



HNB

Hatton National Bank PLC
Integrated Report 2017



16
you

...and you

At Hatton National Bank we have always put people before profit. In a world of constant change, we place our stakeholders and their interests at the centre of everything we do. We're re-inventing the way banking products and services are modelled and delivered; developing our focus on relationship banking and 'Banking beyond transactions' by building customer relationships that go far beyond the business operations we transact every day.

Where others see the balance sheet, we see a person. You will see this attitude at HNB every day, in the little things we do differently that bring people and personalised care back into every financial transaction. It is our way of improving services, reinforcing trust and most of all, perfectly delighting the many customers we serve each day.

Today we are important writers of the growth story of our country. For decades, we have driven job creation and transformation in some of the remotest regions of the country, supporting economic and social development through our many rural credit, SME and micro-finance programmes, designed to advance rural economies. In a world of uncertainty, we pledge to remain an icon of stability for the generations of Sri Lankans we are proud to partner, as we go steadily forward, eager to help our nation prosper.

Whoever you are, wherever you are from, whether you're a new customer or one who's been banking with us for generations, our approach remains the same. We're delivering exceptional value, generated through excellence in banking, to you.

And you and you and you...

...and you

“Together with my colleague Athula Silva, I ventured into the business of importing spare parts four decades ago. It was HNB that believed in us from the very inception, and supported us right through to become a leading automobile auto part distributing agency in the country..”

Tissa Gunawardena
Co-founder, Taas Agencies



...and you

“Over the years I was fortunate to witness the transformation of this great institution while I progressed in my career with HNB. I’m grateful to the Bank for the opportunity given to me to make a difference...”

Saumya Aryasinha

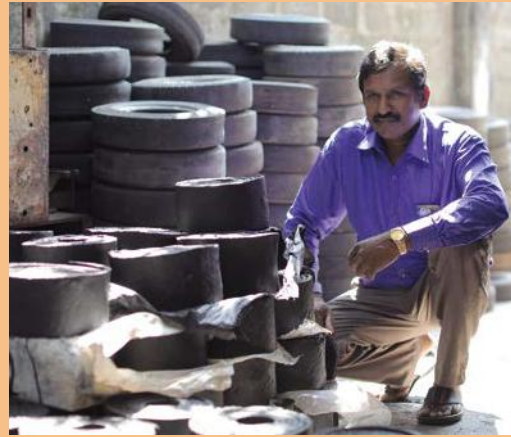
Regional Head - Colombo Region 2
Best Region 2017
Hatton National Bank PLC



...and you

“When I started my tyre shop in 2007 I was in crisis. That is when I met the HNB Gami Pubuduwa Upadeshaka. Today I’m the most reliable supplier to the country’s largest three wheeler company...”

Wimal Weerasinghe
Mytech Retreads
Piliyandala



...and you

“In 1989 I started my journey with a souvenir shop in Kandy. Today I’m the island’s largest exporter of wooden furniture and the owner of a diversified group of companies. I’m extremely grateful to HNB for being a true partner in progress...”

Sujeewa Palliyaguruge
Chairman Oak Ray Holdings
Entrepreneur of the year 2013



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<https://www.hnb.net/2017#annualreport>

SUSTAINABILITY SUPPLEMENT

Please scan the QR Code to read the additional disclosures



<https://www.hnb.net/2017#sustainability-report-2017>

ABOUT OUR REPORT

Our quest for excellence in corporate reporting underpins our approach to our Annual Report each year. This year, we present a collection of reports designed to cater to the specific needs of key stakeholder groups, presenting them with relevant material information in a concise but comprehensive manner in compliance with legal requirements and international best practices.

This report covers the operations of the Bank during the financial year which ended 31 December 2017. The most recent previous report was for the year 2016. The financial performance of the subsidiary and joint

venture companies where the Bank exercises management control are included in the consolidated financial statements of this report.

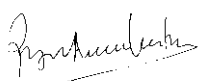
There have been no significant restatements to the non-financial information provided in previous reports or to the scope and aspect boundaries, other than what is captured and reported in the relevant sections of this report.

		FRAMEWORKS APPLIED	ASSURANCE
ANNUAL REPORT	INTEGRATED ANNUAL REPORT 2017 (IR) This report is primarily for providers of financial capital and will be of interest to other stakeholders as it summarises information on all material issues impacting our performance	<ul style="list-style-type: none"> » IR Framework issued by the International Integrated Reporting Council » Sri Lanka Financial Reporting Standards issued by the Institute of Chartered Accountants of Sri Lanka » Companies Act No 7 of 2007 » Banking Act No 30 of 1988 	Assurance has been provided by Ernst & Young on the Financial Statements including the Notes to the Accounts. DNV-GL has provided assurance on non financial sections of the report
	NAVIGATING UNCERTAINTY - CORPORATE GOVERNANCE AND RISK REPORT (CG&RR) This is our Corporate Governance and Risk Management Report intended for providers of financial capital and regulators who require deeper insights to the Bank's governance framework and approach to managing risk	<ul style="list-style-type: none"> » Code of Best Practice on Corporate Governance issued jointly by the Securities & Exchange Commission of Sri Lanka (SEC) and the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka) in 2013 » Banking Act Direction No 11 of 2007 (as amended) » Companies Act No 7 of 2007 » Sri Lanka Financial Reporting Standards issued by the Institute of Chartered Accountants of Sri Lanka » Integrated Risk Management Framework, Direction No 7 of 2011 » Baseline Security Standards for Information Security Management » Banking Act Direction No 1 of 2016 Basel Capital Accord (III) » ISO 27001:2013 Information Security 	The external auditors, Ernst & Young has performed procedures set out in Sri Lanka Standards on Related Service 4400 issued by the Institute of Chartered Accountants of Sri Lanka (SLSRS 4400), to meet the compliance requirement of the Banking Act Direction No 11 of 2007 and subsequent amendments thereto, and provided a report to the Board
SUSTAINABILITY SUPPLEMENT	This report caters to a wide range of stakeholders and provides a balanced review of our economic, environment and social impact and the governance mechanisms in place to measure, monitor and manage the same https://www.hnb.net/2017#sustainability-report-2017	<ul style="list-style-type: none"> » United Nations' Sustainable Development Goals » GRI Standards 	DNV-GL has provided assurance on non financial sections of the Sustainability supplement

The Management of Hatton National Bank PLC has reviewed and approved the relevant content of all reports and recommended the report to the Board Audit Committee and Board for their approval.

The Board acknowledges its responsibility to ensure that the Annual Integrated Report provides a balanced view of its performance in 2017 and is of the opinion that it addresses all material issues.

The reports were unanimously approved by the Board on 20th February 2018 and are signed on its behalf by



Rienzie Arseculeratne
Chairman

Colombo, Sri Lanka
20th February 2018




Jonathan Alles
Managing Director/CEO

Hatton National Bank PLC (HNB) has been a leader in the banking industry in Sri Lanka for 129 years, supporting the economic growth of the country. Our team of 4,348 employees serve over 2.5 Mn customers through our 251 branches and digital platforms. Our growth has been driven by our islandwide reach, strong relationships, our ability to reinvent ourselves and a strong value based organisation culture. HNB is amongst the Top 1000 Banks in the World as published by The Banker Magazine. We are also the 5th largest public listed company by market capitalisation at the Colombo Stock Exchange and ranked as the Sri Lankan entity with the 5th highest brand equity by Interbrand.


OUR BUSINESS

Business verticals determined on the principle of customer centricity and product specialisation enable us to cater to the needs of our customers.




Corporate Banking
We support the growth of our customers by facilitating trade and investment. Expertise in working capital financing, project finance, trade finance, payment and cash management and custodial services supported by cutting edge technology and proactive relationship management drive our growth.

Pg 70




Retail Banking, SME, Micro Finance
We facilitate wealth creation of our customers through our savings, investments, lending, remittance and transactional products. Accessibility and convenience offered through our own extensive branch and ATM network as well through our subsidiary HNB Grameen, coupled with cutting edge technology and insights into customer needs propel our growth.

Pg 64




Transaction Banking
Decades of expertise, global relationships and robust technology underpin our growth in this increasingly important business vertical which includes Trade Finance and Treasury. Linking customers to global opportunities and facilitating transactions, we support economic activity at all levels.

Pg 72



Insurance
Our insurance subsidiary enables our customers to hedge against perceived risks at business and personal levels.

Pg 75



Investment Banking
Supporting capital market operations of the Group, Acuity Partners offer a wide range of Investment Banking services to customers.

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VISION

To be the acknowledged leader and chosen partner in providing financial solutions through inspired people

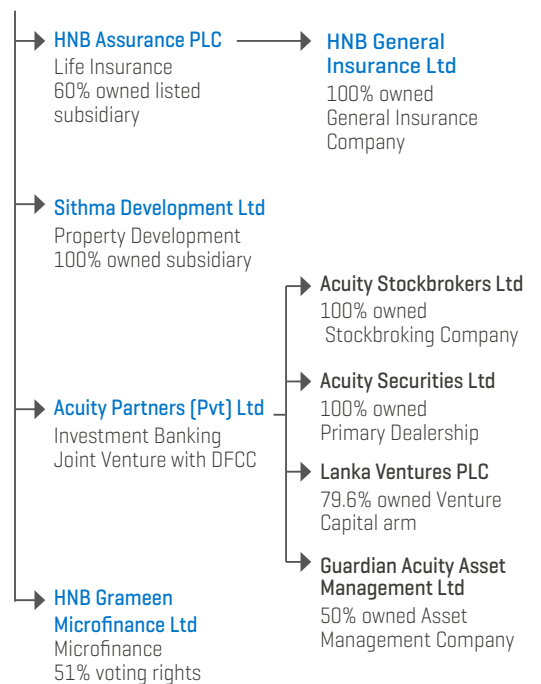
MISSION

Combining entrepreneurial spirit with empowered people and leading edge technology to constantly exceed stakeholder expectations

OUR VALUES

- » Treasure professional and personal integrity at all times
- » Demonstrate mutual respect in all our interactions
- » Passionate about everything we do
- » Committed to being customer centric
- » Courage to change, challenge and be different
- » Demonstrate unity in diversity

GROUP STRUCTURE



OUR REACH

CUSTOMER TOUCHPOINTS

251 Branches

595 ATMs

DIGITAL BANKING

Mobile Banking Apps

Online Banking

Smart ATMs

In App Payment Gateways

BUSINESS PARTNERS

900+
CORRESPONDENT BANKS

15,000+
MERCHANTS

SUPPORTING SRI LANKA'S GROWTH

As a domestic systemically important bank, HNB plays a key role in the country's economic progress and financial sector stability. This is a summary of our impact on the economy.

RS **10.6** BN
TAXES

RS **145** BN
DISBURSED AS MSME LOANS

RS **50** BN
FOR INFRASTRUCTURE PROJECTS

RS **199** BN
INVESTED IN GOVERNMENT SECURITIES

FACILITATED
RS **255** BN
OF COUNTRY'S IMPORTS

AFFIRMATION

While HNB received numerous awards, we have listed below a few that serve to demonstrate our commitment to delivering value to you.



Bank of the Year 2017

Awarded by the
Banker Magazine UK



No 1 Bank

LMD and Business Today



Best Retail Bank in Sri Lanka

Awarded by the
Asian Banker Magazine



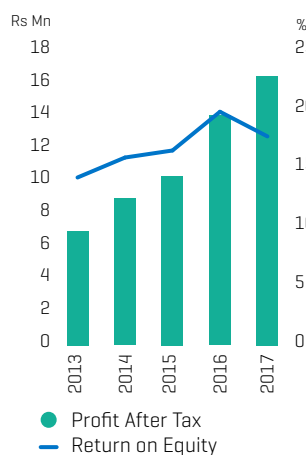
Best Corporate Citizen

Runnerup Award
by the Ceylon Chamber of
Commerce

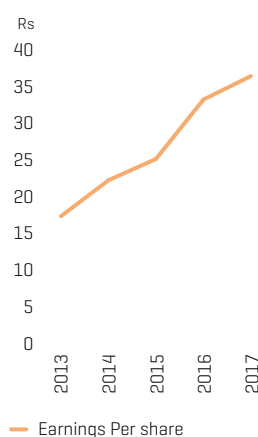
FINANCIAL

	Bank			Group		
	2017 Rs Mn	2016 Rs Mn	% Change	2017 Rs Mn	2016 Rs Mn	% Change
Financial Performance						
Income	106,295	84,351	26.0	119,759	95,991	24.8
Net interest income	39,649	34,372	15.4	45,461	39,089	16.3
Net fee and commission income	8,310	7,049	17.9	9,014	7,725	16.7
Total operating income	49,664	43,024	15.4	61,099	53,366	14.5
Net profit before taxation	27,072	24,499	10.5	28,363	27,085	4.7
Taxation [incl. VAT and NBT on FS, deferred tax]	10,605	10,355	2.4	11,797	11,569	2.0
Net profit after taxation	16,467	14,143	16.4	16,741	15,665	6.9
Financial Position						
Shareholders' funds [Capital and Reserves]	108,148	77,017	40.4	122,009	91,291	33.6
Deposits from customers	701,519	623,495	12.5	718,770	635,371	13.1
Gross loans and receivables to customers	649,547	595,514	9.1	666,768	608,966	9.5
Total assets	954,878	858,963	11.2	1,007,560	901,540	11.8
Profitability						
Return on assets [%]	1.82	1.79	1.7	1.67	1.78	(6.1)
Return on equity [%]	17.79	19.91	(10.7)	14.95	17.69	(15.5)
Cost to income ratio [%]	39.38	42.51	7.4	47.15	48.29	2.4
Investor Information						
Earnings per share [Rs]	36.66	33.53	9.3	35.50	34.99	1.5
Net assets per share [Rs]	221.36	186.11	18.9	249.74	220.61	13.2
Dividend per share [Rs]	8.50	8.50	-			
Regulatory Ratios						
Core capital ratio [%] (Minimum 5%)	13.72	11.22		13.74	11.51	
Total capital ratio [%] (Minimum 10%)	17.04	15.27		16.80	15.37	

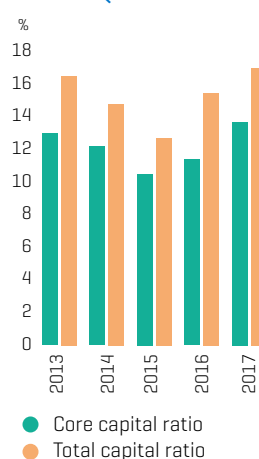
PROFIT AFTER TAX AND ROE



EARNINGS PER SHARE



CAPITAL ADEQUACY RATIO



NON-FINANCIAL

	Key Indicators	Unit	2017	2016	Further details on
Social & Network Capital	Total Taxes	Rs Bn	10.6	10.4	IR Pg 53
	Correspondent Banks	No	900+	800+	
	Loans Disbursed to MSMEs	Rs Bn	145	105	
	No of community project beneficiaries	No	53,957	89,762	
Human & Intellectual Capital	No of Employees	No	4,348	4,190	IR Pg 50
	Retention Rate	%	95.9	96.0	
	Employee remuneration and rewards	Rs Bn	8.9	8.7	
	Investment in Training & Development	Rs Mn	38	28	
	Training Coverage	%	100	100	
	Gender Diversity Ratio (Male: Female)	Ratio	60:40	62:38	
	Profit per Employee	Rs Mn	3.8	3.4	
Manufactured Capital	Branches	No	251	251	IR Pg 48
	ATMs	No	595	485	
	Investment in Technology	Rs Mn	632	495	
	Investment in PPE	Rs Mn	2,004	774	
	Online customer migration	%	12.3	8.9	
	Online Transactions	Mn	1.2	0.9	
Natural Capital	Energy Consumption	Kwh	12,357,011	15,508,707	IR Pg 62
	Carbon Footprint	Kg /Sqft	4.0	5.6	
	Paper Reused/Recycled	No	14,040	6,064	
	Solar Energy	Kwh	2,100,400	776,147	

RS **650** BN
GROSS LOANS

RS **702** BN
TOTAL DEPOSITS

RS **16.5** BN
PROFIT AFTER TAX

39.4 %
COST TO INCOME

1.8 %
RETURN ON ASSETS

**THE
 SPEED READ**

● The Bank's economic impact is significant accounting for 9.3% of the assets in the banking sector.

● 10.1% of loans and advances in the banking industry.

● Market capitalisation on voting and non-voting shares stood at Rs 116.5 Bn at the close of the year.

● Diversity, skills and experience of the Board ensures sufficiency of debate and deliberation on matters set before the Board.

It is my pleasant duty to welcome shareholders to the forty ninth Annual General Meeting and present the Annual Report and Financial Statements of Hatton National Bank PLC for the year ended 31st December 2017.

DELIVERING VALUE TO SHAREHOLDERS

Hatton National Bank PLC has delivered Total Asset growth of 11.2% and a Profit for the year of Rs 16.5 Bn while driving the Bank's digital transformation and improving the funding structure of the Group. HNB is the 5th largest by market capitalisation on the Colombo Stock Exchange and the combined market capitalisation on voting and non-voting shares stood at Rs 116.5 Bn at the close of the year. It remains the most diversified group within the financial services sector with group companies engaged in insurance, investment banking and microfinance complementing growth.

The Bank's economic impact is significant, accounting for 9.3% of the assets in the banking sector and 10.1% of loans and advances in the banking industry. It has contributed Rs 10.6 Bn as taxes during 2017 while investing Rs 198.6 Bn in government securities. The Group is one of the largest players in SME and Microfinance through the Bank and its subsidiary HNB Grameen, supporting the country's goals on financial inclusion, capacity building and access to finance.

From 1888 when we commenced operations as Hatton Bank in the hill country, we have remained relevant to both corporates and individuals alike with a strong presence outside the Western Province which ideal continues to this day. This is reflected in the geographical diversity of our loans and advances portfolio which has a significant exposure outside the Western province. Technology has been a game changer enabling us to significantly strengthen our value propositions for key stakeholders as we transform to a future ready digital bank. These are key competitive advantages that position the Bank as a leader, enhancing our ability to continue to deliver sustainable value to shareholders.

TOTAL MARKET CAPITALISATION

RS 116.5 BN
 as at end of 2017

A CHALLENGING ECONOMIC LANDSCAPE

HNB's performance is commendable considering the challenging macro environment that prevailed in 2017. The effects of climate change on agriculture and agriculture based industries with knock-on effects on other industries, are reflected in GDP growth which moderated to 3.3% in the third quarter of 2017. A relatively tight monetary and fiscal policy stance, which improved macroeconomic stability, contributed in some part to a decline in private and public sector spending, further moderating economic growth. Headline inflation increased during the year due to food supply issues, increased indirect taxes and increased prices of imports. CBSL is expected to use a Flexible Inflation Targeting framework to deliver price stability to maintain inflation within mid-single digits in 2018. Trade flows increased, as earnings from exports grew, supported by growth in key export markets and competitive exchange rates. However, import expenditure offset the gains from increased exports, widening the trade deficit. Remittances from migrant workers declined as well expanding the current account deficit. CBSL's exchange rate policy combined with FDI inflows and the release of the fourth IMF Extended Fund Facility curtailed depreciation of the rupee to 2.3% and this is expected to continue in the year that has commenced. We expect the interest rates to head south to drive economic growth. However, the anticipated rate hikes by the US Federal Reserve as well as Eurozone and the government debt repayments falling due may have adverse knock-on effects on the domestic interest rates.

Banking sector growth was encouraging although loans and advances growth moderated in line with expectation, reflecting the economic landscape. Non-Performing Loans increased during the year, as expected with the turning of the credit cycle with inevitable increases in impairment charges across the sector. The Bank has strengthened its credit risk management processes and set up a Centre of Aspiration to improve recovery processes, supporting improvement of this key indicator. Sector deposits reflected strong growth during the year as high interest rates attracted increased fixed deposits resulting in a decrease of the CASA ratio. In this backdrop, it is indeed gratifying to note HNB's growth in Current Account and Saving Accounts [CASA] affirming our strong domestic franchise reinforced by a sales culture and a relevant



“TECHNOLOGY HAS BEEN A GAME CHANGER ENABLING US TO SIGNIFICANTLY STRENGTHEN OUR VALUE PROPOSITIONS FOR KEY STAKEHOLDERS AS WE TRANSFORM TO A FUTURE READY DIGITAL BANK.”

range of products across all customer segments. HNB's own capital adequacy ratios improved from 13.7% to 17% during the year as funding structures improved, strongly supported by the issue of rights and retained earnings. To this end, I would like to place on record my sincere gratitude to all our shareholders for the trust and confidence in HNB.

STRATEGIC LEADERSHIP

The Board continues to provide leadership and strategic direction through well established Board procedures and strategic planning processes that facilitate structured engagement with key management personnel of the Bank. Diversity, skills and experience of the Board ensures sufficiency of debate and

deliberation on matters set before the Board, paving the way for successful outcomes on strategic goals, which are supported by an effective policy framework that enables business while ensuring compliance. Policy frameworks have been amended and approved to reflect the required changes and incorporate additional safeguards where deemed necessary. The Bank's smooth transition to Basel III is particularly noteworthy and serves as an example of the foresight and detailed planning that supports timely and effective compliance and performance.

Gender diversity of the Board is among the highest in the corporate sector and this is reflected in the senior management of the Bank as well, ensuring that we remain relevant to issues in driving higher female participation

in our own team and maintaining gender diversity in our talent pipelines.

Board and Committee evaluations provide a mechanism for continuous improvement of our own processes and the adoption of best practice in corporate governance in line with changes in standards and codes. In this regard, the Board has noted the issue of a revised Code of Best Practice on Corporate Governance by the Securities & Exchange Commission and the Institute of Chartered Accountants of Sri Lanka in December 2017 and is pleased to note its compliance with many aspects of same. The Board will review proposed changes required for full compliance and take steps to ensure compliance in 2018.

“THE BANK'S SMOOTH TRANSITION TO BASEL III IS PARTICULARLY NOTEWORTHY AND SERVES AS AN EXAMPLE OF THE FORESIGHT AND DETAILED PLANNING THAT SUPPORTS TIMELY AND EFFECTIVE COMPLIANCE AND PERFORMANCE.”

We welcomed on to the Board Mr Dinesh Weerakkody, who brings with him considerable experience in the corporate sector and the banking sector. I extend our appreciation of the contribution made by Mr Damien Fernando during his five year tenure and wish him success in future endeavours.

RESPONSIBLE BANKING

A holistic approach to performance delivery and a long term view ensures that sustainability is embedded in our strategic vision and business operations. We are conscious of the role a bank plays in the economy, facilitating wealth creation, access to markets and finance and reducing inequalities. Access to finance has been in our DNA from our roots in providing banking services to plantation owners and employees alike, gaining deep insights into how a bank can make a difference in the socio-economic progress of communities. Responsible banking has several dimensions, which include our role in channelling funds to growth areas of the economy, ensuring that projects funded by the Bank are compliant with social and environmental legislation and best practice, financial inclusion, ensuring that our own team is motivated and inspired to give their best, group compliance with regulatory and prudential requirements and strategic philanthropy initiatives. I am pleased to note HNB's all round performance in this regard as set out in the suite of reports tailored to meet the information requirements of diverse stakeholder groups. Our growth has been inspired by stakeholder feedback through our comprehensive stakeholder engagement

mechanisms which has enabled delivery of value to stakeholders.

A POSITIVE OUTLOOK

While economic growth is expected to pick up pace gradually over the medium term, the forecast for 2018 is that it would be a challenging year. On the positive side, the key factors have been identified and plans are in place to manage the priorities although downside risks remain.

The banking sector is expected to maintain its growth trajectory and pick up pace with planned growth initiatives in the private sector. Improved liquidity and capital adequacy in the sector in 2017 provides a sound platform for growth in the year that has commenced and many players in the sector will take stringent and holistic measures to improve the credit quality of their portfolios. Capacity building of SMEs is a key agenda, which will incubate the next generation of corporates who will have stronger support. We believe that these initiatives will strengthen the SME sector, stimulating growth in exports and import substitution ventures, facilitating the socioeconomic progress of the country.

HNB's SME and Microfinance verticals continue to support financial inclusivity and poverty reduction as we couple investment with capacity building initiatives. The Bank's plans are closely aligned to the government agenda on issues such as financial inclusion, sustainable businesses, clean energy and channelling funds to high growth sectors of the economy.

GROUP PROFIT AFTER TAX

RS **16.7** BN
for the year 2017

We are closely monitoring the proposed changes to the Banking Act and the introduction of a Bank Sustainability Risk Index, as these will directly impact our operations. While we appreciate the fiscal consolidation efforts of the government, some of the budget proposals targeting the banking sector could thwart the contribution the banking sector can make to the nation, through creation of entrepreneurship as well as by funding large scale projects. Government proposals to channel funds to SME and microentrepreneurs with a focus on empowering women entrepreneurs are welcome as the Group's expertise will enable us to further expand operations in this sector, positioning the HNB Group for further growth.

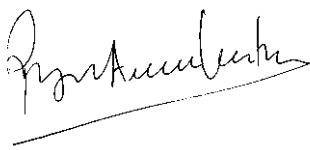
DRIVING A CULTURAL CHANGE

HNB's Digital Banking initiatives are changing the way Sri Lankans bank, as we onboard customers to our digital platforms, offering convenience and more control over their finances. Our innovations this year such as FitApp and Smart Pay have taken a quantum leap to address social issues through banking solutions, taking banking in a new direction towards adding meaningful change to our customers' lives. We note with pleasure the capability of our team to reimagine banking and deliver innovation that is truly groundbreaking. Our internal

digital transformations have been as profound, transforming how we do business and driving efficiency and specialisation in a holistic manner. Given the scale of our digital transformation, we appointed a Chief Information Security Officer and added a new vertical dedicated to managing Information and Cyber Risk to the Risk Management function. They have driven wide ranging changes to the related policy frameworks and risk management processes, strengthening this vital aspect of our operations as we deepen our digital transformation. The growth in digital transaction volumes and the enthusiasm with which our innovations have been received are a clear indication of the Bank's success in driving our digital transformation.

CONCLUSION

The Board joins me in commending the performance of an inspired and motivated team, ably led by the Managing Director/ CEO Mr Jonathan Alles as they delivered a well rounded performance in a challenging year. We also extend our appreciation of the co-operation and initiatives taken by the Central Bank of Sri Lanka in their capacity as the regulator to strengthen the banking sector. I thank the Board of Directors for exercising their judgement and contributions in deliberating matters reserved for the Board. We count on are stakeholders' continued confidence and high levels of engagement as we look to deliver sustainable value to you.



Rienzie Arseculeratne
Chairman

Colombo, Sri Lanka
20th February 2018

THE SPEED READ

HNB has delivered a resilient performance with a profit growth of 16.4%.

HNB's growth in exports was 23.1% comparing favourably with the country's growth.

HNB maintains cost leadership within the sector.

DEAR STAKEHOLDER,

This year's annual report pays tribute to you, our stakeholders, in appreciation of the support extended over our 129 year journey. Today, HNB is a systemically important bank aligned to the vision of our country with a sound track record of delivering value to our stakeholders. We at HNB are conscious of our responsibility to understand your needs and enhance the value delivered to you to ensure you stay with us and grow with us.

PERFORMANCE

HNB has delivered a resilient performance with a profit growth of 16.4%, following a 35% profit growth in 2016, despite a challenging economic landscape in 2017. We retain our position as the leading banking group for income and profitability which bears testimony to our strong franchise and inspired team, guided by a visionary yet pragmatic management team. Profit growth was supported by the high interest rates that prevailed in 2017 easing pressure on margins. Business verticals supported growth in fee based income with successful implementation of strategies to increase market share in trade finance, transaction banking and digital products. Consequently, HNB's growth in exports was 23.1% comparing favourably with the country's growth rate of 10.2% for exports, affirming increased market share. Imports also depict a similar trend with HNB's import business reflecting a growth of 14.1% in comparison to the country's import growth rate of 9.4%. Our Treasury was also supported by a dynamic branch network that enabled strong growth in forex and commission income in an intensely competitive market. An increased impairment charge of Rs 3 Bn reflects the deterioration in the NPA ratio due to one large corporate loan, the macro environment and adverse weather conditions. HNB maintains cost leadership within the sector with a cost to income ratio of 39.4%. This is managed by the judicious use of budgets to inspire and motivate our team and also by enhancing the efficacy of our processes through lean initiatives.

Following two years of strong growth, 2017 was a consolidating year to review the hygiene factors of our portfolios. Consequently, growth as measured by total assets was 11.2% while credit growth was a prudent 9.4%, reflecting rebalancing of portfolios through credit expansion in selected areas in alignment with the national agenda. This also enabled us to optimise risks and rewards and focus on asset quality of the portfolio in a challenging macroeconomic environment, which witnessed increased non-performing loans across the banking sector. Impacts of climate change resulting in severe drought and floods were felt across the agriculture sector. Other industries which rely on agricultural inputs were also impacted as four seasons of crops were affected. HNB has rescheduled over Rs 100 Mn of loans to provide much needed relief in the SME and Microfinance segments, while intensifying loan monitoring processes and capacity building initiatives to ensure a successful outcome. The consolidation also supported in-depth review of stressed portfolios to determine appropriate strategies to prevent further deterioration of Non Performing Loans. While our own Non-Performing Advances belie effective implementation of initiatives to strengthen credit quality as they declined from 1.80% in 2016 to 2.28% in 2017, I am confident that our efforts will bear fruit in the coming year. Our capital structure also strengthened during the year as we reduced borrowings and improved capital adequacy with retained earnings and by raising Rs 14.5 Bn through a rights issue.

TO YOU: OUR SHAREHOLDERS

- Compound Average Growth rate of 24% over the past 5 years in PAT.
- Total Market Capitalisation of Rs 116.5 Bn
- Cost leadership in the industry with a cost income ratio of 39.4%
- Brand Equity of Rs 17.5 Bn
- Dividends of Rs 8.50 per share for 2017

PROFIT AFTER TAX

RS 16.5 BN
for the year 2017

An abundance of international, regional and Sri Lankan awards and accolades affirm the delivery of a holistic performance, innovation, responsible banking and an organisation wide commitment to excellence. They serve to inspire us to reach higher as we continue our journey into our 130th year of operations as an innovator and leading player in the country's banking industry and corporate sector.

DIGITAL INTEGRATION

Our digital journey continues as we use technology to address stakeholder needs through a range of innovative digital products and process transformations, changing the way Sri Lankans bank. HNB's developments during the year have the potential to decrease costs for SMEs and corporates, support supply chains and improve individual's lifestyle, health and wellbeing. We are inspired by our ability to deliver diverse solutions and continue to reimagine how we can create new connections to banking with us as we become more relevant to varying aspects of our customers' lives. Our digital journey has also supported our cost leadership and people initiatives as we transform our systems to deliver enhanced analytical capability, process efficiencies and strengthened monitoring.

ENHANCING OUR CUSTOMER EXPERIENCE

Our investments are primarily directed towards enhancing the customer experience whether they walk into our branches or engage remotely through our array of phone and digital products. The appointment of a Customer Experience Officer in the



“WE RETAIN OUR POSITION AS THE LEADING BANKING GROUP FOR INCOME AND PROFITABILITY WHICH BEARS TESTIMONY TO OUR STRONG FRANCHISE AND INSPIRED TEAM, GUIDED BY A VISIONARY YET PRAGMATIC MANAGEMENT TEAM.”

previous year enabled us to gain valuable insights into how we were delivering value to our customers from their perspective and 2017 was a year where we actioned our learnings. A pre-requisite is to ensure that we have a comprehensive range of products relevant to our customers' needs and fit for purpose. Accordingly, innovation was a key focus and we launched several products addressing needs of specific customer segments. The launch of HNB SME Export Credit in collaboration with the Sri Lanka Export Development Board to facilitate access to finance and markets for SMEs has been well received and is the only branded product catering specifically to the needs of the export oriented SME. The Smart Pay card, launched to provide a

secure payment platform within the school environment addressing concerns of parents and school authorities, won recognition at the National Best Quality Software Awards. The Salary Saver launched in 2017 caters to the professional enabling linking accounts of the immediate family, facilitating convenience. HNB FIT App launched with our customer's health in mind takes banking to another dimension as we reward customers for staying fit, playing our part to address the growing global concerns around health and fitness. The In App Payment solution developed for PickMe is a step forward for Sri Lankan innovators enabling payment without keying in card details for each transaction, significantly enhancing convenience not

TO YOU: OUR CUSTOMERS

- Innovation
 - » HNB SME Export Credit
 - » SmartPay Card
 - » Salary Smart
 - » InApp Payment Gateway for PickMe
 - » HNB Mobile App
 - » HNB FIT App
 - » Free WiFi zones at 12 Priority Centres
 - » Launch of Customer Digital Engagement Centre

Managing Director/CEO's Message

just for HNB's customers but for all PickMe customers.

The HNB Mobile App and the Customer Digital Engagement Centre were also launched during the year broadbasing our engagement platforms while enhancing our customer value proposition. In order to ensure that you are able to conduct business in a conducive environment, we have refurbished and re-located branches to new premises. In recognition of your evolving needs, HNB is the first bank to provide free wi-fi at 12 of its Priority Centres since June 2017 setting yet another milestone in shaping the country's banking industry. Growth of digital transaction volumes confirms the ease of use of our online platforms and customer confidence in using them for transactions. It is a responsibility we take very seriously, investing in enhancing cyber security to strengthen our systems to maintain confidentiality and discharge our responsibilities as custodians of wealth. It is encouraging to note that our customer satisfaction scores visibly improved during the year as we deployed multiple platforms for engagement and increased employee awareness of customer experience initiatives.

HAPPY AND BRIGHT

Our employee experience directly impacts our customer experience and ensuring that employees are happy, bright and motivated is a key strategy that has enabled our growth. Our ability to attract, develop and retain talent, provided us with a sound platform for initiatives to ensure that we have a happy and bright team that works together. Initiatives launched included the appointment of Cross

Functional Teams with responsibility for key strategic goals, enabling employees to get to know colleagues in other departments better. The appointment of an Employee Experience Officer complemented the grievance handling mechanisms in place, giving employees a direct path to the Corporate Management to raise their concerns. We are encouraged by the use of the new communication channel and the new Chief Employee Experience Officer has worked together with HR to address a number of these issues. Initiatives such as refurbishment of not just branches but interiors of our offices providing a pleasant workplace for employees were undertaken solely with the purpose of creating a happy and bright workforce. The recently developed Knowledge Hub enabled employees to serve customers better, enhancing both the employee and customer experience. Our innovations for customers listed previously and the results set out in this report are testimony to the capability and energy of our team to deliver value to our stakeholders.

RISK AND REWARD

Strengthening risk management and compliance has been a priority to ensure that we are fit for the future as it is the foundation on which we build. HNB's smooth transition to Basel III was an example of the Bank's future readiness. The management recommended a number of initiatives to enhance asset quality during the year. Accordingly, credit risk processes were strengthened by: centralisation of credit review processes supporting higher levels of specialisation, establishing a Centre of Aspiration to support collections, improved portfolio management reporting and driving higher levels of credit risk awareness through training. Outsourcing hardcore recoveries and supporting litigation through stronger documentation also supported recoveries. A central Security Repository Unit equipped with state-of-the-art technology ensures that documents are maintained in a highly secured environment and makes information available at the click of a button.

Cyber and information security remains a key area of focus as the number of incidents and their audacity escalate globally and the Bank invested significantly on strengthening its cyber and information security during the year. The occurrence of a single information security breach in 2017 was reported to the regulators, investigated by external

TO YOU: OUR TEAM

- A stronger Employee Value Proposition
- Culture transformation
- Ideabox to drive innovation
- Cross Functional Teams
- Appointment of Chief Employee Experience Officer
- Rs 8.9 Bn paid as employee remuneration and rewards
- Launch of Knowledge Hub
- 406 team members promoted during the year
- HR Roadshows at regions
- New performance management system geared to drive sustainable performance
- Family friendly workplace
- Diversity and inclusion

COST TO INCOME RATIO

39.4%

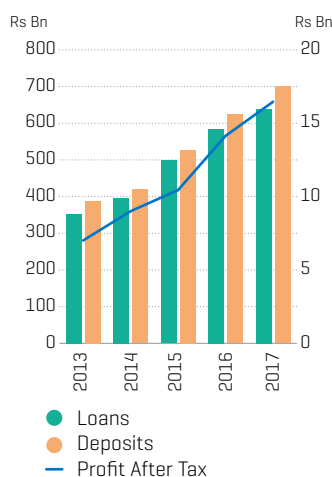
in 2017

consultants engaged by the bank and their findings communicated to the regulator.

OUR PLANS

The macroeconomic environment is expected to remain challenging as GDP growth is expected to marginally exceed 5% in the medium term. We expect monetary policy to be relaxed to drive economic growth however, increased levels of debt repayment and the country's aspiration of maintaining its unblemished repayment record may pose challenges. Inflation is expected to move towards the mid single digit levels as CBSL implements its Flexible Inflation Targeting framework. Strengthening of exports in 2017 augurs well for the future as other favourable factors such as GSP+ are expected to have a greater impact in 2018. Imports will be impacted by food supply factors which are unpredictable given the previous two years of alternating drought and floods. Additionally, diverse opinions on the price movement of oil adds further uncertainty to the direction of imports. However, initiatives implemented by the government for import substitution are also expected to have a positive impact curtailing growth of the country's trade deficit. Interest rates are expected to decrease reducing borrowing costs and stimulating

SUSTAINABLE GROWTH



“OUR EMPLOYEE EXPERIENCE DIRECTLY IMPACTS OUR CUSTOMER EXPERIENCE AND ENSURING THAT EMPLOYEES ARE HAPPY, BRIGHT AND MOTIVATED IS A KEY STRATEGY THAT HAS ENABLED OUR GROWTH.”

TO YOU: OUR REGULATORS

- Corporate taxes and VAT on Financial Services of Rs 10.6 Bn
- Fully compliant with the Banking Act and directions issued which are effective as at 31st December 2017
- Compliance with Continued Listing Rules of the CSE

economic activity. Exchange rate movement, while trending downward, is expected to be more stable due to flexible exchange rate policies of CBSL and plans to strengthen foreign reserves.

HNB's plans for growth, build on a rich heritage of trust and a people centric strategy aligned with the government's agenda. Our digital transformation continues to deliver innovative products, scalability and cost leadership while enhancing the customer and employee experiences which are key to our goal of becoming the No 1 Digital Bank by 2020. Our digital vision is holistic and paperless with enhanced user experiences, strengthened risk management, business analytics and core banking processes. We will continue to calibrate our risk reward balance to deliver optimal results sustainable in the short, medium and long term. Maintaining cost leadership will be a key priority as we build on the foundations and learnings achieved this year.

Declining interest rates will present an opportunity for HNB to improve its asset portfolio through increased credit to high

growth sectors of the economy and credit worthy customers to achieve a balance between margins and the management of non-performing advances. Margin pressure will be compensated by growth of ancillary business and deeper relationships to grow our share of customer wallets. Clean and affordable energy will be a key sustainability goal both in our own operations and investments as climate change moves up the country's agenda. Consequently, client acquisition, working the value chain with cross sell and upsell will be key to our success.

We expect the regulatory environment to maintain its rate of change. HNB is progressing on its internal ratings strengthening its portfolio management capabilities. We are also refining capital allocations on ICAAP with emphasis on operational risk as we move to advanced calculation which is expected to save capital, enhancing ROE.

APPRECIATIONS

I thank the Board for its strategic leadership steering the Bank to be future ready by 2020 and supporting the implementation of strategy with appropriate resource allocations and sound governance frameworks. To my team, I extend my sincere appreciation of their inspired innovations, determination to deliver stretched targets and the camaraderie that makes working at HNB an enjoyable experience. Your ideas and hard work drive our growth and transformation. My team and I are deeply appreciative of the support extended by our customers throughout our

journey and their onboarding of new products and platforms which has been key to our growth and digital transformation. We look forward to supporting your growth as you reach higher. We are deeply appreciative of the support extended by the Governor and the officials of the Central Bank of Sri Lanka and, in particular, the officials of the Department of Banking Supervision in ensuring that we evolve in line with global trends supporting higher levels of productivity through simplified regulation, processes and digitalisation. Our business partners play a key role in extending our reach and ensuring that we operate in a smooth and efficient manner and I thank them for their continued and reliable support. I thank our shareholders for high levels of engagement and the trust and confidence placed in us by subscribing to our right issues and look to delivering sustainable results as we move forward to our 130th year of banking in Sri Lanka.



