilities for each manager, employee and department

- 20 All employees have responsibility for internal controls as part of their accountability for achieving objectives. Employees as a whole should have the necessary knowledge, skills, information and authority to establish, operate and monitor the system of internal control.
- 21 Reviewing the design and effectiveness of the bank's internal control systems and management information systems including systems for compliance with applicable laws, regulations, rules, directives and guidelines is an essential part of the Board's responsibilities.
- 22 The Board should define the process to be adopted for its review of the design and effectiveness of internal control. This should encompass both the scope and frequency of the reports it receives and reviews during the year, and also the process for its assessment.
- 23 The Board should form its own view on the design and effectiveness of the bank's internal control systems after due and careful enquiry based on the information and assurances provided to it. Management is accountable to the Board for monitoring the bank's internal control systems and for providing assurance to the Board that it has done so.
- 24 Effective monitoring on a continuous basis is an essential component of a sound system of internal control. The Board cannot, however, rely solely on the embedded monitoring processes within the bank to discharge its responsibilities. It should regularly receive and review reports on internal control.
- 25 The Board has to set the audit committee to carry out the reviews of internal controls and to document to the Board and Board takes the responsibility for the disclosures on internal controls.
- 26 An effective and comprehensive internal audit of internal control systems carried out operationally independent, appropriately trained and competent staff should be established.
- 27 Where an internal audit function does not exist, assess whether there are other means of obtaining sufficient assurance of regular review and appraisal of the effectiveness of the system of internal controls within the bank.
- 28 The Board should review reports by considering;
- (a) what are the significant risks and assess how they have been identified, evaluated and managed
 - (b) the design and effectiveness of the related system of internal control in managing the significant risks, having regard, in particular, to any significant failures or weaknesses in internal control that have been reported

- (c) whether necessary action are being taken promptly to remedy any significant failings or weaknesses
- (d) whether the findings indicate a need for more extensive monitoring of the system of internal control

The Board's Statement on Internal Control

- 29 The Board is required by the Banking Act Direction on Corporate Governance issued by Central Bank of Sri Lanka to disclose whether there is an ongoing process for identifying, evaluating and managing the significant risks faced by the banks, whether it has been in place for the year under review, whether it is regularly reviewed by the Board and accords with such direction.
- 30 In addition, the Board is also required to present a report on the bank's internal control mechanism that confirms that the financial reporting system 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 relevant accounting principles and regulatory requirements. To fulfill this requirement, the Board should disclose the following as a minimum.
- (a) The Board should summarise the process it has applied in reviewing its design and effectiveness of the system of internal control.
 - (b) It should also disclose the process it has applied to deal with material internal control aspects of any significant problems disclosed in the annual report.
 - (c) An acknowledgement by the Board that it is responsible for the bank's system of internal control and for reviewing its design and effectiveness. It should also explain that such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives, and can only provide reasonable and not absolute assurance against material misstatements of loss.
 - (d) The Directors should disclose that there is an ongoing process for identifying, evaluating and managing the significant risks faced by the bank, whether it has been in place for the year under review, whether it is regularly reviewed by the Board.
 - (e) The Board has to disclose if it has failed to conduct a review of design the effectiveness of the bank's system of internal control.
 - (f) The Board should ensure that its disclosures provide meaningful, high level information and do not give a misleading impression.
 - (g) Where material subsidiaries, joint ventures and associates have not been dealt with in applying this guidance, as part of the group, that fact should be disclosed.

- (h) The confirmation by the Board:

The Board should confirm in its report that the financial reporting system 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 applicable accounting standards and regulatory requirements.

- (i) To be signed by the directors who signed the financial statements and the chairman of the Audit Committee.

31 As a guideline to directors, an illustration of how to document control activities is attached in Appendix 1 identifying significant accounts, significant processes and key risk areas that banks have to address.

Appendix 1

An Illustration of How to Document Control Activities

This illustration gives guidance for the directors to set up the internal control mechanism of the entity that confirms the financial reporting system 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 relevant accounting principles and regulatory requirements.

Illustrative significant processes that are common to a financial institution have been stated as follows.

Significant Processes:

- Operations-Deposits, Withdrawals, Fee Income and Interest Expense
- Operations-Clearing and Settlement
- Credit Origination, Transaction Processing and Income Recognition
- Operations-Electronic Funds Transfers
- Treasury/Investment Securities-Valuation and Income Recognition
- Treasury/Investment Securities-Transaction Execution
- Financial Statement Close
- Cash Receipts
- Cash Disbursements
- Payroll
- Purchase and Pay Assets and Non-Interest Expense
- Investments in Affiliates/Joint Ventures
- Calculate Amortization
- Assess Assets for Impairment
- Calculate Income Taxes
- Calculate Depreciation
- Estimate Commitments and Contingencies
- Estimate Employee Benefits
- Estimate Allowance for Credit Losses
- Manage Derivatives and Hedging

The significant processes identified above affect the following significant accounts.

