

• THE REWARDS OF •  
**EXCELLENCE**





**Content**

**▶ Introduction**

Our Vision, Mission & Values ..... 2  
Who We Are ..... 3  
Awards (2009–16) ..... 4  
Living up to our Name ..... 6  
Financial Highlights ..... 8

**▶ Executive Reviews**

Chairman’s Message ..... 12  
Message from Group Head of Islamic Finance - LOLC .. 16  
SSB Chairman’s Message ..... 18

**▶ Management Discussion and Analysis**

Value Map ..... 20  
Product Review ..... 22

**▶ Governance**

Corporate Governance ..... 26  
Enterprise Risk Management ..... 28  
Charity Fund ..... 30  
Shari’ah Supervisory Board Members ..... 31  
Board of Directors ..... 32  
Directorships held by the Directors ..... 36  
Strategic Business Unit Team ..... 37  
Shari’ah Supervisory Board Audit Report 2016/2017 .... 40  
Product Approval by Shari’ah Supervisory Board ..... 42

**▶ Financial Statements**

Independent Auditors’ Report ..... 44  
Statement of Financial Position ..... 45  
Statement of Profit or Loss  
and Other Comprehensive Income ..... 46  
Statement of Cash Flow ..... 47  
Notes to the Financial Statements ..... 49  
Notes ..... 60  
Corporate Information ..... Inner Back Cover



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# • THE REWARDS OF • EXCELLENCE

Al-Falaah, The Islamic Business Unit of LOLC Finance (LOLC Al-Falaah) has always been a model of business excellence, bringing creativity, passion and commitment to everything we do. For nearly ten years, we have worked to create increasing and sustainable value for the diverse customers and other stakeholders we serve, empowering lives, developing communities and enriching the Sri Lankan economy. Today, the strength of our portfolio has combined with our fine fundamentals to make LOLC Al-Falaah a shining star in the nation's competitive financial sector.

The year reviewed in this annual report has been an exceptional one, seeing the organisation achieve local and international recognition, as we continue to create and share the rewards of excellence with the many stakeholders who place their trust in us.



## Our Vision

To be the most preferred Shari'ah compliant financial solutions provider.

## Our Mission

Assist those driven by the spirit of enterprise to reach greater heights, through our innovative, personalised and wide-ranging Shari'ah compliant financial solutions.

## Our Values

The guiding principles of LOLC Al-Falaah, strictly concentrate on ensuring that no element of 'Gharar' (Uncertainty) is in any transaction. Therefore, in order to adopt a clear separation of in-flow and out-flow of funds, LOLC Al-Falaah maintains separate financials, systems, processes and operations in the strictest form. LOLC Al-Falaah has appointed a dedicated Shari'ah Supervisory Board (SSB) with representation of eminent local and international industry leading scholars together with a permanent and full-time in-house Shari'ah Advisor for guidance and advice on Shari'ah. The SSB also conducts periodic Shari'ah audits on all transactions done by LOLC Al-Falaah.

Guided by our values, we aspire to :

- › Make available broad-based Shari'ah compliant financial services islandwide.
- › Spread the concept amongst all stakeholders and to champion the process of development of Islamic finance in Sri Lanka.
- › Create long-term value for all stakeholders and build lasting relationships with them.
- › Inculcate a 'Service-First' mindset across the organisation and go the extra-mile to provide innovative financial solutions to our customers.
- › Nurture an enterprising spirit through the generation and power of ideas.
- › Respect diversity in the workplace, provide dignity and purpose, and collectively share talents to attain the corporate vision as well as to achieve departmental and individual goals, objectives and aspirations.
- › Be a model corporate citizen by maintaining highest professional and ethical standards.

## Who We Are

LOLC Al-Falaah commenced operations in 2007, led by a mandate to promote and offer Islamic financial solutions in keeping with the growing global popularity of Islamic finance.

LOLC Al-Falaah's product portfolio offers a superior range of Shari'ah compliant financial solutions.

We differentiated our services by focusing on a wider customer base which encompassed clients from all religious persuasions and not merely the Muslim community.

Buoyed by the Company's viable alternative products and services LOLC Al-Falaah gained a steady and loyal customer base. Our key differentiator is our customised and innovative product portfolio which addresses both business and socio-economic requirements of diverse market segments, whilst meeting the specialised needs of individuals.

At LOLC Al-Falaah, we're keeping our pledge of total transparency, trustworthiness and value creation while rewarding your partnership with excellence.

LOLC Al-Falaah's product portfolio offers a superior range of Shari'ah compliant financial solutions in areas of Profit Sharing Investment & Savings, Leasing, Trade Financing, Import Financing, Property & Project Financing, and Business & Working Capital Financing. Customers can access these products and services via dedicated windows within LOLC Finance's extensive channel network of 130 branches & service centres islandwide, including 7 stand-alone LOLC Al-Falaah service centres across the country.

At Al-Falaah, our focus is not solely on the excellence of our business operations - we are mindful of our contribution to society, through various CSR projects which are aligned on a group scale.

The operations of Al-Falaah are closely monitored and guided by a dedicated Shari'ah Supervisory Board to ensure that we are at all times, and in every way, compliant with the principles of Islamic economics vis-a-vis Islamic financing.

# Awards (2009–16)

09

## LACP Global Vision Awards

- Annual Report 'Dressed for Success'  
**BRONZE AWARD**

10

## LACP Global Vision Awards

- Annual Report 'Spreading the Wings of Islamic Finance'  
**BRONZE AWARD**

11

## LACP Global Vision Awards

- Annual Report 'Values Generate Value'  
**SILVER AWARD**

12

## ARC Global Awards

- Annual Report 'Values Generate Value'  
**GOLD AWARD**

## Sri Lanka Islamic Banking & Finance Industry (SLIBFI) Awards

- Rising Islamic Finance Personality of the Year: Shiraz Refai (LOLC Al-Falaah)

---

### 2016 - Islamic Finance News (IFN) Global Awards



IFN Deal of the Year for Ijarah-Sukuk, Sri Lanka (First landmark issuance in the history of Sri Lanka) - **WINNER**



Best Islamic Bank Sri Lanka  
**RUNNER UP**



Best Islamic Leasing Provider  
**RUNNER UP**

---

### 2016 - Sri Lanka Banking & Finance Industry (SLIBFI) Awards



Islamic Finance Entity of the year  
**WINNER/GOLD**



Deal of the Year Ijarah-Sukuk  
**WINNER/GOLD**



Social Upliftment Award  
**SILVER/RUNNER UP**

# 13

## Great Places to Work

- Great Places to Work - LOLC Finance  
**WINNER**

## Islamic Finance News (IFN) Global Awards

- Best Islamic Leasing Provider (Asia/GCC/MENA)  
**2ND PLACE**
- Best Islamic Bank by Country  
**2ND PLACE**

## Sri Lanka Islamic Banking & Finance Industry (SLIBFI) Awards

- Islamic Finance Entity of the Year  
**SILVER AWARD**
- Product of the Year  
**SILVER AWARD**
- Social Upliftment  
**MERIT AWARD**

# 14

## Islamic Finance News (IFN) Global Awards

- Best Islamic Bank by Sector / Best Islamic Leasing Provider  
**3RD PLACE**
- Best Islamic Bank by Country / Indian Sub-Continent  
**2ND PLACE**

## Sri Lanka Islamic Banking & Finance Industry (SLIBFI) Awards

- Islamic Finance Entity of the Year  
**GOLD AWARD**
- Social Upliftment  
**GOLD AWARD**

# 15

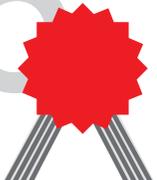
## Islamic Finance News (IFN) Global Awards

- Best Islamic Bank by Sector – Best Islamic Leasing Provider  
**3RD PLACE**
- Runner-up for the Best Islamic Bank by Country – Indian Sub-Continent  
**3RD PLACE**
- Best Islamic Bank by Country / Indian Sub-Continent  
**2ND PLACE**

## Sri Lanka Islamic Banking & Finance Industry (SLIBFI) Awards

- Islamic Finance Entity of the Year  
**SILVER AWARD**
- Social Upliftment  
**GOLD AWARD**
- Rising Islamic Finance Personality of the Year – Nadheer Siddique (Al-Falaah Takaful)

# 16



## Sri Lanka Islamic Banking & Finance Industry (SLIBFI) Awards

- Islamic Finance Entity of the year 2016  
**GOLD AWARD**
- Deal of the Year 2016  
**GOLD AWARD**
- Social Upliftment Award  
**SILVER/RUNNER UP**

## Islamic Finance News (IFN) Global Awards

- IFN Deal of the Year for Ijarah-Sukuk, Sri Lanka (First landmark issuance in the history of Sri Lanka)  
**WINNER**
- Best Islamic Bank in Sri Lanka  
**RUNNER UP**
- Best Islamic Leasing Provider  
**RUNNER UP**

## Global Banking & Finance Review (GBFR) Awards

- Best Islamic SME Leasing and Finance Company in Sri Lanka
- Most Innovative Islamic Investment Product (Wakala)' in Sri Lanka

### 2016 - Global Banking & Finance Review (GBFR) Awards



Best Islamic SME Leasing and Finance Company in Sri Lanka

Most Innovative Islamic Investment Product (Wakala)' in Sri Lanka

# Living up to our Name



## 1. Stability

- 
- ▶ Regulated by the Central Bank of Sri Lanka (CBSL)
- ▶ Rated A (Stable) ICRA Lanka Ltd
- ▶ Only NBFi in the world to be listed in Bankers' almanac
- ▶ Recorded retained earnings of LKR 1.67 Bn carried forward up by 27%
- ▶ Profit paid to Depositors LKR 558 Mn up by 16%
- ▶ Total Deposits portfolio 6.7 Bn up by 5%
- ▶ Total Loans & advances 11 Bn up by 2%
- ▶ Total Assets 11.4 Bn up by 4%
- ▶ Revenue 2.1 Bn up by 29%
- ▶ PBT 550 Mn up by 7%
- ▶ NPL Ratio 1%

## 2. Governance

- 
- ▶ Shari'ah Supervisory Board
- ▶ Dedicated In-House Shari'ah Advisor
- ▶ Specialised Strategic Business Unit
- ▶ Maintenance of a Separate General Ledger for Islamic Business
- ▶ Maintenance of a Separate Banking Accounts for Islamic Business
- ▶ Maintenance of Separate IT System for Islamic Business
- ▶ Maintenance of a Separate Chart of Accounts, - P&L and B/Sheet for Islamic Business
- ▶ Segregation of Receipts & Payments
- ▶ Segregation of Operational Processes & Documentation
- ▶ Specialised & Fully Trained Staff
- ▶ Specialised Quarterly Shari'ah Audit & Report by SSB
- ▶ Charity Fund for Portfolio Cleansing
- ▶ Quarterly & Annual Shari'ah Audits carried out
- ▶ Special Annual Report Published for Stakeholders



## 3. Customer Value Creation

- 
- ▶ Solutions for Deposits & Savings - Mudharbah, Wakala Investments
- ▶ Finance Solutions for Business & Working Capital - Ijarah, Murabaha, Musawamah, Diminishing Musharakah, Wakala for Lending
- ▶ Brands - Al-Falaah Junior, Al-Falaah Senior, Al-Falaah Ladies
- ▶ VISA enabled Debit/ATM Card access to its Savings Account Holders.
- ▶ LOLC Real Time - Online & Mobile banking facilities Highest Profits distributed to Depositors
- ▶ Island-wide Branch-network of 130 including 7 dedicated Al-Falaah Centers
- ▶ 1st NBFi in Sri Lanka to join the SWIFT network
- ▶ 1st NBFi to offer regulated Deposit based Islamic financing products
- ▶ Only NBFi in Sri Lanka permitted to engage in foreign currency business
- ▶ Tailor-made financial solutions
- ▶ Highest professional service



#### 4. Futuristic

2008:

- ▶ 1st RFC to obtain CBSL clearance to offer Shari'ah based investment products
- ▶ 1st Regulated Mudharabah based Minor's Savings account
- ▶ 1st to offer VISA enabled Debit/ATM Card access to its Savings Account Holders.
- ▶ 1st to offer LOLC Real Time Online & Mobile banking facilities on Savings Accounts

2014:

- ▶ 1st NBFI to issue a customer loyalty 'Discount Card' EMPRESS exclusively for the ladies segment

2016:

- ▶ 1st Sukuk Issuance (Ijarah Sukuk) in Sri Lanka by LOLC Al-Falaah



#### 5. Human Capital

- ▶ Winner of the "Islamic Finance Entity of the year" multiple times
- ▶ Fully-trained and certified professionals
- ▶ 100 + dedicated Al-Falaah staff placed in strategic branches and over 500 professionally trained staff across the branch network.
- ▶ 3 member expert Shar'iah panel with a blend of local and international scholars.
- ▶ Full time dedicated in-house Shari'ah advisor.



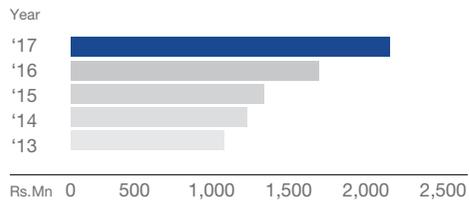
#### 6. International Networks

- ▶ Islamic Development Bank (IDB), Saudi Arabia
- ▶ Islamic Corporation for the Development of the Private Sector (ICD), KSA
- ▶ IFN News, Malaysia
- ▶ ALPEN Capital, U.A.E.
- ▶ Pak-Oman Micro Finance Bank, Pakistan
- ▶ Agra Corp, Indonesia

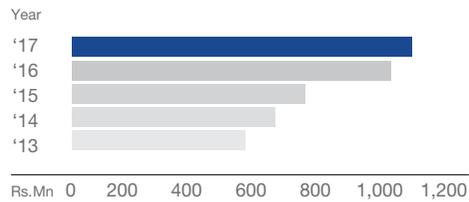
# Financial Highlights

For the year ended 31st March	2017 Rs.	2016 Rs.
<b>Revenue</b>	2,068,595	1,605,795
Profit paid to Mudharabah / Wakala investors	558,486	480,400
Other direct expenses - insurance	453,507	132,557
Non distributable other income / (expenses)	36,066	30,513
Employee benefits	142,044	124,866
Provision for credit losses	45,477	75,856
Other operating expenses	257,501	251,919
Value added tax on financial services	97,114	55,565
Profit before taxation	550,533	515,145
Income tax expense	197,523	138,218
Profit for the year	353,010	376,927
<b>Assets</b>		
Cash and bank balances	315,834	120,481
Murabaha / Musawamah receivables	2,832,391	2,863,475
Diminishing Musharakah receivables	4,956,193	4,692,274
Ijarah rent receivables	3,231,092	3,293,317
Investment in quoted shares	6,600	7,000
Other receivables	75,592	51,658
Investment properties	18,000	15,000
Total assets	11,435,702	11,043,205
<b>Liability</b>		
Mudharabah investments	4,081,858	4,230,559
Mudharabah savings	484,831	466,059
Profit payable on Mudharabah investments	102,355	86,885
Wakala investments	1,991,208	1,569,100
Profit payable on Wakala investments	21,271	7,092
Ijarah Sukuk Bond	422,353	-
Income tax payable	197,523	138,218
Accruals and other payables	242,768	256,180
Due to head office	2,223,189	2,973,777
Retained earnings	1,668,345	1,315,335
Total liabilities & owners fund	11,435,702	11,043,205