Jonathan Alles
Managing Director /CEO

Colombo, Sri Lanka
20th February 2018

THE BOARD OF DIRECTORS

01
RIENZIE ARSECULERATNE
Chairman

02
JONATHAN ALLES
Managing Director
/Chief Executive Officer

03
ROSE COORAY
Director

04
ROHAN KARUNARATNE
Director

05
SUJEEWA MUDALIGE
Director

06
SANJIVANI JAYAWARDENA
Director

07
RUSI CAPTAIN
Director

08
AMAL CABRAAL
Director

09
PALITHA PELPOLA
Director

10
DULIKSHA SOOSAIPILLAI
Director

11
A N DE SILVA
Director

12
DINESH WEERAKODY
Director

13
THUSHARI RANAWEERA
Company Secretary



10

7

1

2

3

6



01

RIENZIE ARSECULERATNE

HNB:

Chairman

Appointed: May 2015

Independent, Non-Executive Director

Appointed: April 2015

HRRC

NC

Skills and Experience:

Having passed the Final Examination for the Admission of Advocates held by the Sri Lanka Law College in October 1973, he was admitted as an Attorney-at-Law of the Supreme Court of the Democratic Socialist Republic of Sri Lanka in June 1974. After a brief period of practice in the unofficial bar, joined the Attorney General's Department in October 1975 and having held appointments as State Counsel, Senior State Counsel, Deputy Solicitor General and Additional Solicitor General, left the Attorney General's Department in May 2003 to join the unofficial bar.

While holding the position of Additional Solicitor General and Head of the Criminal Law Department of the Attorney General's Department, called to the Inner Bar in 1988 upon being appointed as President's Counsel.

Admitted to the Degree of Bachelor of Laws (LLB) by University of Ceylon in 1974 and admitted to the Degree of Master of Laws (LLM) in Commercial Law by the University of Bristol in 1987.

Admitted as a Solicitor of the Supreme Court of England in 1982 and as a Barrister of the Australian Capital Territory in 1991.

Other Current Appointments:

Member of the Board of Governors of the Office of National Unity and Reconciliation.

Previous Appointments:

Director General of the Commission to Investigate Allegations of Bribery or Corruption.

Legal Advisor to the Ministry of Fisheries.

Examiner - Sri Lanka Law College.

02

JONATHAN ALLES

HNB:

Managing Director /Chief Executive Officer

Appointed: July 2013

Executive Director

Appointed: May 2013

BIRMC

RPTRC

CDA

Skills and Experience:

An experienced banker counting over 30 years in the industry with experience in both international and Sri Lankan banks, within the country and overseas. Holds a first class MBA from the University of Stirling, UK and is an Associate Member of the Institute of Bankers of Sri Lanka.

Other Current Appointments:

Chairman of HNB Grameen Finance Ltd and Acuity Partners (Pvt) Ltd and a Director of Lanka Financial Services Bureau Ltd, Lanka Ventures PLC and LVL Energy Fund. A Member of the Sri Lanka Institute of Directors and a Board Member representing Patron Members of the Sri Lanka Business and Biodiversity Platform.

03

ROSE COORAY (MS)

HNB:

Non-Executive Director

Appointed: February 2010

BIRMC

NC

SIRC

CDA

Skills and Experience:

Counts over 43 years of experience in the financial sector, of which over 35 years is with the Central Bank of Sri Lanka, retiring as a Deputy Governor. Has extensive experience in policy making, programme/project implementation particularly in the area of regional development and microfinance, and in negotiation of loans and bilateral trade agreements. She has business experience across different industries, having served as the Government representative on a number of boards.

Holds a MSc from the University of Strathclyde, UK and BA (Hons) from the University of Ceylon, Peradeniya.

Other Current Appointments:

Chairperson of HNB Assurance PLC, HNB General Insurance Limited, Sithma Development (Private) Limited, Ceylon Guardian Investment Trust PLC and Ceylon Investments PLC.

Director of HNB Grameen Finance Limited and Guardian Capital Partners PLC.

Previous Appointments:

Director General Fiscal-Policy and Economic Affairs, Ministry of Finance.

Government Director on the Boards of DFCC Bank, Sri Lanka Institute of Information Technology, Sri Lanka Telecom, Ceylon Electricity Board, De La Rue Currency & Security Print (Pvt) Ltd, Export Development Board, National Housing & Development Authority and Monetary Board Representative on West Coast Power (Pvt) Ltd.

Vice Chairperson, Institute of Bankers of Sri Lanka.

04

ROHAN KARUNARATNE (DR)

HNB:

Independent, Non-Executive Director

Appointed: October 2011

PC

AC

RPTRC

CDA

CC

Skills and Experience:

Consultant Engineer, counts over 30 years of experience in Civil Engineering. Wide business experience gained from leadership roles held in a range of industries.

Holds a PhD in Management and a MBA from the Sussex University (UK). A Civil Engineering Graduate and advanced Diploma holder in HIET (Chennai - India), he is a Fellow of the International Institute of Management (HK) and a Fellow of the Ceylon Institute of Builders.

Other Current Appointments:

President of the Ceylon Institute of Builders (CIOB), Advisory Panel Member of the Ministry of Megapolis & Western Development and Export Development Board.

Chairman of A.K.K Engineers [Pvt] Ltd, Associated Motor Finance Co Ltd, Hybrid Airports [Pvt] Ltd, Master Builders International [Pvt] Ltd, Pinthaliya Holiday Resorts & Spa, Arpico Finance PLC and a Director of Helanko Hotels & Spa [Pvt] Ltd.

Deputy Chairman, International Institute of Management.

Previous Appointments:

Past Chairman of the National Construction Association of Sri Lanka, inaugural Chairman of Human Resources Development [Pvt] Ltd and Advance Construction Training Academy.

05 SUJEEWA MUDALIGE

HNB:

Independent, Non-Executive Director.
Appointed: April 2012

AC	HRRC	SIRC	CDA
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Skills and Experience:

Counts over 25 years of extensive experience in public accounting practice and in industry.

A Fellow of the Institute of Chartered Accountants of Sri Lanka, a Fellow of the Chartered Institute of Management Accountants [UK], a Fellow of the Association of Chartered Certified Accountants [UK] and a Fellow of the Certified Public Accountants [Australia].

Other Current Appointments:

Chairman of the Sri Lanka Accounting Standards Committee.

Previous Appointments:

Past President of the Institute of Chartered Accountants of Sri Lanka [CA – Sri Lanka], Member of the Securities and Exchange Commission of Sri Lanka [SEC] and Chairman of SEC audit committee.

RED – Chairman/Chairperson,
BLACK – Member
AC – Audit Committee
HRRC – HR & Remuneration Committee
NC – Nomination Committee
BIRMC – Integrated Risk Management Committee

Board Member of the Sri Lanka Accounting and Auditing Standards Monitoring Board [SLAASMB] and Deputy Chairman of the Financial Systems Stability Consultative Committee [FSSCC] of the Central Bank of Sri Lanka.

Past President- Confederation of Asian and Pacific Accountants [CAPA].

06 SANJIVANI JAYAWARDENA [MS]

HNB:

Non-Executive Director
Appointed: April 2012

BIRMC	PC	CDA
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Skills and Experience:

Chartered Marketer, Ms Jayawardena has business experience gained from leadership roles held in diverse industries.

Holds a B.A. in Commercial Law, Criminology & Sociology [Monash University, Australia], Professional Certificate in Marketing, Diploma in Marketing and a Professional Postgraduate Diploma in Marketing, is a Certified Auditor [DNV-Norway], and a Member of the Chartered Institute of Marketing [UK] [MCIM].

Other Current Appointments:

Director of Stassen Exports [Pvt] Ltd, Milford Exports [Ceylon] [Pvt] Ltd, Stassen International [Pvt] Ltd, Stassen Natural Foods [Pvt] Ltd, Ceylon Garden Coir [Pvt] Ltd, Milford Developers [Pvt] Ltd, Stassen Foods [Pvt] Ltd, C B D Exports [Pvt] Ltd, Lanka Milk Foods [CWE] Plc., Lanka Dairies [Pvt] Ltd, Ambewela Livestock Company Ltd, Pattipola Livestock Company Ltd, Ambewela Products [Pvt] Ltd and Indo Lanka Exports [Pvt] Ltd.

Previous Appointments:

Has worked as an intern for the Clinton Foundation in 2008.

RPTRC – Related Party Transactions Review Committee
SIRC – Strategy & Investment Review Committee
PC – Procurement Committee
CDA – Committee for Disposal of Assets/Investment Properties
CC – Credit Committee

07 RUSI CAPTAIN

HNB:

Non-Executive Director
Appointed: April 2012

HRRC	NC
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Skills and Experience:

Experience gained in diverse business and leadership roles.

Secondary education at Millfield, U.K. and the University of Miami, Florida

Other Current Appointments:

Director of Polypak Secco Ltd, Paints & General Industries Ltd, Paints & General Industries [Exports] Ltd, Polytex Garments Ltd, CIC Holdings PLC, Propertex Development Ltd, Austin Gloves [Ceylon] Ltd, CEI Plastics Ltd, Ranweli Ltd, Agriland Ltd, Forest Creek Park Ltd, Body Bar [Pvt] Ltd, Horahena Investments Ltd, Palmland Ltd, Parkland Ltd, Cisco Specialty Packaging [Pvt] Ltd and Randiya Farms Ltd.

08

AMAL CABRAAL**HNB:**

Independent, Non-Executive Director
Appointed: April 2014

SIRC	AC	HRRC
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Skills and Experience:

Counts over 30 years of business experience in general management, marketing and sales in Sri Lanka, U.K., India and Bangladesh.

Executive Education Alumnus of INSEAD - France and holds a MBA from the University of Colombo. He is a Chartered Marketer by profession and a Fellow of the Chartered Institute of Marketing - U.K.

Other Current Appointments:

Non-Executive Chairman of Ceylon Beverage Holdings PLC, Lion Brewery (Ceylon) PLC and CIC Feeds Group of companies. Independent Non-Executive Director of John Keells Holdings PLC, Sunshine Holdings PLC & Group Companies, Silvermill Investment Holdings (Pvt) Ltd and a Member of the Supervisory Board of Associated Motorways (Private) Ltd. Member of the Monetary Policy Consultative Committee of the Central Bank of Sri Lanka. Committee Member of the Ceylon Chamber of Commerce and Management Committee of the Mercantile Services Provident Society.

Previous Appointments:

Chairman and CEO of Unilever Sri Lanka.

09

PALITHA PELPOLA**HNB:**

Independent, Non-Executive Director
Appointed: April 2015

NC	RPTRC	CC
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Skills and Experience:

Experience gained in diverse business and leadership roles.

Institute of Cost & Management Accountants Part III.

Other Current Appointments:

Presidential Coordinating Secretary, Ministry of Defense.

Chairman, Ceybank Asset Management Limited.

Previous Appointments:

Has served the Government of Sri Lanka through various appointments including Private Secretary to the President, Private Secretary to the Minister of Mahaweli Development and Lands & Land Development, Special Advisor to the Minister of Plantation Industries, Senior Advisor of the Ministry of Enterprise Development & Investment Promotion. Managing Director of Mahaweli Economic Agency.

Chief Executive Officer of Leader Publications Ltd and Media Consultant of World Health Organization.

Executive Director of Sri Lanka Foundation, Los Angeles, California, USA.

10

DULIKSHA SOOSAIPILLAI**HNB:**

Independent, Non-Executive Director
Appointed: April 2015

BIRMC	SIRC	PC
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Skills and Experience:

Over 30 years' of experience in Financial Services, Risk Management & Compliance.

A Fellow of the Institute of Chartered Accountants of Sri Lanka and a Fellow of the Institute of Certified Management Accountants of Sri Lanka.

Other Current Appointments:

Independent Non-Executive Director of Commercial Credit and Finance PLC and serves in many of the board sub-committees. Independent Non-Executive Director of Udupussellawa Plantations PLC and Hapugastenne Plantations PLC and serves on many of the Board Sub-committees.

Previous Appointments:

Was engaged by the World Bank as a Short Term Consultant on a Payables Assessment assignment in the Maldives as part of a wider Public Finance Management Project in 2012.

Managing Director of the Maldives Finance Leasing Company Pvt Ltd for more than 7 years and the Chief Executive Officer of Ceylease Financial Services Ltd - a subsidiary of the Bank of Ceylon.

Chief Operating Officer of Dunamis Capital PLC, the holding Company of the First Capital Group of Companies and the Kelsey Group of Companies.

11

A N DE SILVA**HNB:**

Independent, Non-Executive Director
Appointed: April 2015

CC	AC	RPTRC
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Skills and Experience:

Over 40 years of experience in commercial banking and Bank Management.

Was elected an Associate of the Chartered Institute of Bankers, London, UK, in December 1978, on successful completion of its professional examinations.

Has been exposed to extensive training attachments in Banking and Management both locally and overseas with Dresdner Bank AG, Germany, National Institute of Bank Management, Pune, India, Centre for Financial Engineering in Development, Washington DC, USA, Mt Eliza Campus-Monash University, Melbourne, Australia.

Team Member of HNB's User Group Heads who evaluated IT Systems in the UK and India.

Participated in a study tour of the South African Banking System organised by the Institute of Bankers, South Africa.

Played a key role in HNB's acquisitions of Indosuez Bank and Habib Bank AG Zurich.

Other Current Appointments:

Independent Non-Executive Director, Malwatte Valley Plantation PLC and Holco (Ceylon) [Private] Ltd.

Previous Appointments :

Former Acting Chief Executive Officer and Chief Operating Officer, Union Bank of Colombo PLC, former Director, Lanka Clear Limited and former Alternate Director, Credit Information Bureau of Sri Lanka (CRIB).

Former Deputy General Manager (Corporate Banking), Hatton National Bank PLC.

12**DINESH WEERAKKODY****HNB:**

Non-Executive Director
Appointed: June 2017

Skills and Experience:

A former Chairman of Commercial Bank of Ceylon PLC, Employees' Trust Fund Board of Sri Lanka and a Director of DFCC Bank.

Holds a MBA (University of Leicester, UK) and is a Fellow of the Chartered Institute of Management Accountants (UK) and of the Certified Management Accountants (Sri Lanka). Also holds a BTEC (UK) Certificate in Information Technology, an Advanced Diploma in Business Administration (ABE UK) and is a Professional Member of the Singapore Human Resource Institute. He was conferred an honorary membership by the Institute of Personnel Management of Sri Lanka for his contribution to HR.

Other Current Appointments:

Chairman of the National Human Resource Development Council of Sri Lanka, International Chamber of Commerce of Sri Lanka and Cornucopia Sri Lanka. Holds several honorary advisory roles in the current government.

RED - Chairman/Chairperson,
BLACK - Member
AC - Audit Committee
HRRC - HR & Remuneration Committee
NC - Nomination Committee
BIRMC - Integrated Risk Management Committee

Currently serves in a number of private sector and MNC boards and sub-committees in several of those companies.

A Council Member of the Employers Federation of Ceylon and Institute of Directors of Sri Lanka. He is also a member of the CIMA Asia Pacific Industry Advisory Body.

13**THUSHARI RANAWEERA (MRS)****HNB:**

Company Secretary,
Appointed: January 2012

Skills and Experience:

She is an Attorney-at-Law and counts over 26 years of experience in Banking.

Ms Ranaweera holds a Master's Degree in Law (LLM) - University of Cambridge, U.K. and a Diploma in International Affairs - Bandaranaike Centre for International Studies, Sri Lanka.

Other Current Appointments:

Deputy General Manager - Legal of HNB.

RPTRC - Related Party Transactions Review Committee
SIRC - Strategy & Investment Review Committee
PC - Procurement Committee
CDA - Committee for Disposal of Assets/Investment Properties
CC - Credit Committee



JONATHAN ALLES
M.B.A. – Finance (Stirling), A.I.B (Sri Lanka)
Managing Director/ Chief Executive Officer



DILSHAN RODRIGO
M.B.A. (Cranfield), F.C.M.A.(UK), F.C.C.A. (UK)
Chief Operating Officer



RUVINI THENABADU
F.C.I.B. (London), F.C.M.A. (UK), C.G.M.A. (UK)
Deputy General Manager – Credit & Transaction
Banking



THUSHARI RANAWEERA
Attorney at Law, LL.M. (Cambridge),
Dip. in Int'l Affairs (BCIS)
Deputy General Manager – Legal/
Company Secretary



RUWAN MANATUNGA
F.C.M.A. (UK), C.G.M.A. (UK), A.C.A. (Sri Lanka)
Deputy General Manager – Corporate Banking



CHIRANTHI COORAY
M.B.A. (Wales), S.C.P. SHRM (USA), I.P.M.A. – CP (USA)
Deputy General Manager – HR /
Chief Human Resource Officer



SIDATH WIJERATNE
M.B.A. (Sri J), B.Sc. (IT) – UK
Chief Digital Officer



JUDE FERNANDO
M.B.A. (Sri J), A.I.B. (Sri Lanka)
Deputy General Manager (SME & Midmarket)



NIROSHANA SENEVIRATNE
F.C.A. (Sri Lanka), F.I.B. (Sri Lanka), C.P.A. (Sri Lanka),
C.I.S.A (USA)
Chief Internal Auditor/ Deputy General Manager –
Internal Audit



KALUM WIJESOORIYA

LL.B [Sri Lanka]
Assistant General Manager - Deposits & Remittances / Chief Employee Experience Officer



ASANGA UDUWELA

M.B.A. [Sri J], B. Sc. Special [Pera]
Assistant General Manager – Operations



DAMITH PALLEWATTE

M.B.A. [PIM-USJ], B.Sc. Mgmt. [Hons.] London School of Economics, F.R.M. [GARP], A.C.I
Chief Risk Officer/Assistant General Manager – Risk / Chief Information Security Officer



ARJUNA ABEYGUNASEKARA

M.B.A. [Colombo], B.Sc. [Colombo], A.C.M.A. [UK], C.G.M.A. A.C.I
Assistant General Manager – Treasury & Markets



ANUSHA GALLAGE

M.B.A. [Sri J], B.B.A.[Special] – Colombo, A.C.M.A [UK], C.G.M.A., C.P.A. [Australia], Dip. in Commerce [Uni of PNG], I.C.A. – Licentiate
Chief Financial Officer



NIROSH PERERA

M.B.A. [Manipal], Dip. in Marketing – L.B.S [Sri Lanka]
Assistant General Manager- Network Management



RAJIVE DISSANAYAKE

B.B.A. [Colombo], C.F.A. [USA], F.C.M.A. [UK], C.G.M.A. [UK]
Assistant General Manager- Strategy / Chief Strategy Officer



JANATH ILANGANTILEKE

M.B.A. [Manipal], B.A. [Hons] – Northumbria[UK], A.I.B. [Sri Lanka], A.C.M.A. [UK], C.G.M.A. [UK], C.P.A. [Australia]
Assistant General Manager - Trade & Financial Institutions

SENIOR MANAGEMENT



NIROSHINI WETTASINHA

Attorney-at-Law & Notary Public
Head of Legal



KRISHANI BALASUBRAMANIAM

LL.B (Sri Lanka)
Head of Human Resource Management



MANGALA WICKRAMASINGHE

M.B.A. - IT (Moratuwa), M.Sc. - Comp. Sc (Colombo),
B.Sc. (Pera.)
Head of Electronic Delivery Channels



CHANDANA PANDITHARATNE

Head of Services



AYANTHI FERNANDO

Chief Manager - Corporate Banking



CHAMMIKA WEERASINGHE

M.B.A. (Sri J), M.C.I.M. (UK)
Head of Marketing



HISHAM ALLY

M.I.M. (Sri Lanka)
Head of Islamic Banking



VIRAJ MENDIS

Head of Personal Financial Services



PRASAD BASTIANZ

M.B.C.S. (UK), C.I.T.P.
Chief Manager - Payment Systems



DAMMIKE DISSANAYAKE

Chief Manager - Senior Regional Head
-Colombo Region 1



RUWAN BAKMEDENIYA
M.Sc. (IT), Uni.of Keele - UK
Head of Information Technology



INDRAJITH SENADHIRA
M.B.A. (Sri J), M.A.L.S. (Colombo), LL.B (Sri Lanka),
Attorney-at-Law, Dip in Marketing (S.L.I.D.A.),
Dip in Cr. Mgmt. (S.L.I.C.M.)
Head of Talent Management



SISIRA ATAPATTU
Chief Manager - City Office



NISHANTHA WEERASINGHE
Chief Manager - Head Office Branch



GUHADASS THIVAKARAN
Head of Recoveries



MOHINI SENEVIRATNE
B.A. (Hons.) - Uni. of Sussex (UK)
Head of Compliance/Compliance Officer



UPUL HETTIARACHCHI
M.B.A. (Manipal), N.D.H.R.M. (I.P.M.)
Chief Manager - Senior Regional Head
- South Western Region 1



VINODH FERNANDO
Chief Manager - Senior Regional Head
- North Western Region 1



MAJELLA RODRIGO
A.C.M.A(UK), M.B.A(Colombo), B.Sc. (Colombo)
Head of Project Finance



JAGATH RUPASINGHE
Senior Manager - Systems Implementation

Senior Management



FAZAL MOHAMED

M.Sc. [IT], [Uni. of Keele] - UK
Senior Manager - Systems Security & Compliance



NEIL RASIAH

M.B.A. - Finance [Australia], M.A. - Fin. Econ. [Colombo]
B.Sc. [Colombo] A.I.B. [Sri Lanka], Dip. in Int. Trade [IBSL]
Senior Regional Head - Greater Colombo Region 1



CANDIAH JEGARAJAH

A.I.B. [Sri Lanka], C.I.M.A. Adv. Dip. M.A.
Senior Regional Head - Eastern Region



THUSITHA EDIRIWEERA

M.B.A. [UK], LL.B [Sri Lanka], Attorney-at-Law, Notary Public & Commissioner for Oaths, M.C.I.C.M. [UK], F.I.C.M. [Sri Lanka], M.I.M.S.L.
Senior Manager - Legal [Recoveries]



MURTAZA NORMANBHOJ

A.C.A. [Sri Lanka], A.C.M.A. [Sri Lanka]
Senior Manager - Internal Audit



MANORI MOHOTTI

Attorney-at-Law, Notary Public & Commissioner for Oaths.
Senior Manager - Legal



SAUMYA ARJASINHA

Regional Head - Colombo Region 2



SIVARAJAH NANDAKUMAR

M.B.A. [Sri J], A.I.B. [Sri Lanka]
Senior Manager - Operations



KAILAVASAN INDRAVASAN

M.B.A. - Finance [Australia], C.M.A. [Australia], A.I.B. [Sri Lanka]
Senior Manager - Mid Market



SUBRAM PARAMESHWARAN

M.B.C.S. [UK]
Senior Manager - IT Operations



KUSHAN JAYASURIYA

M.B.A. (Colombo), B.Sc. (Colombo), A.C.M.A. (UK)
Senior Manager - Market Risk & Special Projects



SUPUN DIAS

Dip in Marketing (U.K.), M.C.I.M. (UK), M.S.L.I.M,
Chartered Marketer
Head of Business Development



AJITH FERDINANDO

Senior Manager - Centralized Operations



INDRAJITH HAPUARACHCHIE

M.B.A. (Manipal), B.I.T. (Colombo), A.C.S.
Senior Manager - Digital Strategy & Solutioning



NELUKA FERNANDO

Senior Manager - CTP



SHIRAL PERERA

M.B.A. (Anglia Ruskin UK)
Regional Head - North Western Region 2



SHERAN PERERA

M.B.A. (UK), A.I.B. (Sri Lanka)
Senior Regional Head - Uva Sabaragamuwa
Region 1



PRIYANTHA SENEVIRATNE

A.C.I.
Senior Manager - Treasury (Corporate Sales)



KANCHANA KARUNAGAMA

M.B.A. (Sri J), A.I.B. (SL), M.C.I.M. (UK), A.I.C.M. (SL)
Senior Manager - Personal Financial Services



RAJITH GUNASEKERA

Senior Manager - System Support

Senior Management



VISHWANATH GUNAWARDENA
Senior Manager - Development Banking



VIJAYA VIDYASAGARA
M.B.A. - Finance (Colombo), A.I.B (Sri Lanka)
Senior Corporate Relationship Manager



SAMPATH KUKULEWITHANA
M.B.A. (Manipal), Dip in Marketing (UK)
Senior Regional Head - Southern Region 1



DILUNIKA JAYASINGHE
M.B.A. (USQ), A.C.A, B.Sc. (Colombo)
Senior Manager - Credit Risk Management



PRIYANKA WIJAYARATNE
M.B.A. (Sri J), A.C.M.A. (UK), B.Sc. (Colombo)
Senior Manager - Strategic Planning



THANGARAJAH THAYALAN
M.B.A. (Australia), A.I.B. (Sri Lanka), M.A.B.E.
Senior Manager - Foreign Exchange & Money Markets



NEVILLE JAYAWARDENA
A.I.B. (Sri Lanka)
Regional Head - Greater Colombo Region 2



V T SAMPANTNER
Senior Regional Head - Central Region 1



ROSHAN FERNANDO
M.B.A. (Col), B.Sc. Eng (Hons) (Moratuwa), M.I.E.T. (UK)
Chief Operating Officer - Sithma Development (Pvt) Ltd / Senior Manager - Facilities Management



PATHMANATHAN SRIKANTH
M.B.A. (Cardiff -UK), A.I.B. (Sri Lanka)
Senior Manager - Financial Institutions



W D B UDUKUMBURA

N.Dip. Technology [Harty TTI], P.G. Dip Management [Rajarata]
Senior Regional Head - North Central Region 1



ANURADHI DELAGE

A.C.A. [Sri Lanka], A.C.M.A [UK], B.Sc. Accountancy [Sri J]
Senior Manager - Finance



ROSHANTHA JAYATUNGE

A.I.B. [Sri Lanka]
Head of Cards



SOTHIRATNAM MATHANAN

M.B.A. [Australia], F.A.B.E. [UK]
Senior Manager - Pettah



SOMASKANDASARMA NARENTHIRAN

M.B.A. [UK]
Senior Manager - Wellawatte



RAJEEV RAJARATNAM

Senior Manager - Systems Implementation



RUKSHAN SENARATNE

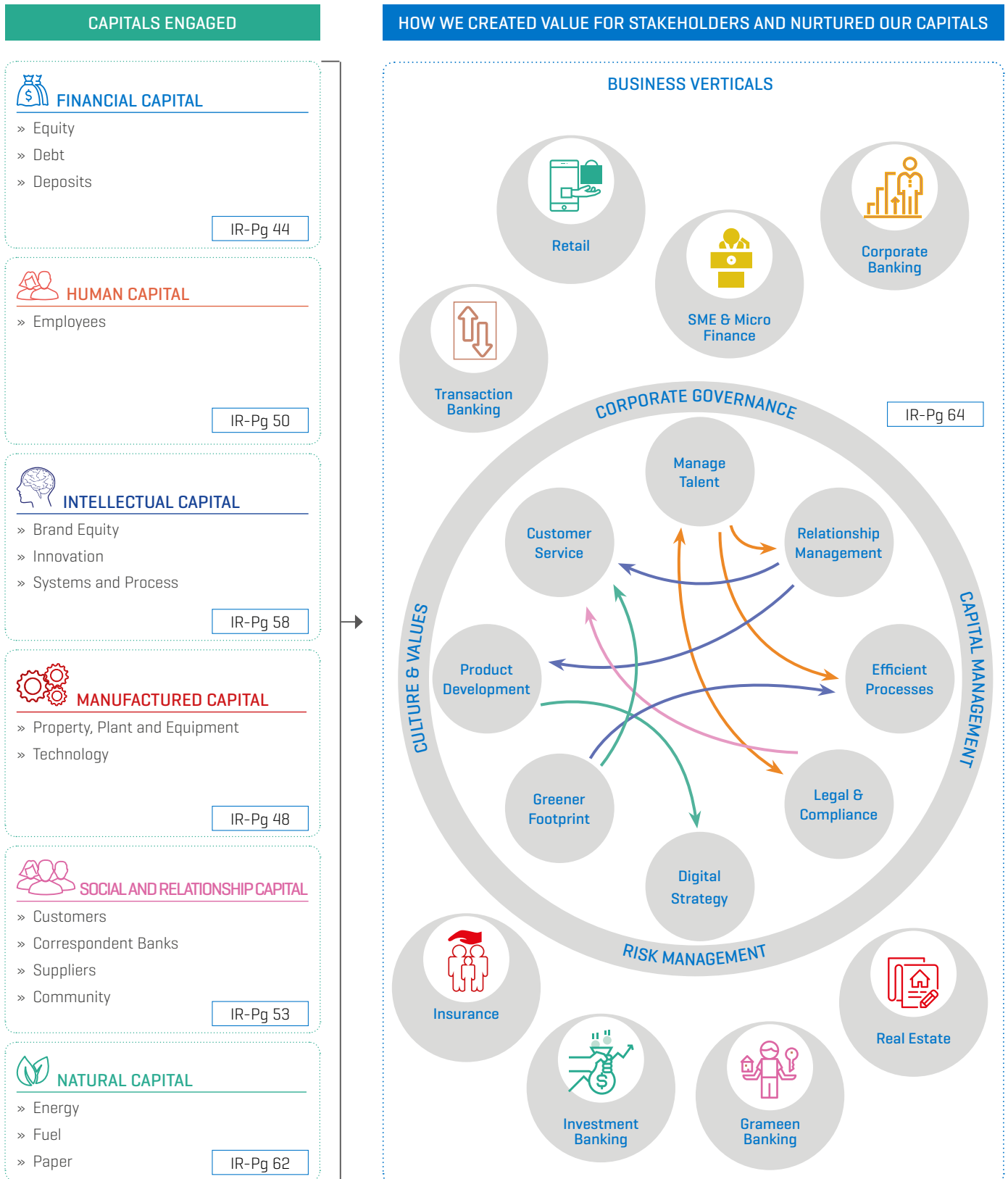
Senior Manager - Centralized Credit Operations



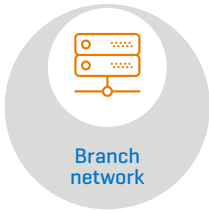
EOMAL MUNASINHA

M.B.A. Uni. of Ecowan [Australia]
Head of Talent Development

We use our capitals to create value for stakeholders, carefully balancing their concerns. Our core expertise and processes support our role as custodians of wealth, providers of capital and facilitators of transactions for our customers.



CHANNELS



Branch network



ATMs



Mobile Banking



On-line Banking

VALUE CREATED FOR KEY STAKEHOLDERS

SHAREHOLDERS

- » PAT Rs 16.5 Bn
- » Rs 8.50 Dividend per share
- » Share price increased by 10.7% against the ASPI movement of 2.3%

IR-Pg 44

PROVIDERS OF DEBT CAPITAL

- » Interest Paid Rs 9.0 Bn

IR-Pg 44

CUSTOMERS

Ref. Social and Relationship Capital, Manufactured Capital and Intellectual Capital Report

- » Interest Paid Rs 47.5 Bn
- » Loans Disbursed Rs 785 Bn
- » Increased access points by adding over 100 Cash Deposit Machines
- » Launch of innovative products

IR-Pg 53

BUSINESS PARTNERS

Ref. Social and Relationship Capital Report

- » Payments to Suppliers Rs 8.8 Bn

IR-Pg 53

EMPLOYEES

Ref. Human Capital Report

- » Remuneration and Rewards of Rs 8.9 Bn
- » Diverse and inclusive work culture
- » Dignity of labour
- » Equal opportunity
- » Freedom of association
- » Family friendly work culture

IR-Pg 50

REGULATORS/GOVERNMENT

Ref. Social and Relationship Capital Report

- » Rs 10.6 Bn in taxes

IR-Pg 53

OTHER IMPACTS



ECONOMIC

- » Financial capital in IR page 44
- » Manufactured capital in IR page 48

SOCIAL

- » Social and relationship in IR page 53
- » Intellectual capital in IR page 58
- » Human capital in IR page 50

ENVIRONMENT

- » Natural capital in IR page 62



ENGAGING STAKEHOLDERS

Robust stakeholder engagement processes have been key to our growth as we recognise that stakeholder concerns provide guidance to our next strategic goal. It is a key input to our strategic planning process as it enables evaluation of our strengths and weaknesses in a systematic manner using feedback from our key stakeholders. The schematic below summarises our engagement mechanisms and stakeholder concerns identified through the same.

Engagement Mechanisms	STAKEHOLDERS							
	Investors	Customers	Employees	Business Partners			Regulator	Community
				Correspondent Banks	Merchants	Suppliers		
Annual Meeting	✓		✓		✓	✓		
Dedicated Channel	✓	✓	✓	✓	✓	✓	✓	✓
Press Releases	✓	✓	✓	✓	✓	✓	✓	✓
Website/Intranet	✓	✓	✓	✓	✓	✓	✓	✓
Written Communications	✓	✓	✓	✓	✓	✓	✓	✓
Structured Group Meetings	✓		✓		✓	✓	✓	
One on One Meetings	✓	✓	✓	✓	✓	✓	✓	✓
Surveys		✓	✓					✓
Social Media		✓	✓					✓

All stakeholders have at least one dedicated grievance handling channel ensuring that concerns are recorded and resolved enabling us to monitor dissatisfaction in delivery of value to stakeholders and address same on a case-by-case basis or through wider systemic initiatives where a holistic response is warranted. Value delivered to stakeholders is highlighted throughout the report reflecting our response to identified concerns.

POINT OF CONTACT

STAKEHOLDER CONCERNS

OUR RESPONSE

POINT OF CONTACT	STAKEHOLDER CONCERNS	OUR RESPONSE
Investors		
» MD/CEO	» Financial performance, sustainable growth, improving shareholder returns	IR Pg 44
» Chief Strategy Officer	» Ethics, corporate governance and regulatory compliance	CG&RR
» Company Secretary	» Responsible lending	IR Pg 64-80
	» Risk Management	CG&RR
	» Innovation	IR Pg 59
Customers		
» Customer Experience Officer	» Product and Service offering	IR Pg 53
» Contact Centre	» Security and privacy	
» Customer Experience Unit	» Accessibility	
	» Convenience	
	» Financial inclusion	Sustainability Supplement
	» Investment returns and cost of borrowing	
Employees		
» Chief Human Resource Officer	» Employee value proposition	IR Pg 50
» Chief Employee Experience Officer	» Remuneration, rewards and recognition	
» Head of HR Management	» Employee motivation	
» Head of Talent Development	» Training and development	
» Human Resource Management Committee	» Occupational health, safety and well being	
» Talent Mobility Appeals Committee	» Employee brand equity	
» Whistle Blowing Mechanisms	» HR best practices	
» Grievance Handling Mechanisms	» Fairplay and equal opportunity	
» HR Roadshows		
» HR Service Days		
Business Partners		
Financial Institution Division	» Ethics, corporate governance and regulatory compliance	CG&RR
» Head of Financial Institution	» Risk management	
Card Centre	» Formal system for handling appeals and other grievances	CG&RR
» Head of Cards		
Banking Services Division	» Preference for Local, SME and Micro.	Sustainability Supplement
» Chief Manager Procurement and Logistics		
Regulator		
» Head of Compliance	» Ethics, corporate governance, regulatory and compliance	CG&RR
	» Responsible lending	IR Pg 64 -80
Community		
» HNB Sustainability Foundation, Chief Human Resource Officer	» Financial inclusion and awareness	IR Pg 53 & 68
	» Responsible lending	IR Pg 64 -80
	» Energy efficiency and carbon footprint	IR Pg 62
	» Ethical behaviour	Sustainability Supplement
	» Employment generation	IR Pg 50

The processes used for stakeholders' engagement are similar to previous years and as such we have reported the process details in brief in this report. Information on stakeholders requirements raised during the year and our responses and achievements, new procedures introduced as relevant, are reported in detail in the respective stakeholder sections of the sustainability report as well as in the integrated report of the bank as appropriate.

DETERMINING MATERIALITY

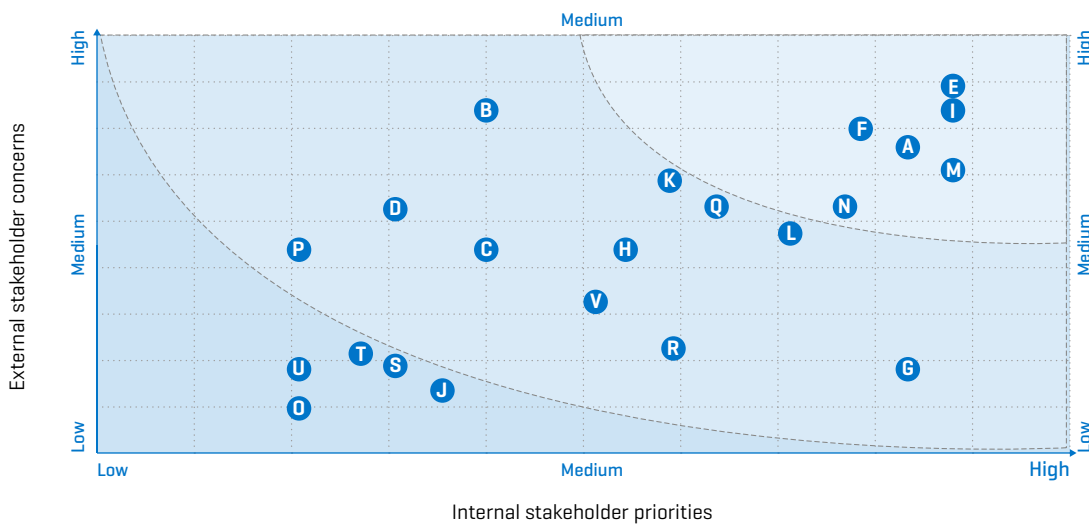
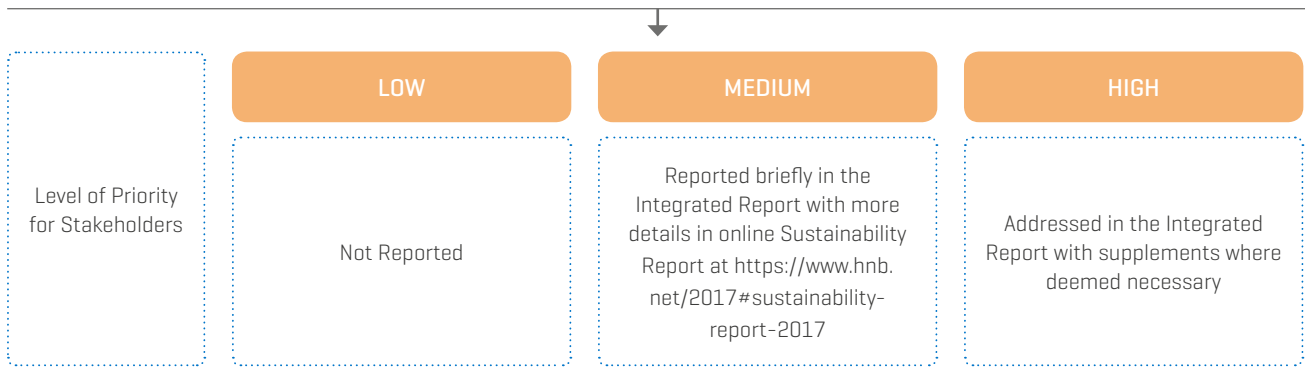
Material issues are factors that can impact our ability to create value across the entire value chain impacting the Bank and/or our stakeholders. Prioritising these issues by the frequency and potential impact of these factors enables us to determine those that require reliable processes to measure, monitor and manage. We continue to refine the processes of determining material topics using the key areas of concern identified from the stakeholder engagement process and potential impacts on our strategic goals. The

five part materiality test that was developed with the assistance of an external consultant to assess and prioritise stakeholder concerns was reviewed in 2017 and same is summarised alongside. These priorities were mapped on to the following grid to determine resource allocation for measuring, monitoring and managing them. It also serves to determine the level of reporting required for these priorities as given below.

FIVE PART MATERIALITY TEST TO PRIORITISE STAKEHOLDER CONCERNS

- Direct financial impact
- Policy related performance
- Organisational peer based norms
- Stakeholder behaviour and norms
- Societal norms

PRIORITISATION OF STAKEHOLDER CONCERNS FROM 5 PART MATERIALITY TEST



- | | |
|--|---|
| <ul style="list-style-type: none"> A Brand Management/Reputation B Climate Change C Community Development D Conservation/Protection of Environment and Habitats E Customer Satisfaction F Direct Economic Value Generated and Distributed [Financial and economic performance] G Employee Training & Development H Energy efficiency and carbon foot print I Ethics, corporate governance and regulatory compliance J Global Economy K Innovation in Process and Products | <ul style="list-style-type: none"> L Opportunities for financial inclusion and capacity building M Responsible lending N Risk Management O Supplier and supply chain management P Supplier human right assessment Q Talent Attraction/Retention R Thought Leadership in Sustainable Finance S Waste management T Water U Usage of recycle material V Anti-corruption |
|--|---|

GRI Standards Reported Under Material Aspects

Fully reported	GRI
Financial & Economic performance	201-1, 201-2, 201-3, 203-1
Financial inclusion	Not covered in GRI
Customer experience	102-43, 102-44, 417-2, 417-3
Brand Management and Reputation	102-2, 417-3, 206-1, 413-1
Ethics, corporate governance and regulatory compliance	102-27, 102-29
Responsible lending	Not covered in GRI
Employee motivation and training and development	404-2, 404-3
Innovation in process and products	Not covered in GRI
Risk management	418-1, 102-15, 102-29, 102-30, 102-31
Partly Reported	GRI
Opportunities for financial inclusion and capacity building	203-2
Employment generation	102-8, 401-1
Supplier and supply chain management	102-9, 204-1
Occupational health, safety and well being	403-1
Energy efficiency and carbon footprint	302-1, 302-3, 302-4

References to GRI Standards

GRI Standards	Reference
201-1, 201-2, 201-3, 203-2, 206-1	This material references GRI 200; Economic 2016
302-1, 302-3, 302-4	This material references GRI 300; Environmental 2016
401-1, 403-1, 404-3, 417-2, 417-3, 418-1	This material references GRI 400; Social 2016

OUR STRATEGY

Our strategic plan is prepared considering our value creation model, inputs from our stakeholder engagement process, risk management process and a thorough evaluation of our macro environment including political, economic, social, technological, legal and environmental factors.