Significant Accounts:

- Cash and Due From Banks
- Investment Securities and Related I/S Activity
- Credit Facilities and Related Interest/Income
- Allowance and Related Provision for Credit Losses
- Other Assets and Related I/S Activity
- Deposits, Fee Income and Related Expense
- Income Taxes (Current & Deferred)
- Other Liabilities and Related I/S Activity
- Borrowings and Related I/S Activity
- Commitments, Contingencies and Related Expense
- Stockholders' Equity
- Payroll Expense and Related Accrued Liabilities

The relationship among those significant processes and significant accounts has been explained in the “Example Significant Accounts and Processes Matrix” as per Annexure 1 - A. Further, each significant process has been related to “What Can Go Wrong Questions” to identify how internal control procedures can address the key risk areas of the entity. Those “What Can Go Wrong Questions” related to each significant process have been attached in subsequent annexure as referred in Appendix 1 – A.

Appendix 1 – A

Example Significant Accounts and Processes Matrix

Banks and Savings Institutions

Example Significant Accounts

Examples Processes	Transaction Types	Cash and Due From Banks	Investment Securities and Related I/S Activity	Credit Facilities and Related Interest/Income	Allowance and Related Provision for Credit Losses	Other Assets and Related I/S Activity	Deposits, Fee Income and Related Expense	Income Taxes (Current & Deferred)	Other Liabilities and Related I/S Activity	Borrowings and Related I/S Activity	Commitments, Contingencies and Related Expense	Stockholders' Equity	Payroll Expense and Related Accrued Liabilities	Reference to "What Can Go Wrong Questions"
Operations-Deposits, Withdrawals, Fee Income and Interest Expense	Routine	x					x							Appendix 1 - B
Operations-Clearing and Settlement	Routine	x	x	x			x							Appendix 1 - C
Credit Origination, Transaction Processing and Income Recognition	Routine	x		x										Appendix 1 - D
Operations-Electronic Funds Transfers	Routine	x	x	x			x							Appendix 1 - E
Treasury/Investment Securities-Valuation and Income Recognition	Routine		x									x		Appendix 1 - F
Treasury/Investment Securities-Transaction Execution	Routine	x	x							x				Appendix 1 - G
Financial Statement Close	Non-Routine	x	x	x	x	x	x	x	x	x	x	x	x	Appendix 1 - H
Cash Receipts	Routine	x				x								Appendix 1 - I
Cash Disbursements	Routine	x							x					Appendix 1 - J
Payroll	Routine	x										x		Appendix 1 - K

Examples Processes	Transaction Types	Cash and Due From Banks	Investment Securities and Related I/S Activity	Credit Facilities and Related Interest/Income	Allowance and Related Provision for Credit Losses	Other Assets and Related I/S Activity	Deposits, Fee Income and Related Expense	Income Taxes (Current & Deferred)	Other Liabilities and Related I/S Activity	Borrowings and Related I/S Activity	Commitments, Contingencies and Related Expense	Stockholders' Equity	Payroll Expense and Related Accrued Liabilities	Reference to "What Can Go Wrong Questions"
Purchase and Pay Assets and Non-Interest Expense	Routine					x			x					Appendix 1 - L
Investments in Affiliates/Joint Ventures	Non-Routine					x								Appendix 1 - M
Calculate Amortization	Non-Routine					x								Appendix 1 - N
Assess Assets for Impairment	Estimation					x								Appendix 1 - O
Calculate Income Taxes	Non-Routine							x						Appendix 1 - P
Calculate Depreciation	Non-Routine					x								Appendix 1 - Q
Estimate Commitments and Contingencies	Estimation										x			Appendix 1 - R
Estimate Employee Benefits	Estimation								x					Appendix 1 - S
Estimate Allowance for Credit Losses	Estimation				x									Appendix 1 - T
Manage Derivatives and Hedging	Non-Routine					x			x			x		Appendix 1 - U

Appendix 1 - B
Example Risk and Control Matrix

Industry: Banks and Savings Institutions
Process: Operations-Deposits, Withdrawals, Fee Income and Interest Expense
Transaction Type: Routine

Example Significant Accounts Affected:
 Cash and Due from Banks
 Deposits, Fee Income and Related Expense

No	Example "What Can Go Wrong" Questions	Applicable Internal Control procedures to address the question				
		Internal Control 1	Internal Control 2	Internal Control 3	Internal Control 4	Internal Control 5
1	What ensures that fee income is charged/recorded on only valid transactions and accounts?					
2	What ensures that fictitious/duplicate deposits and/or withdrawals are not recorded?					
3	What ensures that deposits and withdrawals are correctly recorded?					
4	What ensures that interest expense is correctly recorded?					
5	What ensures that deposits and withdrawals are recorded in the proper period?					
6	What ensures that the deposit trial balance (sub ledger) is properly posted to the general ledger?					
7	What ensures that deposits and withdrawals are correctly coded?					
8	What ensures that fee income is recorded in the proper period?					
9	What ensures that interest expense is recorded in the proper period?					

