

SIGNIFICANT ACCOUNTING POLICIES

1. REPORTING ENTITY

Diesel & Motor Engineering PLC and its Subsidiaries are limited liability companies, incorporated and domiciled in Sri Lanka. The parent Company and its Subsidiaries have the registered office at No. 65, Jethawana Road, Colombo 14. The Consolidated Financial Statements of Diesel & Motor Engineering PLC as at and for the year ended 31st March 2009 comprise the Company and its fully-owned Subsidiaries (together referred to as the 'Group' and individually as 'Group Entities') and the Group's interest in an associate and jointly controlled entities. The Financial Statements of all Companies in the Group are prepared to a common financial year, which ends on 31st March.

There were no significant changes in the nature of principal activities of the Company and the Group during the financial year concerned.

The Financial Statements for the year ended 31st March 2009 were authorised for issue by the Board of Directors on 22nd May 2009.

Diesel & Motor Engineering PLC does not have any identifiable parent of its own.

2. BASIS OF PREPARATION

2.1 Statement of Compliance

The Financial Statements have been prepared in accordance with the Sri Lanka Accounting Standards (SLAS) issued by the Institute of Chartered Accountants of Sri Lanka (ICASL), and the requirements of the Companies Act No. 7 of 2007.

2.2 Basis of Measurement

The Financial Statements have been prepared on the historical cost basis, except for land included in property, Plant & Equipment which has been measured at fair value as explained in Note 8 to the Financial Statements.

2.3 Responsibility for Financial Statements

The Board of Directors is responsible for the preparation and presentation of the Financial Statements. The statement containing the Directors' Responsibilities for Financial Statements is given on page 108.

2.4 Functional and Presentation Currency

The Financial Statements are presented in Sri Lankan Rupees, which is the Company's functional currency. All financial information presented in Sri Lankan Rupees has been rounded to the nearest thousand, unless otherwise stated.

3. USE OF ESTIMATES AND JUDGEMENTS

The preparation of financial statements in conformity with SLAS requires management to make judgements, 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 those estimates and judgemental decisions.

Estimates and underlying assumptions are reviewed on an on going basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if revision affects both current and future periods.

3.1 Judgements

In the process of applying the Company's accounting policies in conformity with SLAS, management has made the judgments, apart from those involving estimations, which has the most significant effect on the amounts recognised in the Financial Statements

3.2 Estimates and Assumptions

The key assumptions concerning the future and other key sources of estimation uncertainty at the Balance Sheet date, that have a significant risk of causing a material adjustments to the carrying amounts of assets and liabilities within the next financial year are discussed below. The respective carrying amounts of assets and liabilities are given in related notes to the Financial Statements.

3.2.1 Fair Value of Property, Plant & Equipment

The property, plant & equipment of the Company are reflected at fair value. When current market prices of similar assets are available, such evidences are considered in estimating fair values of these assets. In the absence of such information the Company determines within a reasonable fair value estimates, amounts that can be attributed as fair values, taking into consideration discounted cash flow projections based on estimates, derived evidence such as current market rents for similar properties and using discount rates that reflect uncertainty in the amount and timing of cash flows.

3.2.2 Fair Value of Unquoted Equity Investments

The unquoted equity instruments have been valued based on the expected cash flows discounted at current rates applicable for items with similar terms and risk characteristics. This valuation requires the Company to make estimates about expected future cash flows and discount rates, and hence they are subject to uncertainty.

3.2.3 Defined Benefit Plans

The cost of defined benefit plans - gratuity is determined using actuarial valuations. The actuarial valuation involves making assumptions about discount rates, expected rates of return on assets, future salary

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increases, mortality rates and future pension increases. Due to the long term nature of these plans, such estimates are subject to significant uncertainty.

4. GOING CONCERN

The Directors have made an assessment of the Group's ability to continue as a going concern in the foreseeable future, and they do not intend either to liquidate or to cease trading.

5. SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below are consistent with those used in the previous year, other than for the effects of SLAS 16 (Revised 2006) - Employee Benefits, which was adopted during the year.

Certain comparative amounts have been reclassified to conform to current year's presentation.

5.1 Basis of Consolidation

The Consolidated Financial Statements are prepared as per the Sri Lanka Accounting Standard 26 on Consolidated Financial Statements and Accounting for Investments in Subsidiaries.

5.1.1 Subsidiaries

Subsidiaries are those entities controlled by the Group. Control exists when the Group has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that are currently exercisable are taken into account. The Financial Statements of Subsidiaries are included in the Consolidated Financial Statements from the date that control commences until the date that control ceases. There is no minority interest in the Consolidated Financial Statements since all Subsidiary Companies are wholly owned.