VISION TO BE THE ACKNOWLEDGED LEADER AND CHOSEN PARTNER IN PROVIDING FINANCIAL SOLUTIONS THROUGH INSPIRED PEOPLE

OUR FORMULA



WORKING TOGETHER TO DRIVE MEANINGFUL TRANSFORMATION

KEY STRATEGIC PRIORITIES	Customer Experience and Branding	Digital Banking	New Products and Services	New Business Opportunities		
FOCUS AREAS	<ul style="list-style-type: none"> » Improve customer experience » Enhance customer support 	<ul style="list-style-type: none"> » Onboarding customers to digital platforms » Digital transformation within Bank » Launch of digital products 	<ul style="list-style-type: none"> » Introduce new products that serve customer needs 	<ul style="list-style-type: none"> » Target client acquisition » Develop a strong sales culture » Partner in landmark projects 		
MEASURING SUCCESS	<ul style="list-style-type: none"> » Improved Net Promoter score » Reduced customer complaints » Improved brand equity 	<ul style="list-style-type: none"> » Increased volumes and values of online transactions 	<ul style="list-style-type: none"> » No. of products launched 	<ul style="list-style-type: none"> » Advances growth » Deposit growth » Trade growth 		
SIGNPOSTS	Social Capital IR-Pg 53	Manufactured Capital IR-Pg 48	Intellectual Capital IR-Pg 58	Business reviews IR-Pg 64-80		



	Operational Risk Management	Operational Excellence	Talent Management	Funding and Investments	Asset Quality
	<ul style="list-style-type: none"> » Ensure compliance » Minimise operational risk 	<ul style="list-style-type: none"> » Implement lean initiatives » Focus on cost optimisation 	<ul style="list-style-type: none"> » Build a strong talent pipeline » Develop our people » Enhance employee value proposition » Culture transformation 	<ul style="list-style-type: none"> » Grow CASA » Optimise capital adequacy » Optimise return from investments 	<ul style="list-style-type: none"> » Strong relationship management » Improve underwriting standards » Focus on collection
	<ul style="list-style-type: none"> » Reduced compliance incidents » Declining operational risk events 	<ul style="list-style-type: none"> » Declining cost income ratio » Reduced processing times 	<ul style="list-style-type: none"> » Improved employee engagement scores » Enhanced employee productivity » High retention rate » Succession planning » Diversity and inclusion 	<ul style="list-style-type: none"> » Improved CASA ratio » Capital adequacy ratios above statutory minimum levels » Improved loan to deposit ratio » Improved liquidity » Higher returns 	<ul style="list-style-type: none"> » NPA ratio below industry average » Stable provision cover ratio
	Risk Management IR-Pg 109	Financial Capital/ Intellectual Capital IR-Pg 44 & 58	Human Capital IR-Pg 50	Financial Capital IR-Pg 44	Financial Capital IR-Pg 44

THE SPEED READ

ESTIMATED GLOBAL GDP

3.9%
in 2018

The Federal Reserve increased policy interest rates three times during the year

The Bank of England also raised policy rates for the first time in 10 years

The European Central Bank commenced tapering of the net assets purchasing programme but intends to maintain interest rates

SYNCHRONISED GROWTH

Global economic growth is estimated to have picked up by 0.5% over 2016 to 3.7%. World trade picked up in the third quarter, supported by the increased investment in advanced economies. Purchasing manager indices and consumer confidence movements are consistent indicating improved demand for the fourth quarter. Improving global demand and supply factors including an OPEC agreement to limit production, supported increased crude oil prices which rose to over USD 60 a barrel from around USD 54 at the beginning of the year. This in turn impacted headline inflation although core and wage inflation in advanced economies remained weak.

The Federal Reserve increased policy interest rates three times during the year from 0.75% to 1.5% as economic growth maintained a steady pace of just over 3%. The Bank of England also raised policy rates for the first time in 10 years from 0.25% to 0.5% based on low unemployment, rising inflation and stronger global growth. Both institutions are expected to announce further increases in the future as priority changes from driving growth to managing inflation. The European Central Bank commenced tapering of the net assets purchasing programme but intends to maintain interest rates at current historically low levels for the duration of the quantitative easing programme which may be extended. Despite rising interest rates in developed economies, capital inflows to emerging economies remained resilient supporting broad based growth.

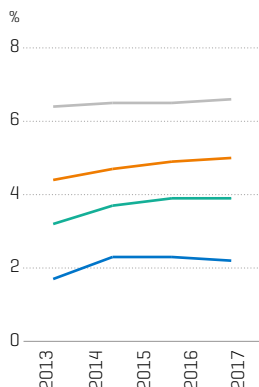
Global growth is expected to pick up pace to 3.9% in 2018 and 2019 with advanced economies growth exceeding 2% while Emerging & Developing Asia is expected to maintain its growth rate of 6.5%. Downside risks to the forecast include adoption of inward looking policies and escalation of geopolitical tensions.

SRI LANKAN ECONOMY

GDP growth moderated to 3.7% yoy during the first nine months of 2017 as economic growth was impacted by droughts and floods which affected agriculture and agriculture based industries. Consequently, the agriculture sector declined by 3.2% YOY during the nine month period following a decline of 4.2% in 2016. The Industry sector recorded a moderated growth rate of 4.5% YOY till September 2017 in comparison to 6.5% in 2016 due to under performance of the Food, Beverages and Tobacco subsector despite increased activity in construction and manufacturing sectors. The services sector maintained its growth rate of 4.2% in 2016 through the first nine months of 2017 supported by financial services and telecommunication subsectors which recorded growth rates of 17.1% and 11.6% respectively.

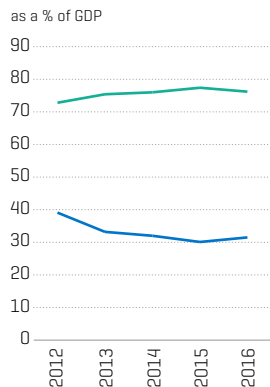
Relatively tight monetary and fiscal policies designed to enhance macroeconomic stability contributed in some part to a decline in private and public sector spending further moderating economic growth. Food supply issues stemming from the drought, increased indirect taxes and increased prices of imports combined to increase headline inflation from 4.2% to 7.3%. Encouragingly, trade flows increased due to strengthening global demand coupled with a competitive exchange rate recording 10.2% growth in exports. Expenditure on imports grew by 9.4% during the year due to increased expenditure of fuel, rice and gold imports resulting in a widening of the country's trade deficit. Despite declining by 1.1% during the year, inward remittances in 2017 amounted to USD 7,164 Mn which along with earnings from tourism growing by 3.2% to USD 3,631 Mn contributed to mitigating the impact from a widened trade deficit on the current account balance. Policy interest rates moved up by 25 basis points as CBSL focused on controlling inflation while AWDR and AWLR increased by 90 bps and 68 bps during the year in response. Nevertheless, interest rates on government securities decreased with

GROWTH RATES FOR KEY ECONOMIC REGIONS



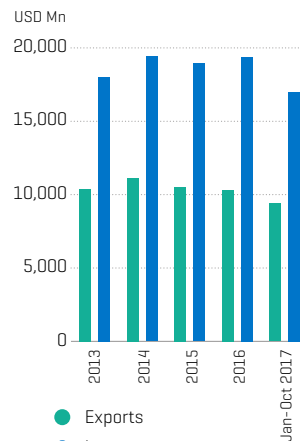
- World
- Advanced Economies
- Emerging Markets & Developing Economies
- Developing & Emerging Asia

UTILISATION OF RESOURCES



- Consumption
- Investment

IMPORTS AND EXPORTS



- Exports
- Imports

one year treasury bill rate declining by 127 bps during the year with treasury bond rates dropping even sharply.

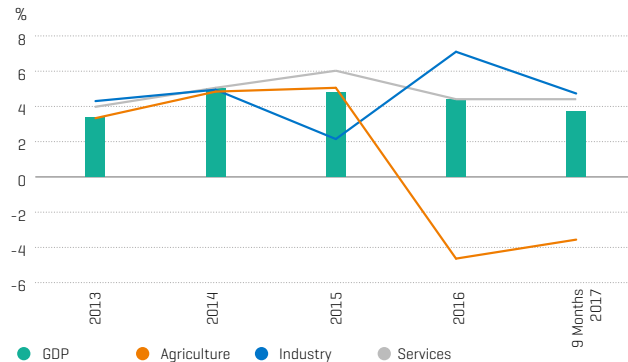
BANKING SECTOR

The Banking sector grew at 13.8% in 2017 as measured by a growth of total assets to Rs 10.3 Tn maintaining the pace of growth from 2016. Loans and advances were the main contributor to growth as portfolios grew by 16.2% to Rs 6.3 Tn accounting for 61.4% of Total Assets of the sector. Growth in consumption loans such as pawning and credit cards moderated during the year while housing loans and project loans witnessed relatively strong growth together with lending to GOSL and State Owned Enterprises. Non-Performing loans increased during the year to Rs 160.7 Bn while the Gross NPA ratio declined marginally to 2.5% from 2.6% recorded in 2016, despite climate change and inflation exerting pressure on cashflows of borrowers. Investments in the Banking sector increased by 12.5% during the year to Rs 2.5 Tn with over 90% invested in government securities.

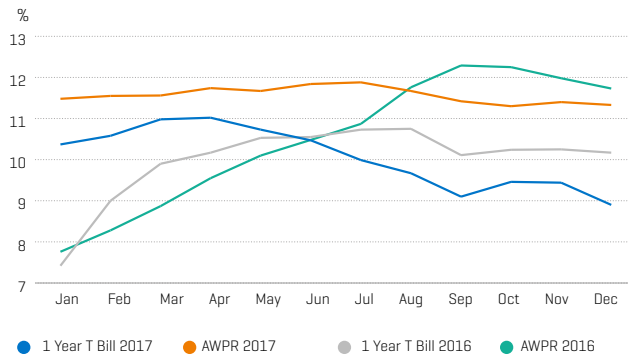
Deposit growth was 17.5% for 2017 with total deposits increasing to Rs 7.4 Tn as at end of the year. The CASA ratio decreased during the year as high interest rates attracted customers to term deposits. Borrowing declined marginally during the year as loan growth slowed down and the industry strategised to improve capital adequacy through equity infusion in line with regulatory requirements. Liquidity improved to healthy levels with over 80% of liquid assets represented by investments in government securities.

Profitability of the Banking sector improved due to strong margins, increased fee based income and curtailing operational expenses despite pressure from increased impairment charges necessitated by rising non-performing advances.

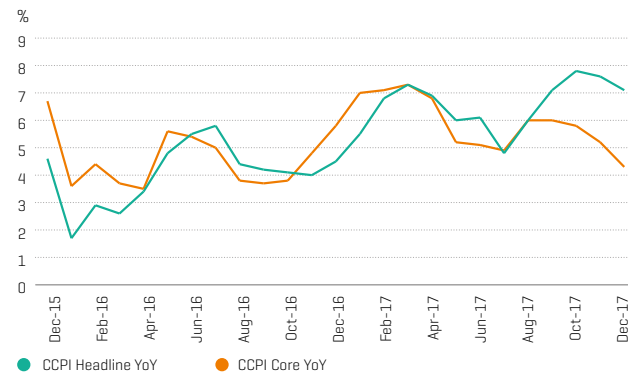
SRI LANKA GDP GROWTH



INTEREST RATES



INFLATION



THE SPEED READ

SL GDP

3.7%
9 months 2017

- Services sector maintained its growth rate of 4.2%

- Financial services and telecommunication subsectors recorded growth rates of 17.1% and 11.6%

- 10.2% growth in exports

- Policy interest rates moved up by 25 basis points

- LKR depreciation 2.3% against USD

MANAGING OUR CAPITALS & IMPACTS

FINANCIAL CAPITAL

DELIVERING A PROFIT OF RS 16.5 BN, HNB RANKS AMONG THE MOST PROFITABLE FINANCIAL CONGLOMERATES IN THE COUNTRY WITH A COST TO INCOME RATIO OF 39.4% WHICH IS THE LOWEST IN THE BANKING SECTOR. WE ALSO STRENGTHENED OUR BALANCE SHEET IN READINESS FOR BASEL III REQUIREMENTS IMPROVING TOTAL CAPITAL ADEQUACY FROM 15.3% IN 2016 TO 17.0% IN 2017, DELIVERING A BALANCED PERFORMANCE IN A CHALLENGING YEAR.








Pursuing a consolidation strategy after two years of fast paced growth, we focused on optimising resource allocations, carefully balancing risk and reward. It proved an appropriate response to moderating economic growth, rising inflation and interest rates and a period of tightening fiscal and monetary policy as evidenced by the results. Consequently, total asset growth moderated to 11.2% in 2017 compared to 18.4% in 2016 as we rebalanced portfolios to compete effectively in lucrative business segments, reflected by Net Interest Income growth of 15.4%.

The financial review reflects the contribution of the Bank to the Group as it accounts for 94.8% of total assets and 98.4% of profit for the year.

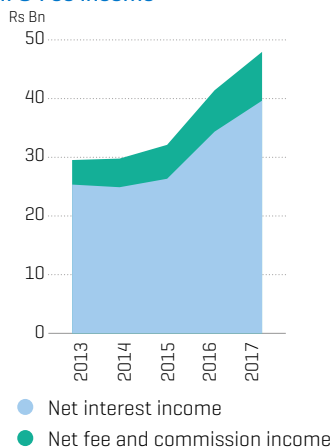
INCOME STATEMENT ANALYSIS

Net Interest Income (NII)

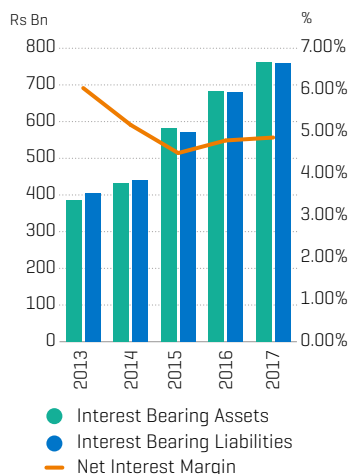
Focused growth in profitable business segments together with a relatively high CASA ratio of 35.5% enabled NII growth of 15.4% in 2017 from banking operations of the Group. CASA growth of Rs 23.4 Bn during the year was a key achievement, given the industry-wide decline in CASA, as high interest rates attracted funds into term deposits. Timely repricing of assets also supported NII growth as approximately 70% of the Bank's loan book matures or reprices within one year. Net Interest Margin (NIM) increased marginally from 4.8% in 2016 to 4.87% in 2017 and remains well above industry norms due to high levels of CASA and efficient funding strategies. Retail Banking, SME and Microfinance were key contributors to Bank NII accounting for nearly 62.4% of the same. Banking operations accounted for 87.2% of Group NII with HNB

-  Total Group Assets Growth of 11.2% to Rs 1 Trillion
-  Profit for the year growth of 16.4% to Rs 16.5 Bn
-  Deposits: Growth of 12.5% to Rs 701.5 Bn
-  Loans & Advances: Growth of 9.4% to Rs 639.1 Bn
-  Core Capital Adequacy improved to 17.0%
-  NPA ratio of 2.3%
-  Cost Income Ratio of 39.4%

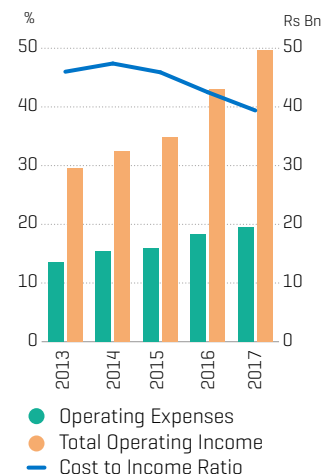
NII & Fee Income



INTEREST MARGIN



COST TO INCOME



Grameen and Acuity Partners contributing the remainder.

Net Fee and Commission Income

Fee and commission income growth of 17.9% was strongly supported by growth in fee income from digital payments and channels and trade, as business verticals worked together to maximise cross sell opportunities. Revenues from digital payment platforms and channels including cards business accounted for 30% of the total Net Fee and Commission income of Rs 8.3 Bn as customers migrated to digital platforms for transactions across retail and corporate customer segments in view of the convenience offered. This compensated for declining fee and commission income from guarantees and loans and advances. Net Fee and Commission Income accounted for 17.3% of Net Interest, Fee and Commission Income, increasing marginally from 2016.

Total Operating Income

Composition of total operating income reflects stable growth in earnings with fund based and fee based activity accounting for 79.8% and 16.7% respectively in 2017. Net losses from trading doubled in 2017 to Rs 3.7 Bn as the swap cost of hedging the exchange rate movement in dollar borrowings for part funding of rupee loan book increased due to higher swap cost. This loss to a great extent is offset by balance sheet translation gains and foreign exchange income which collectively amounted to Rs 3.2 Bn. This together with growth in dividends from group companies improved other operating income by 58.3% to Rs 5.2 Bn.

Net gains from financial investments were Rs 212.1 Mn, an increase of 89.9% over 2016 due to higher dividends received from equity investments held in the available for sale portfolio.

Consolidated financial statements also include Net Insurance Premium from HNB Assurance which recorded a 15.2% growth in 2017 followed a similar strategy to the Bank in focusing on profitable business segments. This supported growth of 14.5% in Group Total Operating Income which increased to Rs 61.1 Bn.

Impairment charges on Loans and Other Losses

Collective impairment charges resulted in a reversal of Rs 1.5 Bn driven by a refinement to the model used for collective impairment. The Loss Given Default rate applied by the Bank previously was higher than the actual rate of loss and the model has now been refined to reflect the historical loss rates. This change was also based on a recommendation made by the Sri Lanka Accounting & Auditing Standards Board. However, this favourable impact was offset by the increase in individual impairment charge from Rs 0.3 Bn in 2016 to Rs 4.4 Bn in 2017 due to a large corporate loan moving into the non-performing category which is being addressed as a priority. The total impairment charge on loans and other losses increased in 2017 to Rs 3.0 Bn from Rs 0.2 Bn in 2016, a year in which a few large loans were recovered.

On a Group basis, impairment of HNB Grameen increased by Rs 0.6 Bn due to the

COST TO INCOME RATIO

39.4%

in 2017

impairment charge made on account of an investment in government securities through a primary dealer which has subsequently been taken over by the Central Bank of Sri Lanka. HNB Grameen is in discussion with the Central Bank of Sri Lanka with regard to recovery of same.

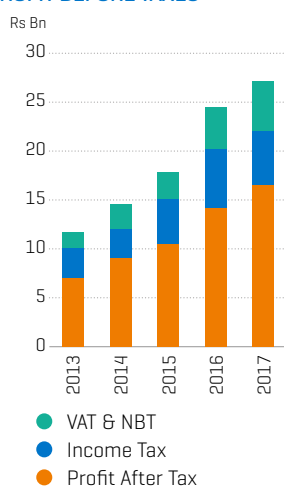
Net operating income increased by 9% driven by stable growth in both fund and fee based activities.

Cost Leadership

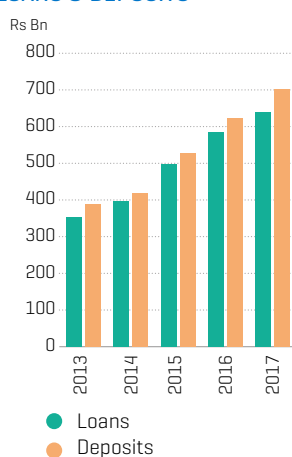
HNB leads the industry with the lowest cost income ratio which declined further to 39.4% in 2017 from 42.5% in 2016 as we reaped the benefits of the extensive business process re-engineering, lean initiatives and digitalisation undertaken over the past four years. The Bank's consistent focus on balancing growth and profitability is evident in the Cost and Income chart which depicts income growth consistently outpacing cost escalations, serving as testimony to the transformational changes undertaken, which have been wide-ranging, reaching every branch and employee.

Total expenses increased by 6.9% from Rs 18.3 Bn to Rs 19.6 Bn as other operating expenses increased by 11.5% and personnel expenses increased by a mere 1.9% during the year. The Bank's talent pipelines remain

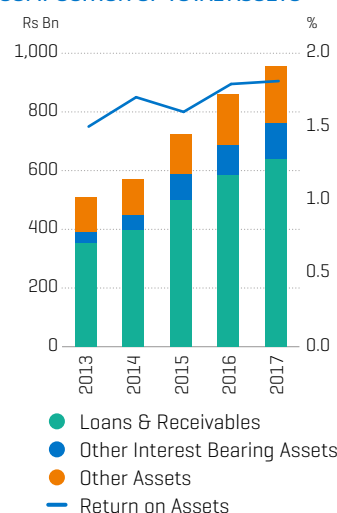
PROFIT BEFORE TAXES



LOANS & DEPOSITS



COMPOSITION OF TOTAL ASSETS



Managing Our Capitals & Impacts

FINANCIAL CAPITAL

robust as succession planning and changes in the organisation structure drive leaner structures, supported by automation driving employee efficiency and productivity. The Sustainability Supplement and other sections of this Capitals Report provide further insights into the initiatives implemented to curtail growth of Operating Expenses using holistic solutions, which also facilitate reducing emissions and consumption of materials while creating a conducive environment for our team.

At a Group level, Personnel Costs and Other Expenses increased by 4.8% and 15% respectively. Additionally, Benefits, Claims and Underwriting expenses of HNB Assurance increased by 20% due to higher claims arising from growth in insurance business despite the improvement in general insurance claims ratio to 64% from 69% in 2016. Consequently, Group's cost to income ratio improved to 47.2% from 48.3% reported in 2016.

Profit After Tax

Operating Profit before Value Added Tax and Nations Building Tax increased by 10.5% to Rs 27.1 Bn with Profit before Tax growing by 9.5% to Rs 22.1 Bn. The income tax for the year declined by 7% to Rs 5.6 Bn arising from reversal of over provisions made during the previous years of assessment with the finalisation of tax assessment. As a result, the Profit after Tax improved by 16.4% for the Bank in 2017.

Group profit for the year of Rs 16.7 Bn is an increase of 6.9% over the previous year.

TOTAL CAPITAL ADEQUACY RATIO

17.0%

in 2017

BALANCE SHEET ANALYSIS

Balanced Growth

Deposits grew by 12.5% to Rs 701.5 Bn during the year as the Bank focused on a CASA drive while giving less focus on driving high cost deposits due to a slowdown in credit growth in the economy. CASA growth during the year was supported by a strong domestic franchise, a strong sales culture and investments in technology which combined to drive growth. CASA raised during the year amounted to Rs 23.4 Bn which is a 10.4% growth, although the CASA ratio declined marginally from 36.2% to 35.5% due to the large fixed deposit base. Deposits account for 73.5% of total assets in comparison to 72.6% in 2016 and remains the main source of funds for the Bank's operations. The Loan to Deposits ratio is 91.1% and improved from 93.7% in 2016 supported by deposit growth.

Loan growth moderated to 9.4% closing at Rs 639.1 Bn as we focused on strengthening credit administration and recovery processes as we established a Centre of Excellence (COE) for evaluating retail credit, a Security Repository Unit (SRU) for credit administration and documentation and a Centre of Aspiration to support recoveries. Loans and advances account for 66.9% of the

Bank's total assets and processes in place to safeguard this vital asset are detailed on the CG&RR.

Total Interest bearing assets and liabilities have demonstrated strong growth with a CAGR of 17.4% and 16.8% over the past five years. Total Interest bearing assets account for 88.5% of Total Assets while Interest Bearing Liabilities account for 86.6% of Total Liabilities and Equity.

Return on assets (ROA) increased marginally during the year to 1.8%, despite strong growth in assets due to focus on income growth and managing costs which were supported by our digital transformation. The Group ROA stood at 1.8% compared to 1.9% in the previous year.

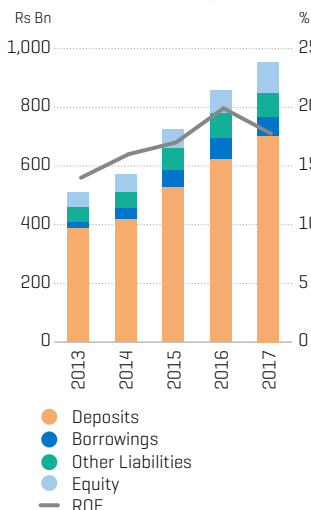
Capital, Funding and Liquidity

HNB raised Rs 14.5 Bn through a rights issue taking its share capital to Rs 31.4 Bn by year end, which is in compliance with the regulatory capital requirements of Rs 20 Bn by 2020 for licensed commercial banks in readiness for Basel III. Strong growth in retained earnings supported 40.4% equity growth to Rs 108.1 Bn further strengthening the Bank's balance sheet.

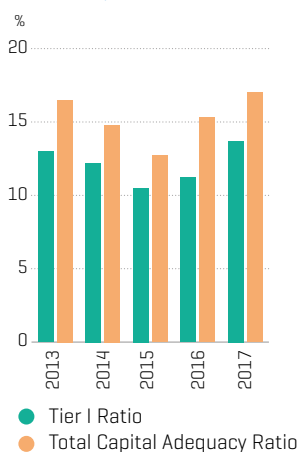
Total liability growth during the year was 8.3% mainly due to strong growth in deposits. Borrowings declined during the year by 13% as the Bank curtailed borrowings in view of slowdown in credit growth.

Inevitably ROE declined to 17.8% reflecting the higher equity base which is expected to

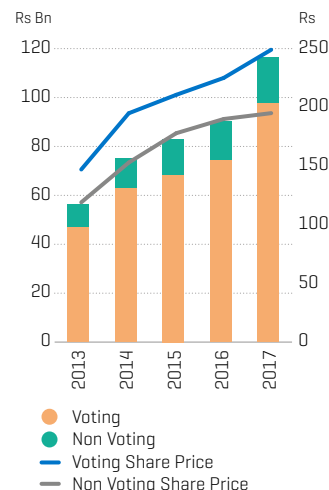
TOTAL LIABILITIES & EQUITY



CAPITAL ADEQUACY RATIO



MARKET CAPITALISATION



improve in 2018 as asset utilisation improves. The equity multiplier improved during the year also reflecting the strengthened balance

sheet. The Group ROE also declined in line from 17.7% in 2016 to 15.0%.

ROE Decomposition

	2013	2014	2015	2016	2017
ROA	1.47%	1.66%	1.61%	1.79%	1.82%
Equity multiplier	9.73	9.64	10.31	11.15	9.80
ROE	14.3%	16.0%	16.6%	19.9%	17.8%

Capital adequacy ratios improved to 13.7% and 17.0% respectively remaining well above regulatory requirements of 6.75% for Tier I and 11.25% for Tier II Capital reflecting a strong balance sheet and capacity for growth. The Statutory Liquid Assets Ratio of 24.1% also is well above the regulatory minimum of 20%.

FINANCIAL STRENGTH OF GROUP

Group companies account for 5.2% of the total assets of the HNB Group. As Sithma Holdings owns the Head Office premises and other commercial buildings, it contributes 28.7% to Property, Plant & Equipment which account for 3.4% of the Group Total Assets. Revenue and other reserves on the consolidated balance sheet also benefit from strong contributions from subsidiaries, due to appreciation in value of properties held and positive contributions to reserves from all subsidiaries. Individual performance of each subsidiary is set out in the business line reviews and demonstrate their strong market positioning within the sub-sectors in which they operate.

VALUE TO SHAREHOLDERS




The Bank paid an interim dividend of Rs 1.50 per share in December 2017 and propose a final dividend of Rs 7.00 per share for both voting and non-voting ordinary shares. Declining dividend yields reflect plans for growth as we penetrate into profitable sectors, leveraging our islandwide presence and investments in technology. Dividend per share is Rs 8.50 maintaining a balance between shareholder expectations and retaining capital for business needs.

The Bank increased its total market capitalisation from Rs 90.2 Bn in 2016 to Rs 116.5 Bn in 2017. HNB ranks as the 5th largest listed company in the Colombo Stock Exchange at the close of the year considering the voting shares although its rank would improve, if the non-voting shares were also included. It is noteworthy that the share price increased during the year despite a significant increase in the number of shares issued during the year. The share price movement continues to be hampered by liquidity as shareholders adopt a holding strategy in view of our plans for growth and related returns.

Managing Our Capitals & Impacts

ENHANCING EXPERIENCE: INVESTING IN MANUFACTURED CAPITAL

OUR DIGITAL TRANSFORMATION IS KEY TO OUR GOALS AS WE RE-IMAGINE BANKING TO ENHANCE CUSTOMER EXPERIENCE AND FACILITATE SCALABILITY AND COST LEADERSHIP TO DELIVER VALUE TO ALL STAKEHOLDERS. THIS IS REFLECTED IN OUR INVESTMENTS IN MANUFACTURED CAPITAL DURING THE YEAR, AS WE INVESTED OVER RS1,000 MN IN TECHNOLOGY AND BUILDINGS, ENHANCING THE CUSTOMER AND EMPLOYEE EXPERIENCES IN ENGAGING WITH US. TECHNOLOGY IS AT THE FRONT AND CENTRE OF OUR OPERATIONS AND IS ARGUABLY THE MOST CRITICAL FACTOR FOR THE BANK.

-  251 Branches
-  595 ATMs
-  Rs 632 Mn invested in Technology

NURTURING MANUFACTURED CAPITAL

Initiatives Implemented 2017	Initiatives Planned 2018
Customer Experience	
» Opened/relocated branches to enhance customer experience	» Upgrade systems to enhance productivity and customer experience
» Opened Priority Centres to better serve the high networth individual segment	» Upgrade premises and facilities.
Digitisation	
» Opened hybrid/digital centres.	» Provide more convenience to customers through digital centres.
» Invested significantly to upgrade the ATM network	» Expand the self-service machine network
» Invested in technology to improve productivity and delivery times to customers.	

Manufactured capital accounts for a mere 1.9% of Total Assets of the Group but provides a clear competitive edge as we seek to deepen penetration of banking services in the country, engaging all Sri Lankans in the country's socioeconomic progress. HNB has one of the largest branch networks and ATM networks among all private sector banks

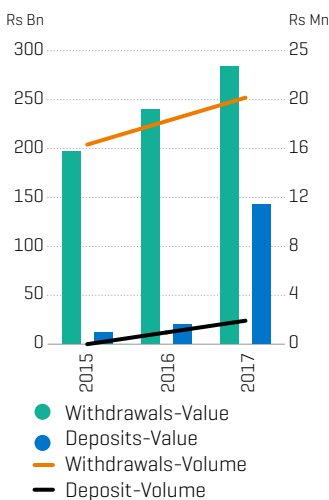
which is testimony to our commitment to making banking relevant to all. In line with our strategic focus on expanding our reach through digital channels during the year we expanded our ATM network extensively by adding over 100 deposit capable machines to the network increasing our total ATM coverage to 595 machines. Today, we account for nearly

14.5% of the total ATMs in the country and 8.4% of the bank branches. The success of the strategic shift is evidenced by the fact that 82.5% of total withdrawals and 20% of total deposits were carried out through ATM's.

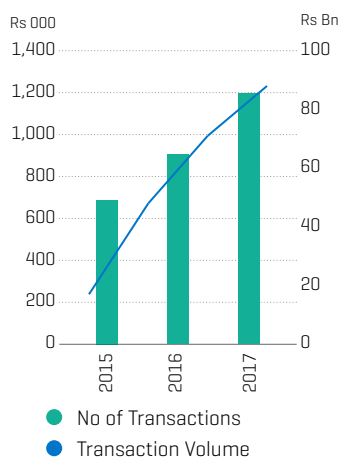
During the year 2017, we opened digital branches at Kollupitiya, Nugegoda, Ratnapura and Trace City. We also invested over Rs 400 Mn in refurbishing branches and relocated 12 branches to provide an enhanced experience to the customers as well as employees.

Having upgraded our electronic banking platform in 2016, we continued to introduce products and services to enable our customers to seamlessly carry out their banking transactions. Our manufactured capital and intellectual capital combine to drive our digital transformation to realise our vision of connecting all Sri Lankans to global opportunities from the convenience of their homes and offices.

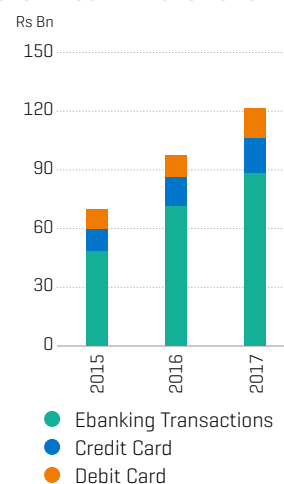
ATM TRANSACTIONS



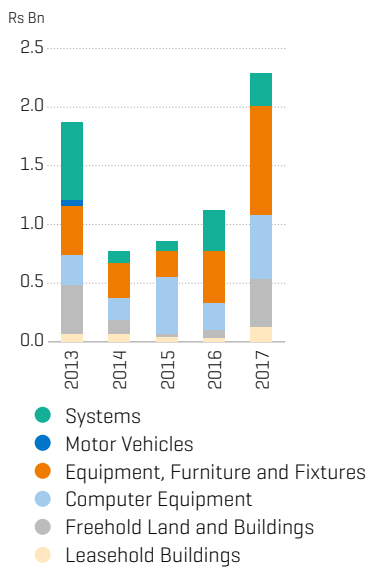
E-BANKING TRANSACTIONS



CASHLESS TRANSACTIONS



INVESTMENTS IN MANUFACTURED CAPITAL



MEASURING SUCCESS

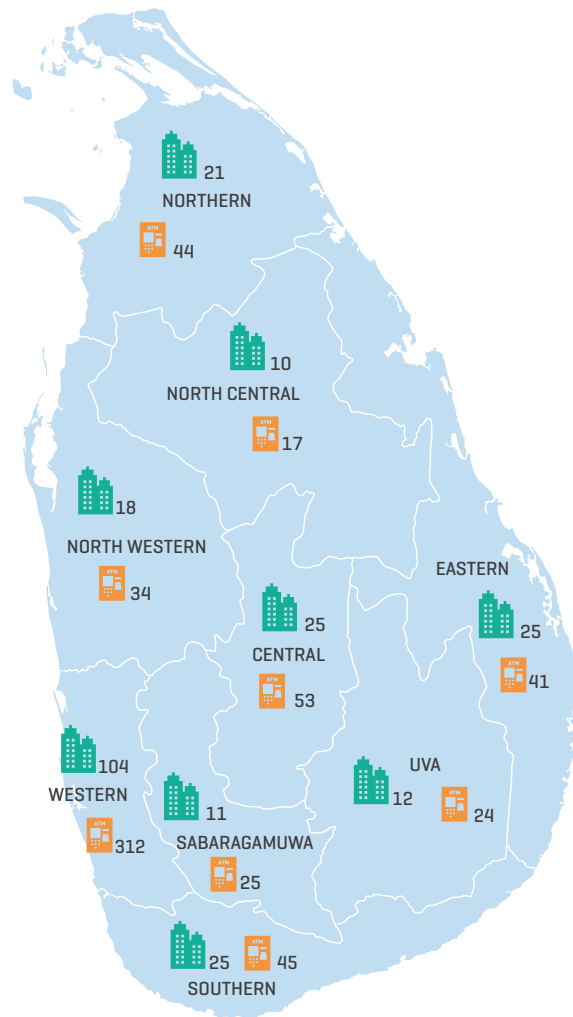
- 12 HNB Branches for 1,000,000 people
- 27 HNB ATMs for 1,000,000 people
- 82.5% of total withdrawals through ATMs
- 20.7% of total deposits through ATMs

REALISING OUR DIGITAL VISION

Charged with effective implementation of the Bank's IT strategy, the Bank's digital vertical drives our transformation, enhancing the customer experience as customer migration to electronic payment channels accelerates supported by growth in mobile penetration of 126%, mobile broadband penetration of 21% and fixed broadband penetration of 4.7%. The results given in this Manufactured Capital Report, both graphically and numerically, are testimony to execution of the plan and the leadership given by HNB to drive digitisation of the industry.

We are conscious of the concerns of our customers and regulators with regard to digitisation of Banking and a comprehensive Cyber Risk Management Framework is in place to address the same as detailed in page 38 of the Corporate Governance & Risk Management Report and the BIRMC report on page 21 of the integrated report.

Our initiatives in the journey of realising our digital vision are summarised below.



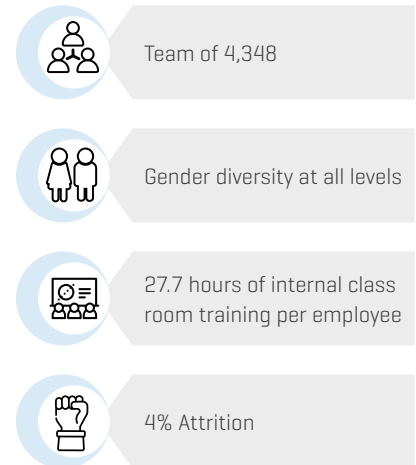
Realising our digital vision: activities in 2017

Activity	Superior Customer Service	Digital Organisation Culture	Design Personalised Digital Solutions	Build futuristic Technical Capability	Establish Complementing Partnerships	Speedy & Timely Release of Products
Completed in 2017						
Expanded deposit capable ATM network	✓					
Largest ATM acquirer across Lanka Clear network	✓					
Inland money transfers to non-account holders	✓			✓		
PickMe payment facilitation	✓			✓	✓	✓
FitApp	✓		✓	✓		✓
School Smart Pay			✓	✓	✓	✓
Digital literacy for staff	✓	✓				
Digital communication platform to manage groups	✓	✓	✓			✓
Cyber security awareness	✓	✓				
Digital Learning Platform		✓		✓		
1st Digital Branch	✓	✓		✓		
Wifi Zones	✓			✓		
Digital Engagement Centre	✓			✓		
Mini Digital Zones	✓			✓		
Recycling ATMs	✓					
Increased Usage/Penetration in 2017						
Cash Management for Corporates	✓					
Online payment to Sri Lanka Customs	✓				✓	
Secure Web Checkouts	✓					

Managing Our Capitals & Impacts

HAPPY PEOPLE : NURTURING HUMAN CAPITAL

AS A SERVICE ORGANISATION, WE ARE CONSCIOUS THAT OUR EMPLOYEES DRIVE OUR SUCCESS. WE FIRMLY BELIEVE THAT HAPPY EMPLOYEES MAKE, HAPPY CUSTOMERS. IN 2017, WE IMPLEMENTED INITIATIVES TO BRING GREATER ALIGNMENT BETWEEN CUSTOMER AND EMPLOYEE VALUE PROPOSITIONS DELIVERING RS 8.9 BN TO EMPLOYEES IN TERMS OF REMUNERATION AND REWARDS WHILE INVESTING IN TALENT DEVELOPMENT.

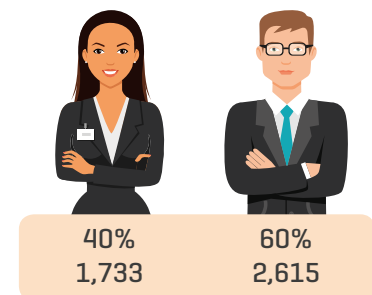


NURTURING HUMAN CAPITAL

Initiatives Implemented 2017	Initiatives Planned 2018
Empowerment through knowledge	
<ul style="list-style-type: none"> » Increased talent development initiatives with 232 in-house training programmes for all categories of staff. » Average training hours per employee 27.70 [excluding elearning, external/foreign training] » Internal promotions in 2017: 406 » Training OMNI Channel contact centre team for inbound calls » Focused training on credit, operations, compliance, cyber security, leadership and soft skills development 	<ul style="list-style-type: none"> » Increased investment for talent development » Implementation of leadership development modules <ul style="list-style-type: none"> - Multiple modules across leadership tiers - Top talent identification and development » Implementation of an organisation wide 'Service Excellence' initiative » Creation of the organisational competency key to define competency and trainings for identified roles. » Implementation of self-development training modules that add value to life in general.
Employee Experience	
<ul style="list-style-type: none"> » Mentoring 575 employees through RISE, mentoring programme » Appointment of Chief Employee Experience Officer (CEEO) » Total issues received for resolution 84, resolved 90% concerns, grievances escalated to CEEO » Structured meetings with employee unions, Employee Focus Group Meetings. » CEO Newsletters and Town hall meetings. 	<ul style="list-style-type: none"> » Promote our employee innovation and Ideation programme with IDEABOX » Consolidation and strengthening the role of Chief Employee Experience Officer. » Implementation of a regular employee happiness level monitoring tool » Drive culture transformation » Happy and Bright initiatives for employees
Tech savvy, Future Ready Team	
<ul style="list-style-type: none"> » HNB Talent Space, an e-learning platform with multiple learning and engagement faculties including peer group discussions » Information security and data loss prevention training 	<ul style="list-style-type: none"> » Digital literacy » Cyber security » Cutting edge Performance Management System
Talent analytics and HRIS	
<ul style="list-style-type: none"> » Greater compliance through employee behaviour analytics 	<ul style="list-style-type: none"> » Launch of Talent Edge a superior dynamic HRIS » Optimise utilisation of features of Talent Space and Talent Edge » Centralisation of staff loans facilities.