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Appendix 1 - C
Example Risk and Control Matrix

Industry: Banks and Savings Institutions
Process: Operations-Clearing and Settlement
Transaction Type: Routine

Example Significant Accounts Affected:
Cash and Due from Banks
Investment Securities and Related Income Statement Activity
Credit Facilities and Related Interest/Income
Deposits, Fee Income and Related Expense

No	Example "What Can Go Wrong" Questions	Applicable Internal Control procedures to address the question				
		Internal Control 1	Internal Control 2	Internal Control 3	Internal Control 4	Internal Control 5
1	What ensures that clearing and settlement items are properly recorded?					
2	What ensures that errors and reconciling differences are corrected on a timely basis?					
3	What ensures that out-of-balance conditions are detected?					
4	What ensures that transactions are not concealed by posting to suspense accounts or preparing erroneous reconciliations?					
5	What ensures that transactions are cleared and settled on a timely basis?					
6	What ensures that processing information is correctly coded?					

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Appendix 1 - D
Example Risk and Control Matrix

Industry: Banks and Savings Institutions
Process: Credit Origination, Transaction Processing and Income Recognition
Transaction Type: Routine

Example Significant Accounts Affected:
 Cash and Due from Banks
 Credit Facilities and Related Interest/Income

No	Example "What Can Go Wrong" Questions	Applicable Internal Control procedures to address the question				
		Internal Control 1	Internal Control 2	Internal Control 3	Internal Control 4	Internal Control 5
1	What ensures that credit originations/transactions are recorded for the proper amount?					
2	What ensures that the credit facility transaction file is correctly posted to the general ledger?					
3	What ensures that credit facility type, payments and disbursements are correctly coded?					
4	What ensures that interest income on credit facilities is correctly recorded?					
5	What ensures that loan disbursements, fees, payments and interest are recorded in the proper period?					
6	What ensures that recorded loans and interest income are for real borrowers?					
7	What ensures that interest calculations are based on correct principal amount, interest rate, and number of days?					

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Appendix 1 - E
Example Risk and Control Matrix

Industry: Banks and Savings Institutions
Process: Operations-Electronic Funds Transfers
Transaction Type: Routine

Example Significant Accounts Affected:
 Cash and Due from Banks
 Investment Securities and Related Income Statement Activity
 Credit Facilities and Related Interest/Income
 Deposits, Fee Income and Related Expense

No	Example "What Can Go Wrong" Questions	Applicable Internal Control procedures to address the question				
		Internal Control 1	Internal Control 2	Internal Control 3	Internal Control 4	Internal Control 5
1	What ensures that electronic funds transfers received/executed are correctly recorded?					
2	What ensure that fictitious, unauthorized or duplicate electronic funds transfers are not recorded?					
3	What ensures that electronic funds transfers and related charges are correctly posted to the transaction files or general ledger?					
4	What ensures that electronic funds transfers and related charges are recorded in the proper period?					
5	What ensures that electronic funds transfers and related charges are recorded at the proper amount?					

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Appendix 1 - F
Example Risk and Control Matrix

Industry: Banks and Savings Institutions
Process: Treasury/Investment Securities-Valuation and Income Recognition
Transaction Type: Routine

Example Significant Accounts Affected:
 Investment Securities and Related Income Statement Activity
 Stockholders' Equity

No	Example "What Can Go Wrong" Questions	Applicable Internal Control procedures to address the question				
		Internal Control 1	Internal Control 2	Internal Control 3	Internal Control 4	Internal Control 5
1	What ensures that gains/losses on disposals are correctly recorded?					
2	What ensures that interest and related income are correctly recorded?					
3	What ensures that interest income/expense and gains/losses are recorded in the proper period?					
4	What ensures that treasury realized and unrealized gains/losses are recorded?					
5	What ensures that calculations of accrued interest income/expense are based on correct data?					
6	What ensures that valuations based on internal models are consistently applied and/or that changes to the model are appropriate?					
7	What ensures that market values used in calculating unrealized gains/losses are correct?					
8	What ensures that treasury activities are correctly classified (e.g., trading, available-for-sale, held-to-maturity)?					