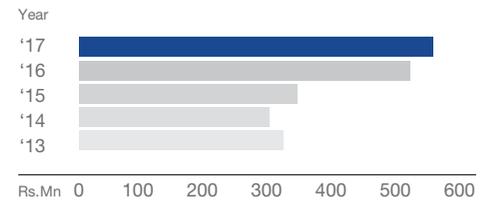
**Revenue - Rs. 2,069 Mn**



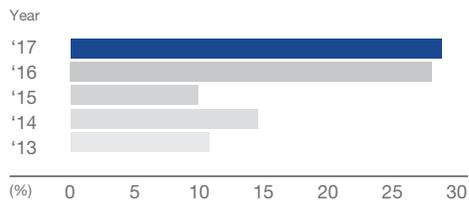
**Gross Profit - Rs. 1,057 Mn**



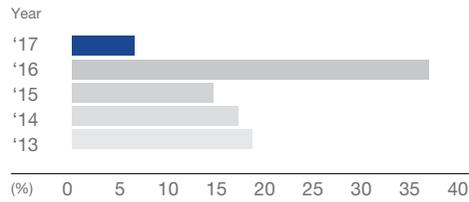
**PBT - Rs. 551 Mn**



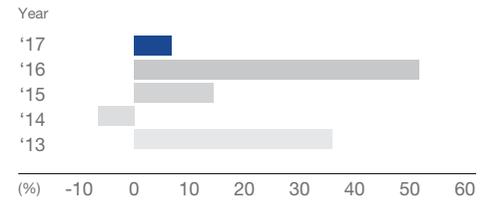
**Revenue Growth - 29% ↑**



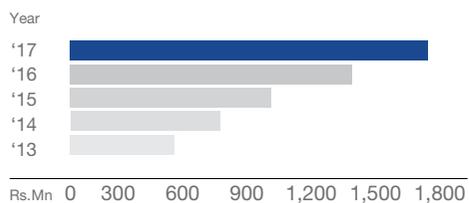
**Gross Profit Growth - 6% ↑**



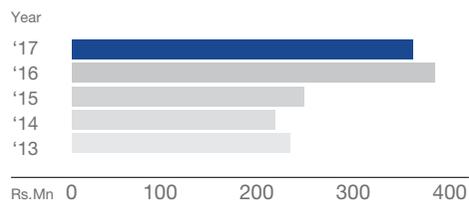
**PBT Growth - 7% ↑**



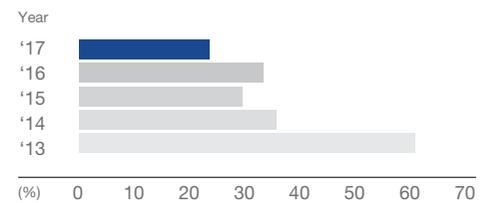
**Retained Earnings - Rs. 1,668 Mn**



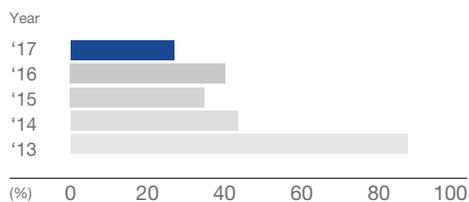
**PAT - Rs. 353 Mn**



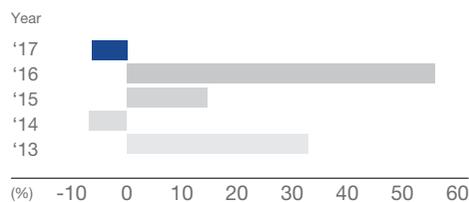
**ROE - 24% ↑**



**Retained Earnings Growth - 27% ↑**

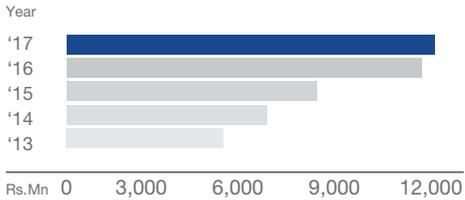


**PAT Growth - -6% ↓**

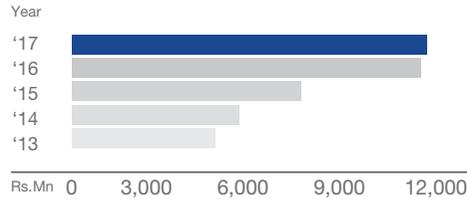


Financial Highlights

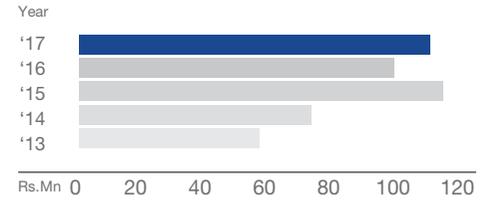
**Total Assets - Rs. 11,436 Mn**



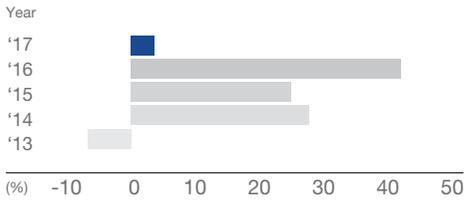
**Loans and Advances - Rs. 11,020 Mn**



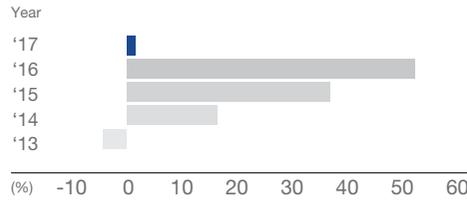
**NPL - Rs. 110 Mn**



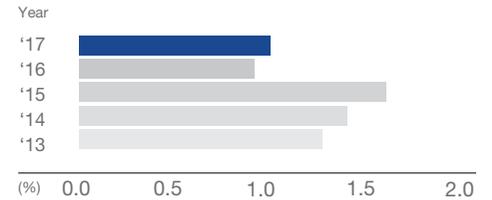
**Total Assets Growth - 4% ↑**



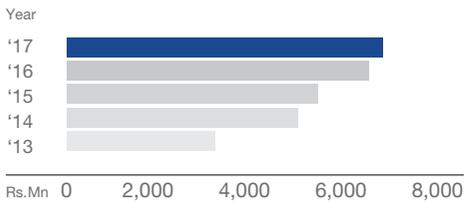
**Loans and Advances Growth - 2% ↑**



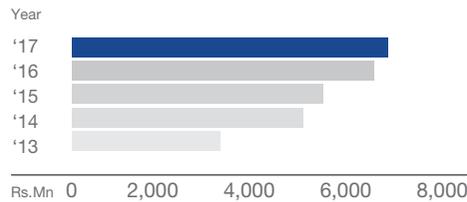
**NPL Ratio - 1% ↑**



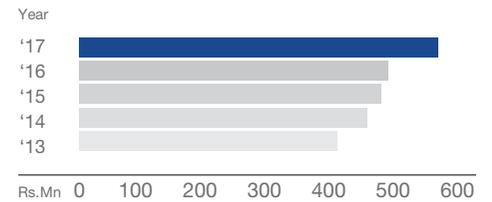
**Total Liabilities - Rs. 6,558 Mn**



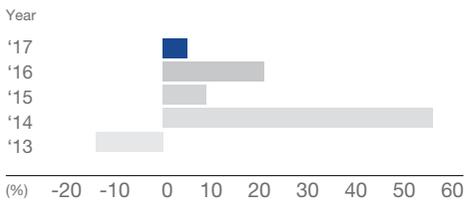
**Deposit Base Growth - Rs. 6,558 Mn**



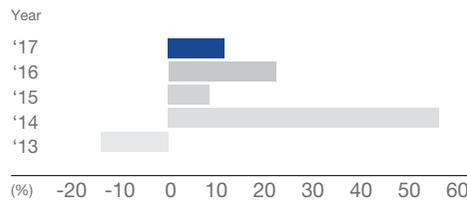
**Profit Paid to Depositors - Rs. 558 Mn**



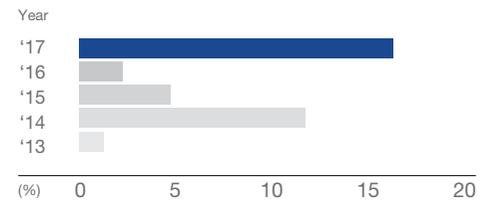
**Total Liabilities - 5% ↑**



**Deposit Base Growth - 12% ↑**



**Profit Paid to Depositors - 16% ↑**



# · EXECUTIVE · REVIEWS

Chairman's Message 12

Message from Group Head of Islamic

Finance - LOLC 16

SSB Chairman's Message 18

# Chairman's Message

**Justice R K S Suresh Chandra**  
Chairman





**The most important highlight of the period was that LOLC Al-Falaah pioneered the country's first-ever Ijarah Sukuk (alternate option for securitisation) in July 2016. A first ever such initiative in the country's Islamic Banking segment, the product has become the benchmark for the most effective method of raising funds within the banking and finance industry.**

It gives me pleasure to present the Annual Report and Audited Financial Statements for LOLC Al-Falaah, the Islamic Business unit of the LOLC Group. The company continued its steady momentum by recording robust year-on-year growth while simultaneously pioneering several firsts in the industry in a similar vein as it has since inception. During the year under consideration, the company was able to record improvements across a broad set of parameters to further entrench its credentials as the foremost entity in the arena of Islamic finance in the country.

### Excellence in Product Innovation

Apart from the financial and operational excellence achieved by the company during the year, the most important highlight of the period was that LOLC Al-Falaah pioneered the country's first-ever Ijarah-Sukuk (alternate option for securitisation) in July 2016. A first-ever such initiative in the country's Islamic Banking segment, the product has become the benchmark for the most effective method of raising funds within the banking and finance industry.

We believe it will prove to be a front-runner and offer encouragement for the rest of the industry in driving innovation. Our enthusiasm

for this initiative was reaffirmed by local and global accolades and recognition received during the year under review. LOLC Al-Falaah's Ijarah-Sukuk was awarded the 'Deal of the year' at the Islamic Finance News (IFN) Global Awards held in Dubai, UAE. The company was further bestowed with the 'Islamic Finance Entity of the Year for 2016' title and 'Deal of The Year' for landmark Ijarah Sukuk at the local Sri Lanka Islamic Banking and Finance Industry (SLIBFI) Awards in 2016, for the second time.

### Company Performance

During the year under review, the company went on to record a revenue of Rs. 2 Bn and Profit before tax of Rs. 551 Mn, reflecting a growth of 29% and 7% respectively in comparison with Rs. 1.6 Bn and Rs. 515 Mn recorded in the preceding financial year. This strong performance is attributable to LOLC Al-Falaah's wide product portfolio which caters to fulfill the current and future needs of its loyal customer base. Our convenient branch network and 'service at customer's doorstep' concept is serving to retain existing customers and attract new ones to our customer base. LOLC Al-Falaah continued to support customers in the SME sector through the year and as a result,

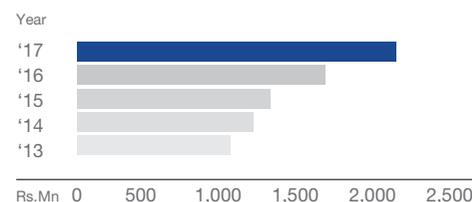
its lending portfolio rose from Rs. 10.8 billion in the previous financial year to Rs. 11 billion for 2016/17, with all core lending products showing decisive growth. This performance by LOLC Al-Falaah's Islamic Banking constitutes 12% of the overall total lending portfolio, which reflects its significant contribution to LOLC Finance's profitability.

### Macro Economic Conditions in 2016

Beset by several challenges, the Sri Lankan economy contracted slightly as compared to the previous year, recording 4.4 per cent in 2016 compared to 4.8 per cent in 2015. While the recommencement of some large scale government infrastructure projects and private sector investment activities boosted the economy during the year, tightening of the monetary policy stance of the Central Bank, uncertainty that arose from frequent policy changes and adverse weather conditions that prevailed throughout the year impacted the growth momentum.

Growth in Industry and Services related activities were the main contributors. Meanwhile, unfavourable weather conditions, fragile demand and low prices for Sri Lanka's major agricultural commodity exports from destinations such as Russia and some of the Middle Eastern countries led to a contraction in Agriculture activities.

### Revenue - Rs. 2,069 Mn

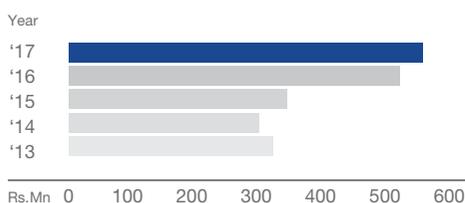


Chairman's Message



**Our journey has been a pioneering and eventful one, in which we have not only attained leadership status in the Islamic Banking & Finance segment, but we have also inspired many other entrants into this segment.**

**PBT - Rs. 551 Mn**



On the world stage, slow global economic recovery, sluggish global trade, tightening interest rates in the US and heightened policy uncertainty from unanticipated outcomes of global economic and political developments that took place throughout 2016 hindered the expected recovery in external demand.

**Performance of Financial Sector**

The financial sector continued to expand during the year whilst exhibiting resilience amidst challenging market conditions both globally and domestically. The 2016 financial year for the Licensed Finance Companies (LFCs) and Specialised Leasing Companies (SLCs) sector was marked by a gradual

movement of business concentration towards other loan products as a result of policy measures taken to curtail vehicle importation since 2015 by the government. The sector was also encouraged to undertake branch expansion while the methodology used in setting the maximum rate caps on deposits and debt instruments was revised to neutralise the impact of sudden changes in the rates during the year.

The LFCs/SLCs sector showed an expansion in the asset base. The growth in assets during the year was funded by domestic borrowings and deposits. During 2016, the LFCs/SLCs sector was able to expand their asset base exceeding the one trillion rupee mark while maintaining marginally lower growth than in the previous year. The total asset base of the sector grew by 21.7 per cent (Rs. 215.8 billion) in 2016 to Rs. 1,211.9 billion compared to a growth of 22.3 per cent (Rs. 181.6 billion) in 2015. The 77.3 per cent growth of assets was mainly led by lending activities.

Although credit growth decelerated in the first quarter of 2016 as a result of macro prudential measures with respect to the lending on motor vehicles, the improvement in other lending activities in the second half of the year caused a rebound in the expansion of credit. While maintaining the growth, risk remained under control, as reflected in healthy level of NPLs and comfortable liquidity and capital levels.

Greater business expansion of the LFCs/ SLCs sector into new areas of lending during the year enabled the sector to post increased level of profits. Accordingly, the sector posted a profit after tax of Rs. 31.5 billion compared to that of Rs. 15.2 billion in 2015 reporting a more than two-fold increase. Increased business volumes, improved other income and improved operational efficiency were the main contributory factors for increased profits.

**Future Prospects**

It gives me great pride to state to our valued stakeholders that LOLC Al-Falaah celebrates its 10th anniversary in 2017. Our journey has been a pioneering and eventful one, in which we have not only attained leadership status in the Islamic Banking segment, but we have also inspired many other entrants into this segment. We believe that by benchmarking high standard of Islamic finance operations, we are serving the industry to grow and prosper. More significantly, the company has proved total compliance with all Shari'ah and other regulatory requirements, thereby rendering LOLC Al-Falaah the top brand in

Islamic Finance in Sri Lanka. The Islamic finance market segment holds much potential and LOLC Al-Falaah's wealth of knowledge and technical expertise puts us in the ideal position to continue to spearhead the industry as we have done over the last decade.

We have ambitious plans for the company going into the future to enhance our presence locally while looking to forge international partnerships, which will help us gain a foothold in overseas markets as well. We are aware of our strategic advantage in taking Islamic finance to rural parts of the country and we will continue to strengthen our grassroots reach while leveraging on group synergies to achieve a wider customer base.

### **Acknowledgements**

I would like to thank my fellow directors on the Board for their wise counsel and support. The management and staff of LOLC Al-Falaah deserve to be commended for their commitment to achieve our goals. I would also like to take this opportunity to express my gratitude to the Shari'ah Supervisory Board (SSB) for their guidance to ensure Al-Falaah's services are in full compliance with the Shari'ah system. The company looks forward to sustaining and growing its position as the market leader in Islamic finance in the country.



**Justice R K S Suresh Chandra**  
Chairman

## Message from Group Head of Islamic Finance - LOLC

**Krishan Thilakaratne**  
Group Head of Islamic Finance





## The year under review has been marked by awards and accolades for the company. LOLC Al-Falaah was recognised at the Islamic Finance News, Global Poll, IFN Best Banks Awards 2016 for the fourth consecutive year.

During the 2016/17 financial year, in a historic moment, LOLC Al-Falaah secured a Rs. 500 million (US\$ 3.37 million) Sukuk deal, the 'IFN Deal of the Year for Sukuk (Alternate option for Securitisation)' at the 'IFN Deals of the Year for 2016' awards ceremony held on 28th February 2017 in Dubai, UAE. This was the direct result of Al-Falaah devising a signature financial instrument that can be offered as an alternate format for the conventional securitisation product. Although Rs. 500 mn could be considered a modest ticket amount for a sukuk transaction, it has thrown open a whole new path for the company and other Islamic Finance Institutions in the industry. I believe this deal has paved the way for others to follow suit and we at LOLC Al-Falaah are happy to lead the way.

LOLC Al-Falaah's role in the Islamic Finance industry is a critical one in Sri Lanka as it is the lead player in Islamic SME and Microfinance business in both lending and investment areas. Our key point of differentiation has been the granular business that we are garnering through the comprehensive product range and our distribution channel of 130 LOLC Finance branches. All our branches have dedicated Islamic finance marketers and other marketers too are well-equipped and knowledgeable about the specialised products and processes.

I am proud to bring to your notice that LOLC Al-Falaah will be celebrating its 10th anniversary in 2018 and we can look back on a decade's journey that has been

unblemished and uncompromised on Shari'ah and other regulatory requirements, which has made LOLC Al-Falaah the top brand in Islamic Finance in Sri Lanka.

The year under review has been marked by awards and accolades for the company. LOLC Al-Falaah was recognised at the Islamic Finance News, Global Poll, IFN-Best Banks Awards 2016 for the fourth consecutive year. The global Islamic finance fraternity voted LOLC Al-Falaah amongst the top global industry giants. The recognitions received are 'Best Islamic Leasing Provider, Runner Up', where LOLC Al-Falaah moved up from 3rd Place in 2015, and maintained the position of 'Best Islamic Bank Sri Lanka, Runner Up' for 2016 as well. LOLC Al-Falaah also secured two prestigious awards at the Global Banking & Finance Review (GBFR) Awards 2016 - UK, by being crowned the 'Best Islamic SME Leasing and Finance Company' and the 'Most Innovative Islamic Investment Product (Wakala)' in Sri Lanka for 2016. This is Al-Falaah's first win at the GBFR which is created to recognise companies of all sizes that are prominent in particular areas of expertise and procure excellence within the global financial community.