5.1.2 Associates (Equity Accounted Investees)

Associates are those entities in which the Group has significant influence, but not control, over the financial and operating policies. Significant influence is presumed to exist when the Group holds between 20 and 50% of the voting power of another entity. Associates are accounted for using the equity method (equity accounted investees) and are initially recognised at cost. The Consolidated Financial Statements include the Group's share of the income and expenses and equity movements of equity accounted investees, from the date that significant influence commences until the date that significant influence ceases. When the Group's share of losses exceeds its interest in an equity accounted investee, the carrying amount of that interest is reduced to nil and the recognition of further losses is discontinued except to the extent that the Group has incurred obligations or has made payments on behalf of the investee.

5.1.3 Jointly Controlled Entities

Jointly controlled entities are those entities over whose activities the Group has joint control, established by contractual agreement and requiring unanimous consent for strategic, financial and operating decisions.

The Consolidated Financial Statements include the Group's proportionate share of the joint venture assets/liabilities, revenue and expenses with items of a similar nature on a line by line basis.

5.1.4 Transactions Eliminated on Consolidation

Intra-group balances and transactions, and any unrealised income and expenses arising from intra-group transactions are eliminated in preparing the Consolidated Financial Statements. Unrealised gains arising from transactions with equity accounted investees are eliminated against the investment to the extent of the Group's interest in the investee.

Unrealised losses are also eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

5.2 Foreign Currency Transactions

Transactions in foreign currencies are translated into Sri Lankan Rupees at the rates exchange prevailing at the time the transactions are affected. Monetary assets and liabilities denominated in foreign currencies at the Balance Sheet date are retranslated into Sri Lankan Rupees at the exchange rate prevailed at that date. Foreign exchange differences arising on translation are recognised in profit and loss.

5.3 Segment Reporting

A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those other segments.

The segment reporting is presented on the primary format, business segments, as per the Sri Lanka Accounting Standard No. 28 - Segment Reporting. Inter-segment pricing is determined on an arm's length basis. Segment information is based on the identified product segments reflecting the Groups' 'core' and 'non-core' business activities. Segment information includes revenue, segment result, assets, liabilities and cash flows.

Segment assets and liabilities include those operational assets and liabilities that can be allocated to the segment on a reasonable basis. Segment expenses consist of direct expenses pertaining to and directly attributable to the segment. Considering activities of the operations, segment information based on geographical segments does not arise.

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5.4 Assets and Bases of Their Valuation

Assets classified as current assets on the Balance Sheet are cash and bank balances and those which are expected to be realised in cash during the normal operating cycle or within one year from the Balance Sheet date, whichever is shorter.

5.4.1 Property, Plant & Equipment

Items of property, plant & equipment are measured at cost or fair value less, accumulated depreciation and any accumulated impairment in value. The carrying value of property, plant & equipment is reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable.

a. Cost

The cost of property, plant & equipment is the cost of acquisition or construction together with any expenses incurred in bringing the assets to their working condition for their intended use. Where parts of an item of property, plant & equipment have different useful lives, they are accounted for as separate items (major components) of property, plant & equipment.

b. Subsequent Costs

The cost of replacing part of an item of property, plant & equipment is recognised in the carrying amount of the item, if it is probable that the future economic benefits embodied within the part will flow to the Group and its cost can be measured reliably.

The cost of the day-to-day servicing and maintenance of property, plant & equipment is recognised in profit and loss as incurred.

c. Revaluation

A revaluation of land is done when there is a substantial deviation between the fair value (market value) and the carrying amount of the land and is undertaken by professionally qualified valuers. Increases in the carrying amount on revaluation are credited to the

revaluation reserve included in shareholders equity. Decreases that offset previous increases of the same individual asset are charged against revaluation reserve directly in equity. All other decreases are recognised in profit and loss.

d. Derecognition

The carrying amount of an item of property, plant & equipment is derecognised upon disposal or when no future economic benefits are expected from its use. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is recognised in profit and loss in the year the asset is derecognised.

e. Depreciation

Depreciation is recognised in profit and loss on a straight-line basis over the estimated useful lives of items of each part of an item of property, plant & equipment. Assets held under finance lease are depreciated over the shorter of the lease term and the useful lives of equivalent owned assets. Freehold land is not depreciated.