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Appendix 1 - G

Example Risk and Control Matrix

Industry: Banks and Savings Institutions

Process: Treasury/Investment Securities-Transaction Execution

Transaction Type: Routine

Example Significant Accounts Affected:

Cash and Due from Banks

Investment Securities and Related Income Statement Activity

Borrowings and Related Interest Expense

No	Example "What Can Go Wrong" Questions	Applicable Internal Control procedures to address the question				
		Internal Control 1	Internal Control 2	Internal Control 3	Internal Control 4	Internal Control 5
1	What ensures that treasury commitments (e.g., off-balance sheet obligations) are recorded?					
2	What ensures that treasury transactions are recorded on the trade date?					
3	What ensures that treasury transactions are recorded?					
4	What ensures that contractual interest, effective yield or exchange rates on treasury products are recorded?					
5	What ensures that the investment trial balance (sub ledger) is properly posted to the general ledger?					
6	What ensures that fictitious/duplicate investment transactions are not recorded?					
7	What ensures that collections/payments are correctly allocated to principal, interest, etc.?					

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Appendix 1 - H

Example Risk and Control Matrix

Industry: Banks and Savings Institutions
Process: Financial Statement Close
Transaction Type: Non-Routine

Example Significant Accounts Affected:
 All Accounts

No	Example "What Can Go Wrong" Questions	Applicable Internal Control procedures to address the question				
		Internal Control 1	Internal Control 2	Internal Control 3	Internal Control 4	Internal Control 5
1	What ensures that elimination entries are recorded correctly?					
2	What ensures that valid journal entries are posted on a timely basis?					
3	What ensures that duplicate journal entries are not posted?					
4	What ensures that amounts reported to parent from subsidiary are correct?					
5	What ensures that accounts roll up into the correct trial balance or financial statement line?					
6	What ensures that accumulated amounts for footnotes are correct?					
7	What ensures that no errors or omissions exist in the compilation of consolidated financial statements?					
8	What ensures that the financial statements and trial are in balance (I.e., foot to zero)?					
9	What ensures that financial statement disclosures required by SLASs have been made?					
10	What ensures that financial statements are clerically accurate?					

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Appendix 1 - I
Example Risk and Control Matrix

Industry: Banks and Savings Institutions
Process: Cash Receipts
Transaction Type: Routine

Example Significant Accounts Affected:
 Cash and Due from Banks
 Other Assets and Related Income Statement Activity

No	Example "What Can Go Wrong" Questions	Applicable Internal Control procedures to address the question				
		Internal Control 1	Internal Control 2	Internal Control 3	Internal Control 4	Internal Control 5
1	What ensures that cash receipts are recorded when received?					
2	What ensures that cash receipts/transfers are recorded in the correct period?					
3	What ensures that coding of cash receipts is correct?					
4	What ensures that duplicate postings of cash receipts are not made to the general ledger?					
5	What ensures that cash receipts recorded equal amounts deposited?					

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Appendix 1 - J
Example Risk and Control Matrix

Industry: Banks and Savings Institutions
Process: Cash Disbursements
Transaction Type: Routine

Example Significant Accounts Affected:
 Cash and Due from Banks
 Other Liabilities and Related Income Statement Activity

No	Example "What Can Go Wrong" Questions	Applicable Internal Control procedures to address the question				
		Internal Control 1	Internal Control 2	Internal Control 3	Internal Control 4	Internal Control 5
1	What ensures that cash disbursements are correctly coded?					
2	What ensures that disbursements/transfers are recorded in the proper period?					
3	What ensures that duplicate postings of cash disbursements are not made to the general ledger?					
4	What ensures that cash disbursements are real?					
5	What ensures that all cash disbursements are recorded?					
6	What ensures that cash disbursement amounts recorded agree with amounts paid?					

Prepared by:
 (Name and Designation of the person responsible)

Approved by:
 (Name and Designation of the person responsible)

Appendix 1 - K
Example Risk and Control Matrix

Industry: Banks and Savings Institutions
Process: Payroll
Transaction Type: Routine

Example Significant Accounts Affected:
 Cash and Due from Banks
 Payroll Expense and Related Accrued Liabilities

No	Example "What Can Go Wrong" Questions	Applicable Internal Control procedures to address the question				
		Internal Control 1	Internal Control 2	Internal Control 3	Internal Control 4	Internal Control 5
1	What ensures that duplicate/fictitious paychecks are not recorded?					
2	What ensures that coding of payroll to the general ledger, subsidiary, department, etc. is correct?					
3	What ensures that payroll expenses are recorded in the proper period?					
4	What ensures that timecards correctly summarize time worked?					
5	What ensures that work performed is recorded?					
6	What ensures that payments are not made for time not worked?					
7	What ensures that correct pay rates are used in computing gross pay?					
8	What ensures that payroll expenses, including deductions, are correctly computed?					

Prepared by:
 (Name and Designation of the person responsible)

Approved by:
 (Name and Designation of the person responsible)

Appendix 1 - L
Example Risk and Control Matrix

Industry: Banks and Savings Institutions
Process: Purchase and Pay for Assets and Non-Interest Expenses
Transaction Type: Routine

Example Significant Accounts Affected:
 Other Assets and Related Income Statement Activity
 Other Liabilities and Related Income Statement Activity

No	Example "What Can Go Wrong" Questions	Applicable Internal Control procedures to address the question				
		Internal Control 1	Internal Control 2	Internal Control 3	Internal Control 4	Internal Control 5
1	What ensures that purchases are correctly coded?					
2	What ensures that purchases are recorded in the proper period?					
3	What ensures that purchases/payables are recorded?					
4	What ensures that vendor invoices reflect correct prices/quantities?					
5	What ensures that fictitious/duplicate purchases are not recorded?					