The Hatna Team

Female	Staff Category	Male
3	Corporate Management	12
10	Senior Management	46
196	Managers & Executives	653
337	Junior Officers	577
890	Banking Associates	1092
244	Secretaries	5
0	Support staff	193
Employment Type		
53	Contract staff	37
1680	Permanent	2578
Geographical Diversity		
81	Central Province	230
47	Eastern Province	161
16	North Central Province	109
66	North Western Province	158
72	Northern Province	131
40	Sabaragamuwa Province	103
53	Southern	207
22	Uva	93
1336	Western	1423
208	New Recruits	127
76	Employee Turnover	101



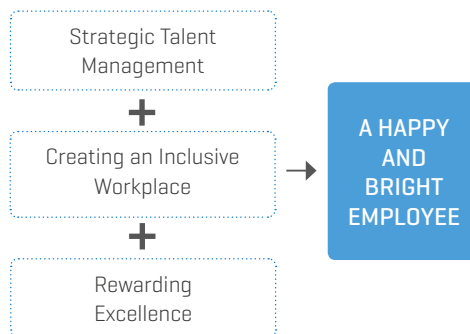


MEASURING SUCCESS

Employee Voice	Employee value contribution	Employee Inclusion																		
Measuring Employee Experience : Leadership Top 100 Happy and Bright Survey Highlights: Continue to do: <ul style="list-style-type: none"> » Mentor, guide, coach » Innovation » Cherish Hatna Family Start : <ul style="list-style-type: none"> » Showing value in outstation placements Improve: <ul style="list-style-type: none"> » Meeting productivity 	PRODUCTIVITY & GROWTH <table border="1"> <caption>Productivity & Growth Data (2013-2017)</caption> <thead> <tr> <th>Year</th> <th>Value Contribution (Approx.)</th> <th>Percentage (Approx.)</th> </tr> </thead> <tbody> <tr> <td>2013</td> <td>4,500</td> <td>12%</td> </tr> <tr> <td>2014</td> <td>4,300</td> <td>13%</td> </tr> <tr> <td>2015</td> <td>4,200</td> <td>14%</td> </tr> <tr> <td>2016</td> <td>4,100</td> <td>18%</td> </tr> <tr> <td>2017</td> <td>4,200</td> <td>25%</td> </tr> </tbody> </table>	Year	Value Contribution (Approx.)	Percentage (Approx.)	2013	4,500	12%	2014	4,300	13%	2015	4,200	14%	2016	4,100	18%	2017	4,200	25%	The Hatna family creates <ul style="list-style-type: none"> » Economic value » Emotional value » Social value to the stakeholders we serve by consistently upholding our commitment to nurture relationships <ul style="list-style-type: none"> » Happy and Bright employees are the driving force of our culture transformation
Year	Value Contribution (Approx.)	Percentage (Approx.)																		
2013	4,500	12%																		
2014	4,300	13%																		
2015	4,200	14%																		
2016	4,100	18%																		
2017	4,200	25%																		
		<ul style="list-style-type: none"> » We are proud to claim that we have gender diversity at all levels » We have taken active steps to create an inclusive workplace for all employees » We promote family friendly workplace policies » We are committed to generate employment creation in all parts of the island » We have a healthy mix of 4 generations in our workforce » Our policies and best practices have helped our retention levels to record a low attrition rate of 4% 																		

NURTURING A HAPPY AND ENGAGED TEAM

HNB's approach to managing our human capital is supported by a strong HR policy framework, and well governed systems and processes. Inspiring and motivating our team to reach higher while ensuring regulatory compliance is important to us. A detailed human capital report is included in our online Sustainability Supplement which can be accessed at <https://www.hnb.net/2017#sustainability-report-2017>.



CREATING AN INCLUSIVE WORKPLACE

Bank transformation initiatives implemented during the year included the sharing results of Organisation Culture Assessment Impact (OCAI) conducted with external consultants in 2016. The establishment of nine cross functional teams addressed key aspects of the Bank's 2020 strategic plan. The OCAI covered all employees in an online survey and over 900 employees in workshops. The results were shared amongst the top 100 Leaders of the Bank and all the branch managers. The Chief Employee Experience Officer's role was strengthened by ensuring strong synergistic partnerships between the CEO & team HR to resolve employee concerns.

STRATEGIC TALENT MANAGEMENT

Talent development remains high on our agenda and 232 training programmes were delivered covering 100% of our employees during the year resulting in average training per employee of 27.7 hours (excluding e-learning and external programmes). Significant efforts were made to ensure that our teams were upskilled to embrace a digital future as we built a tech savvy team.

Talent acquisition activities also focused on enhancing the tech savvy pool of talent within the Bank as we recruited talent with strong technology backgrounds to meet our future demands. A strong mentoring culture was reinforced with "RISE", the Bank's structured mentoring programme while LEAD enabled staff newly promoted to executive category to prepare themselves for their new roles over a period of six months. Grooming future leaders continues to be a key HR priority for us.



Managing Our Capitals & Impacts

HAPPY PEOPLE : NURTURING HUMAN CAPITAL

REWARDING EXCELLENCE

Our employees received Rs 8.9 Bn in remuneration and rewards in 2017 with further value delivered as training and welfare. We are working with the trade unions to introduce pay for performance to non-executive categories following the successful roll out to junior executives. Our success in this initiative is witnessed by the fact that 90% of our junior executives got 3.75 months bonus in 2017. This is a 25% increase in bonus over the previous year.

A robust performance management system underpins our rewards and recognition initiatives. We have empowered departmental heads to reward employees outside the performance management system enhancing employee morale.



A Healthy Workforce

FIT Account
Lose to win programme for employees
Gym at the Head Office and swimming pool subscriptions paid to encourage a healthy lifestyle
Encouraging sports with HNB teams at mercantile level and internal sports days at regional level



Women at Work Initiative

Healthy gender representation at all levels including Board and Senior Management.
99% of women returning to work after maternity leave
Leadership programmes tailor made for women



Life-long Learning

Rs 38.2 Mn invested in developing our employees
Reimbursement of professional membership subscriptions for executive staff.
On-demand learning solutions - classroom, virtual, office home or on the commute



An inclusive Workplace




Employee remuneration and rewards Rs 8.9 Bn
81% of employees are members of trade unions
Employee pulse surveys taken regularly
Appointment of Chief Employee Experience Officer




Managing Our Capitals & Impacts

PARTNERING GROWTH: OUR SOCIAL AND RELATIONSHIP CAPITAL REPORT

CUSTOMERS DRIVE OUR GROWTH, WHILE OUR BUSINESS PARTNERS ENABLE US TO EXTEND OUR REACH AND ENHANCE THE CUSTOMER EXPERIENCE. WE UNDERSTAND THAT WE GROW TOGETHER WITH OUR COMMUNITY AND SUPPORT THE SOCIOECONOMIC PROGRESS OF THE COUNTRY THROUGH A RESPONSIBLE BUSINESS MODEL THAT ENABLES ACCESS TO FINANCE AND THROUGH SOCIAL CORPORATE CITIZENSHIP.

-  Over 2.5 Mn Customers
-  900 Correspondent Banks
-  15,000+ Merchants

Initiatives Implemented 2017	Initiatives Planned 2018
Enhancing Customer Experience	
<ul style="list-style-type: none"> » Launch of Customer Complaint Management System » Launch of Knowledge Hub giving information on key products to employee screens enhancing user experience » Service Champions appointed at branches » Launch of Net Promoter Score » Launch of products to promote a healthy lifestyle 	<ul style="list-style-type: none"> » Setting up an omni channel call centre » Training on service excellence » Improve turnaround times through process improvements
Capacity building	
<ul style="list-style-type: none"> » Conducted financial literacy workshops » Programme to drive SME exports. 	<ul style="list-style-type: none"> » Continue capacity building, financial literacy programmes for customers



MEASURING SUCCESS

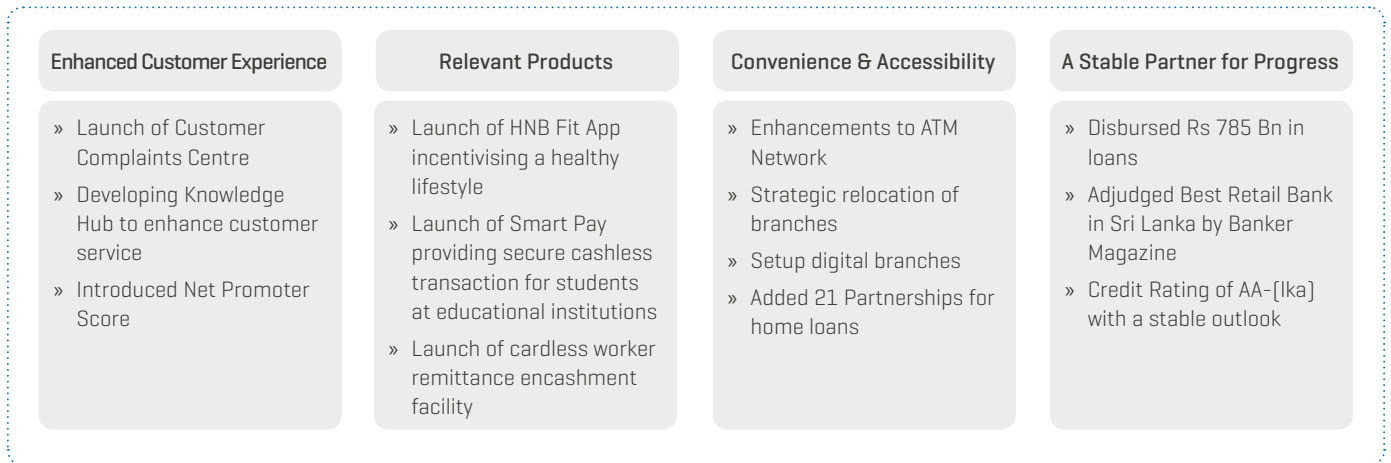
VALUE TO CUSTOMERS	VALUE TO OTHER BUSINESS PARTNERS	VALUE TO REGULATORS & COMMUNITY
Rs 47.5 Bn paid as interest	Rs 8.8 Bn paid to suppliers	Loans over Rs 15 Mn reviewed for social and environment compliance through ESMS
Rs 785 Bn disbursed	Facilitated Rs 175 Bn in transactions for merchants	57% of the customers outside the Western Province
Facilitated over Rs 300 Bn in imports and exports		Rs 145 Bn disbursed to MSMEs

Managing Our Capitals & Impacts

PARTNERING GROWTH: OUR SOCIAL AND RELATIONSHIP CAPITAL REPORT

CUSTOMERS

A multipronged customer value proposition drives our initiatives to deliver value to this key group of stakeholders. It is shaped by feedback received from our comprehensive customer engagement which has been the cornerstone of our growth over 129 years. The diagram below summarises how we enhanced value delivered to customers in 2017. Customer growth continues to be encouraging as we increase our penetration within the country and we are encouraged by the customer uptake of our cross-sell and upsell initiatives which have driven our growth this year. A key development has been the customer migration to digital platforms taking advantage of the state-of-the-art online banking solutions offered resulting in an increase of 23.8% of online transaction values and 31.9% of online transaction numbers validating this key value pillar.



BUSINESS PARTNERS

Our business partner network growth continued during the year as we enhanced our reach beyond our shores and within to deliver our customer value proposition. A well-established correspondent banking network of over 900 and over 15,000 merchants give us extensive reach connecting customers to global opportunities. Joint promotions were conducted with a number of our business partners for targeted customer segments to drive mutual growth with positive results. Tripartite agreements with real estate developers paved the way for home ownership supporting sustainable cities. Fair dealing has been key to growing these relationships supported by structured engagement and grievance mechanisms that enable raising concerns.

SUPPLIERS

We rely on our suppliers for the smooth running of our operations and seek to be a partner in their growth with many of them being customers of the Bank. We consciously seek local suppliers with growth potential and have partnered the transitioning of SMEs to corporate through our supplier development initiatives. Strong procurement processes which feature multiple committees, adherence to a procurement policy and grievance mechanisms support our mutual growth. Foreign suppliers are generally

contracted for IT hardware and software categories which involves rigorous screening and due diligence prior to supplier selection with comprehensive contracts defining key deliverables and service levels, often including penalties against non-performance as they have a significant impact on the operations of the Bank. Over 60% of our suppliers are SMEs who are customers of the Bank.

The E-procurement system will be effective from 1st January 2018 facilitating greater transparency in our procurement processes. Tenders will be called from registered suppliers with tenders required to be submitted online. This system has the added advantage of eliminating paper from the procurement process saving significant quantities of paper not just for the Bank but for our suppliers as well.

COMMUNITY

Our primary role in community engagement is to facilitate the socioeconomic progress of the communities we work in by supporting trade, access to finance and as a custodian of wealth as a responsible Bank. We also engage in strategic philanthropy in acknowledgement of our social responsibility under four pillars. Initiatives implemented in 2017 are summarised below.



Managing Our Capitals & Impacts

PARTNERING GROWTH: OUR SOCIAL AND RELATIONSHIP CAPITAL REPORT

SGD	Our Role	What we did in 2017
	<p>Providing financial capital and enabling transactions for SMEs, Corporates and Government</p>	<ul style="list-style-type: none"> » Disbursed Rs 590 Bn loans to Corporates <ul style="list-style-type: none"> - Infrastructure development project disbursements Rs 5 Bn » SME disbursements Rs 137 Bn » Promoting social entrepreneurship through 'Ath Pawura' » Supporting growth of 240 SME exporters in four regions by arranging workshops
 	<p>As a Group HNB is the largest provider of financial capital to the microfinance sector through the Bank's Microfinance department and HNB Grameen</p>	<ul style="list-style-type: none"> » Total disbursements of Rs 24 Bn by HNB and HNB Grameen » 17% of branches and 14% of ATMs located in the three lowest contributing provinces accounting for 14% of GDP » Network of Gami Pubuduwa Officers 100 (barefoot bankers) who reach out to village leaders to identify financial support requirements and visit potential customers » Increased non-collateralised lending to sector » 593 Capacity building workshops and 30,000 beneficiaries
	<p>As health is a key concern for customers and employees alike, we have incorporated this in to our product innovation and HR strategies, incentivising exercise for a healthy lifestyle</p>	<ul style="list-style-type: none"> » Launch of FIT Account » Blood donation campaigns » Lose to win programme for employees » Gymnasium facility at the Head Office and payment of swimming pool subscription » Rs 5 Bn disbursed for healthcare with exposure particularly in SME portfolio for affordable healthcare » Encouraging sports with HNB teams and internal sports days at regional level
	<p>Quality education is a sine qua non for socio economic progress and we seek to inspire people of all ages to continue learning</p>	<ul style="list-style-type: none"> » Diri daru scholarships for Grade 5, Ordinary Level and Advanced Level examinations » Rs 38.2 Mn invested in talent development covering all employees » Education sector exposure » Retail loans for education
	<p>HNB accounts for 8% of the employees in the Banking sector and its growth bears testimony to our commitment to employees</p>	<ul style="list-style-type: none"> » Employee remuneration and rewards Rs 8.9 Bn » Employee Welfare & Talent development Rs 38.2 Mn » Over 81% of our employees belong to one of two trade unions » Cordial relations with trade unions
	<p>Gender balance with 40% being women</p>	<ul style="list-style-type: none"> » Gender diversity at all levels. » 99% of women returning to work after maternity » Nearly 90% of HNB Grameen facilities granted to women
	<p>HNB supports agri business as 10% of its portfolio is invested in the same</p>	<ul style="list-style-type: none"> » Agriculture loans of Rs 45 Bn disbursed » Value chain financing benefitted over 1,100 farmers

SGD

Our Role

What we did in 2017



Shanthy Housing loans and financing of the housing construction sector

- » Rs 9 Bn housing loan disbursements in 2017
- » Rs 37 Bn financial support provided to construction sector in 2017
- » Eight partnerships with merchants for Shanthy loyalty card members



The Bank supports clean energy through investments in solar energy and by facilitating investments in renewable energy for home owners and the private sector

- » Generated 2,100,400 kwh of solar energy in 2017
- » Arranged a syndicated facility of Rs 9 Bn to fund country's first waste to energy project
- » Solar panels installed at 69 branches at a total investment of Rs 353.2 Mn
- » Rs 4 Bn exposure to clean energy projects
- » Reduced energy consumption from National Grid by 4,087,736 kwhs



We are consciously reducing consumption and migrating customers to paperless transactions and e-statements.

The ESMS policy ensures that loans above Rs 15 Mn are reviewed for social and environmental compliance of projects financed

- » Smart Pay card launched to facilitate cashless transactions
- » 84,291 customers migrated to online solutions in 2017
- » 32% growth in number of online transactions in 2017



Corporate governance, risk management frameworks and a Code of Ethics support our financial stability and fair competition

- » There were no instances of bribery or corruption reported during the year



Our business partners extend our reach and enable our growth connecting communities to global opportunities

- » Network of 900 correspondent banks
- » Working with utilities, telecom providers and other enterprises to deliver value added services and convenience to customers
- » Work with partners to deliver holistic solutions on CSR fund activities including education

The Bank is a member of the following organisations that support policy formulation by identifying areas of concern for the economy and undertaking studies and analysis to support recommendations made to policy makers.

- » Sri Lanka Banker's Association
- » Institute of Bankers, Sri Lanka
- » Ceylon Chamber of Commerce
- » National Chamber of Commerce
- » Association of Banking Sector Risk Professionals, Sri Lanka
- » The Association of Compliance Officers of Banks, Sri Lanka

Managing Our Capitals & Impacts

SHAPING OUR FUTURE: OUR INTELLECTUAL CAPITAL REPORT

THE COLLECTIVE KNOWLEDGE OF OUR TEAM, THE ROBUST SYSTEMS AND PROCESSES, GOVERNANCE AND RISK MANAGEMENT FRAMEWORKS SUPPORT OUR GROWTH AND ENHANCE BRAND EQUITY. IT IS A KEY REASON WHY WE ARE THE LEADING PRIVATE SECTOR FINANCIAL SERVICES GROUP IN THE COUNTRY.

NURTURING INTELLECTUAL CAPITAL

Initiatives Implemented 2017	Initiatives Planned 2018
Systems & Processes	
<ul style="list-style-type: none"> » Centralisation of key credit functions » Reduce turnaround times through process improvements 	<ul style="list-style-type: none"> » Continuous improvement in processes » Rolling out the centralised operations to the network.
Innovation	
<ul style="list-style-type: none"> » Introduced award winning products. 	<ul style="list-style-type: none"> » Launch new products to cater to the changing needs of the customers



BRAND EQUITY

HNB has been ranked as the 5th most valuable brand in Sri Lanka, with an estimated brand value of Rs 17.5 Bn by Interbrand, the world's largest brand consultancy company. The ranking is based on the financial performance of the branded products and services as well as the strength and the role the brand plays in influencing customer choice.

TACIT KNOWLEDGE, SKILLS AND EXPERIENCE

HNB's tacit knowledge has been built over a century of banking in Sri Lanka, working across all customer segments and industries gaining insights from our experiences. A culture of mentoring has ensured that key learnings are passed down through generations of HNB employees both informally and formally, creating an invaluable body of knowledge that cannot be replicated. This tacit knowledge is part of our DNA which plays a key role in how we reinvent ourselves to be future ready.

HNB's ability to attract, develop and retain talent has ensured that we have one of the most skilled and experienced teams in the sector. Retention rates of over 95% over the past five years has ensured that we retain talent to develop them to reach higher as we carve new paths for mutual growth.

SYSTEMS AND PROCESSES

Our systems and processes play a key role in managing risk, financial stability and productivity directly impacting customer and employee experiences. During the year, we continued our BPR activities introducing lean management concepts which have enhanced employee productivity and cost leadership among the domestic banks. Among the initiatives implemented include, the 'Centre of Aspiration' which was set up during the latter part of 2017 to focus on overdue facilities from day one. This centre which is equipped with a fully automated collections system, enables the dedicated team to monitor overdue facilities more stringently and is expected to improve the asset quality of the Bank further. We also centralised the disbursement of all credit, relating to the greater Colombo region and set up the central security repository. Both these centralised operations are to be rolled out to the entire network over the next couple of years. These centralisation efforts of the Bank have contributed significantly towards improving the operational efficiency of the Bank. In addition to the focus on continuous improvement, the lean learning culture in place with accreditations for six sigma yellow belt, will also enable the Bank to further its goals in the area.





MEASURING SUCCESS

- 5th Most valuable Brand in Sri Lanka by Interbrand
- Highest ranked bank in the country by Business Today and LMD
- A 'Top 1,000 Bank in the World' by The Banker



INNOVATION CAPABILITY

Innovation is a core capability of the Bank as we have re-imagined and re-invented ourselves over 129 years of existence to deliver value to our stakeholders and remain relevant to an ever-increasing customer base. Our digital vision and focus on cross functional projects has provided direction and wings to innovators across business verticals and support functions to accelerate our pace

of innovation and deliver products that truly make a difference and make banking more relevant to all aspects of their lifestyle as described in Manufactured Capital on page 48. Two products won recognition at the National Best Quality Software Awards 2017 and these are showcased as testimony to our innovation capability.

Managing Our Capitals & Impacts

SHAPING OUR FUTURE: OUR INTELLECTUAL CAPITAL REPORT

Awards and accolades received during the year affirm the strength of our brand.

International Awards	
Bank of the Year	The Banker
Top 1000 Banks in the World	The Banker
Best Retail Bank in Sri Lanka	The Asian Banker
Best SME Bank in Sri Lanka	Asiamoney
The most innovative Microfinance Product Sri Lanka	International Finance Magazine
Best Cash Management Bank in Sri Lanka	Asiamoney
Best CSR Bank in Sri Lanka	Asiamoney

Regional Awards	
Best Microfinance Product of the year – Asia Pacific	The Asian Banker
Silver Award – Islamic Financing Entity	Islamic Finance Forum South Asia (IIFSA)
Silver Award – Islamic Window	
Bronze Award – Islamic Finance Deal of the year	
Emerging Technologies Led Innovation award – HNB Fit account (mid-size bank category)	Infosys India
Certificate of Merit – Category – Private Sector Banks (including Co-operative Banks)	South Asian Federation of Accountants
Certificate of Merit – Category – SAARC Anniversary Award for Corporate Governance	South Asian Federation of Accountants

National Awards	
Highest Ranked Bank	LMD
Highest Ranked Bank	Business Today
5th Most valuable bank	Interbrand
Bronze - HNB SmartPay (Inclusion and Community Category)	National Best Quality ICT Awards (NBQSA) by the British Computer Society (BCS)
Merit - HNB Fit account (R&D Category)	
Best ATM Network in Sri Lanka	LankaPay Technnovation Awards
Gold Award - Deal of the Year	Sri Lanka Islamic Banking and Finance Awards
Gold Award - Best Islamic Finance Window/Unit of the year	
Bronze Award - Islamic Banking Entity of the year	
Silver Award - Banking Sector	CA Sri Lanka Annual Report Awards
Bronze Award - Corporate Governance	
Runner Up- Banking Sector	ACCA – Sustainability Reporting Awards
Top 10 Best Integrated Reports	CMA
Runner Up - Best Corporate Citizen	Ceylon Chamber of Commerce
Winner - Top Ten Corporate Citizen	
Winner - Finance Sector	
Winner - Environment beyond the Business	
Winner - Best Sustainability Project Award	
Best Investor Relations - Bronze	CFA Sri Lanka

HNB SMART PAY

HNB launched Smart Pay is a card designed to create a secure payment eco system for educational institutions giving parents and school authorities the ability to empower children to manage money within a secure environment. The card leverages Near-Field Communication (NFC) technology for greater user convenience enabling students to make payments at selected partner outlets. Launched at Gateway School in August 2017, this is an example of HNB's approach to anticipating customer concerns and providing holistic solutions that benefit all stakeholders.



Students

- » Able to purchase using the card at the nominated merchants
- » Commence banking through Student Saving Unit



Teachers

- » An exclusive teacher retail package for the staff looking after their entire retail banking requirements
- » Reduced administrative duties



School

- » A Payee partnership offering multiple payment points to parents and significant efficiency in administration
- » Electronically registering the attendance record of students



Parents

- » Ability to pay school fees through multiple channels
- » Ability to empower children to manage money within a secure eco system

SMART PAY

HNB FIT

Incorporating banking and lifestyle together, HNB FIT incentivises our customers to live a healthy life and maintain it, addressing the growing global issue of obesity and related complications which sap health budgets of nations. This innovative app integrates with the fitness brands such as Apple, Fitbit and Jawbone to make sure that every movement is counted, helping customers realise their fitness goals to gain financial benefits.



The Product

- » A mobile app linked to your HNB savings account
- » Synced with wearable tech to monitor your fitness
- » Fitness motivator to encourage a healthy lifestyle

10%

Financial Rewards

- » Interest of 10% for every 10,000 steps count



Supporting your Lifestyle

- » Wearable technology devices sync with Fit App
- » Helps you stick to your fitness routine for good

TRY HNB FIT

The ultimate fitness motivator and interest generator today and get paid for burning calories.






Managing Our Capitals & Impacts

MANAGING OUR IMPACTS: OUR NATURAL CAPITAL REPORT

OUR COMMITMENT TO ENVIRONMENTALLY SUSTAINABLE PRACTICES IS INTEGRATED INTO OUR CULTURE THROUGH OUR GREEN PLEDGE WHICH IS A PROMISE THAT WE WILL JOIN HANDS TO COMBAT CLIMATE CHANGE. THE GREEN PLEDGE IS NOW IN ITS 9TH YEAR AND HAS EVOLVED INTO A MULTI-PRONGED APPROACH TO MINIMISE OUR NEGATIVE IMPACTS ON THE ENVIRONMENT, CREATE AWARENESS OF THE NEED FOR ACTION ON CLIMATE CHANGE AND REJUVENATING THE ENVIRONMENT.

OUR GREEN PLEDGE

-  Reduce our carbon footprint
-  Responsible lending
-  Green initiatives

NURTURING NATURAL CAPITAL

Initiatives Implemented 2017	Initiatives Planned 2018
Management Approach	
<ul style="list-style-type: none"> » Continued to monitor sustainability indices through the CEO dashboard implemented in 2016. » Reviewed and revised process for determining material topics » 220 employees trained on ESMS system 	<ul style="list-style-type: none"> » Further strengthen the environment and social management system.
Responsible Business	
<ul style="list-style-type: none"> » Invested Rs 353.2 Mn in clean energy initiatives within the Bank » Financed Rs 1.8 Bn in renewable power generation projects with corporates » Financed Rs 33.3 Mn in solar energy project for homes » Arranged syndication of Rs 9 bn waste to energy projects 	<ul style="list-style-type: none"> » Continue to invest in solar PV system installation project in branches » Introduce energy efficient lighting systems in branches
CSR	
<ul style="list-style-type: none"> » 24% of total CSR spent on projects that care for the environment 	<ul style="list-style-type: none"> » Continue to support ecofriendly initiatives


As the Bank accounts for 90% of the total assets of the Group, the indicators for environmental performance includes only those of the Bank. We have reported on the relevant and material indicators which are monitored on a quarterly basis on the CEO's sustainability dashboard introduced in 2016. It monitors key indicators such as carbon footprint, material usage and disposal, supply chain assessments and risks, occupational injuries, customer safety and security. The dashboard which monitors progress on a quarterly basis against pre-determined targets has resulted not only in better monitoring of sustainability performance but

has also strengthened the decision-making process.

REDUCING OUR CARBON FOOTPRINT

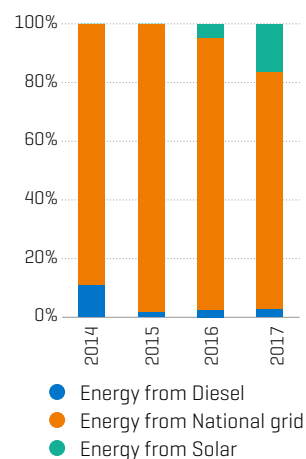
Energy Efficiency

We aim to halve our carbon footprint by 2020. One of the key initiatives in this regard is our solarising project which involves the systematic conversion of branches to solar power. As part of this project, we installed solar energy at 25 of our branches during the year to generate 2,100 Mwh of power; reducing dependence on the national grid by 17% and achieving significant reductions

 **MEASURING SUCCESS**

	2017	2016
Emissions Scope 1 & 2 - MT	4,643.69	6,551.27
Emissions Intensity - Kg/ Sqft	4.0	5.6
Diesel Usage for Generators - Ltrs	99,500	161,258
Electricity Usage - kWh	12,357,011	15,120,494
Renewables - kWh	2,100,400	776,147
Renewable Energy as percentage of Total Energy - %	17.00%	5.13%

ENERGY MIX



in the energy bill. As at the end of 2017, a total of 69 branches have been completely converted to solar power. Apart from this we continue to introduce more energy efficient processes throughout the Bank, such as investing in energy efficient lights, an better utilisation of space in order to optimise energy efficiency.

Reduced emissions

We have also commenced migrating to ozone friendly gases in air-conditioning across all branches in an attempt to reduce emissions. During the year 2017, 207 units were replaced and this has resulted in emissions being reduced by 408.8 kg.

Paperless office initiative

Our “paperless office initiative” continued during the year with a number of internal documentation processes being automated and re-engineered in order to further reduce paper usage. As a result, the paper consumption during the year reduced by a significant amount.

The Bank also opened its first ever hybrid/digital banking units in four branches namely Kollupitiya, Nugegoda, Ratnapura and Trace City during the year with a view towards a paperless banking culture.

RESPONSIBLE LENDING

As a lender to the nation we are aware of the tremendous impact we can have indirectly through engagement with customers and society. The Bank’s Environmental and Social Management System (ESMS) ensures that the Bank’s credit portfolio conforms with all financial, judicial, regulatory and socially acceptable standards and applies a process of Environmental and Social (E&S) risk assessment to ensure that the portfolio is E&S risk free. In addition, the ESMS also promotes improved social and environmental performance by customers which may arise from existing weaknesses in local legislation.

We continue to conduct training on ESMS and aim at achieving 100% training and certification of all employees responsible for business loan approval by 2018. Additionally, 275 staff were trained on Environmental and Social Management System (ESMS) in 2017.



Responsible Consumption

Continued investment in energy efficient measures such as solar powered branches, better utilisation of space, paperless initiative and sustainability dashboard



Bio Diversity Conservation

CSR Initiatives that revolved around creating awareness on bio diversity conservation



Environmentally Friendly Investments

Reducing emissions by investing in ozone friendly gases in air-conditioning across all branches

HNB has continuously been in the forefront of lending to the renewable power sector



A comprehensive ESMS

Our ESMS ensures that Bank’s credit portfolio conforms with all financial, judicial, regulatory and socially acceptable standards and applies a process of Environmental and Social (E&S) risk assessment

GREEN LENDING

HNB has continuously been in the forefront of lending to the renewable power sector. During 2017, three new green energy projects of solar and hydro were financed with a total exposure amounting to Rs 1.8 Bn. HNB’s most recent involvement has been as the lead arranger to a syndicated loan of Rs 9 Bn towards the construction of a 10MW waste-to-energy power plant that will contribute to the national grid through the conversion of between 500-700 metric tonnes of garbage into energy.

GREEN PROCUREMENT

Our suppliers’ environmental credentials are evaluated when awarding contracts. We follow a comprehensive process of engagement in this regard with suppliers whose turnover exceeds Rs 1 Mn.

CSR GREEN INITIATIVES

Our CSR green initiatives during the year revolved around creating awareness about bio diversity conservation. Some of the programme carried out during the year are listed below.

- » The Bank partnered with Sri Lanka Water Partnership and conducted a project on disaster risk reduction through climate

change adaptation for landslide effected communities in Aranayake. The Bank has funded rain water harvesting units in 10 schools in the areas effected by catastrophic landslides in 2016. Awareness programmes on disaster risk reduction were conducted for effected communities, school children and the public sector. The bank also conducted catchment conservation programmes, such as planting trees and applying soil conservation methods identified locations.

- » Sponsored the International Day of Biological Diversity on 21st of May 2017. Organised by ‘Biodiversity Sri Lanka’ with the aim of creating awareness on the conservation of bio diversity.
- » Conducted a workshop on waste management for corporates, highlighting opportunists for innovative waste management projects in collaboration with Bio-diversity Sri Lanka.
- » HNB also sponsored a beach cleaning project together with project partners. Partners were made up from students of the Faculty of Management & Finance of the University of Colombo, Nalanda College Colombo and St.Peter’s College.

RELEVANCE TO BANK

- » 34.5% NII
- » 13.0% of Total Assets
- » 49.8% of Liabilities

KEY FACTS

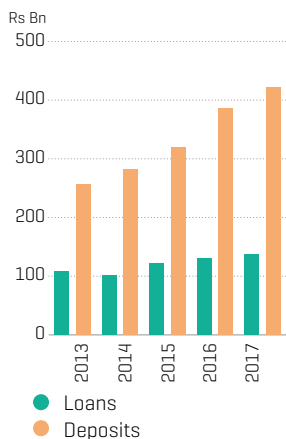
- » Largest leasing portfolio among private commercial banks
- » Largest card acquirer
- » Dedicated Islamic Banking Unit

LEVERAGING THE LARGEST NETWORK OF CUSTOMER TOUCH POINTS IN THE COUNTRY, HNB PROVIDES ACCESS TO BANKING TO OVER 2.5 MN CUSTOMERS ISLANDWIDE CONNECTING SRI LANKANS TO ECONOMIC OPPORTUNITY. THIS YEAR WE FOCUSED ON DRIVING CUSTOMER CENTRICITY THROUGHOUT THE ENTIRE BRANCH NETWORK BY CENTRALISING PROCESSES ENABLING BRANCHES TO FOCUS ON NETWORKING, RELATIONSHIP BUILDING AND IMPROVING SHARE OF WALLET FACILITATING THEIR GROWTH.

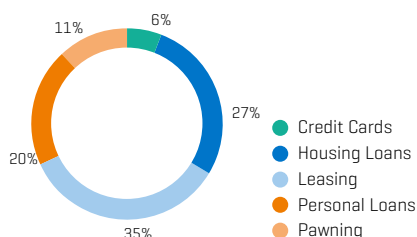
Retail banking caters to customer needs throughout their lifecycle across all customer profiles making HNB a key partner in the country's socioeconomic progress. A comprehensive product suite supported by sound digital platforms and an extensive network of customer touch points, provide

unparalleled access to financial services for Sri Lankans islandwide. We continue to innovate solutions, driving growth of a strong domestic franchise through a deep understanding of the aspirations of our customers and challenges faced by them.

LOANS & DEPOSITS



RETAIL LOAN MIX



PERFORMANCE

Highlights	2017	2016	Change
NII [Rs Mn]	14,787	11,669	26.7%
Deposits [Rs Mn]	422,228	386,578	9.2%
Loans & Advances [Rs Mn]	122,730	116,722	5.1%
NPA Ratio	2.3%	2.2%	

Retail banking delivered growth in NII of 26.7% through deposit growth of 9.2% and loans and advances growth of 5.1% during the year. Loans and advances growth moderated in line with the country's economic growth and prudent credit acceptance. Centralisation and automation of processes facilitated enhanced customer experience and convenience while enabling scalability curtailing operational cost increases. Retail impairments were contained effectively through strengthened underwriting standards driving focus on salaried and captive employees of our Corporate and SME customers. The launch of the Centre of Aspiration in October 2017 brought in significant credit collections and augurs well for further improvements in asset quality for the future.

Through concerted efforts HNB maintained its CASA ratio in a year when the industry saw a marked reduction. A key contributor to maintaining CASA was the focus through multiple initiatives and a value proposition tailored to different business segments.

Payfast, our payroll package saw a quantum improvement in transaction volumes since its launch in the last three years affirming its success.

INNOVATIVE SOLUTIONS

We continued to enhance our comprehensive product suite set out in the Sustainability Supplement, through innovative solutions that address challenges faced by our customers. Loans and advances growth was supported by personal loans to target segments and credit cards with growth rates of 13.1% and 17.0% largely attributable to superior relationships and ease of processing. Our deposit products HNB You and Money Market Savings proved to be popular deposit products both growing by 167% and 212% respectively, a result of the value-added features and enhancements effected during the year. The customer touch points as given in the Manufactured Capital Report enhanced customer service together with the digital transformation that deepened during the year. Appointment of a Customer

Experience Officer facilitated higher levels of objective engagement with customers and regular measurement of customer satisfaction levels which remained high throughout the year.

Cards maintains its position as the largest acquirer of cards in the country with a market share of approximately 45% and is a key driver of fee income growth. We continue to expand our merchant network, work in partnership with merchants for promotions and discounts and enhance security of the card operations. The value of transactions increased to Rs 18 Bn, recording a growth of 18.7%, reflecting increasing utilisation of cards as we move towards cashless transactions.

In December 2017, the dedicated Islamic Banking Unit relocated to a new location in recognition of its potential for the future. The lending portfolio recorded growth of 33.2% to Rs 13.2 Bn while the deposit portfolio recorded growth of 65.6% to Rs 8.3 Bn. Awards for Deal of the Year and Islamic Finance Entity of the year from the Sri Lanka Islamic Banking & Finance Industry awards

and the Islamic Finance Forum of South Asia stand testimony to the success of this unit together with a track record of exceeding targets since commencement in 2012.

As one of the pioneering banks to spread out its Inward Remittance businesses to the Middle Eastern region in the late 1980's, HNB now has access to a wide network of Exchange Houses and Global Remittance partners. The Bank further strengthened its global remittance partnering network by adding three more exchange houses and deploying own officials to represent the Bank in Israel.

Despite the drop in inward remittances to the country, our inward remittance volumes grew by 5% during the year.

We continued to enhance our service offering to this economically important customer segment by introducing card-less remittance claiming facility through the HNB ATM network.

OUTLOOK

Strong brand equity supports the growth of Retail banking operations together with a suite of products that is fit for the future, extensive customer touch points and user friendly interfaces that support digitalisation of banking operations. The continuing journey of centralisation, business process re-engineering, automation and outsourcing has positioned the Bank for growth as branch staff are being increasingly relieved of cumbersome duties facilitating more customer facing activity. While slowing remittances is a concern, Islamic Banking and Cards demonstrate significant potential for growth. Interest margins are expected to remain under pressure which will intensify in 2018. Impairment charges are expected to decline as measures taken during the year to strengthen recoveries bear fruit. Our strategies for the future will solidify HNB's leadership in retail banking as we leverage our relationships and service to deliver growth.



Partnerships with Union Pay International

First local bank to accept China Union Pay cards on POS network and planning to extend partnership to ATM cards. UPI is the fastest growing global payment network.



Affinity Card to promote sustainable construction

Launched a co-branded affinity MasterCard credit card with the Ceylon Institute of Builders (CIOB), the pioneer institute promoting sustainable and green constructions in Sri Lanka for entrepreneurs and corporates with lounge access at over 850 airports



Breakthrough partnership with Visa

A special range of benefits for the HNB Visa Infinite and Visa Signature cardholders including concessionary access to over 900 of the world's most prestigious airport lounges and an outstanding range of discounts.



Airport Companion Programme by DragonPass

This provides Visa Infinity card holders access to over 900 of the world's most lavish airport lounges in the world in addition to concessionary rates for lounge visits, the option of reserving a limousine service in 140 of the world's most bustling cities and discounts of up-to 50% at over 800 dining outlets at airports globally for Visa Infinite cardholders.

Business Reviews

SME

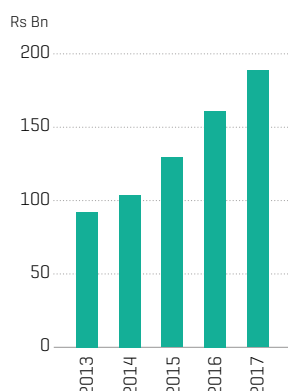
RELEVANCE TO BANK

- » 25.9% NII
- » 19.9% of Total Assets
- » 15.4% of Liabilities

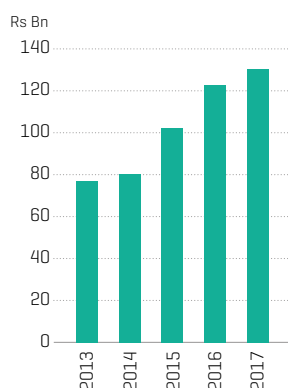
KEY FACTS

- » Largest player in SME and Micro Finance segment
- » Rs 82 Bn of the portfolio outside the Western Province
- » Launch of HNB SME Export Credit with SLEDB

LOANS & ADVANCES



DEPOSIT GROWTH



RECOGNISED AS THE BEST BANK FOR SME BY THE ASIA MONEY MAGAZINE, THE SME OPERATIONS OF THE BANK SUPPORT THE GROWTH OF TOMORROW'S CORPORATES, SUPPLY CHAINS OF EXISTING CORPORATES AND THE SOCIOECONOMIC PROGRESS OF THE LARGEST CATEGORY OF ENTREPRENEURS IN THE COUNTRY.