Closer to home, the business volumes and profitability achieved during the year under review is a testimony to our brand. We had an exceptional year in 2016/17, some highlights of which are 2% portfolio growth, 29% topline growth and Rs. 558 Mn profit distributed to investors.

LOLC Al-Falaah remains the centre of innovation for the entire group. Other group companies such as LOLC General Insurance and Life Insurance have also successfully launched the takaful business by leveraging on our learnings and success. Our aim is also to expand our base outside the country into overseas subsidiaries. The yet untapped Islamic Finance market holds immense potential in Sri Lanka and worldwide. One main reason for this is the lack of knowledge and commitment, hence, LOLC Al-Falaah sees a critical advantage in this arena.

Our future plans include sourcing overseas funds especially from the Gulf Cooperation Council (GCC) countries which sit on large pools of cash. In this regard, we intend to work with highly recognised partners such as the Islamic Development Bank (ICD) and top banks from the Middle-East and other developed markets such as Malaysia. We are confident of securing significant funding in the course of the 2017/18 financial year.

While we are looking at the bigger picture in international markets, we will continue our tireless efforts to educate the domestic market, improve our delivery channels, and offer best price and value for money products to our customers. The eventual success of Islamic Finance lies in fulfilling basic customer needs in this segment.

### Acknowledgements

I wish to thank my Board of Directors for the confidence placed in me and my team as we forge a bold and confident path in taking Islamic Finance to all people in the true spirit of Shari'ah principles.

**Krishan Thilakarathne**  
Group Head of Islamic Finance - LOLC

# SSB Chairman's Message

**Ash-Shaikh Fazil Farook**  
SSB Chairman's Message



It gives me satisfaction to state on behalf of the Shari'ah Supervisory Board (SSB) that LOLC Al-Falaah concluded the 2016/17 financial year on a successful note and in strict adherence with the code of SSB. We are encouraged by the extent of commitment shown by LOLC Al-Falaah to adhere to the core principles of the Shari'ah across all its functions and in its efforts to drive penetration of Islamic Finance island-wide.

2016/17 year marks the ninth year of Shari'ah audits by SSB to assess compliance to its requirements by LOLC Al-Falaah, apart from daily Shari'ah audits conducted by its in-house Shari'ah advisor. Compliance improvement is addressed by the quarterly Shari'ah audits carried out by the local SSB members, with reviews taking place bi-annually and annually with the presence of the entire SSB team. On conclusion, SSB submits a concise annual Shari'ah report to the Board of Directors and all stakeholders. The company has remained in close communication with SSB, regularly providing updates of its compliance and performance achievements.

SSB is further heartened by the measures taken by LOLC Al-Falaah to take Islamic Finance to the rural areas where the majority are yet unbanked and unaware of this concept. The company enjoys a strategic advantage because of its ability to leverage on group synergies, namely, the wide LOLC Finance channel network in rural pockets of the country. LOLC Al-Falaah organised 12 small to mass-scale customer awareness events as part of its promotional activities during the period under review and has ambitious plans to cover new regions going forward. Islamic Finance is now an accepted and fast evolving concept in the country, with LOLC Al-Falaah playing a major role as a proactive leading player.

Islamic Finance celebrates two decades of operations in Sri Lanka. Over this period, major players from commercial banks and finance companies have aggressively joined the Islamic Finance industry. Moreover, the regulatory framework of Sri Lanka too has welcomed the concept. The Central Bank of Sri Lanka (CBSL) and Insurance Board of Sri Lanka (IBSL) have made periodic amendments to accommodate Islamic Finance. The Securities Exchange Commission (SEC) and Inland Revenue (IR) are looking favourably at the proposals and suggestion made by the industry to cater to specific needs of Islamic Finance products to the mainstream.

The newly-formed Association of Alternate Finance Institutes (AAFI) guided by KPMG, with members from banking, finance, tax and insurance sectors is a recent catalyst that promotes Islamic Finance and lobbies constructive proposals to all regulatory bodies in a forward-thinking strategy for the industry. The support from the Government of Sri Lanka is noteworthy as it is encouraging Islamic Finance in order to attract international markets to invest in the country.

The Middle-Eastern region has always been at the pinnacle in product innovations. In fact, the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) based in Bahrain is a trendsetter globally, with most parts of the world following the directions and guidelines issued by them. LOLC Al-Falaah too follows guidelines issued by the AAOIFI since inception and continues to modify the product offering based on the directions of AAOIFI.

During the year, LOLC Al-Falaah launched Sri Lanka's first Sukuk Al-Ijarah issuance and this 'Shari'ah-compliant' securitisation alternative has received an overwhelming

response. As the pioneering Sukuk issuance in Sri Lanka and the region, SSB believes that it will contribute to further develop the Islamic Finance capital market. This issuance will go down in history as it will open the floodgates for further such issuances to benefit the industry.

Al-Falaah has played a significant role in uplifting Islamic Finance in Sri Lanka by expanding its branch network to spread the message of this alternate financing and its benefits to all communities. LOLC Al-Falaah staff are fully-trained and certified periodically to handle inquiries and attend to clients needs.

LOLC Al-Falaah's comprehensive product portfolio caters to various needs of clients seeking Islamic Finance solutions coupled with its doorstep service and 130 branch network, which lends the company a unique advantage in terms of reach and penetration. The company can be credited with the introduction of novel products such as variants of the core concepts of Ijarah, Diminishing Musharakah, Murabaha and Musawamah, and on the investment side, Mudharabah and Wakala. Its capacity for product innovation has enhanced its status as the foremost provider of Islamic Finance in the country.

Finally, I must commend the Board of Directors and senior management and staff of LOLC Al-Falaah for their committed pursuit in driving Islamic Finance in the country and for their commitment to understand and comply with core principles of the SSB.



**Ash-Shaikh Fazil Farook**

Chairman - Shari'ah Supervisory Board  
Al-Falaah, Islamic Business Unit - LOLC  
Finance PLC

# Value Map



LOLC Al-Falaah is focused on product sophistication and innovation in order to fulfil ever-evolving requirements of investors. We remain the centre of innovation for the entire group and persevere to infuse shared value to ensure long term prosperity for our investors..

## PRODUCT RANGE



### MUDHARABAH

Fixed Deposits and Savings



### WAKALA FOR INVESTMENT

Term Investments



### DIMINISHING MUSHARAKAH

Property & Project Financing



### IJARAH

Leasing



### WAKALA

Business & Working Capital Financing



### MURABAHA

Trade Financing



### MUSAWAMAH

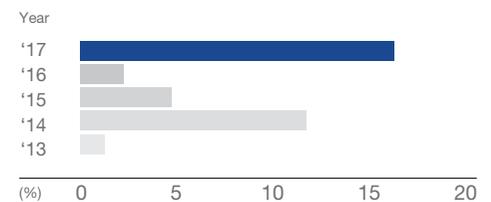
Import Financing

## BEST INVESTOR RETURNS

### Profit Paid to Depositors

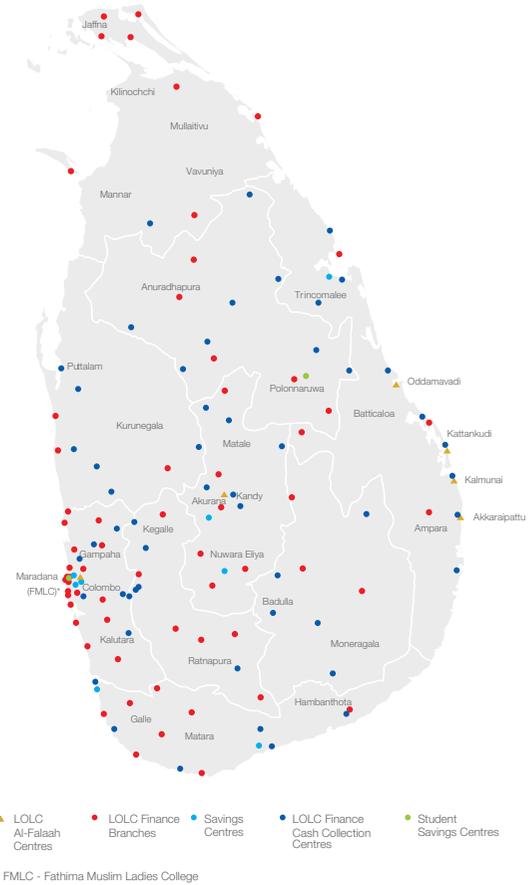


### Profit Paid to Depositors - 16% ↑



## DISTRIBUTION CHANNEL MAP

- ▶ **Northern Province**  
LOLC Finance Branches : 8
- ▶ **North Central Province**  
LOLC Finance Branches : 14
- ▶ **North Western Province**  
LOLC Finance Branches : 09
- ▶ **Western Province**  
LOLC Finance Branches : 29  
Student Savings Centre : 01  
LOLC AI-Falaah Centers : 01
- ▶ **Central Province**  
LOLC Finance Branches : 14  
LOLC AI-Falaah Centers : 02
- ▶ **Eastern Province**  
LOLC Finance Branches : 14  
LOLC AI-Falaah Centers : 04
- ▶ **Sabaragamuwa Province**  
LOLC Finance Branches : 09
- ▶ **Uva Province**  
LOLC Finance Branches : 08
- ▶ **Southern Province**  
LOLC Finance Branches : 17



## DISTRIBUTION CHANNEL



**130**  
Branches



**500+**  
Fully-Trained Staff



**100+**  
Dedicated AI-Falaah Staff



**07**  
Dedicated Centres

# Product Review



LOLC Al-Falaah realizes the unique needs of its customer base and offers a diverse basket of products that offer flexibility and enhanced benefits while ensuring full compliance with principles of Islamic finance. Our investors' financial health is of prime importance to us and our entire team is geared to provide personalized financial services and guidance.



• Revenue Growth •  
35.64 percent



• Profit Paid to Depositors •  
Over 558 million



• Loans & Advances •  
10.8 billion



• Customers •  
Over 25,000

## Deposits & Savings

The macro economic condition during the 2016/17 financial year was challenging as a result of a severe liquidity crunch in the market. With funding avenues dwindling during the year for the industry, the Non Banking Finance Industry (NBFI) experienced tough operating conditions. Tightening of the monetary policy and other government protocols imposed to safeguard the industry from any negative impact of certain NBFIs undergoing financial difficulty, placed added pressure on the rest of the players. During the year, the trend for customers to favour the banking industry over the NBFI sector was seen. Despite all these seemingly insurmountable challenges, Al-Falaah performed satisfactorily and outperformed the Islamic Finance industry.

During the period, we circumvented the liquidity crisis in the market by focusing on raising capital in overseas markets and

ended the year by outperforming the rest of the Islamic Finance industry. We are proud to note that our sound financial performance and consistent service served to channel investor confidence back into the sector. As the oldest Islamic Finance institution in the country, our customers know they can depend on our rock solid track record. Our commitment to our investors can be evidenced by the fact that LOLC Al-Falaah paid depositors a total sum of Rs. 558,485,895 for the 2016/17 financial year as compared to Rs. 480,400,473 in the preceding year.

The company's performance against the odds can be attributed to the extensive branch network and geographical reach of parent groups LOLC Finance and the LOLC Group, whose credentials inspire confidence amongst our investors. LOLC Al-Falaah, which is running upto its 10th year in operation, functions directly under the

auspices of LOLC Finance PLC, which is one of Sri Lanka's largest NBFIs.

## Products

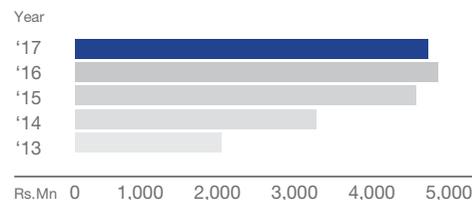


### MUDHARABAH

Fixed Deposits and Savings

- Savings Accounts
- Fixed Deposits

### Mudharabah - Rs. 4,567 Mn



On the whole, the Mudharabah financial instrument reflected a slight dip over the last year due to the stressful market conditions during the year with business confidence dipping amongst investors. However, by year-end a reversal in the trend was seen.



- ▶ ‘Al-Falaah Ladies’ Savings Account
- ▶ ‘Al-Falaah Ladies’ Mudharabah Fixed Deposits
- ▶ “Empress Discount Card”

### Ladies Segment

By offering a product focused on women, we are empowering them to plan their finances better in order to plan their financial future wisely. We are currently focused on empowering the ladies segment by giving better returns and security. Our branch outlook was enhanced so that they have a sense of comfort in walking into any branch or can even access our services online. The company has customised solutions for both investors and borrowers alike. During the year, we added greater value to Empress Merchant Card by extending the facility to 100 plus merchants. During the year, we conducted a few more campaign related promotions such as cookery classes, a financial awareness programme and a workshop to empower our women investors with confidence and offer insights into opportunities. A series of related workshops are planned for the coming months to engage female investors further and encourage them to understand financial management while sparking an entrepreneurial streak in them.



- ▶ ‘Al-Falaah Junior Mudharabah Savings Account

### Junior Segment

We were able to grow deposits in junior accounts by holding value adding promotions such as quiz and art competitions to create awareness amongst children for the need to save from a young age. These campaigns not only spiked creativity in children but they also familiarised them with Islamic Banking principles while inculcating the savings habit. We believe Islamic Finance will progress at an accelerated speed in the future and we are also interesting youth in considering a career in Islamic Finance. This would help create a valuable staff for the future. A plethora of attractive gifts were distributed amongst junior account holders during the year, in order to show them how much the company values them. LOLC Al-Falaah has installed a Student Savings Centre at the Fathima Muslim Ladies College, Colombo 10 as a compliment to develop the savings habit and also to expose the students to the industry from a younger age.

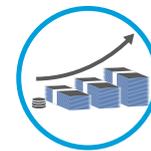


- ▶ ‘Al-Falaah’ Senior Savings Account
- ▶ ‘Al-Falaah Senior’ Mudharabah Fixed Deposits

### Senior Segment

As life expectancy rises, senior citizens need better access to financial security and

independence so that they may live their life with dignity. Realising their unique needs, LOLC Al-Falaah has designed solutions that offer them maximum returns and a feeling of security in their twilight years. Expenditure on healthcare problems related to old age are an area of concern for our senior investors due to which we have arranged discounts at pharmacies and much more.

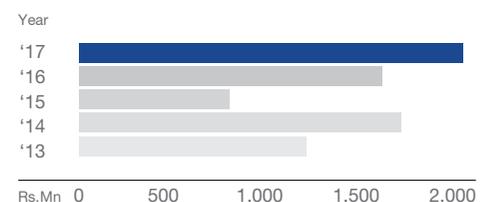


### WAKALA FOR INVESTMENT

Term Investments

- ▶ Corporate Term Investments

### Wakala Investments - Rs. 1,991 Mn



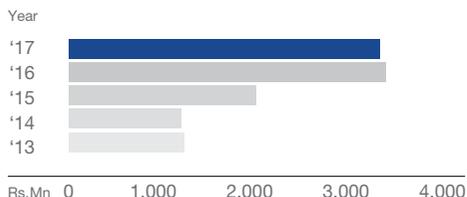
### Corporate & Fixed Term Investor Segment

During the year, Wakala Term Investments product grew by as much as 27%, which although was a reasonable growth, was considerably lower than the 101% growth experienced in the previous year. This product is extended for corporate fixed term investors who seek a fixed-return or a stable return for its investments. However, the unfavourable market conditions during the year deterred investors from making investment of large sums.

Product Review

**Ijarah for Leasing**

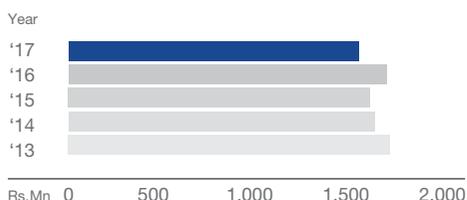
**Ijarah - Rs. 3,231 Mn**



With new vehicle registrations dropping drastically due to hiked taxes and rigid leasing conditions, the leasing market remained subdued during the year, Ijarah products witnessed a decline in performance as compared to the previous year. With confidence returning to the market, this trend is expected to reverse.

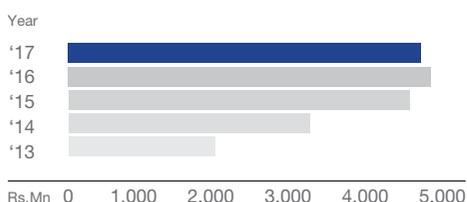
**Murabaha for Trade Finance**

**Murabah - Rs. 1,507 Mn**



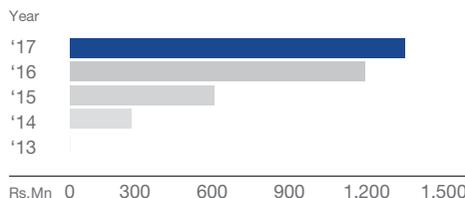
In a similar vein, the liquidity crunch in the market and inclement weather during the year which affected various sectors adversely served to depress the demand for trade finance and as a result, decline -9% in comparison to 6% in the preceding year.