The estimated useful lives are as follows:

	Years
Buildings	36-40
Plant & Machinery	08-13
Workshop Implements	03-04
Motor Vehicles	03-04
Furniture & Fittings	09-13
Office Equipment & Electrical	06-10
Computer Hardware & Software	03-04

Depreciation of an asset begins when it is available for use and ceases at the earlier of the date that the asset is classified as held for sale and the date that the asset is derecognised.

The asset's residual values, useful lives and methods of depreciation are reviewed and adjusted if appropriate, at the end of each financial year.

f. Capital Work-in-Progress

Capital expenditure incurred during the year, which is not completed as at the Balance Sheet date is shown as Capital work-in-progress.

5.4.2 Intangible Assets

An intangible asset is recognised if it is probable that future economic benefits that are attributable to the asset will flow to the enterprise and the cost of the asset can be measured reliably in accordance with SLAS 37 on Intangible Assets. Accordingly, assets with finite useful lives are measured at cost less accumulated amortisation and accumulated impairment losses. All computer software development and purchase costs incurred by the Company which are not integrally related to computer hardware and can be clearly identifiable and reliably measured, are included in the non-current assets under the category of intangible assets and carried at cost less cumulative amortisation.

a. Subsequent Expenditure

Subsequent expenditure on intangible assets is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates.

b. Amortisation

Intangible assets with finite useful lives are amortised on a straight-line-basis on monthly basis and recognised in profit and loss from the date when the asset is available for use, over the best estimate of its useful economic life.

- Computer software - 4 years.

5.4.3 Investments

All quoted and unquoted shares, which are held as non-current investments, are measured at cost. In the Company's separate Financial Statements, investments in Subsidiaries, Associate and jointly - controlled entity are accounted for at cost. Income from these investments is recognised only to the extent of dividends received.

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The carrying amounts of long-term investments are reduced to recognise a decline which is considered other than temporary, determined on an individual investment basis.

5.4.4 Inventories

Inventories are valued at the lower of cost and net realisable value, after making due allowances for obsolete and slow moving items. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses.

The cost of inventories is based on the weighted average cost principle and includes expenditure incurred in acquiring the inventories and bringing them to their existing location and condition.

5.4.5 Trade and Other Receivables

Trade receivables are stated at their estimated realisable value. A provision has been made in respect of bad and doubtful receivables when the debts.

Bad debts are written-off when those are known to be uncollectable.

5.4.6 Cash & Cash Equivalents

Cash & cash equivalents comprise cash balances and demand deposits. Bank overdrafts and short-term borrowings that are repayable on demand and form an integral part of the Group's cash management, are included as a component of cash & cash equivalents for the purpose of the Statement of Cash Flows.

5.4.7 Impairment

The carrying amounts of the Group's assets, other than inventories and deferred tax assets, are reviewed at each reporting date to

determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated.

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value, less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. A cash-generating unit is the smallest identifiable asset group that generates cash flows that largely are independent from other assets and groups.

An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its estimated recoverable amount. Impairment losses are recognised in profit or loss. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amount of the other assets in the unit (group of units) on a pro-rata basis.

Impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

5.5 Liabilities and Provisions

Liabilities classified as current liabilities in the Balance Sheet are those which fall due for payment on demand or within one year from the Balance Sheet date. Non-current liabilities are those balances that fall due for payment after one year from the Balance Sheet date.

All known liabilities have been accounted for in preparing the Financial Statements.

5.5.1 Employee Benefits

a. 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. Employees are eligible for Employees' Provident Fund (EPF) contributions and Employees' Trust Fund (ETF) contributions in line with respective statutes and regulations. The companies contribute the defined percentages of gross emoluments of employees to approved funds and are recognised as an expense in profit and loss as they fall due.

b. Defined Benefits Plans - Retiring Gratuity

A defined benefit plan is a post-employment benefit plan other than a defined contribution plan. The Group adopted the revised SLAS 16 - Employee Benefits with effect from 1st April 2008. Since the transitional liability as at this date is less than the liability as per the previous accounting policy, the decrease has been recognised immediately under SLAS 10 - Accounting Policies, Changes in Accounting Estimates and Errors. Provision for retirement benefit obligations is calculated by estimating the future benefits that employees have earned in return for their services in the current and prior periods; this benefit is

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discounted to determine its present value. The discount rate is based on the current market interest rates with necessary adjustments to match the term of the obligation. The calculation is performed by a qualified actuary using the projected unit credit method.

The liability is not externally funded.