Providing access to finance for the SMEs in the country from inception, HNB has gathered deep insights into the challenges faced by them [entities with less than Rs 750 Mn turnover] over the years. With 10 dedicated SME Cells and 35 dedicated SME Cell Officers

supporting our extensive branch network, we are positioned in the market as 'HNB SME', reflecting our passion for growing this sector. Our success stories and comprehensive SME offering stands testimony to our commitment.

PERFORMANCE

Highlights	2017	2016	Change
NII [Rs Mn]	11,120	8,133	36.7%
Deposits [Rs Mn]	130,333	122,927	6.0%
Loans & Advances [Rs Mn]	188,673	161,048	17.2%
NPA Ratio	4.2%	4.2%	

The SME portfolio recorded a commendable growth rate of 17.2% despite the adverse impacts of climate change on agriculture and the knock on effect on related industries and communities. This growth in balance sheet coupled with healthy margins enabled a strong growth in NII. Growth in fee income was mainly driven by the transaction banking team who provided the required knowledge to Relationship Managers and customers. Notwithstanding the negativities from extreme weather conditions, the SME NPA ratio was maintained during the year through concerted recovery efforts and focus on booking quality credit.

SUPPORTING SME GROWTH

A number of initiatives were launched to support the growth of SMEs as listed on the adjacent page. The initiatives include product innovations to target growth areas supporting macroeconomic growth, connecting SMEs to markets and capacity building. Women entrepreneurs were given special attention in line with HNB's Women Empowerment initiatives to reduce gender disparities.

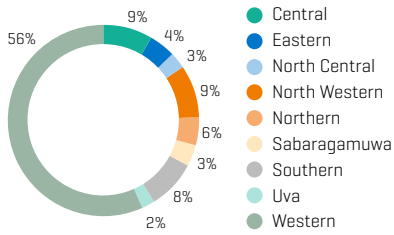
Moving SMEs to digital platforms is key to growth in a digitally driven economy. An MOU was signed in this regard with WEBXPAY to launch an integrated ecommerce platform to assist SMEs to transition into the digital space with websites and cashless transactions. We have also encouraged customers to remit staff salaries and bill payments using HNB's digital platforms which will reduce administration and related costs for SMEs.

In close collaboration with the Export Development Board of Sri Lanka (EDB) we launched the HNB SME Export Credit product to finance the pre and post shipment working capital requirements of the segment.

Distributor Financing was a key area of focus enabling growth of this vital category of SMEs who support growth of the corporate sector. Credit processes were strengthened to support growth in this segment while maintaining a sound risk profile. The product gained traction with total disbursements amounting to over Rs 10 Bn for the year.

Capacity building of our own Relationship Managers was a key area of focus to deliver growth. Cell Officers were trained to support

DISTRIBUTION OF LOANS



SMEs with particular attention paid to assisting them to overcome challenges faced by the sector. An experienced panel of internal and external experts on related areas ensured a holistic approach and diverse perspectives to issues in the sector.

OUTLOOK

SME being the backbone of the economy of Sri Lanka, we see vast potential for growth in the SME sector. We will further enhance our value proposition to the sector to propel growth and accelerate their migration to the digital space connecting them to global markets.



Launch of HNB SME Export Credit

Collaborated with the Export Development Board of Sri Lanka to design a customised product for export oriented SMEs to enable their growth while supporting the macroeconomic goals of the country.



Transitioning SMEs to Digital Platforms

MOU was signed with WEBXPAY to launch an integrated ecommerce platform aimed at empowering Micro, Small and Medium businesses in Sri Lanka to adapt to ecommerce.



Disbursements to SMEs

Rs 137 Bn disbursed to SMEs during the year taking the portfolio to Rs 188.7 Bn.



Workshop for Women Owned/Women Led Businesses

Guided women-led SMEs to increase their awareness about financial management and successfully overcome finance related bottlenecks.



SME Exports Workshops

Completion of two export related workshops in order to identify potential markets for exporters, identification of buyers and sellers and bank financing under HNB SME Expo Credit.



Capacity Building of SMEs

Provided training in financial management, HR management, resolving business challenges, assuring compliance, gaining visibility and improving supply chain management of their companies.



Capacity Building of SME Officers

SME Cell Officers were trained on the use of proper financials, business challenges, assure compliance, NPV and IRR calculations, project managements etc., to support growth of this sector.

Business Reviews

MICRO FINANCE

RELEVANCE TO BANK

- » 2% NII
- » 2.3% of Total Assets
- » 0.6% of Liabilities

KEY FACTS

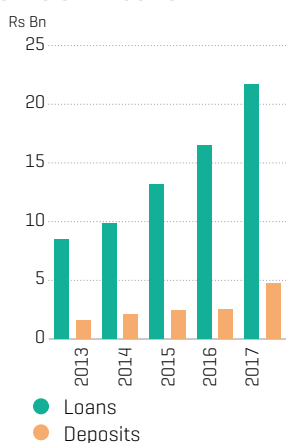
- » Leading player in Micro Finance
- » 58% of portfolio is outside the Western Province
- » Channelled Rs 2.4 Bn into micro entrepreneurs as a participating bank in 2017

MICRO FINANCE OPERATIONS OF THE BANK SUPPORT THE GROWTH OF TOMORROW'S SMES, KEY SUPPLY CHAINS OF CORPORATES AND SUPPORT LIVELIHOODS OF ASPIRING ENTREPRENEURS WITH A COMPREHENSIVE RANGE OF SERVICES THAT ADDRESS THE CHALLENGES TO GROWTH OF THIS SEGMENT. AWARDED THE BEST MICRO FINANCE PRODUCT BY THE ASIAN BANKER AND THE MOST INNOVATIVE MICROFINANCE BANK IN SRI LANKA BY THE INTERNATIONAL FINANCE MAGAZINE, HNB'S MICROFINANCE BUSINESS PLAYS A KEY ROLE IN FINANCING THIS SECTOR IN A SOCIALLY RESPONSIBLE MANNER.

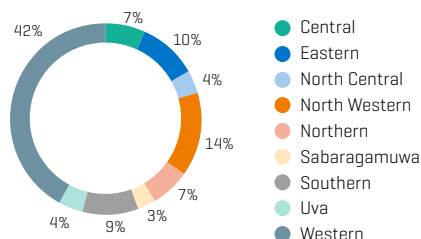
Micro Entrepreneurs (entities requiring loans below Rs 5 Mn) play a key role in the country's supply chains. HNB has a unique approach to financing this sector using a combination of

direct financing and capacity building while also collaborating with established micro finance institutions.

LOANS & DEPOSITS



DISTRIBUTION OF LOANS



PERFORMANCE

Highlights	2017	2016	Change
NII [Rs Mn]	861	656	31.3%
Deposits [Rs Mn]	4,747	2,494	90.4%
Loans & Advances [Rs Mn]	21,677	16,458	31.7%
NPA Ratio	4.5%	3.3%	

The Micro Finance loans and advances portfolio recorded 31.7% growth, while deposits from this segment recorded exponential growth of 90.4% reflecting initiatives taken to introduce a higher degree of financial management in the sector. NII growth reflects the growth of the portfolio while fee based income growth bears testimony to higher levels of activity facilitated by the 'Gami Pubuduwa Updeshakas', the field officers through transaction banking products and access to expertise of the Bank. Predictably NPA's increased due to adverse impacts of inclement weather on the agriculture, agri based industry and their impacts on communities. Micro finance facilities in the agriculture sector will be rescheduled to ease the burden and ensure that they stay afloat.

SUPPORTING GROWTH OF MICRO ENTREPRENEURS

The Bank continues to use its insights to innovate and enhance the value delivered to its customers. Consequently, the Bank's annual HNB Gami Pubuduwa Avurudu Pola event conducted regionally was modified in 2017 to a single mega event over two days at BMICH attracting over 40,000 consumers at which 100 micro entrepreneurs from all regions were given an opportunity to market their wares. The Bank also provided ATMs and electronic banking facilities (POS terminals) enabling sales of over Rs 10 Mn and insights into succeeding in a more competitive market.

Establishing partnerships for providing access to finance was a key strength in expanding our role in Microfinance. Partnering with the Ceylon Chamber of Commerce and Citibank in the Rural Economic Empowerment Programme, 50 rural entrepreneurs were assisted in improving their financial literacy, business management and were provided

finance in the first phase with a further 30 assisted in the second phase. Beneficiaries in the first phase were from the Matara and Ratnapura districts while those in the second phase were from the Anuradhapura district. Additionally, the Bank partnered with the International Executive Service Corps (IESC) for USAID-funded YouLead programme to improve technical, vocational education and training, and to increase the employability of young people in Sri Lanka by extending financial assistance to youth-led start-ups. HNB is also a key participating bank in government and donor funded initiatives for this sector, channelling over Rs 2.4 Bn in 2017.

Supply chain financing leveraging the strength of our corporate customers for mutual growth was also a growth area particularly for dairy and maize farmers. We were able to build up financial literacy, technical know-how among the rural farmer community through agricultural officers and micro finance officers serving in the rural areas creating new employment opportunities in the agricultural sector and related fields.

OUTLOOK

We will continue with the initiatives commenced in 2017, acting as a catalyst in the evolution of micro entrepreneurs to commercially savvy SMEs. Capacity building initiatives, access to markets, finance and technology are key areas of focus within the sector. Collaborative partnerships will also play a key role as they enable delivery of holistic solutions and extend our reach to under-served communities facilitating financial inclusion. This segment is vital to the stability in supply chains as witnessed in 2016 and 2017 and we will continue to facilitate their progress through innovative and meaningful interventions.



Ath Pawura

Banker for this reality TV show to inspire innovators in collaboration with ITN. Successful innovators receive support and guidance in commercialising their concepts.



Disbursed Rs 8 Bn Micro Finance Loans

Rs 8 Bn was disbursed to micro entrepreneurs providing much needed capital to support their livelihoods taking the portfolio to Rs 22 Bn.



Rural Empowerment Programme

Training 300 people from Puttalam, Anuradhapura, Ratnapura and Matara in a joint programme with Citibank and the Ceylon Chamber of Commerce.



HNB Gami Pubuduwa Avurudu Pola

Organising annual mega fairs for micro entrepreneurs spread across the country to build connections and expand their market.



Channelling funds to MicroFinance

HNB has participated in seven refinancing schemes taking a lead role in identifying beneficiaries for funds given at concessionary rates.



Supply Chain Financing for Dairy and Maize farmers

Working with corporate customers to create new employment opportunities, use of modern tools and technologies and providing access to finance.

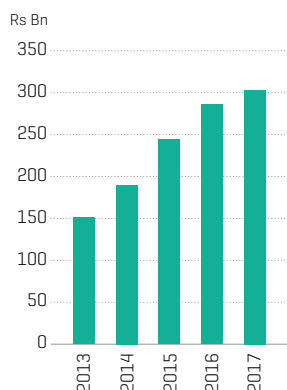
RELEVANCE TO BANK

- » 24.2% NII
- » 33.4% of Total Assets
- » 15.0% of Liabilities

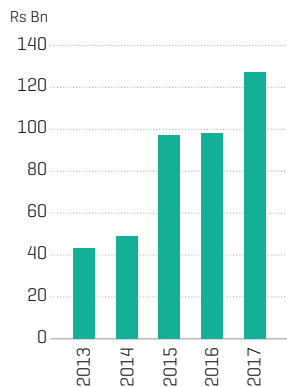
KEY FACTS

- » Largest Corporate Banking balance sheet among private sector banks
- » Complete array of products and services including payment and cash management, custodial and trustee services
- » Lead arranger for key projects

LOANS & ADVANCES



DEPOSIT GROWTH



OWNING THE LARGEST CORPORATE BANKING BALANCE SHEET AMONG ALL FOREIGN AND LOCAL PRIVATE SECTOR BANKS, HNB SUPPORTS THE GROWTH OF THE PRIVATE SECTOR THROUGH INNOVATIVE FINANCIAL SOLUTIONS USING STATE-OF-THE-ART TECHNOLOGY.

A complete array of corporate banking products and services including working capital financing, trade finance, project finance, custodian services combine with a fully-fledged electronic payment and cash management platform to support sustainable growth of our clients. Initiatives to improve our customer solutions are based on decades

of insights as we grew together with the corporates in the country. We continue to expand our portfolios in new markets such as Maldives, Bangladesh, Uganda and Cambodia, supporting our customers' growth as they venture into new markets as true business partners in a symbiotic relationship.

PERFORMANCE

Highlights	2017	2016	Change
NII [Rs Mn]	10,389	7,150	45.3%
Deposits [Rs Mn]	126,807	98,168	29.2%
Assets [Rs Mn]	316,410	300,314	5.4%
NPA Ratio	1.3%	0.7%	

Growth in advances was relatively subdued at 5.4% due to the Bank's focus on profitable balance sheet growth, and accordingly the Corporate Banking business recorded a 45.3% growth in Net Interest Income (NII). Consequently, focus on improving CASA and ancillary business yielded results supported by our digital cash management solutions, improving the funding structure of the Bank. Corporate Banking accounted for 45% of the Bank's CASA growth during the year, playing a pivotal role in business acquisition for the

Bank demonstrating success of our cross sell initiatives. Regrettably, impairment charges increased during the year due to a one off large exposure, which is expected to revert to profitability.

The Bank continued to expand its overseas lending operations supporting customer ventures overseas together with Development Financing Institutions, with our own customers and through referrals. The overseas lending portfolio is over USD 123 Mn.



Upskilling our team was key to successful implementation of strategy in line with our belief that happy employees are a sine qua non for happy customers. Several initiatives were implemented to ensure happiness of staff and an engagement score survey is done on a monthly basis to monitor happiness and engagement levels of staff. Improvement in scores to 75% is indicative of the scope of initiatives and high levels of engagement.

OUTLOOK

Growth in corporate banking is dependent on the country getting back on its planned growth trajectory. The Bank continues to stimulate FDI in targeted hubs, supporting growth of the economy and is an active participant financing landmark projects and capacity building within the country. It will continue to maintain its position as one of the largest corporate bankers to the private sector, leveraging its expertise and insights to finance this vital engine of economic growth.



Housing in the Maldives

Committed USD 6.5 Mn to a client in the Maldives to finance construction of 7000 housing units in Hulumale to ease the population density in Male



Funding Clean Energy

Rs 2.5 Bn disbursed for hydro, solar and bio-mass energy projects in 2017 taking the portfolio in clean energy to Rs 4 Bn



Funding Waste to Energy

Lead arranger for Rs 9 Bn facility for a waste to energy project that will resolve Colombo city's staggering garbage problem. HNB's own commitment is Rs 2 Bn



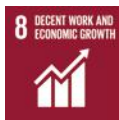
Funding Healthcare

Funding Rs 1.9 Bn for the construction of a government hospital



Introduced Custodian and Trustee Services

Trustee for nearly 90% of the securitisation transactions by the industry in 2017



Funding Capital Market Transactions

Arranged funding for largest capital market transaction in the history of the Colombo Stock Exchange



Funding iconic real estate projects

Appointed Lead Funding Arranger for the iconic Odel Mega Mall project

Business Reviews

TRANSACTION BANKING

TRADE

RELEVANCE TO BANK

- » 20.1% Fee Income
- » 5.2% of Total Assets

KEY FACTS

- » Trade Fee Income Growth 20.3%
- » Import Growth 14.1%
- » Export Growth 23.1%
- » Introduction of the Export Direct Collection Product
- » Introduction of Online payment of SLPA charges and Customs Duty

HNB'S TRANSACTION BANKING FACILITATES TRADE AND CONNECTING SRI LANKAN BUSINESSES TO GLOBAL OPPORTUNITIES. DECADES OF EXPERTISE, GLOBAL NETWORK OF FINANCIAL INSTITUTIONS, FUTURE READY TECHNOLOGY COUPLED WITH HIGH STANDARDS OF CUSTOMER SERVICE, DRIVE OUR PERFORMANCE WHICH IS PIVOTAL TO GROWTH OF THE BANK.

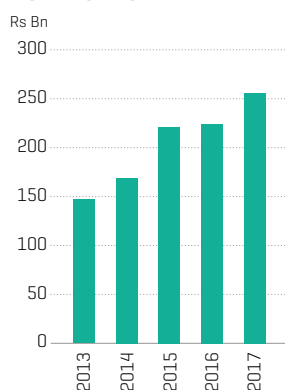
Supporting Corporate Banking, Mid Market and SME verticals of the Bank, the Transaction Banking vertical provides specialised trade

finance services to their clients, facilitating the Bank's and country's trade growth.

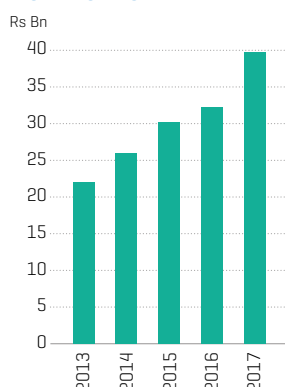
PERFORMANCE

Highlights	2017	2016	Change
NII [Rs Mn]	1,261	934	35.1%
Fee Income [Rs Mn]	1,461	1,215	20.3%
Loans & Advances[Rs Mn]	49,362	38,192	29.2%

IMPORT TURNOVER



EXPORT TURNOVER



Both imports and exports recorded encouraging growth rates of 14.1% and 23.1% exceeding the country's import and export growth rates as of November 2017 of 9.4% and 10.2%, reflecting gains in market share. Focus on exports through targeted programmes for relationship managers and branches to enhance product knowledge and for better evaluation of lending, supported growth of export volumes. Further, programmes conducted in collaboration with the Export Development Board of Sri Lanka and the National Chamber of Exporters to enhance knowledge of exporters complemented the growth in export volumes. Technology played a key role, with the introduction of online access to HNB trade services making banking more convenient. Import growth was driven through both client acquisition and volume growth of existing clients. Driving digitalisation has also been a key strategy during the year with the introduction of the Export Direct collection product, facilitation of online payment of Sri Lanka Ports Authority (SLPA) charges and Customs duty, and encouraging the use of other online services.

Launch of HNB SME Expo Credit in August 2017 in collaboration with the Export Development Board of Sri Lanka was a key initiative by the Transaction and SME verticals

to support growth of the SME sector. It provides pre and post shipment financing support to SME Exporters with limited tangible security, based on their business performances.

Happy-people initiatives to make learning fun through quizzes and alternative media vs classroom training played a key role in driving success. The Bank has one of the largest talent pools of Certified Documentary Credit Specialists in the entire banking industry in the country strengthening our competitive position.

The Special Trade Unit set up in 2015 to support branches with lower levels of trade expertise, has proved successful and this was expanded during the year as business from branches increased due to higher levels of engagement by the Special Trade Unit. Additionally, all processes have been reviewed and lean solutions implemented including digitalisation of processes to drive efficiency and productivity which enabled accommodation of enhanced volumes while maintaining head count.

FINANCIAL INSTITUTIONS

This key business vertical manages over 900 strategic correspondent banking

network relationships across 85 countries supporting all cross-border transactions and provides cross border guarantees supporting the development of the country's infrastructure projects. Income from issuance of international guarantees recorded a growth of 16% from Rs 188 Mn in 2016 to Rs 218 Mn in 2017 supported by infrastructure related growth necessitating cross border guarantees. HNB is a leading private bank providing guarantees related to infrastructure projects as we leverage relationships between correspondent banks and their clients to service local requirements.

This vertical generates significant cross sell opportunities to trade finance, retail and SME verticals and is a key contributor to the growth of trade finance.

In keeping with the Bank's sustainable business model, all projects which are generally of national interest and significance in areas such as water, health, waste management, energy and roads, are screened for environment and social compliance through Environmental and Social Management System [ESMS]. We also focused on driving productivity and training our staff to compete effectively and deliver efficiently.

Key strengths of the business include the relationship with our clients, correspondent bank network, and product expertise. Competing with foreign banks that have the competitive advantage to cover both sides of the transactions and adherence to strict regulatory and compliance requirements remain challenges to further increasing market share.

OUTLOOK

The outlook is positive as trade flows are expected to increase in 2018 as exports gather momentum. The Bank will be seeking ISO 9001: 2015 certification in 2018 for its processes upgrading from the existing 9001: 2008 version. Competition from foreign banks is expected to remain as a key challenge together with the intensifying pressure on margins. We will also be seeking further efficiencies through process improvements and employee productivity.



NORTH AMERICA

- Canada
- Mexico
- United States of America

SOUTH AMERICA

- Argentina
- Bolivia
- Brazil
- Chile
- Colombia
- Ecuador
- Peru

EUROPE

- Austria
- Belgium
- Bulgaria
- Channel Islands
- Cyprus
- Czech Republic
- Denmark
- Finland
- France
- Germany
- Greece
- Hungary
- Ireland
- Isle of Man
- Italy
- Kosovo
- Latvia

- Liechtenstein
- Luxembourg
- Macedonia
- Monaco
- Netherlands
- Norway
- Poland
- Portugal
- Romania
- Slovakia
- Slovenia
- Spain
- Sweden
- Switzerland
- Turkey
- Ukraine
- United Kingdom

AFRICA

- Botswana
- Egypt
- Ethiopia
- Ghana
- Kenya
- Mauritius
- Morocco
- Seychelles
- South Africa
- Swaziland
- Uganda

AUSTRALIA

- Australia
- New Zealand

ASIA

- Bahrain
- Bangladesh
- China
- Hong Kong
- Georgia
- India
- Indonesia
- Israel
- Japan
- Jordan
- Korea (Republic of)
- Kuwait
- Lebanon
- Malaysia
- Maldives Islands
- Nepal
- Oman
- Pakistan
- Philippines
- Qatar
- Saudi Arabia
- Singapore
- Taiwan
- Thailand
- United Arab Emirates
- Vietnam

TREASURY

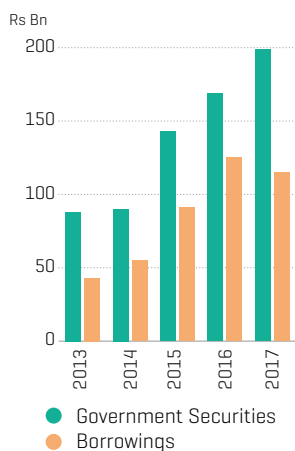
RELEVANCE TO BANK

- » 13.3% NII
- » 20.8% of Total Assets
- » 13.6% of Liabilities

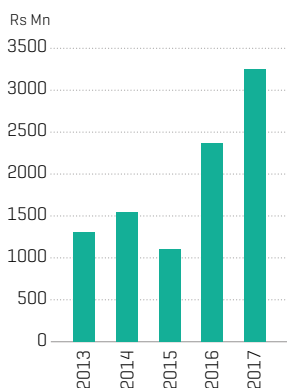
KEY FACTS

- » Maintained Liquid Asset Ratio at 24.1% against the statutory minimum of 20%
- » 37.6% growth in forex income

GOVT SECURITIES AND BORROWINGS



FOREX INCOME



TREASURY PLAYS A VITAL ROLE IN MANAGING THE LIQUIDITY RISK, INTEREST RATE RISK AND FOREX RISK OF THE BANK AND DRIVES GROWTH OF OUR KEY BUSINESS VERTICALS. IT ALSO SUPPORTS OUR CUSTOMERS' GROWTH THROUGH INNOVATIVE TREASURY PRODUCTS THAT FACILITATE THEIR FINANCIAL RISK MANAGEMENT.

The Federal Reserve increased rates three times in 2017 by 25 bps each, strengthening the US Dollar. Market volatility increased in the first half of the year due to uncertainty on foreign policy and trade stance of the USA. Eurozone issues also remain as Brexit issues dominate the agenda. Middle East volatility and risk levels increased due to international events which impacted business status quo. Japan remained relatively stable during the year. Notably, the Chinese currency stabilised in 2017 and Sri Lanka's business volumes with China recorded growth. Oil prices also increased during the year as a result of higher

demand arising from the higher growth in the world economy.

2017 commenced with low confidence in markets and negative LKR liquidity. Interest rates on government securities started moving down with improved liquidity. The clear policy direction outlined by the Governor of the Central Bank enhanced investor confidence which resulted in attracting foreign investments to the country during the year. The Sri Lankan rupee depreciated against all currencies with a gradual depreciation versus the US Dollar. In 2017 CBSL accumulated foreign reserves by buying Dollars in the market.

PERFORMANCE

Highlights	2017	2016	Change
NII [Rs Mn]	5,716	4,649	23.0%
Forex Profit [Rs Mn]	3,249	2,362	37.6%
Investment in Government Securities [Rs Mn]	198,615	169,081	17.4%
Borrowings [Rs Mn]	114,966	124,563	(7.7%)
Loan to Deposits Ratio	91.1%	93.7%	

Trade volumes increased by 20% during the year both in exports as well as imports leading to growth in Treasury volumes. The Bank is also in the process of upgrading its Treasury system which will support the growth in transactions, scalability and process efficiencies while acquiring more product capability to cater to evolving customer needs. In addition, in 2017 the Bank invested on training treasury staff, enhancing their skills as well as conducted treasury related training programmes for branch staff to promote treasury products and improved awareness at branches.

During 2017, the Treasury also raised USD 100 Mn by way of a loan from a European Bank for two years strengthening the Bank's liquidity position at a time when the local market liquidity was tight.

OUTLOOK

The outlook for 2018 is positive with international trade and tourism expected to grow. Liberalisation of the Exchange Control Act also enables marketing of more advanced treasury products, thereby expanding the scope of Treasury activities. However the new guidelines issued by the regulator towards December 2017 in the areas of foreign borrowings and derivative products may affect the market activity and will remain the biggest challenge in 2018.

Business Reviews

INSURANCE

RELEVANCE TO GROUP

- » 4% of Profit Before Tax
- » 1.9% of Total Assets
- » 1.7% of Liabilities

KEY FACTS

- » Rated A(Ik) by Fitch Ratings Lanka Ltd.
- » PAT Rs 909.8 Mn
- » ROE 28%

HNB ASSURANCE IS ONE OF THE FASTEST GROWING INSURERS IN THE COUNTRY, OFFERING A COMPREHENSIVE PORTFOLIO OF PRODUCTS TOGETHER WITH ITS SUBSIDIARY HNB GENERAL INSURANCE LTD INCLUDING CONVENTIONAL AND TAKAFUL SOLUTIONS. RATED A LKA BY FITCH FOR NATIONAL INSURER FINANCIAL STRENGTH RATING AND NATIONAL LONG-TERM RATING, HNBA CONTINUES TO EXPAND ITS FOOTPRINT ACROSS THE COUNTRY ENHANCING FINANCIAL STABILITY.

PERFORMANCE

Highlights	2017	2016	Change
Gross Written Premiums [Rs Mn]	7,821	6,657	17.5%
PAT [Rs Mn]	910	647	40.6%
Total Comprehensive Income [Rs Mn]	935	648	44.3%
Total Assets	18,649	14,529	28.4%
Insurance Contract Liabilities [Rs Mn] - Life	10,916	8,748	24.8%
Insurance Contract Liabilities [Rs Mn] - General	2,385	1,922	24.1%
Equity [Rs Mn]	3,796	2,697	40.7%
ROE	28%	26%	

HNBA recorded a commendable Gross Written Premium growth of 17.5% for 2017, outpacing consolidated industry growth of 14%. The Group's risk profile was maintained at prudent levels resulting in an increase of premium ceded to reinsurers by 25% reflecting the company's robust risk transfer approach. Portfolio growth and increasing interest rates supported the growth of investment income by 52% to Rs 1.7 Bn contributing towards enhanced profitability as claims and expense ratios to Net Earned premium decreased from 107% to 102% reflecting improvement in operational efficiency of the General Insurance operation. Profit after Tax and Total Comprehensive Income increased by 40.6% and 44.3% respectively to Rs 910 Mn and Rs 935 Mn in testimony of well-focused strategies of 2017.

LIFE SECTOR

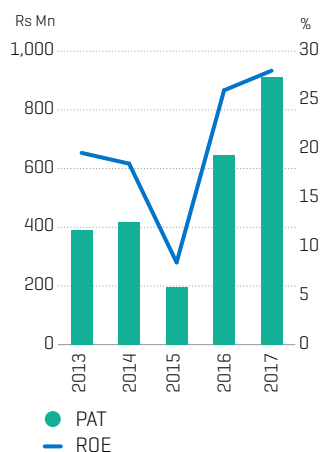
Gross Written premiums in Life sector recorded 12% growth driven by the Bancassurance initiative with HNB as HNB Assurance focused on leveraging group synergies. The Agency network which is also a key channel was also supported by facilitating their migration through a layered approach,

incentivising enhanced performance and empowerment to access a mass affluent market. While lower disposable incomes and high deposit rates offered by banks and finance companies were a challenge for growth. These conditions were met through close performance management and targeted marketing, initiatives enabling HNBA to be on par with the industry growth of 12%. Additionally, high interest rates supported strong growth in Investment Income as mentioned above.

GENERAL SECTOR

The General Insurance sector recorded 24% growth strongly supporting profitability of HNB General Insurance which is now in its 3rd year of operation since the split of the Life and General Insurance businesses. Profit after Tax improved by 289% to Rs 184 Mn reflecting focused risk selection, effective pricing of risks and a strong sales culture. The steady growth achieved by the Company enabled the absorption of a high level of claims due to floods in May 2017. All our distribution channels grew significantly in all geographic segments as we focused efforts on making business partners and agents more

PROFITABILITY



Business Reviews

INSURANCE

productive within identified segments with the right products. Targeted engagement with the brokers, branches and bancassurance, agents, leasing companies supported growth while a clear focus on underwriting contributed to improved profitability.

STABILITY AND GROWTH

Our financial capital growth has been supported by growth of our human, social and relationship and intellectual capitals. Balance sheet growth of 28.4% reflects business growth combined with investment portfolio growth of 30%. Capital adequacy ratios of Life and General insurance businesses improved to 358% and 178% supported by strong equity growth as profitability of the Group improved. Diversity across industry, market and geographic segments was enhanced as high levels of engagement, support and empowerment of agents, brokers and business partners by our centralised marketing teams steered broad based growth in the right direction. We are confident that these foundations, an inclusive strategy and sound business principles provide a strong platform for future growth and we maintain adequate buffers for anticipated volatility in macroeconomic trends.

OUTLOOK

Sound financial health of the company supports expansion in profitable business segments, leveraging group synergies and business partner networks. Life insurance business is expected to grow as investment in capacity building of agents support mutual growth aspirations driving business volumes. General Insurance will focus on providing customised solutions, focused underwriting and cost leadership initiatives which are expected to support growth and contribute to improved profit margins. Sound governance and a prudent risk appetite ensure regulatory compliance with capital and other requirements, auguring well for the long term value creation ability of the HNB Assurance Group.

RELEVANCE TO GROUP

- » 6.4% of Profit Before Tax
- » 2.5% of Total Assets
- » 1.7% of Liabilities

KEY FACTS

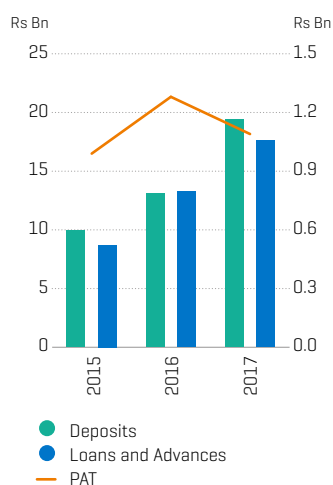
- » 74% of credit portfolio lies outside the Western Province
- » Over 90% of loan facilities are for women
- » Credit rating of A-
- » Rated among the Best 25 Companies to work in Sri Lanka

FOCUSING ON WOMEN IN RURAL AREAS, HNB GRAMEEN PROMOTES FINANCIAL INCLUSION AND WOMEN EMPOWERMENT THROUGH A HYBRID MODEL OF THE GRAMEEN MICROFINANCE CONCEPT TO FACILITATE THE SOCIOECONOMIC PROGRESS OF THE POOREST OF THE POOR

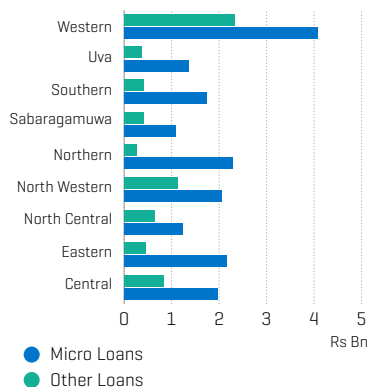
HNB Grameen extends the Group’s ability to reach the unbanked segments, supporting livelihoods with access to finance and financial literacy, enabling them to uplift their lives from poverty with loans ranging from Rs 10,000 to Rs 20 Mn. Cultivating a savings habit in our customers has been key to their success, empowering them to dream bigger and reach higher with us. Our tag line “Andura duralana sonduru mehewara” captures our passionate commitment to serving this

sector. Entry of Developing World Markets, a leading emerging markets impact investment firm, will strengthen our business model as we seek to penetrate deeper into the market. Being ranked among the 25 best companies to work for in Sri Lanka by the Great Place to Work Institute and winning the Best in Pride & Advocacy and the Bronze in the Large Enterprises category in our first year of entry is testimony to how we live our values.

GROWTH



DISTRIBUTION OF LOANS



PERFORMANCE

Highlights	2017	2016	Change
Gross Income (Rs Mn)	7,294.6	5,795.3	26%
NII (Rs Mn)	4,197.5	3,617.4	16%
PAT (Rs Mn)	1,084.6	1,280.7	-15%
Equity (Rs Mn)	4,274.3	3,322.5	29%
ROE	29%	47%	

Customer acquisition was healthy during the period with deposit growth of 48% outstripping loans and advances growth of 33%. New products gained traction supporting Net Interest Income growth of 16% with 73% derived from Micro Financing operations. Interest margins were impacted by increased costs of capital and the growth in new products at lower margins. In the backdrop of adverse weather conditions moderating economic growth, asset quality also declined with NPA increasing from 1.6% to 3.8% impacting the bottom line together with a provision of Rs 465.9 Mn for the investments in government securities made through Entrust Securities PLC. Notwithstanding, HNB Grameen recorded a ROE of 29% comparing favourably with other players in the sector.

Our operations now extend beyond Micro Finance to leasing, personal loans and SME loans enabling us to support the growth of

our customers. The average tenure of loan is two years enabling customers to realise goals and repay facilities prior to setting more ambitious goals. Loans to new customers take three weeks to process enabling robust due diligence and assessment. However, subsequent facilities are typically disbursed within one week while leasing facilities are processed within two to three days.

Capacity building of customers has been a key area of focus and forms part of the credit evaluation. Partnerships with external resources for training enhanced internal capabilities in delivering comprehensive training programmes for our customers. Distribution channels were expanded to include ATM cards and 134,641 cards were issued during the year making saving and repayment easier for our customers as they are able to access entire network of 595 ATMs of HNB, using the card.

Business Reviews

HNB GRAMEEN

OUTLOOK

We will continue to increase penetration and deliver growth using innovation as a strategy to further differentiate our products, leveraging our experience gained in the sector. Strong risk management and monitoring processes is key to sustained growth and profitability and we will continue to invest resources to strengthen this area, leveraging expertise of our parent company. Capacity building of micro-entrepreneurs will remain

a key component of our growth strategy having witnessed the positive impact of the programmes in the past and its ability to uplift their lives in alignment with the country's vision and the sustainability development goals.



Disbursed of microfinance loans

Rs 17.9 Bn was disbursed to micro entrepreneurs who were also provided financial literacy training



Lending outside the Western Province

Over 74% of our loan portfolio is outside the Western Province



Empowering women

Over 90% of loans and advances are given to women who have reinforced our belief in this segment by maintaining high repayment rates



Reducing use of polythene

Launched programme to reduce the use of polythene



Capacity Building Programmes

All loan beneficiaries are given one day's training on financial management prior to disbursement of loan



Inspiring and Motivating Customers

We continue to inspire and encourage our customers through a magazine featuring success stories and articles to develop skills for managing a business

Business Reviews

INVESTMENT BANKING

RELEVANCE TO GROUP

- » 0.8% of Profit Before Tax
- » 0.2% of Total Assets

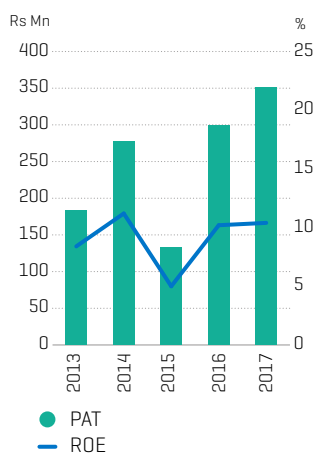
KEY FACTS

- » Full Service Investment Bank
- » PAT Rs 351.2 Mn
- » ROE 10.4%

ACUITY PARTNERS (PVT) LTD.



PROFITABILITY



ACUITY PARTNERS IS AN INTEGRATED, FULL SERVICE INVESTMENT BANK WITH A COMPREHENSIVE SUITE OF PRODUCTS COVERING CORPORATE FINANCE, FIXED INCOME SECURITIES, STOCK BROKING, VENTURE CAPITAL AND ASSET MANAGEMENT.

Highlights	2017	2016	Change
Fund Based Income (Rs Mn)	1,162	1,021	13.8%
Fee Based Income (Rs Mn)	90	88	2.2%
PAT attributable to shareholders (Rs Mn)	351	299	17.6%
Assets (Rs Mn)	14,541	11,574	25.6%
Equity (Rs Mn)	3,602	3,125	15.3%
ROE	10.4%	10.2%	

Acuity Partners recorded a 17.6% growth in PAT attributable to shareholders, contributing Rs 175.5 Mn to PAT of the HNB Group despite lackluster equity markets and moderation in economic growth. The benchmark ASPI moved up 2.3% in 2017 while the S&P 20 SL Index gained 5.0% as there was renewed foreign interest as foreign buying reached Rs 112.3 Bn by end December leading to a net inflow of Rs 17.7 Bn. However, overall deal flows in the market remained sluggish offering limited opportunity for growth although this is expected to change with the proposed IPOs of key state owned enterprises and the proposed changes to the SEC Act which will pave the way for a greater range of tools and sophistication in the market.

Guardian Acuity Asset Management Ltd, continued to perform well, despite non conducive policy environment due to taxation of mutual funds. The growth in assets under management is indeed commendable as industry players witnessed significant declines.

Acuity Stockbrokers delivered a modest performance in line with the improved albeit subdued performance of the Colombo Stock Exchange. It continues to be a leading player, well positioned for growth when markets become buoyant.

Acuity Securities delivered strong growth and profits as government security rates gradually moved down during the year. Prudent trading strategies facilitated profit growth of 206%.

Although Acuity Corporate Finance was impacted by the tepid interest in offerings,

it recorded a commendable profit during the year. Some of the key projects completed by Acuity Corporate Finance in 2017 include the IPO of LVL Energy Fund of Rs 1.2 Bn, the largest IPO on the CSE since 2014, sale of a 7.9% stake in HNB Grameen Limited to a foreign institutional investor, the sale of AT Cooray to Nawaloka Group, acquisition of a 45% stake in Ascot Holdings PLC by a consortium of foreign and local investors and the listing by introduction of Renuka Hotels Limited. Acuity is also mandated for several large IPOs and debenture issues which are expected to materialise in 2018.

Lanka Ventures Ltd, (LVL) continues to be a key investor in the energy sector of the country through its special purpose investment vehicle LVL Energy Fund. The fund raised Rs 1.2 Bn in equity during the year for investment in three projects growing its portfolio of investments by 23% to approximately Rs 4.8 Bn.

OUTLOOK

Acuity Partners continues to be a leading player in the country's capital markets, enabling corporates to raise capital for business needs. Profitability of LVL is also expected to improve as the portfolio matures. Prudent trading strategies will support profitability of Acuity Securities while the performance of Acuity Stock Brokers is highly dependent on the performance of the Colombo Stock Exchange. Guardian Asset Management is expected to maintain its commendable track record of earnings and growth, supporting wealth management aspirations of clients.

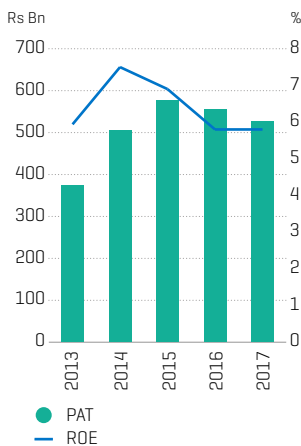
RELEVANCE TO GROUP

- » 2.4% of Profit Before Tax
- » 1% of Total Assets

KEY FACTS

- » Owns HNB Towers
- » Venturing into facilities management

PROFITABILITY



THE REAL ESTATE ARM OF HNB GROUP, SITHMA DEVELOPMENT PVT LTD., OWNS AND MANAGES HNB TOWERS, A STATE OF THE ART COMMERCIAL BUILDING WHICH HOUSES THE HEAD OFFICE OF THE BANK.