**Mudharabah - Rs. 4,567 Mn**



**Wakala for Business and Working Capital Finance**

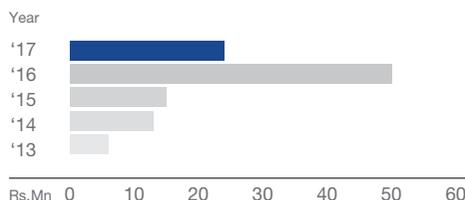
**Wakala Lending - Rs. 1,300 Mn**



This segment of our products grew modestly at 13% during the year under review to record Rs. 1,300,477,028 against Rs. 1,147,513,097 posted in 2015/16.

**Musawamah for Import Finance**

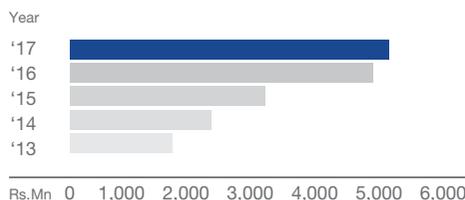
**Musawamah - Rs. 25 Mn**



LOLC Al-Falaah has garnered a large swathe of the import fraternity as customers, but during the year their businesses were impacted negatively due to the macro economic conditions prevailing in the market.

**Diminishing Musharakah for Property and Project Finance**

**Diminishing Musharaka - Rs. 4,956 Mn**



This product witnessed a slight growth of 5% to record Rs. 4,956,192,913 against Rs. 4,703,640,240 achieved last year which reflected a growth of 5%.

**Performance Overview**

The financial year under consideration proved to be a critical one due to the high non performing loans in the industry as markets were not lucrative due to external pressures. Both external and domestic sectors were affected as a result of which our client base of traders was impacted adversely. Nevertheless, Loans and Advances grew to Rs. 11,019,676,427 from Rs. 10,849,065,911 in the previous year. The company succeeded in growing its asset portfolio growth to Rs. 11,435,701,552 from Rs. 11,043,205,173 in the previous financial year, which reflects a growth of 4%.

We are keenly concentrating on the unbanked segment of the population by way of offering small ticket facilities for home industries and light vehicle owners such as three wheelers and motorbikes, and we will be entering the micro finance segment in a big way shortly as this step is in line with our objective to offer all segments of the population a life of dignity through financial inclusion,

Several milestones were achieved during the year. LOLC Al-Falaah secured a Rs. 500 Mn Ijarah-Sukuk deal, the 'IFN Deal of the Year for Sukuk (Alternate option for Securitisation)' at the 'IFN Deals of the Year for 2016' awards ceremony held on 28th February 2017 in Dubai, UAE. This was the direct result of Al-Falaah devising a signature financial instrument that can be offered as an alternate format for the conventional securitisation product. This pioneering innovation has forged a new pathway and recognition for the Company and other Islamic Finance Institutions in the industry.

## Customer Service

During the year, we continued to respond to the needs of our customers by offering tailor-made solutions, working finance solutions, flexible repayment underscored by a professional and considerate approach by minimising paperwork to cut down on time taken to turnaround loans.

Moreover, we have dedicated staff for each business unit who receive intensive training at regular intervals to ensure they are abreast of evolving trends in Islamic Finance. We also extend certification for staff who undergo tests after completing one year with the company, which are conducted by Islamic Finance professionals.

Customer service is at the core of the operation and we maintain an open door policy to empower customers to come forward with suggestions and complaints for us to serve them better. Any grievance is reported directly to the SSB for their attention.

Our customer enjoy access to 7 dedicated AI-Falaah centres and 130 LOLC Finance branches and Savings Centres islandwide, with the facility to make unlimited withdrawals and deposits. The nature of the Shari'ah compliant products offer our investors a higher profit returns on a monthly basis on similar products in the industry. Other features such as a fully-integrated Savings Account with Pass Book and ATM/Debit Card facilities with global access through the VISA network and Real Time online Banking offer ease of banking.

## Sustainable Approach

Apart from extending our signature Shari'ah compliant products and services, as a long term service to the Islamic Finance industry at large, we conducted a series of public awareness programmes supervised by the Shari'ah Supervisory Board (SSB) members from within and outside the company. During the year, we

held 12 events with participation numbers of 120-150 per event, which reflects the rising interest in this alternative financing and banking stream.

Our commitment to all communities in the country is evident in the fact that the LOLC AI-Falaah Charity Fund remains focused on key pillars of education, healthcare and social upliftment projects that benefit people who need it the most, regardless of race, religion and ethnicity.

## Outlook for the Future

Our achievements during the year under review have spurred us to set ambitious targets for the future. A milestone achieved during the year was the Ijarah-Sukuk of Rs. 500 Mn which was a significant transaction as it is the first of its kind in the country. The instrument was subscribed by a single entity, Bank of Ceylon. We are the first in the Islamic Finance industry to receive this funding amongst NBFIs, which has contributed to the promise of innovation and product diversification of LOLC AI-Falaah.

Going ahead, we plan alternative financial solutions to the more established conventional products such as bank overdrafts and pawning services and are in the process of evaluating innovative trade finance solutions as well. Our trade finance model was well accepted both locally and by foreign accreditation bodies. We are exploring the possibility of establishing similar instruments to the Ijarah-Sukuk in sister companies locally and in Pakistan and Indonesia. This global acceptance of our innovation is a confidence builder for the LOLC AI-Falaah team as much as it is for the company's loyal investor base. We have also shared our Islamic Finance and Takaful expertise with group companies LOLC Insurance, Commercial Leasing & Finance PLC and strategic alliances in Pakistan and Indonesia.

All our products and services, and systems and processes are supervised on a daily, monthly, quarterly and annual basis by in-house and external SSB boards, which instills confidence in all our stakeholders about our compliance levels.

The year under review has been marked by awards and accolades for the company. LOLC AI-Falaah was recognised at the Islamic Finance News, Global Poll, IFN-Best Banks Awards 2016 for the fourth consecutive year. The global Islamic finance fraternity voted LOLC AI-Falaah amongst the top global industry giants. The recognitions received are 'Best Islamic Leasing Provider, Runner Up', where LOLC AI-Falaah moved up from 3rd Place in 2015, and maintained the position of 'Best Islamic Bank Sri Lanka, Runner Up' for 2016 as well. LOLC AI-Falaah also secured two prestigious awards at the Global Banking & Finance Review (GBFR) Awards 2016 - UK, by being crowned the 'Best Islamic SME Leasing and Finance Company' and the 'Most Innovative Islamic Investment Product (Wakala)' in Sri Lanka for 2016.

All these accomplishments by LOLC AI-Falaah despite a challenging year reflects our strong fundamentals and pioneering expertise in Islamic Finance.

# Corporate Governance



**LOLC Finance PLC continued to maintain high standards of corporate governance and ethical business conduct across all aspects of its operations and decision-making processes during the year under review.**

LOLC Finance PLC continued to maintain high standards of corporate governance and ethical business conduct across all aspects of its operations and decision-making processes during the year under review.

## Structure

For LOLC Finance corporate governance is about ensuring an effective, transparent and accountable management of affairs by the Board of Directors, the highest governing body, with the ultimate objective of protecting the interests of all stakeholders. The governance structure of LOLC Finance ensures alignment of its business strategy and direction through effective engagement and communication with its stakeholders, Board of Directors, Board Sub-Committees and Management.

## Instruments of Governance

The corporate governance framework of LOLC Finance encompassing external and internal instruments of governance, enables the Board to provide assurance to investors that they have discharged their duties responsibly. The Board of Directors of LOLC Finance and staff at all levels consider it their duty and responsibility to act in the best interests of the Company. It is this strong set of values that has facilitated the trust that our stakeholders have continued to place on the core values underlying our corporate activities.

The external instruments of governance at LOLC Finance include the Companies Act No. 7 of 2007, the Finance Business Act No. 42 of 2011, the Finance Leasing Act, No. 56 of 2000, the Exchange Control Act, No. 24 of 1953, the Payment and Settlement Systems Act, No. 28 of 2005, the Securities and Exchange Commission of Sri Lanka Act, No. 36 of 1987, and any amendments thereto, including rules and directions issued to finance companies from time to time by the Monetary Board of the Central Bank of Sri Lanka and the Listing Rules of the Colombo Stock Exchange. The internal instruments of governance include the Articles of Association, the Role of the Board, Board approved policies, procedures, and processes for internal controls and anti-money laundering.

Policies and procedures have been established taking into consideration governance principles that define the structure and responsibility of the Board to ensure legal and regulatory compliance, to protect stakeholder interests, to manage risk and enhance the integrity of financial reporting. A whistle blowing policy has been introduced and the number of the related 'hotline' has been shared with all employees. This was done to enhance accountability, so that deliberate deviations from controls and/or processes and procedures could be highlighted by any employee and thus addressed promptly.

## Board of Directors

The Board is responsible for the stewardship of the Company and the Directors ensure good governance at Board level and below on the basis of sound principles that provide the framework of how the business is conducted.

The members of the Board consist of persons with multiple industrial/professional backgrounds in which they have achieved eminence, who contribute effectively to decisions made by the Board to guide LOLC Finance towards achieving its objectives. In accordance with best practices, the offices of Chairman and Chief Executive Officer are separate. This ensures a balance of power and enhances accountability. To bring in a greater element of independence the Board appointed Justice R K S Suresh Chandra, Independent Non Executive Director as the Chairman.

## Monitoring and Evaluation by the Board

LOLC Finance has in place a number of mandatory and voluntary Board Sub-Committees to fulfil regulatory requirements and for better governance of its activities. These committees meet periodically to deliberate on matters falling within their respective charters/terms of reference and their recommendations are duly communicated to the main Board.

The following mechanisms are in place for the Board to oversee the accomplishment of the targets in the business plan: review the performance of LOLC Finance at monthly Board meetings; seeking recommendations through Board appointed Sub-Committees on governance, including compliance with internal controls, human resources, risk management, credit and IT; review of

statutory and other compliances through a monthly paper on compliance submitted to the Board covering the operations of LOLC Finance.

The corporate governance philosophy of LOLC Finance is within a framework of compliance and conformance, which has been established at all levels through a strong set of corporate values and a written Code of Conduct. All employees are required to embrace this philosophy in the performance of their official duties and in other situations that could affect the Company's image.

### **Skills and Performance of the Board**

The updating of the skills and knowledge of all Directors is achieved by updates on proposed/new regulations, industry best practices, market trends and changes in the macro environment. It is also facilitated by providing them access to external and internal auditors, access to other external professional advisory services and the Company Secretaries, keeping them fully briefed on important developments in the business activities of the Group and by periodic reports on performance, and opportunities to meet Senior Management.

As required by the Finance Companies Corporate Governance Direction, LOLC Finance has established a well-defined self evaluation mechanism undertaken by each director annually to evaluate performance of the Board. These evaluations are subsequently tabled at a Board meeting and the records are maintained by the Company Secretaries.

### **Engagement with Shareholders**

The shareholders of LOLC Finance have multiple ways of engaging with the Board: the Annual general meetings which are the main forum at which the Board maintains effective communication with its shareholders on matters which are relevant and of concern to the general membership such as the performance and their return on investment of LOLC Finance; access to the Board and the Company Secretaries; written correspondence from the Company Secretaries to inform shareholders of relevant matters; the website of LOLC Finance which is accessible by all stakeholders and the general public; and disclosures disseminated through the Colombo Stock Exchange including interim reporting.

### **Engagement with Employees**

LOLC Finance recognises that employee involvement is a critical pre-requisite towards ensuring the effectiveness of the corporate governance system and therefore attaches great importance to employee communications and employee awareness of key events and significant developments. The necessity of sincere and regular communication in gaining employee commitment to organisational goals and values are stressed extensively and intensively through various communiques issued periodically by the Directors Office. LOLC Finance follows an open-door policy for its employees at all levels. Regular dialogue is also maintained on work related issues as well as on matters pertaining to general interest that affect employees and their families.

In terms of engaging with the employees, the key channels used by the Board include the Executive Director/CEO who is an employee Director and the main link between the Board and the rest of the employees; and the Board members and Board sub committees who conduct effective dialogue with the members of the Management on matters of strategic direction.

### **Avoiding Conflicts of Interest**

The Governance structure at LOLC Finance ensures that the Directors take all necessary steps to avoid conflicts of interest in their activities with, and commitments to other organisations or related parties. If a Director has a conflict of interest in a matter to be considered by the Board, such matters are disclosed and discussed at Board meetings, where Independent Directors who have no material interest in the transaction are present.

### **External Audit**

M/s Ernst & Young, Chartered Accountants were re-appointed as External Auditors of the Company by the shareholders at the Annual General Meeting held in August 2016. Their services were also engaged to seek: a) an assessment of the Company's compliance with the requirements of the Finance Companies Corporate Governance Direction No. 3 of 2008 issued by the Monetary Board; and b) the Company's level of adherence to the internal controls on financial reporting.

The Directors confirm that no significant deviations have been observed by the External Auditors and that the Company has not engaged in any activity that contravenes any applicable law or regulation. To the best of the knowledge of the Directors the Company has been in compliance with all prudential requirements, regulations and laws.

# Enterprise Risk Management



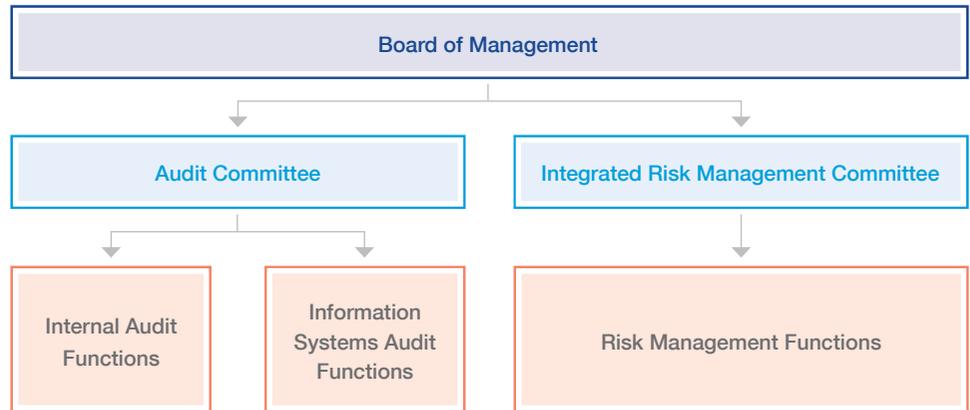
**The Islamic Business Unit is a business silo under LOLC Finance PLC. The risk management function comes under the scope of the Enterprise Risk Management structures of LOLC Finance PLC.**

Risk Management is a dynamic and evolving process that needs to adapt to the changing business landscape. Therefore, we believe that the Risk Governance structures should be geared to respond to organisation dynamics in an efficient and effective manner.

Risk Management at LOLC is a group level centralised function, with risk governance structures in place driven by group level policies. Stemming from this, risk management initiatives cascade down to entities in the group with minimum delay, ensuring structural changes and process level changes can be replicated at any entity in the group. This strategy enables the Group to maximise resource utilisation.

The Board of Management drives the risk governance effort via the Integrated Risk Management Committee and the Audit Committee. The Risk governance structures adopted at LOLC Finance reflect the commitment to Group Risk management initiatives, with both the Risk Management function and Audit function being given total independence via their operational and reporting lines.

This allows the Board of Management to be appraised of the organisational risks in an unbiased manner and also boosts the confidence the Board has on the internal control structures implemented and their effectiveness.



Risk Governance structures implemented at LOLC Finance is a combination of Risk Management, Internal Audit and Information Systems (IS) audit functions which collectively forms the Enterprise Risk Management Department (ERM) while the compliance department functions separately. The Audit function and the Risk Management function work in cohesion to derive the best possible synergies

The role of the Risk Management function is to identify possible risks and impacts, which have a reasonable probability to hinder the realisation of LOLC Finance’s strategic and tactical objectives. The Integrated risk management committee (IRMC) evaluates the possible impacts and in consultation with the risk owners decides on the best possible risk mitigation strategies and the internal controls to be adopted. The board of

Directors are kept informed through regular communications of the activities of the IRMC.

Enterprise risk management is a collaborative effort between all stakeholders and the views and the perception of risk of process owners are taken in to account by compulsory reporting requirements established, which requires them to submit risk related information to ERM on a monthly basis for further analysis and onward submission to the Board of Directors while the IRMC is conveyed every quarter for a more detailed analysis of the risk landscape of the company.

Enterprise Risk Management at LOLC Finance is an organisation wide process where every employee has a responsibility to manage risks with in their scope of

functions. Our vision in risk management “Building an organisational Culture where Protection, Assurance, Reliability, Accountability, Transparency and Confidentiality are treasured and lasting values” which require us to inculcate within all stake holders the appropriate risk culture. Enterprise risk management department firmly believes proper risk awareness facilitates the appropriate risk response. Therefore, dissemination of risk & response related knowledge to all employees is a critical success factor. The Enterprise risk management department continues to engage in structured training in co-ordination with the human resource department and other business units to enhance the knowledge and skills of staff engaged in critical operational activities in the organisation.