Prepared by:
 (Name and Designation of the person responsible)

Approved by:
 (Name and Designation of the person responsible)

Appendix 1 - M
Example Risk and Control Matrix

Industry: Banks and Savings Institutions
Process: Investments in Affiliates/Joint Ventures
Transaction Type: Non-Routine

Example Significant Accounts Affected:
 Other Assets and Related Income Statement Activity

No	Example "What Can Go Wrong" Questions	Applicable Internal Control procedures to address the question				
		Internal Control 1	Internal Control 2	Internal Control 3	Internal Control 4	Internal Control 5
1	What ensures that the investment and related income/loss are recorded in the proper period?					
2	What ensures that investment income/loss is correctly recorded?					
3	What ensures that recorded investments are real?					
4	What ensures that advances made to affiliates are recoverable?					
5	What ensures that the investment is not impaired or is not recoverable?					
6	What ensures that minority interest is correctly calculated?					
7	What ensures that information used for recording the investment/income is correct?					
8	What ensures that the investment is recorded using the proper method (cost vs. equity)?					

Prepared by:
 (Name and Designation of the person responsible)

Approved by:
 (Name and Designation of the person responsible)

Appendix 1 - N
Example Risk and Control Matrix

Industry: Banks and Savings Institutions
Process: Calculate Amortization
Transaction Type: Non-Routine

Example Significant Accounts Affected:
 Other Assets and Related Income Statement Activity

No	Example "What Can Go Wrong" Questions	Applicable Internal Control procedures to address the question				
		Internal Control 1	Internal Control 2	Internal Control 3	Internal Control 4	Internal Control 5
1	What ensures that amortization is correctly recorded?					
2	What ensures that amortization is not recorded on assets with no future benefit?					
3	What ensures that disposed assets do not remain recorded?					
4	What ensures that amortization expense is recorded at the proper amount?					
5	What ensures that amortization is calculated using the appropriate bases?					

Prepared by:
 (Name and Designation of the person responsible)

Approved by:
 (Name and Designation of the person responsible)

Appendix 1 - O
Example Risk and Control Matrix

Industry: Banks and Savings Institutions
Process: Assess Assets for Impairment
Transaction Type: Estimation

Example Significant Accounts Affected:
 Other Assets and Related Income Statement Activity

No	Example "What Can Go Wrong" Questions	Applicable Internal Control procedures to address the question				
		Internal Control 1	Internal Control 2	Internal Control 3	Internal Control 4	Internal Control 5
1	What ensures that fair value declines are properly identified and recorded?					
2	What ensures that all factors affecting the impairment estimate are identified?					
3	What ensures that assumptions for the impairment estimate are correct?					
4	What ensures that fair value declines are properly valued?					

Prepared by:
 (Name and Designation of the person responsible)

Approved by:
 (Name and Designation of the person responsible)

Appendix 1 - P
Example Risk and Control Matrix

Industry: Banks and Savings Institutions
Process: Calculate Income Taxes

Example Significant Accounts Affected:
 Income Taxes (Current, Deferred) and Related Income
 Statement Activity

Transaction Type: Non-Routine

No	Example "What Can Go Wrong" Questions	Applicable Internal Control procedures to address the question				
		Internal Control 1	Internal Control 2	Internal Control 3	Internal Control 4	Internal Control 5
1	What ensures that tax expenses are recorded in the proper period?					
2	What ensures that tax exposures and valuation allowances are properly calculated and recorded?					
3	What ensures that the correct book income amount is used in the tax accrual?					
4	What ensures that permanent/temporary differences are identified?					
5	What ensures that tax assets/liabilities/expenses are correctly calculated?					

Prepared by:
 (Name and Designation of the person responsible)

Approved by:
 (Name and Designation of the person responsible)

Appendix 1 - Q
Example Risk and Control Matrix

Industry: Banks and Savings Institutions
Process: Calculate Depreciation
Transaction Type: Non-Routine

Example Significant Accounts Affected:
 Other Assets and Related Income Statement Activity

No	Example "What Can Go Wrong" Questions	Applicable Internal Control procedures to address the question				
		Internal Control 1	Internal Control 2	Internal Control 3	Internal Control 4	Internal Control 5
1	What ensures that depreciation is properly recorded?					
2	What ensures that disposed assets (sales and write-offs) do not remain recorded?					
3	What ensures that depreciation expense is recorded at the correct amount?					
4	What ensures that depreciation is calculated using the appropriate bases?					