Highlights	2017	2016	Change
Income [Rs Mn]	986	940	4.8%
PBT [Rs Mn]	532	561	-5.2%
PAT [Rs Mn]	526	555	-5.2%
Total Assets [Rs Mn]	10,145	10,203	-0.6%
Equity [Rs Mn]	8,513	9,578	-11.1%
ROE	5.8%	5.8%	

Sithma has developed considerable expertise in managing real estate and construction over the years and is expanding its activities to manage the Bank's branch premises from 2018 driving group synergies. Additionally, the commercial complex in Kegalle was completed during the year and is now occupied, generating revenue.

Income from rental of space is a relatively stable source of income and likely to remain at current levels in accordance with agreements currently in place. Revenue from managing the branch network will be a new source of revenue which will enhance revenue and profit growth in the future.

Addressing client concerns regarding utility costs which are borne by Sithma and charged to occupants, the company engaged in activities to mitigate cost escalations and reduce the carbon footprint. These included the following:

- » Migrating from fluorescent tubes to LED lighting
- » Invested in solar energy
- » Upgrading Building Management

These initiatives ensure that HNB Towers continues to be one of the smartest buildings in Colombo with the ability to attract a discerning corporate clientele.

OUTLOOK

Revenue and profit growth will be driven primarily by the expansion of activities to provide facility management services to branch network of the Bank. This will amalgamate the premises and engineering division of the Bank with Sithma to drive synergies within the Group.

CORPORATE GOVERNANCE: ANNUAL REPORT OF THE BOARD OF DIRECTORS ON THE AFFAIRS OF THE COMPANY

- Profiles of Board Members are given in IR page 22 to 25.
- List of Directors of Subsidiaries and Joint Ventures of the Bank are given in IR page 85 to 86.

CHANGES IN BOARD 2017

RETIREMENT / RESIGNATION OF DIRECTORS

- Mr Damien Fernando resigned in April 2017.

APPOINTMENT OF DIRECTORS

- Mr Dinesh Weerakkody was appointed during the year to fill the casual vacancy created by the resignation of Mr Damien Fernando. He will offer himself for re-election at the AGM to be held on 28th March 2018.

RETIREMENT BY ROTATION / REAPPOINTMENT OF DIRECTORS

- Ms Rose Cooray, Mr Palitha Pelpola and Mr Duliksha Soosaipillai who account for 1/3rd of the NED, will retire and being eligible, avail themselves for re-election, as required by the Articles of Association.

The Board of Directors of Hatton National Bank PLC takes pleasure in presenting its Annual Report to the shareholders for the financial year ended 31st December 2017, together with the audited financial statements of the Bank, consolidated financial statements of the Group for the said year and the Auditor’s Report on those financial statements, conforming to the requirements of the Companies Act No 7 of 2007, Banking Act Direction No 11 of 2007 [Corporate Governance for Licensed Commercial Banks and subsequent amendments thereto] and Listing Rules of the Colombo Stock Exchange [CSE]. The Report is also guided by the recommended best practices on Corporate Governance.

This year, the Annual Report of the Board of Directors on Affairs of the company has been expanded to increase the disclosures on the Bank’s corporate governance practices. A more detailed report on Corporate Governance forms part of the suite of reports produced by the Bank this year and is included as a supplement to the Annual Report.

Hatton National Bank PLC (“the Bank”) is a Licensed Commercial Bank registered under the Banking Act No 30 of 1988 and was incorporated as a public limited liability company in Sri Lanka on 5th March 1970 under the Companies Ordinance No 51 of 1938. The Bank was re-registered as required under the provisions of the Companies Act

No 7 of 2007 on 27th September 2007. The re-registration number of the Bank is PQ 82.

The ordinary shares (both voting and non-voting) and unsecured subordinated/senior redeemable debentures of the Bank are listed on the main board of the Colombo Stock Exchange in Sri Lanka. The Bank has been assigned a National Long-Term Rating of AA-[lka] with a Stable Outlook by Fitch Ratings Lanka Ltd and a foreign currency issuer rating of B1 by Moody’s Investors Service which is on par with the sovereign rating. HNB is the first Sri Lankan Bank to obtain an international rating.

The registered office and Head Office of the Bank is located at No 479, T B Jayah Mawatha, Colombo 10, Sri Lanka.

The financial statements were reviewed and approved by the Board of Directors on 20th February 2018.

CORPORATE GOVERNANCE HIGHLIGHTS

The HNB Board is conscious of its responsibility towards shareholders and other stakeholders, in upholding high standards of Corporate Governance and is committed to driving accountability, fairness, and transparency throughout the Bank’s governance framework ensuring it remains robust and relevant in a highly regulated industry and challenging business environment. Industry regulations and internal policies, underpin the governance framework, which is regularly reviewed to adapt to internal developments and benchmarked against international best practice.

The Board

The Board is diverse in its experience, expertise, age and gender, contributing varied perspectives to boardroom deliberations and constructively challenging management on matters set before them. Directors are appointed through a formal and transparent process and are assessed for their independence and approved by the Central Bank of Sri Lanka. New Board members are inducted through a well-constructed programme, aimed at providing them with the information and support they need to be effective in the discharge of duties, as quickly as possible. Directors continue to keep abreast of changes in regulations and the business environment by attending seminars, workshops, conferences and formal training programmes.

AN EFFECTIVE BOARD

*Balanced Board.
Proportion of Independent NED is high.*

BOARD COMPOSITION

Chairman [Independent Non-Executive]



Independent Directors



Non-Independent Non-Executive Directors

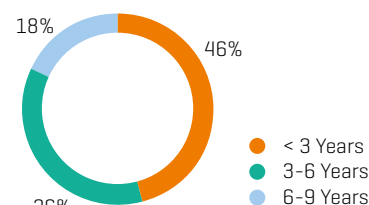


Executive Director



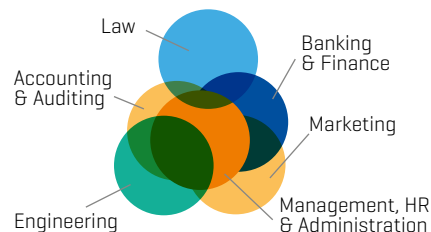
*Sound balance between continuity
and fresh perspectives*

NON-EXECUTIVE DIRECTOR TENURE

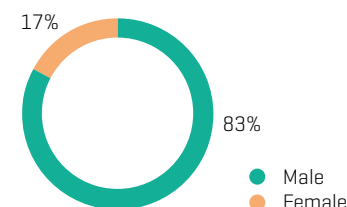


*Diverse Board. Varied perspectives.
Rich decision making*

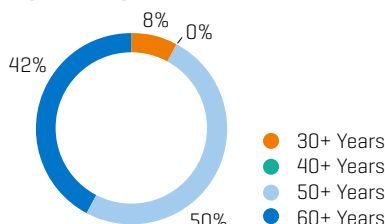
EXPERIENCE AND EXPERTISE



GENDER DIVERSITY



AGE DIVERSITY



Corporate Governance: Annual Report of the Board of Directors on the Affairs of the Company

Board Meetings

Details of Directors' meetings are given below.

Board Member	Directorship Status	Date of Appointment to the Board	Board	Audit Committee	HR & Remuneration Committee	Nomination Committee	Board Integrated Risk Management Committee	Related Party Transactions Review Committee	Strategy & Investment Committee	Procurement Committee	Credit Committee
Total Meetings Held			17	7	7	6	9	5	8	12	6
Mr Rienzie Arseculeratne, [Chairman]	●	30th April 2015	17/17		7/7	6/6			1 ^a		
Mr Jonathan Alles [MD/CEO]	●	01st May 2013	*15/17	6 ^a	7 ^a	6 ^a	4/9	4/5	8 ^a		4 ^a
Ms Rose Cooray	●	15th February 2010	17/17	7 ^a	1 ^a	6/6	9/9		7/8		
Dr Rohan Karunaratne	●	06th October 2011	15/17	7/7				2/5		10/12	3/6
Mr Damien Fernando [Resigned w.e.f 3rd April 2017]	●	02nd April 2012	5/5		2/2		2/2				
Mr Sujeewa Mudalige	●	02nd April 2012	17/17	7/7	7/7		5 ^a		6/8		
Ms Sanjivani Jayawardena	●	02nd April 2012	16/17				8/9			12/12	
Mr Rusi Captain	●	02nd April 2012	*16/17		*1/4	*6/6					
Mr Amal Cabraal	●	01st April 2014	15/17	7/7	7/7				8/8		
Mr Palitha Pelpola	●	30th April 2015	*17/17			6/6		5/5			6/6
Mr Duliksha Soosaipillai	●	30th April 2015	17/17				9/9		8/8	12/12	
Mr A N de Silva	●	30th April 2015	17/17	7/7				5/5			6/6
Mr Dinesh Weerakkody	●	29th June 2017	7/9								

● Executive Director ● Independent Non-Executive Director ● Non-Executive Director
 ■ Chairman/Chairperson of the Board/Sub-committee as at 31st December 2017

^a Meetings attended by invitation

* includes meetings attended by an alternative Director/s

** The Board Sub-Committee for disposal of assets/investment properties - The papers to this Committee are submitted via circular resolutions and physical meeting are held only on need basis.

The agenda and Board papers are sent seven days before the meeting, allowing members sufficient time to review the same. The Chairman sets the Board agenda, assisted by the Company Secretary. Care is taken to ensure that the Board spends sufficient time considering matters critical to the Bank's success, as well as compliance and administrative matters.

Leadership

The Board provides effective leadership in formulating the Bank's strategy and subsequent achievement of goals. No one Director has unfettered power and authority and the roles and responsibilities of the Chairman and Chief Executive Officer have been clearly defined. In-depth interactions between the Board and management strengthen the Board's decision making. The Board has delegated certain functions warranting greater attention, to nine (09) Board Sub-Committees with oversight responsibility for same. Of these, five are mandated and are compliant with the regulations. These Committee reports are given on page 90 to 102 in IR. Committee mandates are reviewed regularly.

Remuneration

The HNB remuneration policy supports the motivation and reward of performance of employees while meeting regulatory requirements and stakeholder expectations. Remuneration consists of two components - fixed remuneration and variable remuneration including of an annual performance bonus. Details of Directors' emoluments and other benefits paid in respect of the Group and the Bank during the financial year ended 31st December 2017 are given in Note 17 to the financial statements in IR page 164.

Board Evaluation

Designed to improve the Board's effectiveness and that of its Committees, a performance evaluation is conducted annually in line with good Corporate Governance practices. Each member of the Board carries out a self-assessment of his/her own effectiveness as an individual as well as effectiveness of the Board as a team. The outcome of the assessment carried was tabled at the Board meeting held in February 2018.

Directors Interests and Related Party Transactions

The Board is committed to conducting its business professionally and ethically. Directors declare their outside business interests at appointment and quarterly thereafter which details are recorded in the Directors' Interests Register, and available for inspection in terms of the Companies Act. The Directors have no direct or indirect interest in a contract or a proposed contract with the Bank other than those disclosed on page 106 to 110 in IR.

The Related Party Transactions Review Committee considers all transactions that require approval, in line with the Bank's Related Party Transactions Policy and in compliance with regulations. Related party transactions are disclosed in Note 60 to the financial statements in IR page 236.

Independence

The independence of Non-Executive Directors is reviewed on an annual basis as part of the Directors' evaluation process. Directors do not participate in, and excuse themselves from, the meeting when the Board considers any matters in which a conflict may arise.

Compliance

The Board complies with all applicable laws and regulations including the Listing Rules of the CSE, and the directions issued by the Central Bank. The Board is also guided by the Bank's policies, its value standards and its Code of Conduct & Ethics. The Compliance Officer who reports to Board Integrated Risk Management Committee, tables a report on compliance at the quarterly meetings of the

Board Audit Committee and where necessary such non-compliant issues are escalated to the Board for necessary action.

Group Corporate Governance

The HNB Board is responsible for Corporate Governance across the Group, ensuring the consistent application of sound policies and procedures fitting to the structure, business and risks of the Group and each entity.

Statutory Disclosures

Section 168 of the Companies Act No 7 of 2007, requires the following information to be published in the Annual Report prepared for the year under review.

No.	Disclosure requirements	Reference to the Companies Act No 7 of 2007	Disclosure reference for compliance	Page
1	The nature of the business of the Bank and the Group	Section 168 (1) (a)	About Us	IR 8
2	Financial statements for the accounting period completed and signed in accordance with Section 152	Section 168 (1) (b)	The financial statements of the Group and the Bank for the year ended December 31, 2017	IR 118-246 Signed on page IR 120
3	Auditor's report on the financial statements of the Bank and the Group	Section 168 (1) (c)	Independent Auditors' Report	IR 117
4	Any change in accounting policies made during the accounting period	Section 168 (1) (d)	Note 2.1.7 to the financial statements - Changes in Accounting Policies	IR 127
5	Particulars of entries in the interests register made during the accounting period	Section 168 (1) (e)	Directors' Interest in Contracts with the Bank Section 3.5 to the Corporate Governance report - Other Business Commitments and Conflicts of Interests, provides details of management of Directors' Interests	IR 106-110 CG&RR 7
6	Remuneration and other benefits of Directors during the accounting period	Section 168 (1) (f)	Note 17 to the financial statements - Other Expenses Section 3.13 to the Corporate Governance report - Directors' and Executive remuneration, provides details of the remuneration framework	IR 164 CG&RR 9
7	Total amount of donations made by the Company during the accounting period	Section 168 (1) (g)	Note 17 to the financial statements - Other Expenses	IR 164
8	Names of the persons holding office as Directors of the company as at the end of the accounting period and the names of any persons who ceased to hold office as Directors of the company during the accounting period	Section 168 (1) (h)	Board Profiles	IR 22-25

Corporate Governance: Annual Report of the Board of Directors on the Affairs of the Company

No.	Disclosure requirements	Reference to the Companies Act No 7 of 2007	Disclosure reference for compliance	Page
9	Amounts payable by the company to the Person or firm holding office as auditor of the company as audit fees and as a separate item, fees payable by the company for other services provided by that person or firm	Section 168 (1) (i)	Note 17 to the financial statements – Other Expenses	IR 164
10	Particulars of any relationship (other than that of auditor) which the auditor has with or any interests which the auditor has in, the company or any of its subsidiaries	Section 168 (1) (j)	<p>The Bank's auditors during the period under review were Messrs. Ernst & Young, Chartered Accountants. Section 6 to the Corporate Governance Report – External Auditors, provides details of the Policy for the Engagement of the External Auditor for Audit and Non-Audit services.</p> <p>Based on the declaration provided by Messrs. Ernst & Young, and as far as the Directors are aware, the auditors do not have any relationship or interest with the Bank that in our judgement, may reasonably be thought to have a bearing on their independence within the meaning of the Code of Professional Conduct and Ethics issued by the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka), applicable on the date of this Report.</p> <p>A resolution appointing Messrs Ernst & Young as Auditors and authorising the Directors to fix their remuneration will be proposed at the Annual General Meeting.</p>	CG&RR 11
11	Signed on behalf of the Board by two Directors and the Company Secretary	Section 168 (1) (k)	Complied with as stipulated below	IR 84

Additional Disclosures

Following information is disclosed additionally. The details are provided within notes to the Annual Report, which form an integral part of the Annual Report of the Board of Directors.

No.	Disclosure	Note Reference	Page
1	Vision, Mission and Corporate Conduct	About Us - Vision and mission The Bank is committed to upholding high standards of business conduct and ethics in the work place at all times, paramount in retaining the trust of our stakeholders. All employees of the Bank abide by the Bank's Code of Conduct and Ethics, which has been communicated via electronic and visual mediums and been made available in three languages. The Code of Conduct and Ethics for Directors is embodied in the Board Charter.	IR 8
2	Principal Activities	About us	IR 8
3	Changes to the Group Structure	There were no changes to Group structure during the year	-
4	List of Directors of Subsidiaries and Joint Ventures of the Bank as at 31st December 2017	<p>Subsidiaries</p> <p>HNB Assurance PLC Ms Rose Cooray - Chairperson Mr D P Lokuarachchi - MD/CEO Mr S C Ratwatte Mr Dilshan Rodrigo Ms S N Wickramasinghe Dr S Selliah Mr J A P M Jayasekera Mr Rajive Dissanayake Mr D Ravindra Abeyhuriya</p> <p>HNB Grameen Finance Limited Mr Jonathan Alles - Chairman Mr B Premalal - Deputy Chairman Mr B M D C Prabath - MD/CEO Ms Rose Cooray Ms L L C C Thambiah Mr A S Wijesinha Mr S U H Fernando Mr P A H D Wijesundara Mr Rajive Dissanayake Mr Mahinda Perera</p> <p>Joint Ventures</p> <p>Acuity Partners (Pvt) Ltd Mr Jonathan Alles - Chairman Mr M R Abeywardena - MD Mr T W de Silva Mr D A B Ellepola Mr Rajive Dissanayake Mr L H A L Silva Mr Damith Pallewatte</p> <p>Other Group Companies</p> <p>HNB General Insurance Ltd Ms Rose Cooray - Chairperson Mr D P Lokuarachchi - MD/CEO Ms M Tharmaratnam Mr M O F Salieh Mr Dilshan Rodrigo Mr Rajive Dissanayake</p> <p>Sithma Development (Pvt) Ltd Ms Rose Cooray - Chairperson Mr Chandana Panditharatne - Director/CEO Mr Dilshan Rodrigo Ms Anusha Gallage</p> <p>Lanka Ventures PLC Mr L H A L Silva - Chairman Mr Jonathan Alles Mr M R Abeywardena Mr S E de Silva Mr A R Munasinghe Mr T W de Silva Mr Rajive Dissanayake</p>	-

Corporate Governance: Annual Report of the Board of Directors on the Affairs of the Company

No.	Disclosure	Note Reference	Page	
		<p>Acuity Securities Ltd</p> <p>Mr M R Abeywardena - Chairman Mr I A S P Fernando Mr L H A L Silva Mr Rajive Dissanayake Mr Damith Pallewatte</p> <p>LVL Energy Fund Ltd [Subsidiary of Lanka Ventures PLC]</p> <p>Mr L H A L Silva - Chairman Mr Jonathan Alles Mr M R Abeywardena Mr D S Arangala Mr S E de Silva Mr T W de Silva Mr M Wijetunge Mr A R Munasinghe</p>	<p>Acuity Stockbrokers Ltd</p> <p>Mr M R Abeywardena - Chairman Mr D A B Ellepola Mr Prashan Fernando Mr Ruwan Manatunga Mr Rajive Dissanayake Mr N H T I Perera</p>	
5	Review of Operations	<p>Chairman's Message</p> <p>Managing Director's Review</p> <p>Managing Our Capitals and Impacts</p> <p>Business Line Review</p>	<p>IR 12-15</p> <p>IR 16-19</p> <p>IR 44-63</p> <p>IR 64-80</p>	
6	Future Developments	<p>Chairman's Message</p> <p>Managing Director's Review</p> <p>Managing Our Capitals and Impacts</p> <p>Business Line Review</p>	<p>IR 12-15</p> <p>IR 16-19</p> <p>IR 44-63</p> <p>IR 64-80</p>	
7	Financial Statements	<p>The financial statements of the Bank and the Group have been prepared in accordance with Sri Lanka Accounting Standards laid down by the Institute of Chartered Accountants of Sri Lanka [CA Sri Lanka] and they comply with the requirements of Companies Act No 7 of 2007 and Banking Act No 30 of 1988.</p> <p>The financial statements of the Group and the Bank for the year ended December 31, 2017</p>	IR 118-246	
8	Directors' Responsibility for Financial Reporting	The Statement of Directors' Responsibility for Financial Reporting	IR 116	
9	Auditors' Report	Independent Auditors' Report	IR 117	
10	Significant Accounting Policies	Note 2 to the financial statements - Basis of Preparation and Other Significant Accounting Policies	IR 126	
11	Going Concern	Note 2.2.1 to the financial statements - Going Concern	IR 127	
12	Income	Note 7 to the financial statements - Gross Income	IR 158	
13	Financial Results and Appropriations	<p>Statement of Profit or Loss</p> <p>Statement of Comprehensive Income</p> <p>Statement of Changes in Equity</p>	<p>IR 118</p> <p>IR 119</p> <p>IR 121-123</p>	
14	Reserves	Statement of Changes in Equity	IR 121-123	
15	Corporate Donations	<p>Note 17 to the financial statements - Other Expenses</p> <p>The Bank did not make any donations to Government approved charities</p>	IR 164	
16	Taxation	Note 20 to the financial statements - Taxation	IR 167	
17	Statutory Payments	The Directors, to the best of their knowledge and belief, are satisfied that all statutory payments in relation to the Government and the employees have been made up to date.	-	
18	Dividends on Ordinary Shares	Note 22 to the financial statements - Dividends Paid and Proposed	IR 170	

No.	Disclosure	Note Reference	Page																																										
19	Capital Expenditure	The total capital expenditure on acquisition of investment property, property, plant and equipment and intangible assets of the Bank and the Group amounted to 1,996,829,000/- and 2,296,235,000/- respectively (2016 Bank: Rs 1,348,462,000/- and Group: 1,749,220,000/-). Details are given in Note 37, 38 and 39 to the financial statements. Capital expenditure approved and contracted for, and not contracted for, as at Balance Sheet date are given in Note 59(b) to the financial statements -Capital Commitments	IR 198-217 IR 235																																										
20	Property, Plant and Equipment	Note 38 to the financial statements - Property, Plant and Equipment	IR 202																																										
21	Net Book Value of Freehold Properties	Note 38 to the financial statements - Property, Plant and Equipment.	IR 202																																										
22	Outstanding Litigation	In the opinion of the Directors and the Bank's Lawyers, pending litigation against the Bank disclosed in Note 59 (d) of the financial statements, will not have a material impact on the financial position of the Bank or its future operations. Notes 59 (d) to the financial statements - Litigation against the Bank	IR 236																																										
23	Events after the Reporting Date	Note 64 to the financial statements - Events Occurring After the Reporting Period	IR 246																																										
24	Stated Capital and Debentures	Notes 54 and 47 to the financial statements - Stated Capital and Subordinated Term Debts, respectively	IR 230 & 221																																										
25	Share Information	Investor Relations	IR 257 - 265																																										
26	Shareholdings	Investor Relations	IR 257 - 265																																										
27	Equitable Treatment to Shareholders	The Bank has at all times ensured that all shareholders (both voting and non-voting) are treated equitably except for the right to vote.	-																																										
28	Register of Directors and Secretaries	As required under Section 223 (1) of the Companies Act No 7 of 2007, the Bank maintains a Register of Directors and Secretaries which contains the name, surname, former name (if any), residential address, business, occupation, dates of appointment and dates of resignation (if applicable) of each Director and the Secretary.	-																																										
29	Directors' Interests in the Ordinary Shares (Voting and Non-Voting)	<table border="1"> <thead> <tr> <th></th> <th>As at 31st December 2017</th> <th>As at 31st December 2016</th> </tr> <tr> <th></th> <th>No of Shares</th> <th>No of Shares</th> </tr> </thead> <tbody> <tr> <td>Mr Rienzie Arseculeratne</td> <td>11,825</td> <td>-</td> </tr> <tr> <td>Mr Jonathan Alles</td> <td>122,542</td> <td>101,959</td> </tr> <tr> <td>Ms Rose Cooray</td> <td>7,003</td> <td>5,404</td> </tr> <tr> <td>Dr Rohan Karunaratne</td> <td>1,048</td> <td>1,034</td> </tr> <tr> <td>Mr Sujeewa Mudalige</td> <td>-</td> <td>-</td> </tr> <tr> <td>Ms Sanjivani Jayawardena</td> <td>514</td> <td>508</td> </tr> <tr> <td>Mr Rusi Captain</td> <td>7,218</td> <td>6,104</td> </tr> <tr> <td>Mr Amal Cabraal</td> <td>-</td> <td>-</td> </tr> <tr> <td>Mr Palitha Pelpola</td> <td>-</td> <td>-</td> </tr> <tr> <td>Mr Duliksha Soosaipillai</td> <td>-</td> <td>-</td> </tr> <tr> <td>Mr A N de Silva</td> <td>101</td> <td>100</td> </tr> <tr> <td>Mr. Dinesh Weerakkody</td> <td>2,031</td> <td>-</td> </tr> </tbody> </table>		As at 31st December 2017	As at 31st December 2016		No of Shares	No of Shares	Mr Rienzie Arseculeratne	11,825	-	Mr Jonathan Alles	122,542	101,959	Ms Rose Cooray	7,003	5,404	Dr Rohan Karunaratne	1,048	1,034	Mr Sujeewa Mudalige	-	-	Ms Sanjivani Jayawardena	514	508	Mr Rusi Captain	7,218	6,104	Mr Amal Cabraal	-	-	Mr Palitha Pelpola	-	-	Mr Duliksha Soosaipillai	-	-	Mr A N de Silva	101	100	Mr. Dinesh Weerakkody	2,031	-	-
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30	Directors' Interest in Debentures	<table border="1"> <thead> <tr> <th></th> <th>As at 31st December 2017</th> <th>As at 31st December 2016</th> </tr> <tr> <th></th> <th>No of Debentures</th> <th>No of Debentures</th> </tr> </thead> <tbody> <tr> <td>Mr Amal Cabraal</td> <td>100,000</td> <td>100,000</td> </tr> </tbody> </table>		As at 31st December 2017	As at 31st December 2016		No of Debentures	No of Debentures	Mr Amal Cabraal	100,000	100,000	-																																	
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Corporate Governance: Annual Report of the Board of Directors on the Affairs of the Company

No.	Disclosure	Note Reference	Page
31	Directors' Remuneration	Note 17 to the financial statements - Other Expenses	IR 164
32	Human Resources	Human Capital	IR 50-52
33	Employee Share Option Plan	Note 54 to the financial statements - Stated Capital	IR 230
34	Environmental Protection	To the best of knowledge of the Board, the Bank has complied with the relevant environmental laws and regulations. The Bank has not engaged in any activity that is harmful or hazardous to the environment. Specific measures taken to protect the environment are found in the Managing Our Capitals and Impacts Report.	IR 44-63
35	Risk Management and Internal Control	Section 3.10 to the Corporate Governance Report - Risk Management and Internal control	CG&RR 8
36	Directors' Statement on Internal Control	Directors' Statement on Internal Control	IR 103-104
37	Corporate Governance	Corporate Governance Report	CG&RR 1-27
38	Insurance and Indemnity	Pursuant to a decision of the Board, the Bank obtained an Insurance Policy to cover Directors' and Officers' liability	-
39	Material Foreseeable Risk Factors [As per Rule No 7.6 (VI) of the Listing Rules of the Colombo Stock Exchange]	Risk Management Review	CG&RR 28-52
40	Material Issues Pertaining to Employees and Industrial Relations Pertaining to the Bank [As per Rule No 7.6 (VII) of the Listing Rules of the Colombo Stock Exchange]	No material issues occurred during the year	-
41	Operational Excellence	Performance Highlights	IR 10-11
42	Shareholder Litigation	Pursuant to an action filed by Stassen Exports (Private) Limited (Case No CHC/59/2016/CO) - a shareholder of the Bank, interim orders were issued by the Commercial High Court of Colombo, pending the final determination of the case (i) restraining HNB, its Directors and the Company Secretary from taking any action regarding a share issue including issuing of shares to Asian Development Bank (ADB) by way of a private placement; and (ii) restraining the 1st to the 14th Respondents in the case, from holding and/or proceeding with the Extra-Ordinary General Meeting of HNB which was scheduled for Wednesday, 26th October 2016 or any time thereafter for the purpose of obtaining the approval of the shareholders to issue shares to ADB by way of a private placement, in consideration of the proposal made by ADB to make an equity investment in HNB, in any manner whatsoever. The Bank filed necessary papers for the vacation of the interim orders referred to above but on 12th July 2017 orders were given dismissing the applications made by the Bank. Bank has now filed papers in the Supreme Court of Sri Lanka appealing against the orders given under the said case No CHC/59/2016/CO. In the meantime Commercial High Court of Colombo issued an order on 14th December 2017 directing the parties to lead oral evidence on the substantive matters of the case.	-

No.	Disclosure	Note Reference	Page
43	Significant Non Performing Advance	<p>Facilities to Magampura Port Management Company (Private) Limited (MPMC)</p> <p>In 2014 the Bank granted certain foreign currency facilities to Magampura Port Management Company (Private) Limited (MPMC) which is a company fully owned by Sri Lanka Ports Authority (SLPA) to operate a licensed bunkering business. These facilities, which were granted on the strength of a Guarantee provided by SLPA, were fallen into arrears and declared to be included in the Non Performing Advances (NPA) category with effect from 1st September 2017. The total outstanding of these facilities as at the date of this report is USD 21,223,642.52. The Bank is having discussions with the relevant authorities to arrive at a settlement plan. In the meantime, in December 2017, the Board decided to make a full provision in respect of those facilities, as a prudential measure, with a further direction to the management to initiate legal action in the event the same is not recovered within a reasonable period of time.</p>	-

Notice of Annual General Meeting

The 49th Annual General Meeting of the Bank is convened on 28th March 2018, at 10.00 in the forenoon, at the Auditorium on Level 22 of "HNB Towers" (Registered Office), No 479, T B Jayah Mawatha, Colombo 10. The Notice of the 49th Annual General Meeting is enclosed.

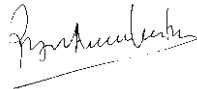
Acknowledgement of the Contents of the Report

As required by Section 168 [1] [k] of the Companies Act No 7 of 2007, the Board of Directors hereby acknowledges the contents of this Annual Report.

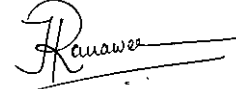
For and on behalf of the Board of Directors,



Jonathan Alles
Managing Director / Chief Executive Officer



Rienzie Arseculeratne
Chairman



K A L Thushari Ranaweera
Deputy General Manager (Legal) / Company Secretary

Colombo, Sri Lanka
20th February 2018

Key initiatives implemented in 2017:

- Review of HR Policy & Strategy
- Review of CEO & KMP KRAs, KPIs & Compensation
- Review of Directors' compensation

ACTIVITIES IN 2017

- » Discuss global and local best practice insights to shape the HR strategy and policy of the Bank.
- » Review Bank's Rewards policy with a view to attract, motivate and retain best in class talent.
- » Deliberate on succession planning, human capital risks and plans to mitigate them.

COMPOSITION & MEETINGS

The Human Resources & Remuneration Committee ('the Committee'), appointed by the Board of Directors comprises four Non-Executive Directors, of whom three including the Chairman are Independent Directors. One member is Non-Independent. The following Directors serve on the HR & Remuneration Committee:

Mr Rienzie Arseculeratne (IND / NED) - Chairman

Mr Sujeewa Mudalige (IND / NED)

Mr Damien Fernando (NIND / NED) [Resigned w.e.f 3rd April 2017]

Mr Rusi Captain (NIND / NED)

Mr Amal Cabraal (IND / NED)

(IND - Independent Director, NIND Non-Independent Director and NED - Non Executive Director)

Brief profiles of the Directors are given on page 22 to 25 in IR.

MEETINGS

The Committee met seven (07) times during 2017.

Attendance at the meetings is also given in the table in IR page 82.

	Eligible to attend	Attended
Mr Rienzie Arseculeratne	07	07
Mr Sujeewa Mudalige	07	07
Mr Damien Fernando	02	02
Mr Amal Cabraal	07	06
Mr Rusi Captain	04	-

Ms Rose Cooray attended the meeting on 2nd October 2017 as Alternate Director for Mr Rusi Captain.

Regular Attendees by Invitation

The Managing Director/Chief Executive Officer (MD/ CEO) who is responsible for the overall management of the Bank, attends meetings and participates in the Committee meetings by invitation. The MD/CEO takes part in all deliberations except when his own performance and remuneration is discussed.

Secretary to the Committee:

The Chief Human Resource Officer/DGM-HR (CHRO/DGM-HR) functions as the Secretary to the Committee.

Summary of HRRC Charter

- » Implementation of strategic human resource objectives of the Bank.
- » Monitor the human resource policies
- » Evaluate the performance of MD/CEO and Key Management Personnel (KMP) periodically
- » Interview applicants for senior corporate management posts
- » Upholding Corporate Governance

POLICY

The Bank's HR remuneration policy aims to attract, motivate and retain talent with the appropriate professional, managerial and operational expertise, necessary to achieve the objectives of the Bank in a competitive environment.

The focus of the Committee is to oversee and provide directions to the implementation of strategic human resource objectives of the Bank in keeping with the following Terms of Reference [TOR].

"The Committee shall consider/evaluate the performance of the MD/CEO and KMP periodically against the targets and goals set by it and determine the basis for revising the remuneration, increments, bonuses and other performance based incentives of the MD/CEO and KMP. The Committee shall consult MD/CEO and take into account his/her recommendations when determining the performance of the KMP, increments, bonuses and other performance based incentives payable to such KMP."

SCOPE

The Committee is vested with power to examine, evaluate and recommend to the Board of Directors on any matter that may affect the human resource management of the Bank within its TOR and any other matter referred to it by the Board or any other Sub-Committee.

The Committee sets targets and goals to the Directors, MD/CEO and the KMP annually. It reviews the Human Resource policies and initiatives, salary structures, terms and conditions relating to staff at senior

management level. In this process, necessary information and recommendations are obtained from the MD/CEO and the CHRO/DGM-HR. The Committee deliberates and recommends to the Board of Directors the remuneration packages, annual increments and bonuses of the MD/CEO, Chief Operating Officer (COO), members of the corporate management and senior management staff, having evaluated their performance.

The organizational structure is reviewed periodically and adjustments are made according to the focus of the strategic plan. An ongoing priority is to ensure proper succession for key positions. In doing so, the aspirations of the staff for career progression are taken into account.

Recruitments and promotions of staff at management level are also considered and approved by the Committee based on proposals submitted by the MD/CEO and CHRO/DGM-HR following a formal process of evaluation.

Reports of meetings of the Committee with its recommendations are referred to the Board for information and follow up action where necessary.

During the year under review, the HR policies of the Bank and the TOR of this Committee were revised.

FEES

All Non-Executive Directors receive a monthly fee for participation in the deliberations of the Board as per the Director's Remuneration Policy. They also receive fees for attending sub-committee meetings/and/or meetings of subsidiary boards. They do not receive any

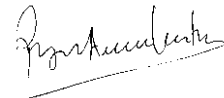
performance or incentive payments. Although a review of Directors' remuneration was carried out during the year 2017, no change was effected.

PROFESSIONAL ADVICE

The Committee is authorised to seek external professional advice on matters within its purview.

COMMITTEE EVALUATION

In order to ensure that the Committee's performance is optimal, a self-evaluation of the Committee members was also carried out and circulated amongst the members of the Committee.



Rienzie Arseculeratne

Chairman

*Human Resources & Remuneration
Committee*

Colombo, Sri Lanka
20th February 2018

Key initiatives recommended in 2017 were:

- Formulation of a Critical Skills Acquisition and Management Plan to realize Vision 2020
- Formulation of a Shareholder Complaints Procedure
- Formulation of a Policy for KMP to be appointed to Boards of Subsidiary Companies

ACTIVITIES IN 2017

In discharging its duties during the year 2017 the Committee mainly focussed on identifying the additional/critical skills required at Board and Key Management level with a view to successfully implementing the 2020 Strategic Plan of the Bank and further streamlined the process of appointing new Directors to the Board. The succession planning efforts at the level of Key Management Personnel [KMP] were continuously reviewed by the Committee whilst improving the Group Governance Code with a view to meeting future challenges in maintaining high level of compliance with good governance practices of the HNB Group. The Committee also responded positively to the recommendations of the Management to appoint KMP to the Director Boards of subsidiary companies of the HNB Group with a view to giving them an opportunity to get wider exposure by functioning as Directors of such subsidiary companies. The effectiveness and robustness of the process envisaged in the Articles of Association of the Bank on Directors' Retirement by Rotation was reconsidered by the Committee and an amendment to the Articles of Association is under consideration. Furthermore, the Committee having reviewed the existing shareholder complaints process of the Bank, a new written procedure was put in place in order to further strengthen the stakeholder value addition. In addition to the above the fit and propriety of the Directors and the new KMP were examined during the year as and when it was required to ensure compliance with the statutory requirements.

COMPOSITION & MEETINGS

The Nomination Committee ['the Committee'] comprises of four Non-Executive Directors appointed by the Board of Directors of the Bank. The following Directors serve / served on the Nomination Committee during the year under reference:

Mr Rienzie Arseculeratne [IND/NED] - Chairman

Ms Rose Cooray [NIND/NED]

Mr Rusi Captain [NIND/NED]

Mr Palitha Pelpola [IND/NED]

[IND - Independent Director, NIND-Non Independent Director and NED - Non Executive Director]

Brief profiles of the members of the Committee are given on page 22 to 25 in IR.

Committee Meetings and how it discharged its duties

The Nomination Committee met six [06] times during the year under review. Attendance by the Committee members at the meetings is also given in the table in IR page 82.

	Eligible to attend	Attended
Mr Rienzie Arseculeratne	6	6
Ms Rose Cooray	6	6
Mr Rusi Captain	6	6 [3 - Thro' Alternate Director]
Mr Palitha Pelpola	6	6

Regular Attendees by Invitation:

The Chief Executive Officer also attended the six [06] meetings by invitation.

Secretary to the Committee:

The Board Secretary functions as the Secretary to the Nomination Committee.

Summary of Nomination Committee Charter.

Terms of Reference (TOR) covers the main responsibilities entrusted to the Nomination Committee under Corporate Governance regulations promulgated by the Central Bank under Direction No 11 of 2007 and also the Code of Best Practice on Corporate Governance - 2017 published by the Institute of Chartered Accountants of Sri Lanka. The TOR also spells out the constitution and the composition of the Committee; that the Chairman should be an Independent Director; at least once in every quarter the Committee should meet and it has direct access to the required data and information in order to discharge its duties and when in doubt the Committee has the right to obtain appropriate opinions.

COMMITTEE RESPONSIBILITIES

The Nomination Committee is responsible for reviewing the composition of the Board and Board Sub - Committees to ensure that they are properly constituted and balanced in terms of skills, experience and diversity. In addition, the Committee is entrusted with the responsibility of:

1. Recommending to the Board on appointments of new Directors and Key Management Personnel [KMP] and ensuring the implementation of the approved procedure in selecting such Directors and Key Management Personnel;
2. Recommending the re-election of current Directors to the Board of Directors, taking into account the performance and contribution made by such Directors towards the overall discharge of responsibilities of the Board;

3. Reviewing criteria such as qualifications, experience and key attributes required for eligibility to be considered for appointment or promotion to the post of Managing Director/CEO and/or the Key Management positions;
4. Ensuring that the Directors, Managing Director/CEO and the Key Management Personnel are fit and proper persons to hold office as required by the Banking Act and other applicable statutes;
5. Assessing from time to time the requirements of additional/new expertise and the succession arrangements for retiring Directors and Key Management Personnel with a view to providing advice and recommendations to the Board on any such appointment;
6. Monitoring Corporate Governance issues.

- » Recommended the appointment of a Director to fill a casual vacancy created by the resignation of another Director and subject to the Director so appointed further recommended that the Director so appointed be formally appointed by the shareholders at the 49th Annual General Meeting to be held on 28th March 2018 in terms of Article 36 of the Articles of Association of the Bank.

Succession Planning

The Committee:

- » Continuously assessed the adequacy of the expertise available at the Senior Management level;
- » Reviewed and discussed the processes, overall methodology and contingency plans in place for senior strategic roles;
- » Reviewed the Bank's succession and talent management programme below Board level;
- » Specifically discussed succession planning for the positions of Key Management Personnel of the Bank and reviewed potential candidates for those roles;

Board Effectiveness

The Committee:

- » Reviewed and recommended all new appointments to the Boards of subsidiary and associate companies of the Bank.
- » Reviewed and recommended all strategic recruitments to the Senior Management cadre of the Bank;
- » Job Descriptions [the JDs] of the Key Management Personnel were analysed in detail and the Committee was satisfied that the JDs are in line with the respective qualifications, experience and key attributes set forth by the Committee pertaining to each office of KMP;

Group Governance/ Management Principles

- » Having promulgated a Group Governance Code in 2016, the Committee, on 19th January 2018, assessed the level of compliance by the Group Companies of the requirements envisaged in the Group Governance Code, for the year 2017, and further recommended that the Compliance Department should validate the level of implementation of

the governance principles prescribed in the Charter in accordance with the returns submitted by the respective Group Companies.

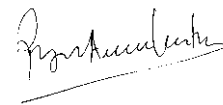
Re-election / Re-appointment of Directors at the 49th Annual General Meeting

- » When this matter came up for consideration the Committee having evaluated the position, appraised the Board of the injustice perpetrated on the Directors by requiring them to stand for re-election even before spending at least three years as a Director by operation of Article 34 of the Articles of Association of the Bank and recommended that this anomaly should be rectified as a result of which an appropriate amendment to Articles is under consideration.
- » Director - Mr Dinesh Weerakkody who was appointed to fill a casual vacancy has offered himself for formal appointment under Article 36 of the Articles of Association. The re-appointment of Mr Weerakkody was recommended by the Committee.