We strongly believe in that there are no limits to improvements and risk management process is also no exception and in order to

add value to the business, we incorporated risk department participation in an advisory capacity for major product or process formulations. We have contributed 119 consultative hours during the year under review on efforts to formulate appropriate risk control and internal control structures within the organisation.

Internal Audit is entrusted with providing the management a reasonable assurance of the reliability, consistency and effectiveness of the internal control framework. The audit teams adopt a three pronged strategy consisting of process level /department level audits, branch based audits and region based audits. This strategy has allowed us to maintain a more frequent presence in different level of operations at any given time. In addition, data analytic techniques are used for auditing purposes which facilitate the analysis of the entire audit universe rather than sampling.

The Information Systems Audit function reviews information systems and critical system infrastructure and plays a supporting role to general audits in reviewing the relevant processes and controls, which are supported by computer systems.

A Corporate whistle blower hotline is available for employees to report any irregularity or suspicious activities and a customer feedback line is also operational for customers to escalate any dissatisfaction or any fact which needs the attention of the management. These lines are operated by ERM and any information provided is treated confidentially. All complains are followed up until resolution.

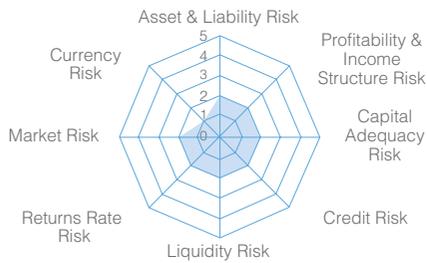
Continuous quality, knowledge and skill improvements are a prerequisite of an effective risk management strategy and the ERM staff are continuously trained and opportunities/facilities provided for enhancement of their skills and knowledge inventory. An internal quality assurance system is operational within the department, which enables us to maintain consistent and uniformity in our processes reporting.

**Risk Profile**

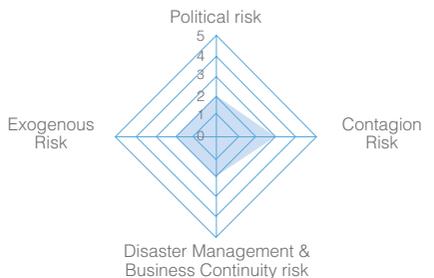
The following is based on the perceived risk and is a high level categorisation of risk used only for the illustration purposes of this report.

Risk Levels	Risk Score
Very High	5
High	4
Medium	3
Low	2
Very Low	1

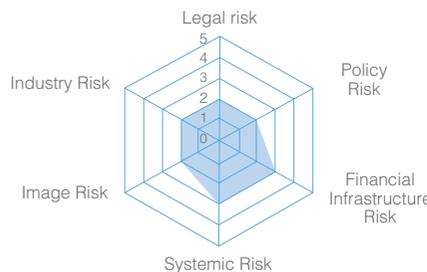
**Financial Risks**



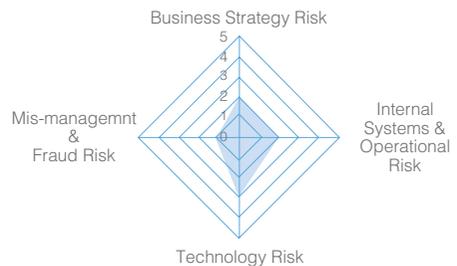
**Event Risk**



**Business Risks**



**Operational Risks**



# Charity Fund



**Charity is one of the key precepts of Islamic fundamentals and by supporting underserved segments of the population through the 'Charity Fund', LOLC Al-Falaah is making a significant contribution towards promoting social equality.**

LOLC Al-Falaah has succeeded in having a meaningful impact on the Islamic Finance industry in Sri Lanka. As the frontrunner in the Islamic Finance industry, LOLC Al-Falaah has established its credentials as a key player and a socially responsible entity that operates within the ambit of guiding Shari'ah principles. LOLC Al-Falaah is cognizant of its shared responsibility towards all communities and has devised Shari'ah compliant products and services to fulfil the diverse needs of its customers.

During the year under review, the company's dedicated 'Charity Fund' disbursed a large proportion of the company's revenue for the upliftment of society and to benefit the under-privileged sections of the community. The 'Charity Fund' is mandated by the Shari'ah Supervisory Board (SSB) both as contingency for portfolio cleansing as well as a business commitment toward sustainable Corporate Social Responsibility (CSR).

Disbursements for the beneficiaries of the 'Charity Fund' are channeled towards deserving initiatives in the sectors of Education, Health and Community causes. We take pride in the fact that a large proportion of funds are distributed amongst all communities, thereby demonstrating that the core fundamentals of the economic principles of Shari'ah is an alternate form of economic practice for all communities and not relegated to a specific one.

Charity is one of the key precepts of Islamic fundamentals and by supporting underserved segments of the population through the 'Charity Fund', LOLC Al-Falaah is making a significant contribution towards promoting social equality.

During 2015/16, the Charity Fund disbursed a total of Rs. 9.67 Mn amongst 96 beneficiaries. The Charity Fund's financial support to the under privileged

is designed to fulfil their health needs by providing medical support for a variety of treatments on periodic need basis, as also for hospitalisation/surgical expenses. A sum of Rs. 5,068,000/- was spent on providing medical care for identified beneficiaries during 2016/17.

Education is yet another critical area focused on by the 'Charity Fund', offering much-needed scholarships for school, university, post-graduate and professional programmes to ensure that students from economically under-privileged backgrounds do not have to discontinue their education due to financial hardships. During the year under consideration, the Charity Fund directed Rs. 1,873,518 Mn towards educational needs in communities.

Moreover, under the overarching theme of driving social equality, the Charity Fund actively supports social upliftment to promote self-employment and financial independence, while also offering help and succour to victims of natural disasters such as floods and drought. A stringent selection and approval procedure is followed to ensure transparency and accountability at all times. During the year under review, a sum of Rs. 2,732,953/- was disbursed for community projects. The 'Charity Fund' plays a vital role to fulfil LOLC Al-Falaah's strategy for giving back to the community.

## AL – FALAAH YEAR 2016/17 IBU CHARITY FUND DISBURSEMENTS



**Rs. 5.07Mn**

Medical Needs



**Rs. 1.87Mn**

Education



**Rs. 2.73Mn**

Social Upliftment & Miscellaneous Instances



**96**

Total Beneficiaries



**Rs. 9.67Mn**

Total disbursements for the year 2016/17

# Shari'ah Supervisory Board Members



**LOLC Al-Falaah has been able to consistently meet compliance requirements laid down by the Shari'ah Supervisory Board (SSB), which consists of eminent Islamic scholars. We work closely with SSB on all aspects of our products and solutions such as product design and mechanism, and practicality and compliance of new products.**

## **Ash-Shaikh Fazil M. Farook** **Chairman**

Graduate of Islamic Shari'ah and completed Dharuthul Hadith from The Darul Uloom, Newcastle, South Africa. A qualified scholar in Islamic Banking and Finance from the Islamic University, Malaysia, he is also a lecturer at The Al-Ain Islamic Institute and The Darul Uloom Islamiya, Colombo and a leading Islamic Banking and Finance consultant in Sri Lanka. Ash-Shaikh Fazil Farook is the Chairman of the Shari'ah Supervisory Board of Al-Falaah, the Islamic Business Unit of LOLC Finance PLC.

## **Ash-Shaikh Murshid M. Mulaffar** **Member**

Graduate from the Darul Uloom Al-Humaidhiya in Islamic Shari'ah, Colombo and a qualified scholar in Islamic Banking and Finance from the Centre for Islamic Economics, Karachi, Pakistan whilst being a leading Islamic Finance consultant in Sri Lanka, he is also the Assistant General Secretary of the All Ceylon Jamiyyathul Ulama (ACJU) Ash-Shaikh Murshid Mulaffar and is a Member of the Shari'ah Supervisory Board of Al-Falaah, the Islamic Business Unit of LOLC Finance PLC.

## **Ash-Shaikh Shafique A. Jakhura** **(Mufti)** **Member**

Mufti Shafique is a Registered, Certified Shari'ah Advisor and Auditor by the Accounting and Auditing Organisation for Islamic Financial Institutions of Bahrain (AAOIFI). He serves in the Fatwa Department preparing and issuing Islamic Juristic Rulings at the Darul Ihsan Centre in Durban, South Africa. He is also a founding member of the Centre of Islamic Economics and Finance South Africa (CIEFSA). He completed the Aalimiyah Course at Madrasah Taleemuddeen in 2002 in Durban and completed a three-year specialisation course in Islamic jurisprudence (Fiqh and Fatwa) from the Jami'ah Darul Uloom, Karachi, Pakistan in 2005, under the guidance of Mufti Taqi Usmani, which culminated in the submission of a thesis on the topic of Shirkat and Mudharabah. He also has an Advanced Diploma in Islamic Banking and Finance from the Centre for Islamic Economics based in Karachi, Pakistan. A leading International Consultant in Islamic Finance, Mufti Shafique Jakhura is a Member of the Shari'ah Supervisory Board of Al-Falaah, the Islamic Business Unit of LOLC Finance PLC.

# Board of Directors



## 1 Justice R K S Suresh Chandra

Justice Suresh Chandra was appointed to the Board as a Non-Executive Independent Director in July 2012 and was nominated as the Senior Independent Director in August 2015.

He was admitted to the Bar as an Advocate in 1972 after having obtained a Bachelor of Laws (LL.B.) Degree from the University of Colombo. He obtained his Master of Law (LL.M.) Degree from the University of Colombo.

He was a practitioner at the Private Bar from 1972 to 2008 and was a Consultant to several leading banks, private and public institutions. He served as a Member of the Panel of Arbitrators of the National Arbitration Centre.

He was also a Visiting Lecturer, Course Director and Examiner of the Faculty of Graduate Studies of the Colombo University, at the Open University of Sri Lanka, Moratuwa University and the Sri Lanka Law College. He was the Senior Consulting Editor of the Colombo Appellate Law Reports.

He was a Consultant to the World Bank on the Land Titling Project in Sri Lanka, a Consultant to USAID projects and was instrumental in structuring the Coir Council, the Ceramics Council and the Spice Council. He also served as a Legal Consultant to the Tea Sourcing Partnership of London.

He was the Senior Legal Consultant to the Southern Development Authority and the Board of Investments on Industrial Relations. He was a member

of the National Labour Advisory Council of Sri Lanka and a member of the Labour Law Reforms Committee.

He served as the Deputy Permanent Representative of Sri Lanka to United Nations in New York in 2009.

He was appointed as a Judge of the Supreme Court of Sri Lanka in June 2010 and retired from that position in July 2012.

He is serving as a Judge of the Supreme Court in Fiji since his appointment in Fiji in 2011 and as the Resident Judge of Appeals since 2012.

He has been a Resource Person for the International Labour Organisation, the International Organisation for Migration, the Judges Training Institute of Sri Lanka and the Bar Association of Sri Lanka.

## 2 Mr. I C Nanayakkara

Mr. Ishara Nanayakkara is prominent entrepreneur serving on the Boards of many corporates and conglomerates in the region. He initially ventured into the arena of financial services with a strategic investment in Lanka ORIX Leasing Company PLC and was appointed to the Board in 2002. Today, he is the Deputy Chairman of LOLC and the Executive Deputy Chairman of LOLC Finance PLC, holding directorships in many of its subsidiaries and associate companies.

Backed by over a decade of professional experience in the industry, Mr. Nanayakkara holds the role of

Chairman of Commercial Leasing & Finance PLC, one of Sri Lanka's leading financial service providers for over 28 years, as well as LOLC Life Assurance Limited. He is also Deputy Chairman of Seylan Bank PLC, a premier commercial bank in the country. His vision to cater to the entire value chain of the finance sector manifested in the development of Micro Finance, Islamic Finance, factoring through LOLC Factors, LOLC Life & General Insurance Companies and stock broking through LOLC Securities Ltd.

Leveraging LOLC Group's expertise in the SME sector, the expansion into the Micro Sector was spearheaded by Mr. Nanayakkara, who is the Chairman of their Micro Credit Companies: LOLC Micro Credit Company Ltd, the only private sector microfinance institution in the country with foreign equity, and BRAC Lanka Finance PLC. He also holds a directorship at PRASAC, the largest microfinance Company in Cambodia. Mr. Nanayakkara's interest in microfinance lead to the inauguration of LOLC Myanmar Micro Finance Company Ltd, a green field investment in Myanmar in which he was the founding Chairman, and currently serves as a Director. His proficiency in micro finance in the region is further demonstrated by his involvement at strategic level in LOLC Cambodia Ltd (Previously known as Thaneakea Phum Ltd); the 5th largest microfinance company in Cambodia. He was also recently appointed as a director in LOLC International Private Limited & LOLC Private Limited.

## Board of Directors

Mr. Nanayakkara's motivation to expand into various growth peripheries is further illustrated through his role as the Executive Chairman of Browns Investments PLC. Through various strategic investments, he is committed to catalysing development in the growth sectors of the Sri Lankan economy. Mr Nanayakkara's involvement in the Boards of Brown and Company PLC, Agstar Fertilizers PLC, Associated Battery Manufacturers (Cey) Ltd and Sierra Constructions Ltd, reflects this business philosophy.

Endorsing his entrepreneurial spirit, Mr. Ishara Nanayakkara received the prestigious 'Young Entrepreneur of the Year' Award at the Asia Pacific Entrepreneurship Awards (APEA) in 2012. He holds a diploma in Business Accounting from Australia.

### 3 Mrs. K U Amarasinghe

Kalsha Amarasinghe holds an Honours Degree in Economics. She serves on the Boards of Lanka ORIX Leasing Company PLC, Brown & Co. PLC, LOLC Micro Credit Ltd, LOLC Life Assurance Limited, Palm Garden Hotels PLC, Riverina Resorts (Pvt) Ltd and Eden Hotel Lanka PLC. She also serves as a Director on the Boards of Commercial Leasing & Finance PLC, Browns Investments PLC and Browns Capital PLC.

### 4 Dr. H Cabral, PC

Dr. Harsha Cabral was appointed to the Board as an Independent Director in January 2011. He was re-designated as a Non-Executive Director in August 2015 subsequent to his appointment to other group companies.

He holds a PhD in Corporate Law (University of Canberra) Australia and is a Senior Counsel with 29 years experience specialising in the fields of Company Law, Intellectual Property Law, Commercial Arbitration, Commercial Law and International Trade Law. He has been a President's Counsel for 12 years.

He serves in the following capacities: Member ICC International Court of Arbitration, Paris; Member, Law Commission of Sri Lanka; Member, Ministerial Committee appointed to reform Commercial Arbitration in SL; Member, Cabinet Committee on Economic Management; Member, UGC Committee on revisiting Laws on the University system on SL; Council Member, University of Colombo; UGC Nominee, PGIM (Post Graduate Institute of Medicine); Member, Board of Studies (Council of Legal Education); Member, Corporate Governance Committee (CA-SEC); Member, Board of Studies, School of Accounting & Business (CA Sri Lanka); Member, Board of Management, NSBM; Senior Lecturer & Examiner (University of Colombo); Council Member/Faculty Member/Course Director (ICLP).

He is also the Chairman of Tokyo Cement Group of Companies (largest cement company in Sri Lanka) and serves on the Boards of Diesel & Motor Engineering PLC (DIMO), Tokyo Cement Company (Lanka) PLC, Tokyo Super Cement Co (Private) Ltd., Tokyo Cement Power (Lanka) Ltd, Tokyo Eastern Cement Company Ltd, Hayleys PLC., Browns Investments PLC, Alumex PLC and LOLC Life Assurance Ltd.

He is the Author of several books on Company Law & Intellectual Property Law.

He was a key member of the Advisory Commission on Company Law in Sri Lanka which drafted the Companies Act No. 07 of 2007.

He has presented papers in several fora, local and international on Company Law, Intellectual Property Law and Commercial Arbitration.

### 5 Mrs. D P Pieris

Mrs. Priyanthi Pieris an Attorney-at-Law of the Supreme Court of Sri Lanka and has over 37 years of experience in Corporate and Financial Law. Mrs. Pieris is also a Solicitor of England & Wales. She is currently in Private Practice.

Mrs. Pieris served on the Boards of Forbes & Walker Ltd, Forbes Ceylon Ltd, Forbes Stock Brokers Ltd, Forbes

Air Services Ltd (General Sales Agent for Emirates), Vanik Corporate Services Ltd, Office Network (Pvt) Ltd, Capital Reach (Holdings) Ltd and Associated Motorways Ltd.

Mrs. Pieris currently serves on the Boards of Associated Electrical Corporation Ltd, Abans Electricals Ltd, Asia Asset Finance PLC, PW Corporate Secretarial (Pvt) Ltd, Asian Centre for Lease Education (Pvt) Ltd, MTN Corporate Consultants (Pvt) Ltd, Sithijaya Fund (Pvt) Ltd.

Mrs. Pieris served as the Legal Adviser to the Ministry of Finance from 2002 – 2004 and as Legal Consultant to the Colombo Stock Exchange from 2004 – 2011.

Mrs. Pieris is also a member of the Committees set up by the Securities & Exchange Commission of Sri Lanka to recommend amendments to the Takeovers & Mergers Code 1995 (as amended) and the Rule for Corporate Governance.