Prepared by:
 (Name and Designation of the person responsible)

Approved by:
 (Name and Designation of the person responsible)

Appendix 1 - R
Example Risk and Control Matrix

Industry: Banks and Savings Institutions
Process: Estimate Commitments and Contingencies
Transaction Type: Estimation

Example Significant Accounts Affected:
 Commitments, Contingencies and Related Expense

No	Example "What Can Go Wrong" Questions	Applicable Internal Control procedures to address the question				
		Internal Control 1	Internal Control 2	Internal Control 3	Internal Control 4	Internal Control 5
1	What ensures that commitments and contingencies are identified and recorded?					
2	What ensures that factors affecting contingency estimates are identified?					
3	What ensures that assumptions for commitments and contingencies are correct?					
4	What ensures that commitments and contingencies are based on accurate data?					
5	What ensures that commitments and contingencies are correctly calculated?					

Prepared by:.....
 (Name and Designation of the person responsible)

Approved by:
 (Name and Designation of the person responsible)

Appendix 1 - S
Example Risk and Control Matrix

Industry: Banks and Savings Institutions
Process: Estimate Employee Benefits
Transaction Type: Estimation

Example Significant Accounts Affected:
 Other Liabilities and Related Income Statement Activity

No	Example "What Can Go Wrong" Questions	Applicable Internal Control procedures to address the question				
		Internal Control 1	Internal Control 2	Internal Control 3	Internal Control 4	Internal Control 5
1	What ensures that employee benefits expense is recorded in the proper period?					
2	What ensures that employee benefits expense is based on accurate underlying data?					
3	What ensures that employee benefits liability is calculated using the correct assumptions?					

Prepared by:.....
 (Name and Designation of the person responsible)

Approved by:
 (Name and Designation of the person responsible)

Appendix 1 - T
Example Risk and Control Matrix

Industry: Banks and Savings Institutions
Process: Estimate Allowance for Credit Losses
Transaction Type: Estimation

Example Significant Accounts Affected:
 Allowance and Related Provision for Credit Losses

No	Example "What Can Go Wrong" Questions	Applicable Internal Control procedures to address the question				
		Internal Control 1	Internal Control 2	Internal Control 3	Internal Control 4	Internal Control 5
1	What ensures that credit loss allowances are recorded?					
2	What ensures that delinquent loans are identified?					
3	What ensures that the credit loss allowance does not include a reserve for future losses?					
4	What ensures that the allowance calculation is based on accurate data?					
5	What ensures that credit loss allowances are properly calculated?					
6	What ensures that factors affecting the credit loss allowance are considered?					

Prepared by:.....
 (Name and Designation of the person responsible)

Approved by:
 (Name and Designation of the person responsible)

Appendix 1 - U

Example Risk and Control Matrix

Industry: Banks and Savings Institutions
Process: Manage Derivatives and Hedging
Transaction Type: Non-Routine

Example Significant Accounts Affected:
 Other Assets and Related Income Statement Activity
 Other Liabilities and Related Income Statement Activity
 Stockholders' Equity

No	Example "What Can Go Wrong" Questions	Applicable Internal Control procedures to address the question				
		Internal Control 1	Internal Control 2	Internal Control 3	Internal Control 4	Internal Control 5
1	What ensures that derivative instruments are properly identified and recorded?					
2	What ensures that derivative instruments are real?					
3	What ensures that hedge accounting documentation (including documentation of hedging instrument and hedged item) is adequate?					
4	What ensures that hedge effectiveness is properly calculated and monitored?					
5	What ensures that derivative instruments are correctly valued?					
6	What ensures that derivative and hedging activities are properly presented in the financial statements?					
7	What ensures that derivative and hedging disclosures are proper/adequate?					

Prepared by:
 (Name and Designation of the person responsible)

Approved by:
 (Name and Designation of the person responsible)

**SRI LANKA STANDARD ON
ASSURANCE ENGAGEMENTS 3050**

**ASSURANCE REPORT FOR BANKS ON DIRECTORS’
STATEMENT ON INTERNAL CONTROL**

(This Standard is effective for assurance reports dated on or after 01 November 2010)

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Introduction

- 1 The purpose of this Sri Lanka Standard on Assurance Engagements (SLSAE) is to establish and provide guidance on assurance engagements to report on the Directors' Statement on Internal Control.
- 2 Auditor is required to report on the Directors' Statement on Internal Control relating to effectiveness of internal control mechanism that confirms that the financial reporting system 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 relevant accounting principles and regulatory requirements.