COMMITTEE EFFECTIVENESS

The performance of the Committee is reviewed each year as part of the Board effectiveness review.

The Committee completed the self-assessment for the year 2017, which was conducted by the Chairman and Committee Members and the review concluded that the Committee continues to operate effectively.



Rienzie Arseculeratne
Chairman
Nomination Committee

Colombo, Sri Lanka
20th February 2018

THE TERMS OF REFERENCE

The Terms of Reference [TOR] of the Nomination Committee, which was adopted by the Board of Directors in 2012, was further refined in 2013 and 2014. Thereafter, it was reviewed and amended by the members at their meeting held on 19th January 2018 as per the Code of Best Practice on Corporate Governance - 2017 published by the Institute of Chartered Accountants of Sri Lanka.

DETAILS OF THE DUTIES ATTENDED BY THE COMMITTEE

Board Composition

The Committee

- » Identified skill gaps and vacancies created at Board level and made recommendations for certain appointments to be made;
- » Evaluated the constitution of the Board statutory and non-statutory Sub-Committees twice during the year and set out clear guidelines/principles on the constitution of such Committees;
- » Assessed the fitness and propriety of the Directors holding office in terms of the provisions of the Banking Act and the directions of the Monetary Board relating to Corporate Governance;

“Our focus is to make risk management function more dynamic to manage emerging risks in digital and cyber space, whilst preserving the rigour of traditional risk management practices to act as an enabler for business decisions.”

Major initiatives floated by risk management unit during 2017 were:

- Establishment of an Information & Cyber Risk Vertical under the purview of CRO and appointment of CISO
- Implementation of a State-of-the-art Collections System to manage delinquencies early
- Initiation of a project to implement an enhanced Data Loss Prevention [DLP] Tool
- Kick-off of a project to implement next generation Loan Origination System [LOS]

ACTIVITIES IN 2017

- » Establishment of an information and cyber risk vertical within risk management department under the purview of Chief Risk Officer [CRO]. As a part of the process the Bank appointed CRO as the Chief Information Security Officer [CISO] w.e.f. 08th August 2017 in addition to his existing role as the CRO with a view to combating cyber/information security threats. Furthermore, information risk management framework was improved to mitigate and strengthen information and cyber risk management capability.
- » Establishment of a centralized collection function, “Centre of Aspiration” with the implementation of a state of the art IT solution enabling efficient and effective early management of overdue/ distressed credits.
- » Commencement of a project to implement a next generation Loan Originating System [LOS]. This project is expected to bring significant efficiencies in the manner HNB currently assess/ evaluate credit proposals. Project intends to streamline the credit approval process, formats, reduce duplication, improve quality of MI significantly and all credit proposal types will be accommodated in one system.
- » Strengthening of “Portfolio Risk Management” function to enable the Bank to early detect any credit flaws and manage homogeneous risks on a portfolio basis focusing clearly on risk reward formula.
- » Commencement of the validation and re-calibration process of the Internal Risk Rating Models to be in line with Basel III and IFRS requirements.
- » Centralization of credit administration functions covering security documentation process (preparation, verification and custodianship), credit disbursements and recovery/ reschedulements. This initiative will help the Bank to ensure legal risks are managed adequately and approval conditions and covenants are enforced effectively.
- » Implementation of an enhanced ICAAP framework and methodology
- » “Reputation Risk Task Force” was established as a sub-committee of the “Operational Risk Steering Committee” [ORSC] to closely monitor reputational risk trigger events and manage/prevent such events. This will also help the Bank to rationalise the capital allocation for reputational risk under the new ICAAP methodology adopted.

COMPOSITION & MEETINGS

At the end of 2017, the Board Integrated Risk Management Committee [BIRMC] comprised six [06] members, where three [03] members were Non-Executive Directors.

MEMBERS

- Ms Rose Cooray** [NIND / NED] - Chairperson
- Mr Damein Fernando** [NIND / NED] [Resigned w.e.f. 3rd April 2017]
- Ms Sanjivani Jayawardena** [NIND / NED]
- Mr Duliksha Soosaipillai** [IND / NED]
- Mr Jonathan Alles** [MD / CEO]
- Mr Damith Pallewatte** Chief Risk Officer / AGM-Risk /Chief Information Security Officer
- Ms Mohini Seneviratne** Head of Compliance

Brief profiles of the Directors representing the Committee are given on page 22 to 25 in IR.

[IND - Independent Director, NIND - Non Independent Director, NED - Non Executive Director, MD - Managing Director and CEO - Chief Executive Officer]

MEETINGS

Nine [09] meetings were held and at least one in each quarter. Attendances at the meetings are also given in table in IR page 82. The discussions and conclusions reached at the meeting are recorded in minutes and circulated to the Board of Directors for information and advice. The Chairperson of the Committee also briefs the Board of Directors on the main findings of the committee at each Board meeting.

	Eligible to attend	Attended
Ms Rose Cooray	9	9
Mr Damein Fernando	2	2
Ms Sanjivani Jayawardena	9	8
Mr Duliksha Soosaipillai	9	9
Mr Sujeewa Mudalige	9	5

Regular Attendees from the Management by Invitation:

- Mr Dilshan Rodrigo** - Chief Operating Officer
- Mr Niroshana Seneviratne** - Chief Internal Auditor / DGM - Internal Audit
- Ms Anusha Gallage** - Chief Financial Officer
- Mr Ruwan Bakmedeniya** - Head of Information Technology
Appointed w.e.f. 1st January 2017

- » Strengthening of the operational risk vertical by improving the Risk and Control Self-Assessment Process (RCSA) which establishes a living "Risk Library" listing out all material operational risks in the Bank, that are prioritized, based on severity and likelihood. This process would help the Bank to create a master list of dynamic "Key Operational Risk Controls" (KORCs) as well.
- » Risk Management unit has extended its scope and initiated a new project to improve data governance framework including classification of data and establish a Data Loss Prevention (DLP) mechanism across the Bank under information and cyber risk management vertical.
- » Risk management bulletin was introduced where extensive analysis was carried out on selective industries/countries with significant exposures to the Bank on a periodic basis. This has helped improving underwriting standard resulting in on-boarding better quality credit.
- » Credit approval structure was reviewed to ensure a seamless and an efficient credit approval process to uphold a speedy delivery.
- » Policies related to risk were reviewed to improve the effectiveness and applicability.
- » Credit culture transformation through centralization of credit appraisal & processing and movement towards scorecards based credit approval.

Other invitees

Mr Sujeewa Mudalige (IND/NED)

SECRETARY TO THE COMMITTEE:

Mr Damith Pallewatte Chief Risk Officer / AGM-Risk /Chief Information Security Officer.

Appointed as Chief Information Security Officer w.e.f. 08th August 2017.

SUMMARY OF BIRMC CHARTER

Establishing a risk management framework that proactively support the risk assessment, evaluation, monitoring and management whilst creating a strong risk culture, promoting the Bank's strategic objectives. Decisions are made in compliance with the Bank's internal risk policy guidelines and regulatory supervisory requirements and corrective actions are taken to mitigate risks taken beyond the risk tolerance set by the committee.

COMPLIANCE

The BIRMC was established as a committee of the Board, in compliance with Section 3 (6) of the Banking Act Direction No 11 of 2007, on corporate governance for licensed commercial banks in Sri Lanka.

The composition and the scope of work of the committee are in conformity with the provisions of the aforementioned direction.

The Bank has adopted an Integrated Risk Management (IRM) framework in line with the Central Bank of Sri Lanka (CBSL) Banking Act Direction No 7 of 2011.

THE PRIMARY RESPONSIBILITIES OF THE COMMITTEE

The terms of reference sets out by the Board of Directors, include the following:

- » To ensure that the Bank has a comprehensive risk management framework, appropriate compliance policies and systems in place.
- » To assess all risk types, including but not limited to: credit, market, liquidity, operational and strategic/reputational risks to the Bank through appropriate risk indicators and management information.
- » To ensure risk decisions are taken in accordance with established delegated authorities and corrective actions are taken to mitigate risks taken beyond the risk tolerance set by the committee, based on the Bank's policies and regulatory and supervisory requirements.
- » To monitor and assess the effectiveness of the Bank's risk management system and the robustness of the risk management function.
- » Periodically assess performance against internally defined risk appetite.
- » Review issues raised by Internal Audit that impact upon the risk management framework.
- » To review compliance/progress on the Basel III Roadmap implementations.

OTHER RESPONSIBILITIES OF THE COMMITTEE

The BIRMC also assists the Board of Directors in fulfilling its oversight responsibilities relating to compliance matters. In this capacity, the committee reviews the implementation of compliance programs, policies and procedures that are designed to respond to the various compliance and regulatory risks of the Bank. The committee also reviews and monitors the Bank's compliance report on money laundering and action taken in relation to report.

Board Integrated Risk Management Committee Report

LOOKING AHEAD

- » Strengthen market risk management function with scheduled upgrade of treasury system to move in to real time monitoring mechanism and provide a comprehensive management information for risk optimisation.
- » Improve data governance framework by implementing a DLP solution as a post data classification exercise aimed at tightening controls of managing information assets, improve security and prevent potential data loss incidents, and support obtaining quality certificates such as ISO 27001:2013.
- » Implement a next generation LOS, the Bank Intends to introduce non-judgmental scorecards to evaluate personal credit initially and then rolling out to SME and Micro Finance segments.
- » IT enabled process improvements to support personal loans, housing loans and credit card underwriting to improve SLA and to facilitate tracking of end-to-end customer experience.
- » Improve transparency in disclosure requirements under Basel III and the Integrated Risk Management (IRM) framework issued by CBSL by establishing a formal Disclosure Policy in 2018.
- » Intensify the reviewing and monitoring bank wide risks through the introduction of heat map.

PROFESSIONAL ADVICE

The committee has the authority to seek external professional advice on matters within its purview when needed.

COMMITTEE EVALUATION

The committee completed the evaluation process with self-assessment in December 2017 with the result "satisfactory".



Rose Cooray

Chairperson

Board Integrated Risk Management Committee

Colombo, Sri Lanka
20th February 2018

Key initiatives implemented in 2017 were :

- Implementation of SLFRS 9
- Strengthening the capital requirements under BASEL III
- Extensive discussions on adequacy of provisioning
- Evaluation of Tax impact on Bank's business operations pursuant to the proposal to introduce a new Tax Act.
- Enhanced Internal Audit coverage
- Establishment of a Repository of Key Audit issues
- Strengthening the human resource requirements in the specialised areas at the Internal Audit Department

ACTIVITIES IN 2017

- » A comprehensive Internal Audit Plan was introduced based on risk that consisted of thematic reviews, centralized monitoring, information system reviews, operation and credit reviews. Through regular updates from the Chief Internal Auditor (CIA), it was ensured that the audit plan was effectively delivered within the year. The plan essentially covered the branch network, strategic business units and information technology infrastructure amongst others. With the introduction of thematic audit methodology, increased the frequency of the branch audits to an average of three visits per branch, within the year 2017.
- » A repository of all the audit findings with agreed timelines to implement was introduced, and monitored through regular updates from CIA on the status of the implementation.
- » In order to maintain independence of the internal audit function, the CIA continued to report directly to the Board Audit Committee and the performance of the CIA and the senior staff members were reviewed by the Board Audit Committee. Board Audit Committee met the Chief Internal Auditor and the Statutory Audit Engagement Partner, independent of the management, to assess the level of support received from the management and to discuss any matter they wanted to bring to the attention of the Board and require guidance. Strength of the Internal Audit team was evaluated and required resourcing and training was recommended.
- » Considering that SLFRS 9 will pose a significant impact on the Bank's financial statements, measures were taken to identify the key impact areas and the estimated impact on the application of this standard.
- » Impact on future capital requirements was assessed and remedial actions were identified.
- » Measures were taken to ensure adequacy of provisioning for loans and advances via increased monitoring, enhanced system controls and awareness building.
- » An extensive evaluation was undertaken to identify and analyse the key areas of the new Inland Revenue Act and the impact it would have on the Bank.

COMPOSITION & MEETINGS

The Board Audit Committee ('the Committee'), appointed by and responsible to the Board of Directors comprises of four Independent Non-Executive Directors.

The following members serve on the Board Audit Committee:

Mr Sujeewa Mudalige (IND / NED) - Chairman

Dr Rohan Karunaratne (IND / NED)

Mr Amal Cabraal (IND/NED)

Mr A N de Silva (IND / NED)

(IND - Independent Director and NED - Non Executive Director)

Each of the members of the Committee has a depth of financial expertise and collectively, the Committee has considerable financial experience on which to draw. More information on experience of and brief profiles of the members are given on page 22 to 25 in IR.

	Eligible to attend	Attended
Mr Sujeewa Mudalige	7	7
Dr Rohan Karunaratne	7	7
Mr Amal Cabraal	7	7
Mr A N de Silva	7	7

Regular Attendees by Invitation:

Ms Rose Cooray - Non-Executive Director

Other management officers who attended meetings on invitation;

Mr Jonathan Alles - Managing Director/CEO

Mr Dilshan Rodrigo - Chief Operating Officer

Ms Anusha Gallage - Chief Financial Officer

Mr Niroshana Seneviratne - Chief Internal Auditor/ DGM [Internal Audit]

Mr Damith Pallewatte - Chief Risk Officer/AGM [Risk]

Ms Mohini Seneviratne - Head of Compliance

Secretary to the Committee:

The Board Secretary functions as the Secretary to the Board Audit Committee.

Summary of Board Audit Committee Charter

Terms of Reference (TOR) mainly covers the purpose of and the responsibilities entrusted to the Board Audit Committee. It also spells out the constitution and the composition of the of Committee; that the Chairman of the Committee should be an Independent Non-Executive

Board Audit Committee Report

Director and majority of the Committee should be Independent Non Executive Directors. The quorum of the meetings shall be the majority of the members of the Committee. The meetings should be held at least once in every quarter. The Committee members have direct access to the required data and information in order to discharge their duties; it also authorises the Committee to obtain appropriate opinions when in doubt; the Committee also has the investigative authority conferred upon it under the TOR.

AUDIT COMMITTEE RESPONSIBILITIES

The Committee is mainly responsible for:

- (i) Monitoring the integrity of the Bank's financial reporting and satisfying itself that any significant financial judgements by the management are sound;
- (ii) Monitoring the Bank's internal controls including controls relating to financial statement reporting;
- (iii) Monitoring and reviewing the activities and performance of the internal, external and outsourced auditor/s, including monitoring their independence and objectivity;
- (iv) Monitoring and reviewing the integrity of the Bank's financial reporting and internal controls to ensure that material amounts are properly determined and disclosed in the financial statements;
- (v) Monitoring and reviewing the compliance with laws and regulations which are fundamental to the entity's operations and continued business;
- (vi) Monitoring and reviewing the procedures placed by the Bank to ensure that proper awareness is created on 'Responding to Non Compliance with Laws and Regulations' [NOCLAR] standard;

MEETINGS

For the purpose of discharging the above duties, the Board Audit Committee met seven (07) times during the year. Attendance by the Committee members at each of these meetings is also given in the table in IR page 82. Other Management Officers as mentioned under 'Composition of the Committee' also attended these meetings on invitation. On the invitation of the Committee, the Engagement Partner of the Bank's external auditor, Messrs Ernst & Young attended three (03) Committee meetings during the year.

The Committee is conscious of the need to keep its knowledge up to date and Committee members participated at presentations and workshops conducted internally and externally on relevant topics.

Any individual member of the Committee had the opportunity to raise specific issues at the meetings. The undersigned was in regular contact with the management including the Chief Financial Officer and Chief Internal Auditor during 2017 on matters coming under the purview of the Committee.

FINANCIAL REPORTING

The Committee, as part of its responsibility to oversee the Bank's financial reporting process on behalf of the Board of Directors, has reviewed and discussed with the management, the annual and the quarterly financial statements prior to their release. The review included the extent of compliance with the Sri Lanka Accounting Standards, the Companies Act No 7 of 2007, the Banking Act No 30 of 1988 and amendments thereto. The Committee also reviews the effectiveness of the Financial Reporting Systems in place to ensure reliability of the information provided and the accounting policies to determine the most appropriate accounting policies. The Committee assessed, whether the disclosures made under the financial reporting is appropriate and fair. Matters of special interest in the current environment and the processes that support certification of the financial statements by the Bank's Chief Executive Officer, and Chief Financial Officer were also brought up for discussion.

RISKS AND INTERNAL CONTROLS

The Committee also assessed the effectiveness of the Bank's internal control over financial reporting as of 31st December 2017, as required by the Banking Act Direction No 11 of 2007, Corporate Governance for Licensed Commercial Banks in Sri Lanka, Subsection 3(8)(ii)(b), based on the 'Guidance for Directors of Banks on the Directors' Statement on Internal Control' issued by the Institute of Chartered Accountants of Sri Lanka [CA Sri Lanka]. The result of the assessment is given on page 103 and 104 in IR, 'Directors' Statement on Internal Control'.

The external auditors have issued an Assurance Report on Directors' Statement on Internal Controls. The report is given in IR page 105.

The Committee has reviewed the processes for identification, recording, evaluation

Allocation of agenda time of Board Audit Committee was as follows



and management of all significant risks throughout the Bank and other Group entities.

CORPORATE GOVERNANCE REPORT

As required by the Banking Act Direction No 11 of 2007, Corporate Governance for Licensed Commercial Banks in Sri Lanka, Annual Corporate Governance Report for 2017 is included as a supplement to the Annual Report. The external auditors have performed procedures set out in Sri Lanka Standards on Related Service 4400 [SLSRS 4400] issued by the Institute of Chartered Accountants of Sri Lanka [CA Sri Lanka], to meet the compliance requirement of the Corporate Governance Directive. The recommendations made by the Auditors where relevant will be dealt with in 2018.

EXTERNAL AUDIT

The Board Audit Committee has the primary responsibility for making recommendations to the Board on the appointment, re-appointment or removal of the External Auditor in-line with professional standards and regulatory requirements. The Committee also evaluates and makes recommendations to Board with regard to the audit fee.

On the recommendation of the Board, the shareholders have approved the re-appointment of Messrs Ernst & Young [Chartered Accountants] as the External Auditor of the Bank, at the last Annual General Meeting held on 30th March 2017. Messrs Ernst & Young was initially appointed in 2014.

The Committee undertook the annual evaluation of the independence and objectivity of the external auditor and the effectiveness of the audit process. The Committee concluded that the external audit was effective in the year 2017.

The Committee met the external auditor during the year to discuss their audit approach and procedures, including matters relating to the scope of the audit and auditor's independence. The Committee reviewed the audited financial statements with the external auditor who is responsible for expressing an opinion on its conformity with the Sri Lanka Accounting Standards.

The Committee reviewed the Interim Management Letters issued by the external auditor together with the management responses thereto, in the presence of relevant

business heads and senior management along with the external auditor. The Committee also followed up action points taken by the Management in improving the financial reporting based on the 2016 Management Letter by the external auditor Messrs Ernst & Young.

The Committee met the external auditors two (02) times during the year without the presence of MD/CEO and the corporate management to ensure that there was no limitation of scope in relation to the audit and to allow for full disclosure of any incidents which could have had a negative impact on the effectiveness of the external audit, and concluded that there was no cause for concern.

The Committee sets out the policy for the engagement of the External Auditor to provide non-audit services, taking into account:

- » The External Auditor's skills and experience for providing the particular non-audit service.
- » The nature of non-audit services, the related fee levels individually and in aggregate relative to the audit fee.

The Board Audit Committee reviewed the policy for engagement of the external auditor to provide non-audit services. The revised policy was approved by the Board on 19th January 2016. Further, the Committee was of the view that such services were not within the category of services identified as prohibited under:

1. The guidelines issued by the Central Bank of Sri Lanka, for external auditors, relating to their statutory duties in terms of Section 39 of Banking Act No 30 of 1988 and amendments thereto.
2. The Guidelines for Listed Companies on Audit and Audit Committees issued by the Securities and Exchange Commission of Sri Lanka.

The Letter of Representation issued to the external auditor by the Board and Letter of Independence Confirmation issued by the external auditor was tabled at the Board Audit Committee Meeting held on 20th February 2018.

Messrs Ernst & Young also acts as the Tax Advisor of the Bank.

INTERNAL AUDIT

To fulfil its responsibility to monitor the effectiveness of internal audit function, the Committee received regular reports from the Chief Internal Auditor setting out the internal audit function's view of the control environment and performance against any key indicators. During the year, the Committee reviewed the independence, objectivity & performance of the internal audit function, the findings of the internal audits completed and their evaluation of the Bank's internal control system including internal controls over Financial Reporting.

The annual audit plan for the year was prepared on risk based planning methodology. Adequacy and the frequency of the coverage of the internal audit plan was evaluated and approved by the Committee. It also assessed the Internal Audit Department's resource requirements including succession planning.

The Committee reviewed the performance appraisal of the Chief Internal Auditor and other senior staff members of the Internal Audit Department.

The Chief Internal Auditor reports directly to the Board Audit Committee. As per the international best practices, the Committee also had an independent discussion with the Chief Internal Auditor without the management team to ensure independence of the Internal Audit Department's operations.

The Committee concluded that the internal audit function remained effective.

TRAINING AND DEVELOPMENT OF COMMITTEE MEMBERS

The training and continuous professional development undertaken by Committee members in 2017 includes attending seminars, conferences, workshops, presentations done by Tax consultants and external auditor on areas such as new accounting standards, Tax/Basel regulations and directions issued by the Central Bank of Sri Lanka.

REGULATORY COMPLIANCE

The Committee reviewed the procedures established by management for compliance with the requirements of regulatory authorities. The Compliance Officer of the Bank who has oversight of the compliance function, submitted quarterly reports to

Board Audit Committee Report

the Committee on the extent to which the Bank was in compliance with the regulatory requirements.

WHISTLE-BLOWING POLICY

The whistle blowing policy was reviewed in February 2016 by the Board Audit Committee with a view to further strengthening the process by which employees raise concerns in confidence. The revised policy was approved by the Board in May 2016. Ms Rose Cooray, Director to the Board is functioning as the reporting authority.

PROFESSIONAL ADVICE

The Committee has the authority to seek external professional advice on matters within its purview.

SIGNIFICANT ACCOUNTING JUDGEMENTS CONSIDERED DURING 2017

Quarterly and annual reporting

The Committee considered key judgements in relation to quarterly and annual reporting.

Going Concern

The Committee concluded that adequate resources are available for the group to continue in business for the foreseeable future and has the ability to continue as a going concern. Further it was satisfied that there aren't any material uncertainties casting doubt on the group's ability to continue as a going concern.

Loan impairment, allowances and charges

The Committee considered loan impairment allowances for loans and advances. Significant judgements and estimates for personal lending included a review of loss emergence periods across the retail loan portfolios. For wholesale lending, the Committee considered management's judgements and assumptions

in respect of the recognition of judgmental collective impairment allowances and judgements relating to impairment allowances recognised for individual identified cases, as at 31 December 2017.

Carrying value of investments in group companies

During the year, the Committee considered the regular impairment reviews of bank's investments in subsidiaries and joint venture. The Committee reviewed a number of aspects of management's work in this area, including the sensitivity of the result of the impairment review to estimates and assumptions of projected future cash flows and the discount rate. It was concluded that the investments were not impaired.

Valuation of financial instruments

The Committee considered the key valuation metrics and judgements involved in the determination of the fair value of financial instruments. The Committee considered the valuation control framework, valuation metrics, significant year-end judgements and emerging valuation topics. The Committee has considered the Directors' judgement in concluding that the Bank will be able to continue in operation and meet liabilities as they fall due.

Recognition of deferred tax assets

Considering the recoverability of the Group's deferred tax assets, the Committee reviewed the recognition of deferred tax assets and the associated projections of future taxable income.

Operating segments

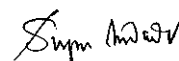
The Committee considered the appropriateness of the reportable segments during the year.

COORDINATION BETWEEN VARIOUS BOARD SUB COMMITTEES

Coordination among the members of the Board Sub Committees and the number of meetings of the Board, Board appointed Sub Committees and individual attendance by members are given in the table on page 5 under Corporate Governance Report included as a supplement to the Annual Report.

COMMITTEE EVALUATION

The annual evaluation of the Committee was conducted by the Independent Non-Executive Chairman, with contributions from the individual assessments by the members of the Audit Committee, Managing Director / CEO, Chief Operating Officer, Chief Financial Officer and Chief Internal Auditor in accordance with international best practices and was deemed to be satisfactory.



Sujeewa Mudalige

Chairman

Board Audit Committee

Colombo, Sri Lanka

20th February 2018

Key initiatives implemented in 2017 were:

- Establishment of a Central Unit to review Related Party transactions
- Development of a Related Party Guideline

ACTIVITIES IN 2017

- » A Central Unit was established to collect and maintain Related Party transactions for the purpose of Related Party Transactions Review Committee meetings.
- » Streamlined further the disclosure process and carried out an audit to ensure the effectiveness of the process and the accuracy of the data generated.
- » Reviewed the Related Party Policy document (RPP) by compiling subsequent changes from last year.
- » Developed Related Party Reporting Guidelines by referring to salient features in Related Party Policy, to assist the Business Heads when reporting Related Party transactions.
- » A report is being developed to extract Related Party transactions which is expected to be completed in first quarter of 2018.

COMPOSITION & MEETINGS

The Bank re-constituted the Related Party Transactions Review Committee [the 'Committee'] as a Board Sub-Committee with effect from 1st January 2016, to review 'Related Party Transactions'. The scope of the Committee covers mainly the requirements of the Code of Best Practices on Related Party transactions ('the Code') issued by the Securities and Exchange Commission of Sri Lanka [SEC].

The Composition of the Committee is as follows:

Mr A N de Silva - [IND/NED] - Chairman

Dr Rohan Karunaratne - [IND/NED]

Mr Palitha Pelpola - [IND/NED]

Mr Jonathan Alles - [MD/CEO]

Brief profiles of the Directors representing the Committee are given on page 22 to 25 in IR.

[IND - Independent Director, NIND - Non Independent Director, NED - Non Executive Director, MD - Managing Director and CEO - Chief Executive Officer]

Regular Attendees by Invitation:

The Committee is assisted by the following Management Officers of the Bank who attended sittings on a regular basis.

Mr Dilshan Rodrigo - Chief Operating Officer

Ms K A L Thushari Ranaweera - DGM - Legal / Board Secretary

Mr Damith Pallewatte - Chief Risk Officer

Ms Anusha Gallage - Chief Financial Officer / Secretary to the Committee

Ms Mohini Seneviratne - Compliance Officer

Ms Angelina Dharmaraj - Senior Manager [Credit Admin]

In addition, the Committee summoned other relevant officials of the Bank to participate in the Committee proceedings on a need basis.

Meetings are held mandatorily, at least once a quarter. During 2017, five [5] such meetings were held and the minutes were circulated to the Board of Directors for their information and review. In the opinion of the Committee there were no transactions with Related Parties that were more favourable or preferential during the period under review and the Bank had been compliant with the Code.

	Eligible to attend	Attended
Mr A N de Silva	5	5
Dr Rohan Karunaratne	5	2
Mr Palitha Pelpola	5	5
Mr Jonathan Alles	5	4

Secretary to the Committee:

The Chief Financial Officer functions as the Secretary to the Related Party Transactions Review Committee.

Summary of Related Party Transactions Review Committee Charter

Terms of Reference [TOR] covers the statutory and fiduciary responsibilities of Related Party Transactions Review Committee, envisaged in the Code of Best Practices on Related Party transactions published by the Securities and Exchange Commission of Sri Lanka [the 'Code'] and

Related Party Transactions Review Committee Report

regulations promulgated by the Colombo Stock Exchange (“the CSE Rules”), Financial Reporting under LKAS 24, the Banking Act Direction No 11 Of 2007 on Corporate Governance for Licensed Commercial Banks in Sri Lanka and Code of best practice on Corporate Governance 2017 issued by the Institute of Chartered Accountant of Sri Lanka.

The TOR also spells out the constitution and the composition of the of Committee; that the Chairman should be a Non - Executive Independent Director; at least once in every quarter the Committee should meet. It sets out the guidelines on Related Party transactions and its reporting. As per the TOR, the Committee has direct access to the required data and information in order to discharge its duties and responsibilities and when in doubt the committee has the right to obtain appropriate opinions.

TOR/Policy on ‘Related Party’ transactions is subject to periodic review based on regulatory as well as operational requirements. During the year the TOR was amended to accommodate desired changes.

TERMS OF REFERENCE AND SCOPE OF OPERATIONS

The Committee operates in accordance with the Terms of Reference of a Policy document on monitoring Related Party transactions, which has been approved by the Board of Directors.

The principal functions of the Committee are the scrutiny of all Related Party transactions with Directors, Key Management Personnel (KMP), Substantial Shareholders, Subsidiaries and Associate Companies of the Bank and such other Related Parties as defined in the Code with a view to determining that they have not received any favourable nor preferential consideration vis a vis the other shareholders and customers of the Bank as well as to ascertain that their transactions and dealings are in strict conformity with Statutory and Regulatory requirements which the Bank is obliged to adhere to.

The Committee relies on the integrity of periodically reportable Related Party transactions data sourced via a comprehensive list of Related Parties based on latest available declarations, signed off by the responsible Directors/KMP, Related Party transactions confirmed by the Business Heads to the Committee and the quarterly CBSL reports on Related Party transactions

reported under the responsibility of Chief Risk Officer, which in turn is further reviewed by the Chief Financial Officer who is the ultimate reporting authority to the Committee and its Secretary. This review is carried out by comparing Related Party transactions with benchmarked criteria applicable for comparable Non Related Party transactions, to determine that Related Parties have not received any favourable nor preferential consideration, based on the reports submitted by the Business Heads to the Committee.

The Bank’s Internal Audit Division is also mandated to verify the integrity of reported data, to ensure greater transparency.

Wherever necessary, the Committee resorts to obtaining legal, financial & technical advice from competent authorities in such fields, to review transactions. Further the Committee has the right of access as well as the power to call for clarification and explanations from Management & Auditors (External & Internal).

In addition, the Committee shares information with the Board Audit Committee as necessary and appropriate to facilitate the Board Audit Committee to conduct its Statutory & Regulatory responsibilities with regard to Related Party transactions.

SELF APPRAISAL OF COMMITTEE FUNCTIONS

A self-evaluation of the effectiveness of the Committee was conducted by the Chairman of the Committee with contributions from the individual assessments by the members of the Committee, Managing Director/CEO, participating KMP referred to at the outset of this Report and the review concluded that the Committee continues to operate effectively.



A N de Silva

Chairman

Related Party Transaction Review Committee

Colombo, Sri Lanka
20th February 2018

RESPONSIBILITY

As per Section 3 (8) (ii) (b) of Banking Act Direction No: 11 of 2007, the Board of Directors present this report on internal control mechanisms of the Bank.

The Board of Directors ('Board') is responsible for the adequacy and effectiveness of Hatton National Bank PLC's ('the Bank') system of internal controls. However, such a system is designed to manage the Bank's key areas of risk within an acceptable risk profile, rather than eliminating the risk of failure to achieve the business objectives and policies of the Bank. Accordingly, the system of internal controls can only provide a reasonable but not absolute assurance against material misstatement of management and financial information and records against financial losses or fraud.

The Board has established an on-going process for identifying, evaluating and managing the significant risks faced by the Bank and this process includes enhancing the system of internal controls as and when there are changes to business environment or regulatory guidelines.

The process is regularly reviewed by the Board in accordance with the guidance for Directors of Banks on the Directors' Statement on Internal Control issued by the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka). As per the said guidance, significant processes affecting significant accounts of the Bank were assessed along with the key risk areas of the Bank.

The management assists the Board in the implementation of the Board's policies and procedures on risk and control by identifying and assessing the risks faced by the Bank, and in the design, operation and monitoring of suitable internal controls to mitigate and control these risks.

The Board is of the view that the system of internal controls in place is sound and adequate to provide a reasonable assurance regarding the reliability of financial reporting, and that the preparation of financial statements for external purposes is in accordance with relevant accounting principles and regulatory requirements.

KEY INTERNAL CONTROL PROCESSES

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

- » The Board Sub Committees are established to assist the Board in ensuring:
 - the effectiveness of the Bank's daily operations.
 - that the Bank's operations are in accordance with the corporate objectives and strategies.
 - that the operations of the Bank are in line with the annual budget as well as the policies and business directions that have been approved by the Board.
- » The Internal Audit Division of the Bank checks for compliance with policies and procedures and the effectiveness of the internal control systems and highlights significant findings in respect of any non-compliance. Audits are carried out on majority of units and branches, the frequency of which is determined by the level of risk assessed by the internal audit, to provide an independent and objective report on operational and management activities of these units and branches. The annual audit plan is reviewed and approved by the Board Audit Committee and the findings of the audits are submitted to the Board Audit Committee for review at their periodic meetings.
- » The Board Audit Committee of the Bank approves the annual audit plan, reviews internal control issues identified by the Internal Audit Division, the external auditors, regulatory authorities and management; and evaluates the adequacy and effectiveness of the risk management and internal control systems. They also review the internal audit function with particular emphasis on the scope of audits and quality of the same. The minutes of the Board Audit Committee meetings are tabled for the information of the Board on a periodic basis. Further details of the activities undertaken by the Board Audit Committee of the Bank are set out in the Board Audit Committee Report on page 97 to 100 in IR.

- » The Board Integrated Risk Management Committee (BIRMC) is established to assist the Board to oversee the overall management of principal areas of risk of the Bank. The Executive Risk Management Committee which includes representation from all key business and operating units of the Bank, assists the Board with the implementation of policies advocated at BIRMC.
- » Operational committees have also been established with appropriate empowerment to ensure effective management and supervision of the Bank's core areas of business operations. These committees include the Human Resource Management Committee, Assets and Liability Committee, the Credit Policy Committee, Investment Committee, the Information Technology Steering Committee, Executive Risk Management Committee and the Operational Risk Steering Committee.

In assessing the internal control system over financial reporting, identified officers of the Bank collated all procedures and controls that are connected with significant accounts and disclosures of the financial statements of the Bank. These in turn were observed and checked by the Internal Audit Department for suitability of design and effectiveness on an on-going basis. The Bank adopted the new Sri Lanka Accounting Standards Comprising LKAS & SLFRS 9 in 2012. Since adoption of such Sri Lanka Accounting Standards, progressive improvements on processes to comply with new requirements of recognition, measurement, classification and disclosure are being made whilst, further strengthening of processes will take place pertaining to impairment of loans and advances and financial statement disclosures.

The Board has given due consideration to the effect of SLFRS 9 – "Financial Instruments", which becomes applicable for financial reporting periods beginning on or after 1st January 2018. Bank has performed a preliminary assessment of Day 1 impact from the application of this standard. SLFRS 9 poses a significant impact on impairment assessment of financial assets where by the impairment assessment approach will shift from an "incurred credit loss model" applied based on LKAS 39 – "Financial

Directors' Statement on Internal Control

Instruments – Recognition and Measurement” to an “expected credit loss model”. Having recognised the importance of an automated financial reporting process to more effectively comply with the recognition, measurement, classification and disclosure requirements for financial instruments, the Bank commenced the implementation of an automated solution in 2015. Given the complex nature of the adjustments involved with SLFRS 9, Bank expects to explore the possibility of converting the said solution to be SLFRS 9 compatible. The assessment did not include subsidiaries of the Bank.

The recommendations made by the external auditors in connection with the internal

control system in previous years were reviewed during the year and appropriate steps have been taken to implement those.

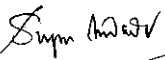
CONFIRMATION

Based on the above processes, the Board confirms that the financial reporting system of the Bank has been designed to provide a reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes has been done in accordance with Sri Lanka Accounting Standards and regulatory requirements of the Central Bank of Sri Lanka.

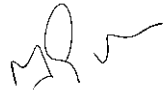
REVIEW OF THE STATEMENT BY EXTERNAL AUDITORS

The external auditor, Messrs Ernst & Young, have reviewed the above Directors' Statement on Internal Control for the year ended 31st December 2017 and reported to the Board that nothing has come to their attention that causes them to believe that the statement is inconsistent with their understanding of the process adopted by the Board in the review of the design and effectiveness of the internal control system of the Bank. Their Report on the Statement of Internal Control is given in IR page 105.

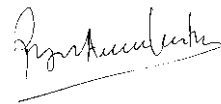
By order of the Board



Sujeewa Mudalige
Chairman
Board Audit Committee



Jonathan Alles
Managing Director / Chief Executive Officer



Rienzie Arseculeratne
Chairman

Colombo, Sri Lanka
20th February 2018

INDEPENDENT ASSURANCE REPORT



Ernst & Young
Chartered Accountants
201 De Saram Place
P.O. Box 101
Colombo 10
Sri Lanka

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INDEPENDENT ASSURANCE REPORT TO THE BOARD OF DIRECTORS OF HATTON NATIONAL BANK PLC

Report on the Directors' Statement on Internal Control over Financial Reporting

We were engaged by the Board of Directors of Hatton National Bank PLC (the "Bank") to provide assurance on the Directors' Statement on Internal Control over Financial Reporting (the "Statement") included in the annual report for the year ended 31 December 2017.

Management's responsibility

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

Our responsibilities and compliance with SLSAE 3050

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

Summary of work performed

We conducted our engagement to assess whether the Statement is supported by the documentation prepared by or for Directors;

and appropriately reflected the process the Directors have adopted in reviewing the system of internal control over financial reporting of the Bank.

The procedures performed were limited primarily to inquiries of Bank personnel and the existence of documentation on a sample basis that supported the process adopted by the Board of Directors.

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

Our conclusion

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

Colombo, Sri Lanka
20th February 2018

Partners: W R H Fernando 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 K B S P Fernando FCA FCMA
Ms. K R M Fernando FCA ACMA 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 Ms. P V K N Sajeewani FCA N M Sulaiman ACA ACMA B E Wijesuriya FCA FCMA

Principal T P M Ruberu FCMA FCCA

A member firm of Ernst & Young Global Limited

DIRECTORS' INTEREST IN CONTRACTS WITH THE BANK

Related party transactions as required by LKAS 24 "Related Party Disclosures", are detailed in Note 60 to the financial statements. In addition, the Bank carries out transactions in the ordinary course of its business at commercial rates with entities in which a Key Management Personnel (KMP) of the Bank is the Chairman or a Director of such entities, the details of which are given below.

Also this complies with the requirements of section 168 of the Companies Act. No 7 of 2007 and directions issued under section 47 (3), (4), (5) and (6) of the Banking Act No 30 of 1988.