6

### **Mr. P A Wijeratne**

Mr. Wijeratne has over twenty years of experience in Accounting, Financial reporting, Investment of internal funds, Foreign loan disbursements and repayments, Auditing and Administration as an ex Officio of the Central Bank of Sri Lanka. He has joined CBSL in 1987 and has worked in the Finance, Public Debt Management and Internal Audit departments till his retirement in year 2016.

He holds a BA degree in Economics (Special Field – Commerce) from University of Kelaniya and a postgraduate Diploma in Accounting and Financial Economics. He has read for his MSc in Accounting and Financial Economics at the University of Essex, UK.

7

### **Mr. A Nissanka**

Mr. Ashan Nissanka was appointed to the Board as its Director and Chief Executive Officer in October 2015.

Mr. Nissanka counts over 23 years of experience in the Banking and Finance sector having commenced his career in 1993 with Seylan Bank PLC prior to joining LOLC Group in 1998 and having held the responsibilities of Strategic Marketing Planning, Development and Management of the Retail Channels for LOLC Finance PLC, LOLC Micro Credit Ltd, and LOLC Insurance Ltd.

He possesses an MBA from Edith Cowan University, Australia, a Graduate Diploma from Chartered Institute of Marketing – UK (CIM) as well as a member of Sri Lanka Institute of Marketing (SLIM) and member of the Institute of Certified Management Accountants Australia (CMA).

He currently serves as a Member of the Council of Management of the Finance Houses Association of Sri Lanka, Board of Director of The Leasing Association of Sri Lanka and Deputy Chairman of The Financial Ombudsman Sri Lanka (Guarantee) Limited.

# Directorships held by the Directors

## › Justice R K S Suresh Chandra

### Chairman:

- LOLC Finance PLC

## › Mr. I C Nanayakkara

### Chairman:

- LOLC Micro Credit Limited
- Brown & Company PLC
- Browns Investments PLC
- BRAC Lanka Finance PLC
- LOLC Life Assurance Limited

### Deputy Chairman:

- Lanka ORIX Leasing Company PLC
- LOLC Finance PLC
- Seylan Bank PLC

### Director:

- PRASAC Micro Finance Institute
- Sierra Constructions Limited
- Agstar Fertilizers PLC
- LOLC Myanmar Microfinance Co. Ltd
- Associated Battery Manufacturers (Ceylon) Ltd
- LOLC International (Pvt) Ltd
- B Commodities ME FZE
- LOLC Private Limited

## › Mrs. K U Amarasinghe

### Director:

- LOLC Finance PLC
- Lanka ORIX Leasing Company PLC
- LOLC Life Assurance Limited
- LOLC Micro Credit Limited
- Eden Hotel Lanka PLC
- Palm Garden Hotels PLC
- Brown & Company PLC
- Browns Investments PLC
- Riverina Resorts (Pvt) Ltd
- Browns Capital PLC

## › Dr. Harsha Cabral, PC

### Chairman:

- Tokyo Cement Company (Lanka) PLC
- Tokyo Super Cement Co (Private) Ltd
- Tokyo Cement Power Co. Ltd
- Tokyo Eastern Cement company Ltd
- Tokyo Super Aggregate (Pvt) Ltd

### Director:

- Diesel & Motor Engineering PLC (DIMO)
- Hayleys PLC
- LOLC Finance PLC
- Alumex PLC
- Browns Investments PLC
- LOLC Life Assurance Ltd

## › Mrs. D P Pieris

### Chairperson:

- PW Corporate Secretarial (Pvt) Ltd

### Director:

- LOLC Finance PLC
- Asia Asset Finance PLC
- Sithijaya Fund Ltd
- Asian Centre for Lease Education
- Associated Electrical Corporation Ltd
- Abans Electricals PLC
- MTN Corporate Consultants (Pvt) Ltd

## › Mr. P A Wijeratne

### Director:

- LOLC Finance PLC

## › Mr. A Nissanka

### Director/ CEO:

- LOLC Finance PLC

# Strategic Business Unit Team



## Strategic Business Unit Team

**1 Krishan Thilakarathne**  
*AIB (SL)*  
**Group Head of Islamic Finance - LOLC**

Joined the LOLC Group in 1995. Counts over 25 years of experience in Banking, Credit, Leasing, Factoring and Branch Management. Conceptualised and introduced Islamic Finance to LOLC Group.

**2 Shiraz Refai**  
*MABE (UK), MCMI (UK), MBA (UK)*  
**Deputy General Manager - Al-Falaah, Islamic Business Unit of LOLC Finance**

Joined LOLC Group in 2006 and counts over 18 years of experience in the Banking and Financial Services sectors in both local and overseas establishments. A key member of the Operational Management Team of LOLC, has played a pivotal role in spear-heading the formation & implementation of Islamic Financial Services projects under LOLC Group financial-services subsidiaries.

**3 Imraz Iqbal**  
*FCA, MBA, ACMA*  
**Head of Finance, LOLC Finance**

Joined LOLC Group in 2010. Counts over 8 years of experience in financial services in the areas of auditing and corporate finance.

**4 Mohamed Ramzi Majeed**  
*MBA (FS) UK, ADMA (UK), DIB (IBSL)*  
**Senior Executive Operations - Al-Falaah, Islamic Business Unit of LOLC Finance**

Joined LOLC Group in 2010 and counts over 11 years of experience in Banking and Financial Services sector in both local and overseas establishments.

**5 Ash-Shaikh Nazhan Naurooz**  
*DUZ (SA), AFIBI (UK), DIB (IBSL)*  
**In-House Shari'ah Advisor - Al-Falaah, Islamic Business Unit of LOLC Finance**

Joined LOLC Group in 2014, counts over 5 years of experience in teaching Islamic theological studies and 3 years of experience in Banking & Finance Services sector and coordination with the Shari'ah Supervisory Board

**6 Imran Zarook**  
*ADCM (SLICM), ADICM (SLICM)*  
**Senior Executive - Recoveries Supervision - Al-Falaah, Islamic Business Unit of LOLC Finance**

Joined LOLC Group in 2015. Counts over 15 years of experience in the field of customer operations/finance including credit control, collection, recovery, legal, risk and relationship management.

**7 Shafin Iqbal**  
*MCIM, MBA (UK)*  
**Senior Executive Institutional Marketing - Al-Falaah, Islamic Business Unit of LOLC Finance**

Joined in 2014. Counts over 11 years of experience in Marketing services in the areas of New Business Development, Public Relation & Networking, and Event Management.

**8 Rishard Muhammad**  
*ADCM (IBSL)*  
**Senior Executive Channel Marketing - Al-Falaah, Islamic Business Unit of LOLC Finance**

Joined LOLC Group in 2009. Counts over 17 years of experience in Marketing of Banking and Financial Services sectors in both local and overseas establishments.

**9 Fazil Mohideen**  
*BA in Usoolud Deen (NALEEMI), DIB (IBSL)*  
**Officer IBU Operations, Al-Falaah, Islamic Business Unit of LOLC Finance**

Joined LOLC Group in 2014. Counts over 2 years of experience in Islamic Banking & Financial Services in both Marketing & Operational areas.

10

### **Ilham Mufaris**

*BA in Usoolud Deen (NALEEMI), BA (University of Peradeniya), AAT (Passed Finalist), CCHRM.*

**Assistant-IBU Operations, Al-Falaah, Islamic Business Unit of LOLC Finance**

Joined LOLC Group in 2015. Counts over a year of experience in Islamic Banking & Financial Services in Operational areas.

### **Al-Falaah Ladies Business Unit**

#### **Rinzi Hussain**

*Dip. in IBF (SL)*

**Customer Service Officer - Al-Falaah, Ladies Business Unit of LOLC Finance**

Joined LOLC Group in 2014. She holds a Higher National Diploma in Business & Financial Management and a Diploma in Islamic Finance and counts over 3 years of experience in Islamic Banking and Financing.

#### **Shafinaz Careem**

*Bus. Mgt, (LSBU, UK)*

**Operations Assistant - Al-Falaah, Ladies Business Unit of LOLC Finance**

Joined LOLC Group in 2016. Reading for an external B.sc in Business Management in London Southbank University, UK. Counts 1 year of experience in the financial sector.

# Shari'ah Supervisory Board Audit Report 2016/2017

**In the name of Almighty Allah,  
the All Merciful, the Very  
Merciful**

**To the Shareholders of LOLC  
Finance PLC**

By the Grace of Allah, the year under review was the ninth year of Al-Falaah, the Islamic Business Unit of LOLC Finance PLC.

During the year, The Shari'ah Supervisory Board (SSB) of the Al-Falaah, Islamic Business Unit (Al-Falaah) and the management held several meetings to review various products, concepts, transactions, processes and its Shari'ah compliance.

We have reviewed the principles and the contracts relating to the transactions and applications introduced by Al-Falaah, as well as audited directly or indirectly through the In-house Shari'ah Supervisor (ISA), the transactions concluded by Al-Falaah during the financial year under review from April 2016 to March 2017.

We have also conducted our review to form an opinion as to whether Al-Falaah, complied with the rules and principles of Shari'ah in accordance with international benchmark standards set out by the Accounting and Auditing Organisation for Islamic Financial Institutions of Bahrain (AAOIFI).

The Management of LOLC Finance PLC, is responsible for ensuring that Al-Falaah, conducts its business in accordance with the rules and principles of the Shari'ah. It

is the Shari'ah Supervisory Board's (SSB) responsibility to form an independent Shari'ah opinion based on its review of the operation of Al-Falaah, and report to you.

The following were the major developments that took place during the year under review:

- SSB Branch Visits:** The In-house Shari'ah Supervisor as well as members of the SSB visited a number of Branches around the Island to review procedures and meet staff involved in all Al-Falaah transactions.
- SSB meetings:** At least 10 Days of meetings were held by members of the SSB during the period.
- Development and launch of the first Ijarah-Sukuk Securitisation Product:** The SSB was actively involved in the structuring and review of this product. This product was recognised at separate annual Industry events hosted by Sri Lanka Islamic Banking and Finance Industry Awards (SLIBFI) and Islamic Finance News (IFN) Global Awards as "Deal of the Year" for 2016.
- Development of New Products:** The SSB is currently in the process of advising, structuring and assisting with the development of various new products required by the Institution.

5. **Review of existing product agreements:**

As part of ongoing reviews and in the effort to constantly improve, the existing Ijarah and Diminishing Musharakah agreements were reviewed and where required, certain amendments were suggested.

6. **Awards:** Various other achievements of Al-Falaah were recognised during the year in categories of Social Upliftment, Innovative Products and performance awards where the SSB played an active role in its developments.

## Shari'ah Audit and Compliance Review

### Purpose:

To ensure that all the products and services being offered by Al-Falaah, adhere to the rules and principles of the Shari'ah.

The scope of the audit included examining on a test basis:

- Ijarah Financing Transactions.
- Murabaha Financing Transactions.
- Diminishing Musharakah Financing Transactions.
- Wakala Financing Transactions.
- Ijarah- Sukuk Audit.
- Profit Distribution.
- Bank Statements.
- Expenditure Apportionment.
- Review of Audited Financial Statements.

10. Excess fund investments.
11. Accrual and Disposal of impermissible Income.
12. Review on Statutory Treasury Bill status.
13. Marketing and Advertising Materials.
14. Reconciliation of Administrative Charges on Delayed Penalties against actual expenses incurred for recoveries.
15. Interview with Al-Falaah staff.

We planned and performed our review so as to obtain all the information and explanations that we considered necessary in order to provide us with sufficient evidence to give us reasonable assurance that Al-Falaah, Islamic Business Unit of LOLC Finance PLC has adhered to Islamic commercial principles.

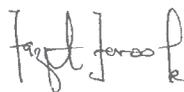
**In our opinion;**

1. The overall structure of the contracts offered by Al-Falaah and their implementation during the year under review are generally in compliance with the rules and principles of the Shari'ah subject to certain observations highlighted below:
  - a. There remains an amount of charity to be disbursed to worthy recipients. This balance has accrued from late payment penalties from customers that have undertaken to pay charity through Al-Falaah as a result of their late payment.
  - b. Certain aspects requiring careful monitoring pertaining to particular transactions were drawn to the attention of management.

- c. The Enterprise Risk Management (ERM) Department of the company has been asked to conduct internal audits and highlight procedural discrepancies to supplement the Shariah Audit.
- d. Management has been asked to rectify certain wording that was erroneously used in certain documents.

2. The allocation of profit relating to investment accounts appears to conform to the rules and principles of Shari'ah.
3. Al-Falaah has been commended with regards to staff training and client awareness programs carried out during the period and has been encouraged to have more such programs in future.

We beseech the Almighty Allah to bless us with the guidance to accomplish His cherished tasks, make us successful in this world and in the hereafter, and to forgive our mistakes.



**(Ash-Shaikh) Fazil A. Farook**  
Chairman - SSB



**(Ash-Shaikh/Mufti) Shafique A. Jakura**  
Member - SSB



**(Ash-Shaikh) Murshid Mulaffar**  
Member - SSB

# Product Approval by Shari'ah Supervisory Board

## To whom it may concern,

This is to confirm that we, the members of the Shari'ah Supervisory Board of Lanka ORIX Leasing company PLC (LOLC), after a careful examination of relevant documents, processes and review of operational procedures, have approved the following Islamic Financing products of the Islamic Business Unit of LOLC Finance PLC.

1. IJARAH - (Since 19th December 2007)
2. MURABAHA - (Since 19th December 2007)
3. MUDHARABAH - (Since 19th December 2007)
4. DIMINISHING MUSHARAKAH - (Since 28th March 2008)
5. MUSAWAMAH - (Since 30th November 2010)
6. WAKALA (Investments) - (Since 26th November 2011)
7. WAKALA (Lending) - (Since 01st July 2013)

The approval has been granted after having taken into consideration the following:

1. Having Guard-Hassanah agreement with LOLC Finance
2. Adhering only to The Shari'ah Supervisory Board of LOLC approved agreements
3. Maintain Chart of Accounts & IT systems to separately identify its transactions
4. Having separate Banking transactions
5. Periodic Audit conducted by the Shari'ah Supervisory Board of LOLC

As members of the Shari'ah Supervisory Board of LOLC, we are duty bound to provide necessary guidance and advice where required, in order to ensure the Shari'ah compliant nature of the Islamic Finance operation of LOLC Finance. The Management of LOLC Finance PLC, is responsible for ensuring that Al-Falaah, the Islamic Business Unit of LOLC Finance conducts its business in accordance with the rules and principles of the Shari'ah as per the guidelines of the SSB.

However, it is important to note that, should there prevail an environment where adequate attention is not given to Shari'ah directives and Shari'ah violations are frequently repeated, in such an environment, we members of the Shari'ah Supervisory Board will exercise the option of revoking our supervisory position from LOLC.



**(Ash-Shaikh) Fazil A. Farook**

Chairman – SSB



**(Ash-Shaikh/Mufti) Shafique A. Jakura**

Member – SSB / Mufti



**(Ash-Shaikh) Murshid Mulaffar**

Member – SSB

# · FINANCIAL · STATEMENTS

Independent Auditors' Report	44
Statement of Financial Position	45
Statement of Profit or Loss and Other Comprehensive Income	46
Statement of Cash Flow	47
Notes to the Financial Statements	49

# Independent Auditors' Report



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## **INDEPENDENT AUDITORS' REPORT BOARD OF DIRECTORS OF LOLC FINANCE PLC**

### **Report on the Special Purpose Financial Statements**

We have audited the accompanying special purpose financial statements of the LOLC Finance PLC Islamic Business Unit ("IBU"), which comprise the statement of financial position as at 31 March 2017 and the statement of comprehensive income and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information. The financial statements have been prepared by Management based on the accounting policies, as set out on pages 49 to 56 of these special purpose financial statements.

### **Board's Responsibility for the Special Purpose Financial Statements**

Board is responsible for the preparation and fair presentation of these special purpose financial statements in accordance with accounting policies as set out on pages 49 to 56 of these special purpose financial statements, and for such internal control as Board determines is necessary to enable the preparation of these special purpose financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditors' Responsibility**

Our responsibility is to express an opinion on these special purpose financial statements based on our audit. We conducted our audit in accordance with Sri Lanka Auditing Standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether these special purpose financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in these special purpose financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of these special purpose financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the IBU's preparation and fair presentation of these special purpose financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the IBU's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates, if any, made by Board, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### **Opinion**

In our opinion, these special purpose financial statements present fairly, in all material respects, the financial position of the IBU as at 31 March 2017 and of its financial performance and cash flows for the year then ended in accordance with the accounting policies of the IBU, as set out on pages 49 to 56 of these special purpose financial statements.

### **Basis of Accounting**

Without modifying our opinion, we draw attention to Note 1.2 to these special purpose financial statements, which describe the basis of accounting. As a result, the financial statements may not be suitable for another purpose.