Auditors' Responsibilities with respect to Directors' Statement on Internal Control

- 3 The objective of the engagement is to assess whether the Statement on Internal Control appropriately reflects the process the directors have adopted in reviewing the design and effectiveness of the system of internal control.
- 4 To achieve this objective, appropriate evidence will have to be obtained by performing the following procedures:
 - (a) Enquire of the directors to obtain an understanding of the process defined by the Board of Directors for their review of the design and effectiveness of internal control and compare their understanding to the Statement intended to be made by the directors in the annual report.
 - (b) Review the documentation prepared by or for the directors to support their Statement intended to be made.
 - (c) Relate the Statement intended to be made by the directors to the auditor's knowledge of the bank obtained during the audit of the financial statements.
 - (d) Review the minutes of the meetings of the Board of Directors and of relevant Board Committees.

- (e) Attend meetings of the audit committee at which the annual report, including the Statement on Internal Control is considered and approved for submission to the Board of Directors.
- (f) Consider whether the Director's Statement on Internal Control covers the year under review and that adequate processes are in place to identify any significant matters arising. Where any such matter has been identified, the auditors should consider the matter and the implications on the Directors' Statement on Internal Control to the date of the approval of the annual report.
- (g) Obtain written representations from directors on matters material to the Statement on Internal Control when other sufficient appropriate audit evidence cannot reasonably be expected to exist.
- (h) Directors' Statement on Internal Control should disclose the process it has applied to deal with material internal control aspects of any significant problems disclosed in the annual report. To address the above, the auditors should;
 - discuss with the directors the steps that have been taken by them to determine what significant problems are disclosed in the annual report; and
 - assess whether disclosures made by the directors of the processes they have applied to deal with material internal control aspects of any significant problems disclosed in the annual report appropriately reflect those processes.

The auditors are not required to assess whether the processes described by the directors will, in fact, remedy the problem described in the annual report. This also has to be communicated through the assurance report.

- (i) If the auditor is aware of a significant problem that is disclosed in the annual report for which the directors have not disclosed the material internal control aspects, the auditors should discuss the position with the directors of the bank.
- (j) The auditor should consider whether the directors have disclosed that there is an ongoing process for identifying, evaluating and managing the significant risks faced by the bank, whether it has been in place for the year under review,

whether it is regularly reviewed by the Board. Further the auditor should consider whether the explanation is consistent with the auditor's understanding.

Contents of the Auditor's Assurance Report to Board of Directors

- 5 The assurance report should include the following basic elements:
- (a) A title that clearly indicates the report is an independent assurance report.
 - (b) An addressee: an addressee identifies the party or parties to whom the assurance report is directed.
 - (c) An identification and description of the assurance engagement:
 - The nature of the engagement;
 - The point in time or period of time to which the engagement relates;
 - The name of the entity or component of the entity to which the engagement relates; and
 - (d) The responsibility of the management: this informs management's responsibility for the preparation and presentation of the Directors' Statement on Internal Control and the respective guidelines in preparation.
 - (e) The responsibility of the auditor to issue a report to the Board on the Directors' Statement on Internal Control based on the work carried out by the auditor.
 - (f) A statement that the engagement was performed in accordance with SLSAE 3050.
 - (g) A summary of the work performed.
 - The fact that the engagement is conducted to assess whether the Statement on Internal Control appropriately reflects that process the directors have adopted in reviewing the design and effectiveness of the system of internal control

- The fact that the auditors are not expected to assess whether all risks and controls have been addressed by the directors or that risks are satisfactorily addressed by internal control, has to be clearly stated in the report.
 - The fact that the auditors are not required to assess whether the processes described to deal with material internal control aspects of any significant problems disclosed in the annual report by the directors will, in fact, remedy the problems.
- (h) The auditor's conclusion: the report should contain a clear written expression of negative assurance.
- (i) The date of the assurance report
- (j) The address of the auditor or the firm

Other Reporting Responsibilities

- 6 The auditors should report the following circumstances to the Board of Directors with a view to seek revision of their draft statement, if they conclude:
- (a) that the directors' summary of the process they have applied in reviewing the design and effectiveness of internal control is either not supported by or does not appropriately reflect the auditor's understanding of the process undertaken;
 - (b) that the processes disclosed to deal with material internal control aspects of significant problems disclosed in the annual report do not appropriately reflect the auditors' understanding of the process undertaken;
 - (c) that no disclosure has been made by the directors that they have failed to conduct a review of the design and effectiveness of the system of internal control;
 - (d) where the directors disclosed that they have not reviewed the design and effectiveness of the system of internal control, that their explanations are not consistent with the auditors' understanding; or
 - (e) that no disclosure has been made by the directors that a material joint venture or associated bank has not been dealt with as part of the Group.