The Company could not carry out an actuarial valuation of Retirement Benefit Obligations for the periods prior to 31st March 2008. Therefore, the Company was unable to apply the change in the accounting policy retrospectively for the earliest periods presented which is 1st April 2007. Due to the limitation of the retrospective application the Company determined the cumulative effect of the change in accounting policy and accordingly applied the change to the carrying amounts of the assets and liabilities as at the beginning of the current period and made the corresponding adjustment to the opening balance of the retained earnings.

Actuarial Gains and Losses

Actuarial gains or losses are recognised immediately profit and loss.

c. Short-Term Benefits

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided.

The liability is not externally funded.

5.5.2 Deferred Income

The excess of sales proceeds over the carrying amount of an asset in a sale and lease back transaction is classified as Deferred Income. Deferred Income is systematically amortised to profit and loss over the lease period.

5.5.3 Trade and Other Payables

Trade and other payables are stated at their costs.

5.5.4 Provisions

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

6. INCOME & EXPENSES

6.1 Revenue Recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Company and the revenue and associated costs incurred or to be incurred can be reliably measured. Revenue is measured at the fair value of the consideration received or receivable net of trade discounts and sales taxes. The following specific criteria are used for the purpose of recognition of revenue.

a. Sale of Goods

Revenue from the sale of goods is measured at the fair value of the consideration received or receivable, net of returns and allowances and trade discounts. Revenue is recognised when the significant risks and rewards of ownership have been transferred to the buyer, recovery of the consideration is probable, the associated costs and possible return of goods can be measured reliably, there is no continuing managerial involvement with the goods and the amount of revenue can be measured reliably.

b. Rendering of Services

Revenue from services rendered is recognised in profit and loss on the invoicing of the job after completion. In instances where the revenue from services spreads over a period of time, revenue is recognised in profit and loss in proportion to the stage of completion of the transaction at the reporting date.

c. Service Support Income

Service support commission income from foreign principals is accounted for on an accrual basis once the shipment is effected.

6.2 Expenditure Recognition

Expenses are recognised in the Income Statement on the basis of costs incurred and earning of specific items of income. All expenditure incurred in the running of the business and in maintaining the property, plant & equipment at an efficient level, has been charged to the Income Statement.

6.2.1 Operating Leases

Leases where the lessor effectively retains substantially all the risks and rewards of ownership over the lease term are classified as operating leases. Payments made under operating leases are recognised as an expense in the Income Statement on a straight-line basis over the lease term.

6.2.2 Borrowing Costs

Borrowing costs are recognised as an expense in the period in which they are incurred, except to the extent where borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset that takes a substantial period of time to get ready for its intended use or sale, is capitalised as part of that asset.

6.2.3 Finance Income and Finance Expenses

Finance income comprises interest income on funds invested, dividend income and gains on translation of foreign currency. Interest income is recognised in profit and loss as it accrues, taking into account the effective yield on the asset.

Finance expenses comprise interest cost on borrowings and losses on translation of foreign currency. The interest expense component of finance lease payments is recognised in profit and loss using the effective interest method.

Dividend income is recognised in profit and loss on the date the entity's right to receive payment is established.

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6.2.4 Income Tax

Income tax expense comprises current and deferred tax. Income tax is recognised in profit and loss, except to the extent that it relates to items directly recognised in equity, in which case it is recognised in equity.

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

Deferred tax is recognised using the Balance Sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognised for the following temporary differences: the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit, and differences relating to investments in subsidiaries to the extent that they probably will not reverse in the foreseeable future. In addition, deferred tax is not recognised for taxable temporary differences arising on the initial recognition of goodwill. Deferred tax is measured at the tax rates that are expected

to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Tax withheld on dividend income from subsidiaries and associates is recognised as an expense in the Consolidated Income Statement at the same time as the liability to pay the related dividend is recognised.

Deferred income tax relating to items recognised directly in equity is recognised in equity and not in the Income Statement.

7. CASH FLOW STATEMENT

The Cash Flow Statement has been prepared using the 'direct method'. Interest paid is classified as operating cash flows, interest and dividend received are classified as investing cash flows, while dividends paid are classified as financing cash flows for the purpose of presenting the Cash Flow Statement.

8. EVENTS OCCURRING AFTER THE BALANCE SHEET DATE

All material post-Balance Sheet events have been considered and where appropriate, adjustment or disclosure has been made according to SLAS 12 (Revised) - Events after the Balance Sheet date, in the respective Notes to the Financial Statements.

9. CAPITAL COMMITMENTS AND CONTINGENCIES

Capital commitments and contingent liabilities of the Group are disclosed in respective Notes to the Financial Statements. Refer Note 30 to the Financial Statements.