23 June 2017  
Colombo

Partners: A D B Talwatte FCA FCMA M P D Cooray FCA FCMA R N de Saram ACA FCMA Ms. N A De Silva FCA Ms. Y A De Silva FCA W R H Fernando FCA FCMA  
W K B S P Fernando FCA FCMA Ms. L K H L Fonseka FCA A P A Gunasekera FCA FCMA A Herath FCA D K Hulangamuwa FCA FCMA LLB (Lond) H M A Jayasinghe FCA FCMA  
Ms. A A Ludowyke FCA FCMA Ms. G G S Manatunga FCA N M Suleiman ACA ACMA B E Wijesuriya FCA FCMA

A member firm of Ernst & Young Global Limited

# Statement of Financial Position

As at 31 March 2017	Notes	2017 Rs.	2016 Rs.
<b>ASSETS</b>			
Cash and bank balances	3	315,833,572	120,480,965
Murabaha / Musawamah /Wakala receivables	4	2,832,391,243	2,863,475,398
Diminishing Musharakah receivables	5	4,956,192,913	4,692,273,871
Ijarah rent receivables	6	3,231,092,271	3,293,316,642
Investment in quoted shares	7	6,600,000	7,000,000
Other receivables	8	75,591,553	51,658,296
Investment properties	9	18,000,000	15,000,000
<b>Total assets</b>		<b>11,435,701,552</b>	<b>11,043,205,173</b>
<b>LIABILITIES</b>			
Mudharabah investments		4,081,857,830	4,230,559,233
Mudharabah savings		484,831,430	466,058,778
Profit payable on Mudharabah investments		102,355,405	86,885,203
Wakala investments		1,991,207,909	1,569,100,000
Profit payable on Wakala investments		21,270,766	7,092,495
Ijarah Sukuk Bond	10	422,353,191	
Income tax payable		197,523,144	138,217,880
Accruals and other payables	11	242,768,438	256,179,639
Due to head office	12	2,223,188,604	2,973,777,435
<b>Total liabilities</b>		<b>9,767,356,717</b>	<b>9,727,870,662</b>
<b>OWNER'S FUND</b>			
Retained earnings		1,668,344,835	1,315,334,511
Total owners fund		1,668,344,835	1,315,334,511
<b>Total liabilities &amp; owners fund</b>		<b>11,435,701,552</b>	<b>11,043,205,173</b>

I certify that these financial statements have been prepared in accordance with the basis of preparation and notes.



**(Mrs.) S.S. Kotakadeniya**

Chief Financial Officer

The Board of Directors is responsible for the preparation and presentation of these special purpose financial statements.

Approved and signed for and on behalf of the Board.



**I.C. Nanayakkara**

Director



**A. Nissanka**

Director / CEO

The above Statement of Financial Position should be read in conjunction with accounting policies and notes, which form an integral part of these special purpose financial statements.

The basis of preparation and notes are given in pages 49 through 59.

23rd June 2017

Rajagiriya (Greater Colombo)

# Statement of Profit or Loss and Other Comprehensive Income

As at 31 March 2017	Notes	2017 Rs.	2016 Rs.
<b>Revenue</b>	13	2,068,594,983	1,605,795,031
Profit paid to Mudharabah/Wakala investors		(558,485,895)	(480,400,473)
Profit paid on other funding arrangement		(315,581,787)	(79,522,472)
Other direct expenses		(137,924,984)	(53,034,258)
		1,056,602,317	992,837,828
Non distributable other income / (expenses)	14	36,065,725	30,513,120
<b>Total operating income</b>		1,092,668,042	1,023,350,948
Employee benefits	15	(142,043,509)	(124,866,148)
(Provision)/reversal for credit losses		(45,476,554)	(75,855,602)
Other operating expenses		(257,500,766)	(251,918,534)
<b>Profit from operations</b>	16	647,647,213	570,710,665
Value added tax on financial services		(97,113,745)	(55,565,443)
<b>Profit before taxation</b>		550,533,468	515,145,222
Income tax expense	17	(197,523,144)	(138,217,880)
<b>Profit for the year</b>		353,010,325	376,927,342
Other comprehensive income		-	-
<b>Total comprehensive income</b>		353,010,325	376,927,342

The above Statement of Profit or Loss should be read in conjunction with accounting policies and notes, which form an integral part of these special purpose financial statements.

The basis of preparation and notes are given in pages 49 through 59.

# Statement of Cash Flow

As at 31 March 2017	2017 Rs.	2016 Rs.
<b>Cash Flows From / (Used in) Operating Activities</b>		
Net Profit before Income Tax Expense	550,533,468	515,145,222
Adjustments for:		
Provision for fall/(Increase) in Value of Investments	400,000	1,500,000
Allowance for/(reversal of) Doubtful Debts	5,421,914	(10,272,521)
Provision for payables to clients	(3,000,000)	(2,500,000)
Change in Fair Value of Investment Property	(3,000,000)	(2,500,000)
Investment income	-	(500,104)
Accrued profit on their instrument	596,189,803	
Profits attributable to Mudharabah / Wakala investors	277,877,880	480,400,473
Operating Profit before Working Capital Changes	1,424,423,065	981,273,070
Change in Other Receivables	(23,933,257)	(14,408,003)
Change in Trade and Other Payables	(10,411,201)	20,957,827
Change in Amounts due to Head office	195,911,171	(658,324,493)
Change in Ijarah rent receivables	60,930,263	(1,338,612,115)
Change in Murabaha / Musawamah receivables	(230,803,106)	(722,192,778)
Change in Diminishing Musharakah receivables	(6,159,586)	(1,656,026,078)
Change in Mudharabah investments from Customers	(148,701,403)	196,121,185
Change in Wakala investments from Customers	422,107,909	789,100,000
Change in Mudharabah savings Deposits from Customers	18,772,652	81,795,605
<b>Cash used in Operations</b>	<b>1,702,136,507</b>	<b>(2,320,315,780)</b>
Profits paid to Mudharabah / Wakala investors	(248,229,405)	(454,728,949)
Income Tax Paid	(138,217,880)	(97,619,204)
<b>Net Cash Used in Operating Activities</b>	<b>1,315,689,221</b>	<b>(2,872,663,932)</b>
<b>Cash Flows from / (Used in) Investing Activities</b>		
Profit Received	-	500,104
<b>Net Cash Flows from Investing Activities</b>	<b>-</b>	<b>500,104</b>

Statement of Cash Flow

As at 31 March 2017	2017 Rs.	2016 Rs.
<b>Cash Flows from / (Used in) Financing Activities</b>		
Net proceeds from other instruments	390,911,482	
Net Proceeds from Qurd hassan	(946,500,000)	2,398,000,000
Profit Paid - Other instruments	(564,748,095)	
<b>Net Cash Flows from Financing Activities</b>	(1,120,336,613)	2,398,000,000
<b>Net Increase/(Decrease) in Cash and Cash Equivalents</b>	195,352,607	(474,163,828)
<b>Cash and Cash Equivalents at the beginning of the period</b>	120,480,965	594,644,793
<b>Cash and Cash Equivalents at the end of the period</b>	315,833,572	120,480,965
<b>Analysis of Cash and Cash equivalents at the end of the period</b>		
Cash and Bank Balances	315,833,572	120,480,965
	315,833,572	120,480,965

The above Statement of Profit or Loss should be read in conjunction with accounting policies and notes, which form an integral part of these special purpose financial statements.

The basis of preparation and notes are given in pages 49 through 59.

# Notes to the Financial Statements

## 1. GENERAL

LOLC Finance PLC (formerly known as Lanka ORIX Finance PLC) (the “Company”) is a quoted public company with limited liability incorporated on 13 December 2001 and domiciled in Sri Lanka. The Company has been registered with the Central Bank of Sri Lanka as a Finance Company under the provisions of the Finance Business Act No 42 of 2011 (formerly Finance Companies Act, No. 78 of 1988.)

LOLC Finance PLC has set up the Islamic Business Unit (“IBU”) which commenced its operations in February 2008, under Islamic Shari’ah Law. It is housed in the head office premises at No. 100/1 Sri Jayawardenepura Mawatha, Rajagiriya.

### 1.1 Principal activities and nature of business

The principal activities of the IBU comprised of Mudharabah and Wakala (Profit Sharing investments), Diminishing Musharakah (Partnership Financing), Murabaha/Musawamah (Trade Financing), Ijarah (Leasing).

### 1.2 Basis of Preparation

#### 1.2.1 Statement of compliance

These supplementary financial statements of the IBU are prepared on based on the accounting policies explained in Note 2.

The results of IBU and the financial position of the IBU form part of the financial statements of LOLC Finance PLC which is prepared in accordance with Sri Lanka Accounting Standards.

LOLC Finance PLC’s primary set of financial statements was authorised for issue by the Board of Directors in accordance with a resolution of the Directors passed on 23 June 2017. Therefore, the isolated financial statements of the IBU should be read in conjunction with the LOLC Finance PLC’s primary set of financial statements.

These Financial Statements include the following components:

- › a Statement of Profit or Loss and Other Comprehensive Income providing the information on the financial performance of the IBU for the year under review;
- › a Statement of Financial Position providing the information on the financial position of the IBU as at the year-end;
- › a Statement of Cash Flows providing the information to the users, on the ability of the IBU to generate cash and cash equivalents and the needs of the IBU to utilise those cash flows; and
- › Notes to the Financial Statements comprising Accounting Policies and other explanatory information.

Details of the company’s accounting policies are included in Note 2

#### 1.2.2 Basis of Measurement

These financial statements have been prepared on a historical cost basis except for the following material items, which are measured on an alternative basis on each reporting date:

Items	Measurement basis
Non-derivative financial instruments at fair value through profit or loss	Fair value
Investment property	Fair value

No adjustments have been made for inflationary factors affecting the Financial Statements.

The Company presents its statement of financial position in order of liquidity.

Financial assets and financial liabilities are offset and the net amount reported in the statement of financial position only when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the assets and settled the liability simultaneously.

#### 1.2.2 Materiality and Aggregation

Each material class of similar items is presented separately. Items of dissimilar nature or function are presented separately unless they are immaterial.

#### 1.2.3 Going Concern

The Directors have made an assessment of the company’s ability to continue as a going concern and is satisfied that it has the resources to continue in business for the foreseeable future. Furthermore, management is not aware of any material uncertainties that may cast significant doubt upon the company’s ability to continue as a going concern. Therefore,

Notes to the Financial Statements

the Financial Statements continue to be prepared on a going concern basis.

**1.2.4 Comparative information**

The accounting policies have been consistently applied by the IBU and are consistent with those used in the previous period. Comparative information has not been reclassified or restated.

**1.3 Functional and presentation currency**

Items included in the financial statements of the company are measured using the currency of the primary economic environment in which the IBU operates (the functional currency).

These financial statements are presented in Sri Lankan Rupees, the Company's functional and presentation currency.

There was no change in the company's presentation and functional currency during the year under review.

All financial information has been rounded to the nearest Rupee unless otherwise specifically indicated.

**1.4 Significant accounting judgments, estimates and assumptions**

The preparation of the financial statements in conformity with the described accounting policies requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are based on historical experience and various other factors, including expectations of future events that are believed to be reasonable under the circumstances, the results which form the basis of making the judgments about the carrying amount of assets and liabilities that are not readily apparent from other sources.

Estimate and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected. The respective carrying amounts of assets and liabilities are given in the related Notes to the financial statements.

Critical Accounting estimate / judgment	Disclosure reference Note
Fair value measurement of financial instruments and investment properties	1.4.1
Impairment losses on loans and advances	1.4.2
Provisions for liabilities and contingencies	1.4.3

**1.4.1 Fair Value Measurement**

A number of the Company's (LOLC Finance PLC including the IBU) accounting policies and disclosures require the measurement of fair values, for both financial and non-financial assets and liabilities.

The Company has an established control framework with respect to the measurement of fair values. This includes a team that has overall responsibility for overseeing all significant fair value measurements, including Level 3 fair values, and reports directly to the Group CFO.

The team regularly reviews significant unobservable inputs and valuation adjustments. If third party information, such as broker quotes or pricing services, is used to measure fair values, then the team assesses the evidence obtained from the third parties to support the conclusion that such valuations meet the requirements of SLFRS, including the level in the fair value hierarchy in which such valuations should be classified.

Significant judgements used in valuation and issues that arises are reported to the Company's Audit Committee.

When measuring the fair value of an asset or a liability, the Company uses observable market data as far as possible. Fair values are categorised into different levels in a fair value hierarchy based on the inputs used in the valuation techniques as follows.

- ▶ **Level 1:** quoted prices (unadjusted) in active markets for identical assets or liabilities.
- ▶ **Level 2:** inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).

- ▶ **Level 3:** inputs for the asset or liability that are not based on observable market data (unobservable inputs).

If the inputs used to measure the fair value of an asset or a liability fall into different levels of the fair value hierarchy, then the fair value measurement is categorised in its entirety in the same level of the fair value hierarchy as the lowest level input that is significant to the entire measurement.

The Company recognises transfers between levels of the fair value hierarchy at the end of the reporting period during which the change has occurred.

#### **1.4.2 Impairment Losses on Loans and Advances**

In addition to the provisions made for possible loan losses based on the parameters and directives for specific provisions on loans and advances by the Central Bank of Sri Lanka, the IBU reviews its loans and advances portfolio at each reporting date to assess whether a further allowance for impairment should be provided in the statement of profit or loss. The judgements by the management is required in the estimation of these amounts and such estimations are based on assumptions about a number of factors though actual results may differ, resulting in future changes to the provisions.

#### **1.4.3 Provisions for liabilities and contingencies**

The IBU receives legal claims against it in the normal course of business. Management has made judgments as to

the likelihood of any claim succeeding in making provisions. The time of concluding legal claims is uncertain, as is the amount of possible outflow of economic benefits. Timing and cost ultimately depend on the due process in the respective legal jurisdictions.

## **2. SIGNIFICANT ACCOUNTING POLICIES - RECOGNITION OF ASSETS AND LIABILITIES**

### **2.1 Financial assets and financial liabilities**

#### **2.1.1 Non-derivative financial assets**

##### **2.1.1.a Initial recognition of financial assets**

###### **Date of recognition**

The IBU initially recognises receivables on the date that they are originated. All other financial assets are recognised initially on the trade date at which the IBU becomes a party to the contractual provisions of the instrument.

###### **Initial measurement of financial Assets**

The classification of financial instruments at initial recognition depends on their purpose and characteristics and the management's intention in acquiring them. All financial instruments are measured initially at their fair value plus transaction costs that are directly attributable to acquisition or issue of such financial instrument, except in the case of financial assets at fair value through profit or loss.

Transaction cost in relation to financial assets at fair value through profit or loss are dealt with through the statement of profit or loss

##### **2.1.1.b Classification of financial assets**

The Company classifies non-derivative financial assets into the following categories:

- ▶ financial assets at fair value through profit or loss;
- ▶ held-to-maturity financial assets;
- ▶ loans and receivables; and
- ▶ available- for-sale financial assets.

##### **2.1.1.c Subsequent measurement of financial assets**

The subsequent measurement of financial assets depends on their classification.

###### **Financial assets at fair value through profit or loss**

A financial asset is classified as fair value through profit or loss if it is held for trading or is designated as such upon initial recognition. Financial assets are designated at fair value through profit or loss if the company manages such investments and makes purchase and sale decisions based on their fair value in accordance with the company's investment strategy. Attributable transaction costs are recognised in statement of profit or loss as incurred.

Financial assets at fair value through profit and loss are carried in the statement of financial position at fair value with changes in fair value recognised in the statement of profit or loss

Financial assets designated at fair value through profit or loss comprises of quoted equity instruments.

## Notes to the Financial Statements

### **Held-to-maturity financial assets**

Financial assets with fixed or determinable payments and fixed maturities are classified as held to maturity when the company has the positive intention and ability to hold it to maturity. Held-to-maturity financial assets are recognised initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition held to-maturity financial assets are measured at amortised cost.

The IBU has not classified any instrument as held to maturity.

### **Loans and Receivables**

Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are recognised initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition loans and receivables are measured at amortised cost.

Loans and receivables comprise of cash and cash equivalents, deposits with banks and other financial institutions, Ijarah receivables, Murabaha, Musawamah and Diminishing Musharakah receivables and other receivables.

#### › **Cash and cash equivalents**

Cash and cash equivalents comprise cash balances and call deposits with maturities of three months or less from the acquisition date that are subject to an insignificant risk of changes in their

fair value, and are used by the IBU in the management of its short-term commitments.

#### › **Ijarah receivables**

The LOLC Finance PLC's IBU buys and lease out equipment required by its clients for a fee (Rental). The duration of the lease and value of the rental is agreed in advance. Ownership of the asset will remain with the Company till the end of the lease period. Rent receivables on Ijarah advances reflected in the statement of financial position are the total rent receivables after eliminating unearned income and deducting pre paid rentals, rental collections and provision for impairment losses.

#### › **Murabaha, Musawamah and Diminishing Musharakah receivables**

Murabaha/Musawamah to customers with fixed installments are stated in the statement of financial position net of provision for impairment losses and income, which is not accrued to revenue.

Diminishing Musharakah to customers is reflected in the statement of financial position at amounts disbursed less repayments and provision for doubtful debts.