- 7 If revisions sought are not accepted by the Board of Directors, the auditors should consider the implications on their reporting responsibilities including the appropriateness of communicating relevant matters of governance interest arising from the assurance engagement with those charged with governance.
- 8 The auditors are not expected to actively search for misstatements or inconsistencies. However, if the auditors become aware of such a matter, the auditors should discuss it with the directors to seek to establish the significance of the lack of proper disclosure. If such lack of proper disclosure is considered significant by the auditors and the directors cannot be persuaded to amend the disclosure to the auditors' satisfaction, the auditors should consider the implications on the auditors' reporting responsibilities and may need to take legal advice.
- 9 If after reviewing the Statement on Internal Control, the auditors identify a material inconsistency, the auditors should determine whether the financial statements or Statement on Internal Control need to be amended.
- 10 If an amendment is necessary in the financial statements and the directors refuse to make the amendment, the auditors should express qualified or adverse opinion.
- 11 If an amendment is necessary in the Statement on Internal Control but not the financial statements, and the directors refuse to make the necessary amendments, the auditors should consider taking further appropriate action, including disclosure in the auditors' report to members. However, as this does not give rise to a qualified audit opinion on the financial statements it is recommended that the auditors' comments are included under the heading "Other matters".

Effective Date

- 12 This SLSAE is effective for assurance engagements where the assurance report is dated on or after 01 November 2010. Earlier application is permissible.

Example of Independent Assurance Report

To the Board of Directors of ABC Bank PLC

Introduction

We were engaged by the Board of Directors of ABC Bank PLC (“Bank”) to provide assurance on the Directors’ Statement on Internal Control (“Statement”) to be included in the annual report for the year ended 31st December 20XX.

Management’s responsibility

Management is responsible for the preparation and presentation of the Statement in accordance with the “Guidance for Directors of Banks, Licensed Finance Companies and Finance leasing Companies on the Directors’ Statement on Internal Control” issued in compliance with the section 3(8)(ii)(b) of the Banking Act Direction No. 11 of 2007, by the Institute of Chartered Accountants of Sri Lanka.

Our responsibilities and compliance with SLSAE 3050

Our responsibility is to issue a report to the board on the Statement based on the work performed. We conducted our engagement in accordance with Sri Lanka Standard on Assurance Engagements SLSAE 3050 – Assurance Report for Banks on Directors’ Statement on Internal Control issued by the Institute of Chartered Accountants of Sri Lanka.

Summary of work performed

Our engagement has been conducted to assess whether the Statement is both supported by the documentation prepared by or for directors and appropriately reflects the process the directors have adopted in reviewing the system of internal control for the Bank.

[Enumerate procedures as required]

SLSRE 3050 does not require us to consider whether the Statement covers all risks and controls, or to form an opinion on the effectiveness of the Bank’s risk and control procedures. SLSRE 3050 also does not require us to consider whether the processes described to deal with material internal control aspects of any significant problems disclosed in the annual report will, in fact, remedy the problems.

Our conclusion

Based on the procedures performed, nothing has come to our attention that causes us to believe that the Statement to be included in the annual report is inconsistent with our understanding of the process the Board of Directors have adopted in the review of the design and effectiveness of internal control of the Bank.

(Audit firm)

Colombo

(Date)

Example of an Engagement Letter for an Assurance Engagement

The following is an illustrative example of paragraphs that may be included in the auditor's engagement letter dealing with their responsibility with respect to the Directors' Statement on Internal Control as required by the Banking Act Directions.

To the Board of Directors:

This letter is to confirm our understanding of the terms and objectives of our engagement and the nature and limitations of the services we will provide.

We will perform the following services:

As per section 3(8)(ii)(c) of the Banking Act Direction No. 11 of 2007, the bank must ensure that the external auditors issue the assurance report on the Directors' Statement on Internal Control to the Board of Directors of the bank.

Accordingly, we will carry out the engagement in accordance with Sri Lanka Standard on Assurance Engagements SLSAE 3050 – Assurance Report for Banks on Directors' Statement on Internal Control issued by the Institute of Chartered Accountants of Sri Lanka.

[Scope may be explained as required]

Under this engagement, we will not perform an audit and, accordingly, we will not express an audit opinion on them.

Responsibility for the Statement on Internal Control is that of the directors of the bank. The directors are responsible for ensuring that the bank complies with the section 3(8)(ii)(b) of the Banking Act Direction No. 11 of 2007 – Corporate Governance for Licensed Commercial Banks in Sri Lanka in relation to the Directors' Statement on Internal Control. In preparing the Statement on Internal Control, the directors should be guided by the "Guidance for Directors of Banks, Licensed Finance Companies and Finance leasing Companies on the Directors' Statement on Internal Control" issued by the Institute of Chartered Accountants of Sri Lanka.

This letter will be effective for future years unless it is terminated, amended or superseded (if applicable). Our engagement cannot be relied upon to disclose whether fraud or errors, or illegal acts exist. However, we will inform you of any material matters that come to our attention.

[Additional terms and conditions may be added by the auditors]

Please sign and return the attached copy of this letter to indicate that it is in accordance with your understanding of the arrangements for our review of the financial statements.

XYZ & Co

Acknowledged on behalf of ABC Bank PLC by

(signed)

.....

Name and Title

Date