### **Available-for-sale financial assets**

Available-for-sale financial assets are financial assets that are not classified in any of the previous categories. Subsequent to initial recognition, they are measured at fair value and changes therein, other than impairment losses

on available-for sale equity instruments, are recognised in other comprehensive income and presented within equity in the available for sale reserve.

When an investment is derecognised, the cumulative gain or loss in other comprehensive income is transferred to the statement of profit or loss.

The IBU has not classified any instrument as available for sale.

### **2.1.2 Non-derivative financial liabilities**

#### **Classification and Subsequent Measurement of Financial Liabilities**

The IBU initially recognises non-derivative financial liabilities on the date that they are originated.

The IBU classifies non-derivative financial liabilities into the other financial liabilities category. Such financial liabilities are recognised initially at fair value less any directly attributable transaction costs. Subsequent to initial recognition, these financial liabilities are measured at amortised cost.

Other financial liabilities comprise of Mudharabah deposits, Wakala deposits, Sukuk bonds, trade payables, accruals & other payables and amounts due to head office.

#### **Profit Payable to the Investors**

Profits payable are recognised on accrual basis and are credited to Investors' accounts when the profit is distributed on a monthly basis on or before the 10th of the following month. Profit on Wakala and Sukuk are accrued on a monthly basis and paid as per the agreement.

### 2.1.3 Derecognition of financial assets and financial liabilities

#### Financial assets

The IBU derecognises a financial asset when the rights to receive cash flows from the asset have expired or the IBU has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass-through' arrangement; and either.

- (a) The IBU has transferred substantially all the risks and rewards of the asset, or
- (b) The IBU has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset transferred), and the sum of;

- (i) The consideration received (including any new asset obtained less any new liability assumed) and
- (ii) Any cumulative gain or loss that had been recognised in other comprehensive income is recognised in profit or loss.

#### Financial liabilities

The IBU derecognises a financial liability when its contractual obligations are discharged or cancelled or expire.

### 2.1.4 Offsetting of financial instruments

Financial assets and financial liabilities are offset and the net amount reported in the statement of financial position if, and only if, there is a currently enforceable legal right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the assets and settle the liabilities simultaneously.

### 2.1.5 Amortised cost measurement

The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, plus the cumulative income, minus principal repayments, minus any reduction for impairment.

### 2.1.6 Fair value measurement

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

#### Determination of fair value

The fair value of financial instruments that are traded in an active market at each reporting date is determined by reference to quoted market prices or dealer price quotations, without any deduction for transaction costs.

For financial instruments not traded in an active market, the fair value is determined using appropriate valuation techniques. Such techniques may include using recent arm's length market transactions, reference to the current fair value of

another instrument that is substantially the same, a discounted cash flow analysis or other valuation models

### 2.1.7 Impairment

#### Non-derivative financial assets

A financial asset not carried at fair value through profit or loss is assessed at each reporting date to determine whether there is objective evidence that it is impaired. A financial asset is impaired if objective evidence indicates that a loss event has occurred after the initial recognition of the asset, and that the loss event had a negative effect on the estimated future cash flows of that asset that can be estimated reliably. Objective evidence that financial assets are impaired can include default or delinquency by a debtor, restructuring of an amount due to the IBU on terms that the IBU would not consider otherwise, indications that a debtor or issuer will enter bankruptcy, adverse changes in the payment status of borrowers or issuers in the IBU, economic conditions that correlate with defaults or the disappearance of an active market for a security.

The IBU computes its impairment on receivables in accordance with Direction No. 03 of 2006 of the Finance Business Act No.42 of 2011 as follows

- › Fifty percent (50%) of Ijarah receivables, Murabaha/Musawamah advances & Diminishing Musharakah advances receivable (net of unearned income) which are in arrears for a period of 06 to 12 months.

## Notes to the Financial Statements

- › One hundred percent (100%) of Ijarah lease, Murabaha/Musawamah advances & Diminishing Musharakah advances receivable (net of unearned income) which are in arrears for a period of 12 months and more

Additional specific provisions are made upon management review on the performance of these portfolios.

Balance receivables on any terminated contracts are fully provided.

The values of the following items held as collateral for a particular advance have been deducted in arriving at the above provisions.

- › **Vehicles that have been repossessed by the Company**  
Eighty per cent (80%) of the valuation obtained during the preceding six months from a professional valuer approved by the Director of the Department of Supervision of Non-Bank Financial Institutions of the Central Bank of Sri Lanka
- › **Lands & Buildings**  
The value of the property on a declining basis based on the age of the facility, in case of a primary mortgage. Such value shall not exceed the value decided by a qualified professional valuer at the time of providing the accommodation.

### 2.2 Investment property

Investment property is property held either to earn rental income or for capital appreciation or for both, but not for sale in the ordinary course of business, use

in the production or supply of goods or services or for administrative purposes.

Investment property is measured at cost on initial recognition and subsequently at fair value with any change therein recognised in profit or loss.

Cost includes expenditure that is directly attributable to the acquisition of the investment property. The cost of self-constructed investment property includes the cost of materials and direct labour, any other costs directly attributable to bringing the investment property to a working condition for their intended use.

Any gain or loss on disposal of investment property (calculated as the difference between the net proceeds from disposal and the carrying amount of the item) is recognised in profit or loss. When investment property that was previously classified as property, plant and equipment is sold, any related amount included in the revaluation reserve is transferred to retained earnings.

#### Determining Fair value

An external, independent valuer, having appropriate recognised professional qualifications and recent experience in the location and category of property being valued, values the company's investment property portfolio annually.

### 2.3 Employee benefits

#### 2.3.1 Short-term employee benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided. A liability is recognised for the amount expected to be paid under

short-term cash bonus if the company has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee, and the obligation can be estimated reliably.

#### 2.3.2 Defined contribution plans

A defined contribution plan is a post-employment benefit plan under which an entity pays fixed contributions into a separate entity and will have no legal or constructive obligation to pay further amounts. Obligations for contributions to defined contribution plans are recognised as an employee benefit expense in profit or loss in the periods during which services are rendered by employees. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in future payments is available. All employees of the Company are members of the Employees' Provident Fund (EPF) and Employees' Trust Fund (ETF), to which the Company contributes 12% and 3% of employee salaries respectively.

### 2.4 Provisions

A provision is recognised if, as a result of a past event, the IBU has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation.

Contingent liabilities are disclosed if there is a possible future obligation as a result of a past event, or if there is a present obligation as a result of a past event but either a payment is not probable or the amount cannot be reasonably estimated.

## 2.5 Events occurring after the reporting date

Events after the reporting period are those events, favourable and unfavourable, that occur between the reporting date and the date when the financial statements are authorised for issue.

All material post reporting date events have been considered and where appropriate, adjustments or disclosures have been made in the respective notes to the financial statements.

## 2.6 Benevolent Loan (Qurd Hassan)

Qurd Hassan is a loan or debt extended which is absolutely free from interest or any charges. The borrower is only required to repay the principal amount borrowed, but it may pay an additional amount at its discretion, as a token of appreciation.

The Company extends Qurd Hassan to the IBU as and when required and the IBU settles those when funds are available.

## SIGNIFICANT ACCOUNTING POLICIES – RECOGNITION OF INCOME AND EXPENSES

### 2.7 Revenue Recognition

#### 2.7.1 Murabaha/Musawamah Income

The profits and losses arising from Murabaha/Musawamah transactions are recognised over the term of the facility, commencing from the month in which the facility is executed.

#### 2.7.2 Ijarah Income

Profits and losses arising from Ijarah assets are recognised over the term of the lease, commencing from the month in which the lease is executed so as to yield a constant periodic rate of return on Ijarah assets.

#### 2.7.3 Diminishing Musharakah Income

Profits and losses arising from Diminishing Musharakah are recognised in the accounting period in which the installments are due.

#### 2.7.4 Profit in Suspense

Profit from advances classified as non-performing is accounted for on cash basis. Income falling due on non-performing advances is credited to profit in suspense account.

#### 2.7.5 Fees and other income

Fees and other income that are integral to the financial asset or liability are included in the measurement of the amortised cost.

Other fees and other income, including account servicing fees are recognised as the related services are performed.

Collections on contracts written off are accounted for on cash basis

#### 2.7.6 Dividends

Dividend income is recognised when the right to receive income is established.

## 2.8 Expenditure Recognition

Expenses are recognised in the statement of profit or loss on the basis of a direct association between the cost

incurred and the earning of specific items of income. All expenditure incurred in the running of the business has been charged to income in arriving at the profit for the year.

Expenses incurred by the IBU for which a fee is charged from the customers, has been presented net of the related income.

### 2.8.1 Value Added Tax (VAT) on financial services

The base for the computation of Value Added Tax on financial services is the accounting profit before income tax adjusted for the economic depreciation and emoluments of employees computed on the prescribed rate.

The VAT on financial service is recognised as expense in the period it becomes due.

### 2.8.2 Nation Building Tax on financial services (NBT)

With effect from January 01, 2014, NBT of 2% was introduced on supply of financial services via an amendment to the NBT Act No. 09 of 2009. NBT is chargeable on the same base used for calculation of VAT on financial services.

## 2.9 Income Tax

Income tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the Inland Revenue. The rate and tax laws used to compute the amount are those that are enacted or substantially enacted as at the statement of financial position date. Accordingly, provisions for taxation is made on the basis of the profit for the year as adjusted

## Notes to the Financial Statements

for taxation purposes in accordance with provisions of Inland Revenue Act No. 10 of 2006 and amendments thereto.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted at the statement of financial position date and any adjustments to tax payable in respect of previous years.

### **SIGNIFICANT ACCOUNTING POLICIES – STATEMENT OF CASH FLOWS**

#### **2.10 Cash flow statements**

The cash flow statement has been prepared using the indirect method of preparing cash flows in accordance with the Sri Lanka Accounting Standard (LKAS) 7, Cash Flow Statements.

Cash and cash equivalents comprise short term, highly liquid investments that are readily convertible to known amounts of cash and are subject to an insignificant risk of changes in value. The cash and cash equivalents include cash in-hand, balances with banks and short term deposits with banks.

### **SIGNIFICANT ACCOUNTING POLICIES – GENERAL**

#### **2.11 Fair value measurement**

Fair value' is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- › In the principal market for the asset or liability, or
- › In the absence of a principal market, in the most advantageous market for the asset or liability

The principal or the most advantageous market must be accessible to the company.

The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use. External professional valuers are involved for valuation of significant assets such as investment properties.

As at 31 March 2017	2017 Rs.	2016 Rs.
<b>3. CASH AND BANK BALANCES</b>		
Cash & bank balances	315,833,572	120,480,965
	315,833,572	120,480,965
<b>4. MURABAHA / MUSAWAMAH / WAKALA RECEIVABLES</b>		
Installment receivable	3,209,917,602	3,216,664,817
Unearned income	(371,263,043)	(345,004,594)
Income in suspense	(1,422,196)	(1,311,924)
Provision for credit losses	(4,841,120)	(6,872,901)
	2,832,391,243	2,863,475,398
<b>5. DIMINISHING MUSHARAKAH RECEIVABLES</b>		
Installment receivable	4,999,695,860	4,726,452,526
Income in suspense	(15,886,748)	(12,065,797)
Provision for credit losses	(27,616,199)	(22,112,858)
	4,956,192,913	4,692,273,871
<b>6. IJARAH RECEIVABLES</b>		
Rent receivables	4,226,927,403	4,305,844,643
Unearned income	(985,695,056)	(1,002,650,815)
Income in suspense	(1,332,053)	(2,363,271)
Provision for credit losses	(8,808,023)	(7,513,915)
	3,231,092,271	3,293,316,642
<b>7. INVESTMENT IN QUOTED SHARES</b>		
Expo Lanka Holdings PLC		
Cost (1,000,000 shares)	18,000,000	18,000,000
Adjustment for fall in value of investments	(11,400,000)	(11,000,000)
	6,600,000	7,000,000

Notes to the Financial Statements

As at 31 March 2017	2017 Rs.	2016 Rs.
<b>8. OTHER RECEIVABLES</b>		
Staff car advances	22,900,478	23,900,153
Insurance premium receivable	19,263,197	4,973,556
Others	33,427,879	22,784,587
	75,591,553	51,658,296
<b>9. INVESTMENT PROPERTIES</b>		
Balance as at 1st April	15,000,000	12,500,000
Additions to Investment Properties from foreclosure of contracts	-	-
Change in fair value	3,000,000	2,500,000
Balance as at 31st March	18,000,000	15,000,000
<b>10. IJARAH SUKUK BOND</b>		
Balance at the beginning of the year	-	-
Ijarah Sukuk issued during the year	500,000,000	-
Repaid during the year	(109,088,517)	-
Balance at the end of the year	390,911,483	-
Profit Payable	31,441,708	-
<b>Liability recognised in statement of financial position</b>	422,353,191	-
<b>11. ACCRUALS AND OTHER PAYABLES</b>		
Lease equipment creditors	54,521,631	112,527,705
Refunds payable	104,328,094	74,567,524
Insurance payable	15,613,306	30,915,207
IBU charity fund	3,432,829	7,199,735
Other payables	64,872,578	30,969,468
	242,768,438	256,179,639
<b>12. DUE TO HEAD OFFICE</b>		
Qurd hassan	1,906,500,000	2,853,000,000
Current account balance due to head office	316,688,604	120,777,435
	2,223,188,604	2,973,777,435

As at 31 March 2017	2017 Rs.	2016 Rs.
<b>13. REVENUE</b>		
Income from Ijarah receivables	593,485,358	503,816,050
Income from Diminishing Musharaka receivables	843,847,036	665,254,234
Income from Murabaha/Musawamah receivables	595,254,330	391,462,948
Profit on terminations	35,684,525	44,873,120
Income from Mudarabah deposits	323,734	388,680
	2,068,594,983	1,605,795,031
<b>14. NON DISTRIBUTABLE OTHER INCOME/(EXPENSES)</b>		
Takaful commission	26,653,279	30,528,896
Others	9,412,446	(15,776)
	36,065,725	30,513,120
<b>15. EMPLOYEE BENEFITS</b>		
Salaries & other benefits	142,043,509	124,866,148
	142,043,509	124,866,148
<b>16. PROFIT FROM OPERATION</b>		
Stated after charging		
Advertising	6,231,428	12,674,674
Business promotion expenses	52,797,630	36,018,342
<b>17. INCOME TAX EXPENSE</b>		
Income tax is provided at 28% of the taxable profits computed in accordance with the inland revenue act No 10 of 2006 (and amendments thereto)	197,523,144	138,217,880
	197,523,144	138,217,880

**18. EVENTS AFTER THE REPORTING DATE**

Subsequent to the reporting date no circumstances have arisen which would require adjustments to, or disclosure in the financial statements.



# Corporate Information

## Name of the Company

LOLC Finance PLC

## Country of Incorporation

Sri Lanka

## Date of Incorporation

13th December 2001

## Legal Form

A quoted public company with limited liability

## Company Registration No.

PB 244 PQ

## Stock Exchange Listing

The ordinary shares of the Company were listed on the Diri Savi Board of the Colombo Stock Exchange on 7th July 2011.

## Credit Rating

ICRA Lanka assigned the company an issuer rating of (SL) A (Stable outlook).

## Registered Office and Head Office

No. 100/1, Sri Jayewardenepura Mawatha,  
Rajagiriya  
Tel: 011 5880880  
Fax: 011 2865606  
Website: <http://www.lankaorix.com>  
Swift: LOFCLKLC

## Directors

Dr. H Cabral PC - Chairman/Non Executive Director

Mr. I C Nanayakkara - Deputy Chairman  
(alternate to Mrs K U Amarasinghe)

Mrs. K U Amarasinghe - Executive Director  
(Alternate to Mr. I C Nanayakkara)

Mrs. D P Pieris - Senior Independent Director

Justice R K S Suresh Chandra - Independent Director - retired with effect from 03.07.2017

Mr. P A Wijeratne - Independent Director  
(a.w.e.f 26.05.2017)

Mr. A Nissanka - Executive Director/ CEO

## Secretaries

LOLC Corporate Services (Private) Limited  
100/1 Sri Jayewardenepura Mawatha  
Rajagiriya  
Tel: 011 5880354/7 0115880880 (general)

## Auditors

Ernst & Young, Chartered Accountants

## Lawyers

Julius & Creasy, Attorneys-at-Law  
Nithya Partners

## Registrars

PW Corporate Secretarial (Private) Ltd  
No. 3/17 Kynsey Road, Colombo 8.  
Tel: 011 4897733-5

## Principal Activities

During the year the principal activities of the Company comprised Finance Business, Finance Leasing, Islamic Finance, Foreign Currency Business including Worker Remittances, issue of Payment Cards, Money Changing Business and provision of Advances for Margin Trading in the Colombo Stock Exchange.

## Bankers

Nations Trust Bank PLC  
Citi Bank N.A.  
Commercial Bank of Ceylon PLC  
NDB Bank  
Bank of Ceylon  
Seylan Bank PLC  
MCB Bank  
Deutsche Bank  
Hatton National Bank PLC  
Pan Asia Bank  
Hong Kong & Shanghai Banking Corporation  
Sampath Bank PLC  
Peoples Bank  
Cargills Bank Limited  
DFCC Bank  
Union Bank of Colombo PLC

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