1. LENDING TRANSACTIONS WITH THE BANK

Director/Company	Name of the Director/Relationship	Nature of Transaction	Aggregate Amount of Accommodation				Security
			As at 31st December 2017		As at 31st December 2016		
			Limit	Outstanding	Limit	Outstanding	
			Rs Mn	Rs Mn	Rs Mn	Rs Mn	
(a) Ms Sanjivani Jayawardena							
Ambewela Livestock Company Ltd	Director	Overdraft	50.00	10.15	50.00	31.26	Quoted shares of DCSL Corporate guarantee
		Letters of Credit	10.00	4.44	10.00	-	
		Total	60.00	14.59	60.00	31.26	
Ambewela Products (Pvt) Ltd	Director	Overdraft	100.00	9.92	100.00	-	Quoted shares of DCSL Corporate guarantee
		Letters of Credit	50.00	2.38	50.00	-	
		Total	150.00	12.30	150.00	-	
Ceylon Garden Coir (Pvt) Ltd	Director	Letter of Credit	10.00	-	10.00	-	Quoted shares of DCSL Corporate guarantee
		Total	10.00	-	10.00	-	
Lanka Dairies (Pvt) Ltd	Director	Overdraft	200.00	87.68	200.00	142.52	Quoted shares of DCSL Corporate guarantee
		Letters of Credit	100.00	8.49	**100.00	195.40	
		Letters of Guarantee	25.00	2.24	25.00	-	
		Total	325.00	98.41	325.00	337.92	
Lanka Milk Foods (CWE) PLC	Director	Overdraft	300.00	-	300.00	18.00	Quoted shares of DCSL Corporate guarantee Clean
		Letters of Credit	600.00	-	600.00	269.94	
		Letter of Guarantee	32.09	32.09	33.49	33.49	
		Letter of Guarantee	*(67.09)	-	(66.05)	-	
		Total	932.09	32.09	933.49	321.43	
Milford Exports (Ceylon) Ltd	Director	Letters of Credit	50.00	-	50.00	-	Quoted shares of DCSL Corporate guarantee
		Neg. of Doc bills	200.00	-	200.00	-	
		Overdraft	10.00	-	10.00	-	
		Letters of Guarantee	40.00	5.00	40.00	5.00	
		Total	300.00	5.00	300.00	5.00	
Pattipola Livestock Company Ltd	Director	Overdraft	50.00	10.37	50.00	10.90	Quoted shares of DCSL Corporate guarantee
		Letters of Credit	10.00	-	10.00	-	
		Total	60.00	10.37	60.00	10.90	
Stassen Natural Foods (Pvt) Ltd	Director	Overdraft	10.00	-	10.00	-	Quoted shares of DCSL Corporate guarantee
		Letter of Credit	50.00	-	50.00	0.04	
		Letters of Guarantee	15.00	15.00	15.00	15.00	
		Nego. of Doc. Bills	200.00	-	200.00	-	
		Total	275.00	15.00	275.00	15.04	
Stassen Int'l (Pvt) Ltd	Director	Overdraft	300.00	113.91	300.00	14.58	Quoted shares of DCSL Corporate guarantee
		Letter of Credit	150.00	-	150.00	5.07	
		Letters of Guarantee	125.00	55.00	125.00	57.84	
		Nego. of Doc. Bills	500.00	-	500.00	-	
		Total	1,075.00	168.91	1,075.00	77.49	
Stassen Exports (Pvt) Ltd	Director	Overdraft	3,048.00	2,204.37	3,048.00	507.80	Quoted shares of DCSL Corporate guarantee
		Letter of Credit	265.00	77.71	265.00	92.24	
		Letters of Guarantee	100.00	24.48	100.00	20.30	
		Forward Exchange	1,300.00	970.71	1,300.00	290.00	
		Nego. of Doc. Bills	500.00	-	500.00	-	
		Total	5,213.00	3,277.27	5,213.00	910.34	

Director/Company	Name of the Director/Relationship	Nature of Transaction	Aggregate Amount of Accommodation				Security
			As at 31st December 2017		As at 31st December 2016		
			Limit	Outstanding	Limit	Outstanding	
			Rs Mn	Rs Mn	Rs Mn	Rs Mn	
(b) Spouse of Mr Sujeewa Mudalige							
Capital holding Maharaja	Group Director	Lease Overdraft Total	7.12 - 7.12	- - -	12.82 19.44 32.26	12.82 - 12.82	Corporate guarantee, absolute ownership of vehicles
Harcros Chemicals (Pvt) Ltd	Subsidiary of Capital Maharaja (Pvt) Ltd	Letters of Credit/Import loan Overdraft Letters of Guarantee Total	305.00 100.00 1.50 406.5	260.72 - - 260.72	305.00 100.00 **1.50 406.5	95.01 4.11 13.13 112.25	Immovable Property Corporate guarantee Trade receivables Goods imported/ property
International Cosmetics Ltd	Subsidiary of Capital Maharaja (Pvt) Ltd	Letter of Credit/Import Loan Overdraft 1 Short term loan Term loan Overdraft 2 Total	245.00 *(245.00) *(45.00) (100.00) 110.00 150.00 505.00	26.43 75.08 45.00 - 110.00 111.89 368.40	245.00 *(245.00) *(40.00) - - - 245.00	44.47 194.58 42.90 - - - 281.95	Mortgage over property, titles of the imported goods/mortgage over immovable property
M Chem (Pvt) Ltd	Subsidiary of Capital Maharaja (Pvt) Ltd	Overdraft Letters of Credit Import Loan Total	5.00 - - 5.00	1.82 - - 1.82	5.00 25.00 *(25.00) 30.00	- - - -	Corporate guarantee
MBC Network (Pvt) Ltd	Subsidiary of Capital Maharaja (Pvt) Ltd	Term Loan Stand by Overdraft Total	75.08 30.00 105.08	75.08 21.45 96.53	- - - -	- - - -	Immovable property. Leeway available on quarternary Mortgage. Corporate Guarantee.
MTV Channel (Pvt) Ltd	Subsidiary of Capital Maharaja (Pvt) Ltd	Letters of Credit Import Loan Overdraft Term Loan Letters of Guarantee Total	45.00 *(45.00) 100.00 153.12 5.00 303.12	43.52 - 44.20 153.12 - 240.84	45.00 *(45.00) 100.00 216.30 5.00 366.30	- - - 216.30 - 216.30	Immovable property. Goods imported. Leeway available in the existing immovable property territory mortgage over improper.
P E Plus (Pvt) Ltd	Subsidiary of Capital Maharaja (Pvt) Ltd	Letter of Credit I-iii/ OD I/ Import Loan I-iii Term loan Total	245.00 5.41 250.41	213.76 5.41 219.17	245.00 7.09 252.09	101.54 7.09 108.63	Corporate guarantee Immovable Property
S - Lon Lanka (Pvt) Ltd	Subsidiary of Capital Maharaja (Pvt) Ltd	Letter of credit 1 Import loan 1 Overdraft Letters of Guarantee Letters of Credit/Im- port loan Import Loan 2 Total	150.00 *(150.00) 310.00 *(100.00) 735.00 *(735.00) 1,195.00	- 107.46 54.75 21.18 299.85 - 483.24	150.00 *(150.00) 310.00 *(100.00) 735.00 *(735.00) 1,195.00	- - - - 263.75 - 263.75	Stock in trade Corporate guarantee Goods imported
Tuffline Ltd	Subsidiary of Capital Maharaja (Pvt) Ltd	Letters of Credit/Im- port Loan Overdraft Letters of Guarantee Local Trading Loan Term Loan/OD Total	150.00 140.00 1.00 - - 61.09 352.09	158.81 138.69 - - - 61.09 358.59	100.00 90.00 1.00 5.00 0.00 66.04 262.04	84.67 84.41 - - - 66.04 235.12	Trade receivables Mortgage over machinery Board Resolution
Keilton Electrical-Products Pvt Ltd	Subsidiary of Capital Maharaja (Pvt) Ltd	Letter of Credit/Import Loan Term loan Overdraft Total	300.00 16.09 100.00 416.09	111.27 16.09 100.02 227.38	150.00 - - 150.00	139.95 - - 139.05	Corporate Guarantee S-Lon Lanka Pvt Ltd

Directors' Interest in Contracts with the Bank

Director/Company	Name of the Director/Relationship	Nature of Transaction	Aggregate Amount of Accommodation				Security
			As at 31st December 2017		As at 31st December 2016		
			Limit	Outstanding	Limit	Outstanding	
			Rs Mn	Rs Mn	Rs Mn	Rs Mn	
Harrisons Shipping Pvt Ltd	Subsidiary of Capital Maharaja (Pvt) Ltd	Overdraft Total	10.00 10.00	1.79 1.79	10.00 10.00	- -	Corp. G'tee of Harcros Chemicals.
(c) Mr Amal Cabraal							
John Keells Holdings PLC	Director	Overdraft Commercial paper Overdraft Term loan Total	200.00 *(200.00) *(200.00) *(200.00) 200.00	- - - - -	200.00 *(200.00) *(200.00) *(200.00) 200.00	- - - - -	Board Resolution Commercial paper agreement
Ceylon Beverage Holding PLC	Director	Overdraft Term loan 1 Term loan 2 Total	- 118.20 122.50 240.70	- 118.20 122.50 240.70	100.00 217.80 - 317.80	95.17 217.80 - 312.97	Board Resolution
Lion Brewery (Ceylon) PLC	Director	Overdraft Letter of guarantee Money market loan Term loan 1 Term Loan 2 Letter of credit 1 Import loan 1 Overdraft 2 Letter of credit 1 Import loan 11 Total	100.00 20.00 5,000.00 *(2,000.00) [722.00] *(2,000.00) *(2,000.00) *(400.00) 50.00 *(50.00) 5,170.00	- - 2,000.00 - 722.00 - - 7.72 - 2,729.72	100.00 20.00 5,000.00 *(1,000.00) - *(2,000.00) *(2,000.00) - 50.00 *(50.00) 5,170.00	8.06 0.52 1,950.00 1,000.00 - 216.87 - - - - 3,175.45	Board Resolution, Demand promissory notes, LG Indemnity, documents of title
Sunshine healthcare Lanka Ltd	Director	L/C Overdraft Letter of guarantee Import loan Forex forward contracts Block lease facility Shipping guarantee Unadvised L/C Total	1,000.00 *(200.00) *(100.00) *(500.00) *(270.00) 4.80 *(400.00) 400.00 1,404.80	709.80 134.70 - - - 4.80 143.40 - 992.70	- - - - N/A - - - - - - N/A -	- - - - N/A - - - - - - N/A -	Docs of title, Duly accepted usance drafts, letter of indemnity Overdraft agreement Concurrent mortgage bond over stock, import loan agreement. forward exchange agreement, Absolute ownership of vehicle.
Healthguard pharmacy ltd	Director	Short term loan 1 LG Overdraft 1 Overdraft 2 letter of credit import loan Short term loan 2 One off Short term loan Total	20.00 25.00 (5.00) 50.00 100.00 *(100.00) 5.00 - 200.00	- - - 52.87 17.40 - - - 70.27	- - - - - N/A - - - - - N/A -	- - - - - N/A - - - - - N/A -	Mortgage over stock LG indemnity Docs of title. duly accepted usance drafts Import loan agreement
Watawala tea ceylon ltd	Director	Overdraft TOD LG Total	200.00 75.00 15.00 290.00	167.50 - - 167.50	200.00 - 15.00 215.00	186.04 - - 186.04	Overdraft agreement LG indemnity

Director/Company	Name of the Director/Relationship	Nature of Transaction	Aggregate Amount of Accommodation				Security
			As at 31st December 2017		As at 31st December 2016		
			Limit	Outstanding	Limit	Outstanding	
			Rs Mn	Rs Mn	Rs Mn	Rs Mn	
(d) Mr A N de Silva							
Malwate Valley Plantations PLC	Director	Overdraft	254.00	58.69	254.00	192.48	Stock & book debts Property Guarantee Board Resolution Dollar bond for \$695,000 Letters of Hypothecation vehicles/equipment
		Commercial paper	-	-	40.00	-	
		Overdraft	-	-	*(40.00)	-	
		Money market Loan	40.00	-	-	-	
		packing credit loan	400.00	101.58	400.00	-	
		Export bill	*(400.00)	201.85	*(400.00)	72.26	
		Lease	61.61	61.61	28.68	28.68	
Total		755.6168	423.73	722.68	293.42		
(e) Mr Duliksha Soosaipillai							
Commercial Credit & Finance PLC	Director	Overdraft	12.00	Cr	12.00	Cr	Mortgage over property, securitisation lease/ hire purchase Commercial Paper agreement Asset backed trust certificates. Asset backed trust certificates Clean
		Securitisations loan	1,322.98	1,322.98	1,031.26	1,031.26	
		Letter of guarantee	2,128.19	2,128.19	2,128.19	2,128.19	
		Temp. S/TLoss	-	-	193.00	193.00	
		Investment loan	-	-	7.30	7.30	
		Term Loan	121.88	121.88	-	-	
Total		3,585.05	3,573.05	3,371.75	3,359.75		
(f) Ms Rose Cooray							
Ceylon Guardian Investment Trust/Ceylon Investment PLC	Director	Overdraft/Term loan	300.00	-	300.00	-	Short term loan agreement
		Overdraft	*(300.00)	-	*(300.00)	-	
		Total	300.00	-	300.00	-	
(g) Mr Dinesh Weerakkody							
Hemas Holdings (Group) PLC	Director	Overdraft	210.00	-	210.00	0.08	Counter Indemnity Demand promissory note Clean
		Letter Of Guarantee	50.00	-	50.00	22.50	
		Total	260.00	-	260.00	22.58	
Access Engineering PLC	Director	Letter of guarantee Letter of Credit	7,000.00	2,363.66	7,000.00	1,765.79	LG Indemnity Documents of title/ Duly Accepted usance drafts
			500.00	52.48	500.00	126.30	
		Total	7,500.00	2,416.14	7,500.00	1,892.09	
Lanka Aluminium Industries PLC	Director	Letter of credit 1	215.00	130.00			Documents of title/ Duly accepted usance drafts. Clean
		Import Loan 1	*(215.00)	85.00			
		Overdraft	*(65.00)	65.56			
		Letter of credit 2	*275.00	-	- N/A -	- N/A -	
		Import loan 2	*(275.00)	68.71			
		Short term loan	*(170.00)	134.18			
		Term loan 1-5	115.57	115.57			
Total		605.57	599.02				
(h) Dr Rohan Karunarathna							
AKK Engineers	Director	Overdraft	27.45	18.72	31.00	0.99	Overdraft agreement Mortgage over property Against fixed deposits personal guarantee mortgage over property
		Letter of guarantee	60.80	64.20	60.80	30.26	
		Letter of guarantee	*(10.00)	-	*(10.00)	-	
		One off LC	11.18	4.02	-	-	
		One off Bridging finance facility	*(11.18)	-	-	-	
		Total		99.43	86.94	91.80	
(i) Mr. Jonathan Alles							
Acuity Partners Pvt Ltd	Director	Overdraft	150.00	-	150.00	70.43	Board Resolution
		Term loan	150.00	126.56	-	145.30	
		Total	300.00	126.56	150.00	215.73	
HNB Grameen Micro Finance Ltd	Director	Term loan 1	49.90	49.90	69.99	69.99	DPN/ MOU Absolute ownership of vehicles over movable & immovable assets
		Lease	9.48	9.48	16.73	16.73	
		Term loan 2	375.00	375.00	500.00	500.00	
		Total	434.38	434.38	586.72	586.72	

Directors' Interest in Contracts with the Bank

Director/Company	Name of the Director/Relationship	Nature of Transaction	Aggregate Amount of Accommodation				Security
			As at 31st December 2017		As at 31st December 2016		
			Limit	Outstanding	Limit	Outstanding	
			Rs Mn	Rs Mn	Rs Mn	Rs Mn	
(j) Mr. Rusi Captain							
Paints & General Industries Ltd		Overdraft/Money market loan	904.61	820.83	3,250.00	2,230.18	shares in the CDS Board resolution Power of attorney Docs of title and duly accepted usance drafts.
		Letter of credit	(100.00)	-	(100.00)	15.68	
		Letter of guarantee	-	-	-	4.07	
		Total	904.61	820.83	3,250.00	2,249.93	

* Figures in brackets indicate sub limits granted to respective entities.

** Approval obtained for the excess.

2. OTHER BUSINESS TRANSACTIONS WITH THE BANK

Company/Director	Name of the Director / Relationship	Nature of Transaction	Amount [RsMn]	
			2017	2016
(a) Ms Sanjivani Jayawardena				
Stassen Exports (Pvt) Ltd	Director	Interest on repurchase agreements	25.49	4.93
(b) Mr Jonathan Alles				
Lanka Financial Services Bureau	Director	Repo (outstanding as at year end)	17.32	-
		Interest on repurchase agreements	1.12	0.88
Acuity Partners (Pvt) Ltd	Director	Interest on repurchase agreements	0.02	0.06
(b) Mr Amal Cabraal				
John keels Holdings PLC	Director	Repo (outstanding as at year end)	4261.10	4261.10
		Interest on repurchase agreements	154.70	322.60

The above entities also held customer deposits with the Bank totalling to 21,666.04 Mn and interest paid was Rs 1,853.80 Mn.

Interest income earned from loans and advances amounted to 1,558.25 Mn for the year ended 31/12/2017.

MANAGING RISK & CAPITAL

A robust risk management framework supports our business strategy balancing profitability and financial stability within the Bank’s defined risk appetite. The Board bears ultimate responsibility for managing risk and is supported by BIRMC and a dedicated risk management unit which is sufficiently staffed and supported by appropriate technology to facilitate and discharge of this key mandates. The CEO and executive committees implement board approved policy and manage risk in accordance with a defined risk appetite and a comprehensive policy framework based on the 3 lines of defence model.

The Bank takes an enterprise risk management approach in line with the COSO framework incorporating the Basel III requirements which came in to effect in 01st July 2017. The migration from Basel II to Basel III was smooth largely due to the regulatory requirements for ICAAP introduced in 2013 and the Bank’s own initiatives to ensure readiness for full compliance with the Basel III requirements as reported in 2016.

Maintaining a culture of risk awareness is a key to managing risk due to the nature of banking operations. Consequently, significant resources are devoted to training employees in risk awareness in general and ensuring those in specialized roles have the required skills and experience to accept and manage risks related to their roles. This is reinforced through the 2nd line of defence who constructively challenge risk assessments submitted by business units and monitor compliance with regulatory requirements. The 3rd line of defence comprising internal and external audit provide assurance on the effective functioning of internal controls set in place on a regular basis.

Key initiatives implemented in 2017 to strengthen risk management are given in the adjacent column demonstrating our commitment to safeguarding the financial stability of the Bank.

Risk Appetite Statement

The Risk Appetite Statement (RAS) sets out the combined risk that the Bank is prepared to assume in realizing its strategic goals. RAS is prepared incorporating regulatory and other internal policy limits and other prudential considerations necessary to ensure that the Bank’s business model operates within its board approved risk appetite. RAS is subject to annual review and is linked to performance

management goals incentivising employees to adopt appropriate risk behaviours.

Risk Landscape

Global events of 2017 highlighted the need for co-ordinated action on addressing inequalities, poverty, inclusion, climate change and cybercrime as geopolitical turmoil and technological disruptions dominated headlines. 2016 heralded the age of populism with Brexit from EU, a new regime in the USA and 2017 witnessed escalation of these trends in 2016 which is likely to translate in to trade protectionism impacting almost all countries in varying degrees with emerging markets being the most affected. Events in 2017 also served to highlight the fact that risk does not have country borders as cyber criminals bridge these with ease.

In July 2017 Sri Lankan banking sector witnessed the transition to Basel III HNB is identified as a Domestic Systemically Important bank by CBSL thus the capital requirement as per new Basel directive has significantly increased by 2020 which HNB has already complied by proactively raising additional capital by way of issuance of rights and debentures.

Licensed Commercial Banks (LCB) managed to maintain asset quality indicators in line with that of 2016 despite climate change impacts on the agriculture and related sectors which continue to subdue GDP growth. Liquidity of LCBs improved during the year as deposit growth exceeded credit growth due to higher interest rates. CASA declined marginally as high interest rates lured depositors to fixed income securities.

KEY RISK SUMMARY

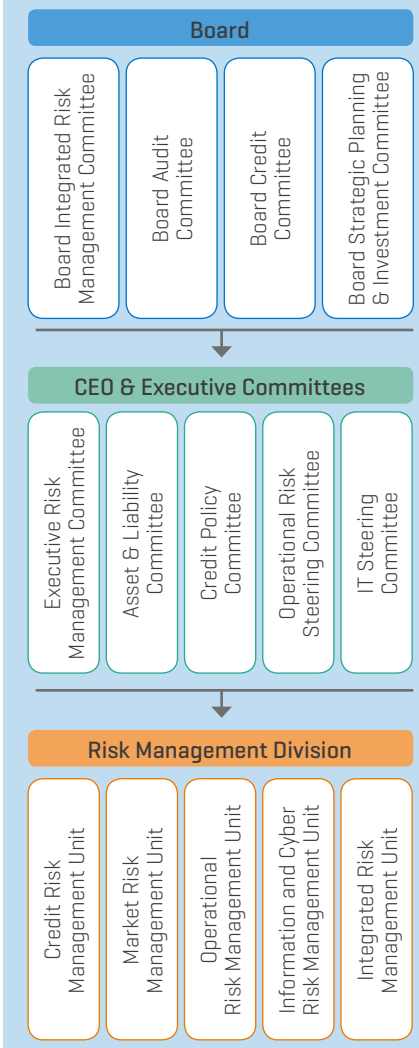
The Bank’s risk indicators remain within the defined risk appetite. Additionally the credit rating affirmed by Fitch Ratings Lanka Ltd., remains at AA-[Ika] Stable reflecting the Bank’s risk appetite. The rating is also influenced by the outlook for Sri Lankan banks, which remains negative.

Statutory Liquid Asset Ratio (SLAR) improved during the year from 24.23% in December 2016 to 26.29% in December 2017 reflecting a strong domestic deposit franchise monitored and nurtured through customer engagement mechanisms. Liquid Coverage Ratios (LCR) too improved from 176.48% in 2016 to 182.39% in 2017 for Sri Lankan

STRENGTHENING RISK MANAGEMENT

- Appointment of CISO
- Establishment of Information and Cyber Risk vertical within IRM framework
- Establishing Centre of Aspiration state-of-the-art Collection centre
- Centralization of Credit Administration function
- Recalibration and validation of Internal Risk Rating Models

RISK GOVERNANCE



RISK MANAGEMENT POLICIES

- Overall Risk Management Policy
- Credit Risk Management Policy
- Treasury management Policy
- Stress Testing Policy
- Cyber Risk Policy/Information Risk Policy
- Operational Risk Management Policy
- Environmental Risk Management Policy

Risk Review

Rupees and 118.48% in 2016 to 124.32% in 2017 for all currencies.

Asset quality declined marginally predominantly due to a single large exposure to a SOE classified in to NPA resulting in a marginal decline in profitability indicators as well although Net Interest Margins

improved due to improved CASA ratios despite a relatively high interest rate scenario. This impacted profitability due to increased impairment charges. Credit and recovery processes are being strengthened significantly to drive improvement in these key indicators and we expect a reversal in the coming year.

Key risks impacting our operations are summarised below:

Risk	Assessment	Trend	Rationale/Description
External			
Economic growth and trade cycles	Moderate	→	Economic growth which has been subdued due to climate change impacts is expected to gain momentum in 2018 with growth forecast to be 4.8% in 2018
Fiscal and monetary policy	Moderate	→	Fiscal and monetary policy is expected to enhance the stability of financial markets in line with stated government policy
Regulation	Moderate	↑	Regulation for LCBs is expected to maintain pace in line with stated policy
Cyber threats	High	↑	Cyber threats remain a key risk with artificial intelligence applications becoming more prevalent in the industry. HNB continues to monitor developments in the field and invest in enhancing cyber security.
Internal			
Credit Risk	Moderate	→	Measures implemented during the year are expected to result in improved credit risk indicators in 2018
People & Operational Risk	High	↑	Operational risk event trends have been maintained within the Bank's risk appetite. A focus on risk culture, continuous training and improvement in effectiveness of internal controls are key mitigants.
Liquidity Risk	Low	→	Liquidity indicators are well above the regulatory requirements and the Bank's risk appetite.

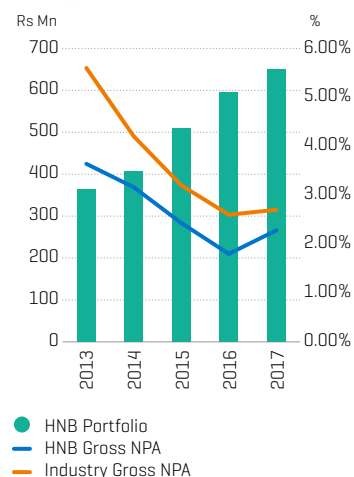
A sound track record of good governance, financial stability, professionalism and consistent delivery of value to stakeholders supports our risk profile, underpinning our strategy and risk culture.

OUTLOOK

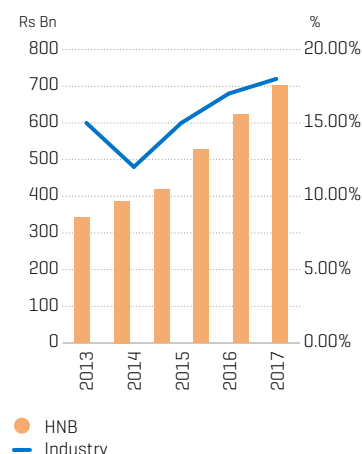
Risk management will continue to maintain its exponential growth as technology enhances risk management capabilities and regulation increases to meet the challenges of a digitized era. Accordingly, HNB continues to upgrade risk management processes to safeguard against emerging threats deploying appropriate technology. Transition to Basel III is expected to complete by December 2018. Additionally, we have commenced other projects to enhance the Bank's risk management processes. Accordingly, we are nearing testing of the upgraded Finacle Treasury System which will enhance market

risk management processes. The non-judgemental scorecards introduced to personal credit will be extended to SME and Micro Finance business verticals as well. Management of cyber security will also be upgraded with Phase II of the data governance framework to combat data loss prevention in parallel to the data classification exercise. We have commenced work towards obtaining ISO 27001:2013 certification in 2018 to benchmark with international best practice in risk management ensuring that HNB is fit for purpose and fit for the future.

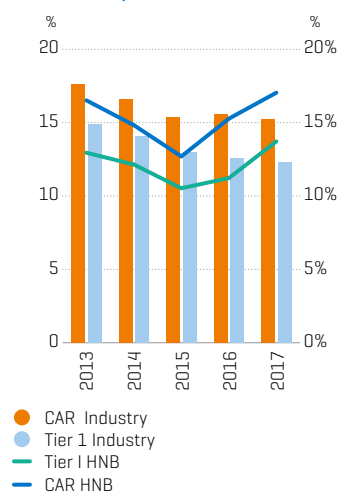
ASSET QUALITY



DEPOSIT GROWTH



CAPITAL ADEQUACY RATIO



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FINANCIAL CALENDAR - 2017	
48th Annual General Meeting held on	30th March 2017
Rs 7/00 per share Final Dividend for 2016 paid on	31st March 2017
[Cash Dividend Rs 3.50 per share and Scrip Dividend Rs 3.50 per share]	
Rs 1/50 per share 1st Interim Dividend for 2017 paid on	21st December 2017
Audited Financial Statements signed on	20th February 2018
Rs 5/00 per share 2nd Interim Dividend for 2017 paid on	12th March 2018
49th Annual General Meeting to be held on	28th March 2018
Rs 2/00 per share Final Scrip Dividend for 2017 payable in	* March 2018
Interim Financial Statements published in terms of Rule 8.3 of the Colombo Stock Exchange and as per the requirements of the Central Bank of Sri Lanka:	
1st Quarter Interim Results released on	15th May 2017
2nd Quarter Interim Results released on	14th August 2017
3rd Quarter Interim Results released on	14th November 2017

FINANCIAL CALENDAR - 2018	
Interim Dividend for 2018 to be payable in **	December 2018
50th Annual General Meeting to be held in	March 2019
Final Dividend for 2018 to be payable in ***	April 2019
Interim Financial Statements published in terms of Rule 8.3 of the Colombo Stock Exchange and as per the requirements of the Central Bank of Sri Lanka:	
1st Quarter Interim Results to be released in	May 2018
2nd Quarter Interim Results to be released in	August 2018
3rd Quarter Interim Results to be released in	November 2018

* Subject to confirmation by Shareholders

** Subject to confirmation by Directors

*** Subject to confirmation by Directors and Shareholders

Chief Executive Officer's and Chief Financial Officer's Responsibility Statement

The financial statements of Hatton National Bank PLC (the Bank) and the consolidated financial statements of the Bank and its subsidiaries as at 31st December 2017 are prepared and presented in compliance with the requirements of the following:

- » Sri Lanka Accounting Standards issued by the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka),
- » Companies Act No 7 of 2007,
- » Sri Lanka Accounting and Auditing Standards Act No 15 of 1995,
- » Banking Act No 30 of 1988 (as amended),
- » Listing Rules of the Colombo Stock Exchange,
- » Banking Act Direction No 11 of 2007 on Corporate Governance for Licensed Commercial Banks in Sri Lanka (as amended from time to time) and
- » Code of Best Practice on Corporate Governance issued jointly by the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka) and the Securities and Exchange Commission of Sri Lanka

The formats used in the preparation of the financial statements and disclosures made comply with the formats prescribed by the Central Bank of Sri Lanka.

The Accounting Policies used in the preparation of the financial statements are appropriate and are consistently applied by the Group. There are no departures from the prescribed Accounting Standards in their adoption. Comparative information has been reclassified wherever necessary to comply with the current presentation.

The significant accounting policies and estimates that involved a high degree of judgment and complexity were discussed with the Board Audit Committee and external auditors.

The Board of Directors and the management of the Bank accept responsibility for the

integrity and objectivity of these financial statements. The estimates and judgments relating to the financial statements were made on a prudent and reasonable basis in order that the financial statements reflect a true and fair view, the form and substance of transactions and the Bank's state of affairs are reasonably presented. To ensure this, the Bank has taken proper and sufficient care in installing a system of internal control and accounting records, for safeguarding assets and for preventing and detecting frauds as well as other irregularities, which are reviewed, evaluated and updated on an on going basis. It is confirmed that the Bank has adequate resources to continue its operations in the foreseeable future. Therefore, the Bank will continue to adopt the 'going concern' basis in preparing these financial statements.

Our internal auditor has conducted periodic audits to provide reasonable assurance that the established policies and procedures of the Bank were consistently followed. However, there are inherent limitations that should be recognised in weighing the assurances provided by any system of internal controls and accounting. Further, your Board assessed the effectiveness of the Bank's internal controls over financial reporting during the year ended 31st December 2017, as required by the Banking Act Direction No 11 of 2007, result of which is given on page 103 to 104 in IR, the 'Directors' Statement on Internal Control'. External auditor's Assurance Report on the 'Directors' Statement on Internal Control' is given in IR page 105.

The financial statements of the Group for the year 2017 were audited by Messrs Ernst & Young, Chartered Accountants, the independent external auditors. Their report is given in IR page 117.

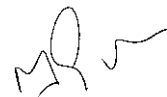
The Board Audit Committee of the Bank meets periodically with the internal audit team and the independent external auditor to review their audit plans, assess the manner in which these auditors are performing their responsibilities and to discuss their reports on internal controls and financial reporting issues. To ensure complete independence, the external auditor and the internal auditor

have access to the members of the Board Audit Committee to discuss any matter of substance. Details of which are given in the 'Board Audit Committee Report' on page 97 to 100 in IR.

The Board Audit Committee approves the audit and non-audit services provided by external auditor, Messrs Ernst & Young, in order to ensure that the provision of such services does not impair Ernst & Young's independence.

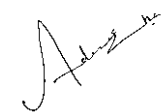
We confirm that,

- » the Bank and its subsidiaries have complied with all applicable laws, regulations and prudential requirements;
- » there are no material non compliances; and
- » there are no material litigations that are pending against the Group other than those disclosed in the Note 59 (d) to the financial statements in this Annual Report.



Jonathan Alles

Managing Director / Chief Executive Officer



Anusha Gallage

Chief Financial Officer

Colombo, Sri Lanka
20th February 2018

Directors' Responsibility for Financial Reporting

The responsibility of the Directors in relation to the financial statements of the Bank and its subsidiaries prepared in accordance with the provisions of the Companies Act No 7 of 2007 is set out in the following statement.

The responsibilities of the external auditor in relation to the financial statements are set out in the report of the auditors given in IR page 117.

As per the provisions of sections 150 [1], 151, 152 and 153 [1] & [2] of the Companies Act No 7 of 2007, the Directors are required to prepare financial statements for each financial year and place them before a General Meeting. The financial statements comprise the Statement of Financial Position as at 31st December 2017, and the Statement of Comprehensive Income, Statement of Changes in Equity and Statement of Cash Flows for the year then ended and notes thereto.

The financial statements of the Bank and its subsidiaries give a true and fair view of:

1. the state of affairs of the Bank and its subsidiaries as at 31st December 2017; and
2. the profit or loss of the Bank and its subsidiaries for the financial year then ended.

In preparing these financial statements, the Directors are required to ensure that:

1. appropriate accounting policies have been selected and applied in a consistent manner and material departures, if any, have been disclosed and explained;
2. judgements and estimates have been made which are reasonable and prudent; and
3. all applicable accounting standards, as relevant, have been complied with;

The Directors are also required to ensure that the Bank and its subsidiaries have adequate resources to continue in operation to justify applying the going concern basis in preparing these financial statements.

Further, the Directors have a responsibility to ensure that the Companies within the Group maintain sufficient accounting records to disclose, with reasonable accuracy the financial position of the Bank and its subsidiaries.

Financial statements prepared and presented in this report have been prepared based on

new Sri Lanka Accounting Standards (SLFRS) which came in to effect from January 01, 2012 are consistent with the underlying books of accounts and are in conformity with the requirements of Sri Lanka Accounting Standards, Companies Act No 7 of 2007, Sri Lanka Accounting and Auditing Standard Act No 15 of 1995, Banking Act No 30 of 1988 and amendments thereto, Banking Act Direction No 11 of 2007 on Corporate Governance for Licensed Commercial Banks in Sri Lanka (as amended from time to time), the Listing Rules of the Colombo Stock Exchange and the Code of Best Practice on Corporate Governance issued jointly by the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka) and the Securities and Exchange Commission of Sri Lanka (SEC).

In addition, these financial statements comply with the prescribed format issued by the Central Bank of Sri Lanka for the preparation of annual financial statements of Licensed Commercial Banks.

The Directors have also instituted effective and comprehensive systems of internal control for identifying, recording, evaluating and managing the significant risks faced by the Bank throughout the year and it is being under regular review of the Board of Directors. This comprises internal reviews, internal audit and the whole system of financial and other controls required to carry on the business of banking in an orderly manner, safeguard its assets, prevent and detect frauds and other irregularities and secure as far as practicable the accuracy and reliability of the records. The results of such reviews carried out during the year ended 31st December 2017 are given on page 103 to 104 in IR, Directors' Statement on Internal Control. External Auditor's Assurance Report on the Directors' Statement on Internal Control is given in IR page 105.

The Directors have taken appropriate steps to ensure that the Bank and Group maintain proper books of accounts and review the financial reporting system directly by them at their regular meetings and also through the Board Audit Committee. The report of the said Committee is given on page 97 to 100 in IR. The Board of Directors also approves the interim financial statements prior to their release following a review and recommendation by the Board Audit Committee.

The Board of Directors accepts responsibility for the integrity and objectivity of the financial statements presented in this Integrated Report.

Directors are required to prepare the financial statements and provide the Bank's external auditor, Messrs Ernst & Young, with every opportunity to carry out whatever reviews and checks on the system of internal control they may consider appropriate and necessary for expressing their independent audit opinion on the financial statements.

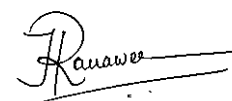
The financial statements of the Bank and the Group have been certified by the Chief Financial Officer of the Bank, the officer responsible for their preparation, as required by Sections 150 [1] (b) and 152 [1] (b) of the Companies Act. Also the financial statements of the Bank and the Group have been signed by two Directors and the Company Secretary of the Bank on February 20th, 2018 as required by Sections 150 [1] (c) and 152 [1] (c) of the Companies Act.

Further, as required by Section 56 [2] of the Companies Act No 7 of 2007, the Directors have confirmed that the Bank, based on the information available, satisfies the solvency test immediately after the distribution of dividends, in accordance with Section 57 of the Companies Act No 7 of 2007, and has obtained a certificate from the auditors, prior to declaring a final dividend of Rs 2/- per share (in the form of a script) for the year 2017.

The Directors to the best of their knowledge and belief, are satisfied that all statutory payments in relation to all relevant regulatory and statutory authorities which were due and payable by the Bank and its subsidiaries as at the Statement of Financial Position date have been paid or where relevant provided for.

The Directors are of the view that they have discharged their responsibilities as set out in this statement.

By order of the Board



K A L Thushari Ranaweera (Mrs)

Deputy General Manager (Legal) / Company Secretary

Colombo, Sri Lanka
20th February 2018

Independent Auditors' Report



Ernst & Young
Chartered Accountants
201 De Saram Place
P.O. Box 101
Colombo 10
Sri Lanka

Tel : +94 11 2463500
Fax Gen : +94 11 2697369
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eysl@lk.ey.com
ey.com

TO THE SHAREHOLDERS OF HATTON NATIONAL BANK PLC

Report on the Financial Statements

We have audited the accompanying financial statements of Hatton National Bank PLC, (the "Bank"), and the consolidated financial statements of the Bank and its subsidiaries (the "Group"), which comprise the statement of financial position as at 31 December 2017, and the statement of profit or loss, statement of comprehensive income, statement of changes in equity and, statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Board's Responsibility for the Financial Statements

The Board of Directors (the "Board") is responsible for the preparation of these financial statements that give a true and fair view in accordance with Sri Lanka Accounting Standards, and for such internal control as Board determines is necessary to enable the preparation of 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 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 the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the Bank's preparation of the financial statements that give a true and fair view 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 Bank's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates 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, the consolidated financial statements give a true and fair view of the financial position of the Group as at 31 December 2017, and of its financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

Report on Other Legal and Regulatory Requirements

As required by Section 163[2] of the Companies Act No. 7 of 2007, we state the following:

- a) The basis of opinion, scope and limitations of the audit are as stated above.
- b) In our opinion :
 - we have obtained all the information and explanations that were required for the audit, and as far as appears from our examination, proper accounting records have been kept by the Bank,
 - the financial statements of the Bank give a true and fair view of the financial position as at 31 December 2017, and of its financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards, and
 - the financial statements of the Bank and the Group, comply with the requirements of sections 151 and 153 of the Companies Act No. 07 of 2007.

20 February 2018
Colombo

Partners: W R H Fernando 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 K B S P Fernando FCA FCMA
Ms. K R M Fernando FCA ACMA 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 Ms. P V K N Sajeewani FCA N M Sulaiman ACA ACMA B E Wijesuriya FCA FCMA

Principal T P M Ruberu FCMA FCCA

A member firm of Ernst & Young Global Limited

Statement of Profit or Loss

For the year ended 31st December	Note	Bank		Group	
		2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Gross income	7	106,295,194	84,350,823	119,759,106	95,990,771
Interest income		96,175,453	75,608,193	103,908,195	81,533,502
Less: Interest expenses		56,526,138	41,236,605	58,446,928	42,444,643
Net interest income	8	39,649,315	34,371,588	45,461,267	39,088,859
Fee and commission income		8,415,579	7,139,253	9,227,529	7,905,879
Less: Fee and commission expenses		105,482	90,594	213,143	180,531
Net fee and commission income	9	8,310,097	7,048,659	9,014,386	7,725,348
Net interest, fee and commission income		47,959,412	41,420,247	54,475,653	46,814,207
Net gain/(loss) from trading	10	(3,711,203)	(1,795,691)	(3,695,658)	(1,824,452)
Net gain from financial investments	11	212,129	111,713	247,166	103,165
Net insurance premium income	12	-	-	6,326,292	5,490,712
Other operating income	13	5,203,236	3,287,355	3,745,582	2,781,965
Total operating income		49,663,574	43,023,624	61,099,035	53,365,597
Less: Impairment charge for loans and other losses	14	3,035,468	237,160	3,926,149	508,159
Net operating income		46,628,106	42,786,464	57,172,886	52,857,438
Less : Operating expenses					
Personnel expenses	15	8,866,642	8,703,575	10,916,284	10,416,099
Benefits, claims and underwriting expenditure	16	-	-	5,485,864	4,571,389
Other expenses	17	10,689,807	9,584,304	12,407,714	10,785,144
Total operating expenses		19,556,449	18,287,879	28,809,862	25,772,632
Operating profit before Value Added Tax (VAT) and Nation Building Tax (NBT) on financial services		27,071,657	24,498,585	28,363,024	27,084,806
Less: Value Added Tax (VAT) and Nation Building Tax (NBT) on financial services	18	5,021,446	4,352,756	5,435,628	4,734,949
Operating profit after Value Added Tax (VAT) and Nation Building Tax (NBT) on financial services		22,050,211	20,145,829	22,927,396	22,349,857
Share of profit of joint venture (net of income tax)	19	-	-	175,616	148,790
PROFIT BEFORE INCOME TAX		22,050,211	20,145,829	23,103,012	22,498,647
Less: Income tax expense	20	5,583,421	6,002,423	6,361,616	6,833,685
PROFIT FOR THE YEAR		16,466,790	14,143,406	16,741,396	15,664,962
Profit attributable to:					
Equity holders of the Bank		16,466,790	14,143,406	15,946,989	14,755,634
Non-controlling interests		-	-	794,407	909,328
PROFIT FOR THE YEAR		16,466,790	14,143,406	16,741,396	15,664,962
Earnings per share	21				
Basic earnings per ordinary share (Rs)		36.66	33.53	35.50	34.99
Diluted earnings per ordinary share (Rs)		36.62	33.46	35.47	34.91
Dividend per share					
Dividend per share: Gross (Rs)		*8.50	8.50	*8.50	8.50

The notes to the financial statements from pages 126 to 246 form an integral part of these financial statements.

*Calculated on interim dividends (paid and proposed) and proposed final dividend, which is to be approved at the Annual General Meeting.

Statement of Comprehensive Income

For the year ended 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
PROFIT FOR THE YEAR	16,466,790	14,143,406	16,741,396	15,664,962
OTHER COMPREHENSIVE INCOME FOR THE YEAR, NET OF TAX				
Other comprehensive income to be reclassified to profit or loss in subsequent periods				
Available-for-sale financial assets:				
Net change in fair value during the year	3,308,142	(3,158,637)	3,797,637	(3,312,113)
Transfer (to)/from life policy holder reserve fund	-	-	(414,402)	134,781
Net amount transferred to profit or loss [available-for-sale financial assets]	83,249	-	52,764	14,466
Deferred tax effect on above	(926,481)	404,328	(933,251)	406,153
Share of other comprehensive income of equity accounted joint venture	-	-	(21,417)	(21,154)
Net other comprehensive income to be reclassified to profit or loss in subsequent periods	2,464,910	(2,754,309)	2,481,331	(2,777,867)
Other comprehensive income not to be reclassified to profit or loss in subsequent periods				
Re-measurement gains/(losses) on defined benefit plans	(284,960)	361,720	(292,000)	377,525
Revaluation of freehold land and buildings	2,981,379	2,273,397	4,146,677	5,748,917
Deferred tax effect on above	(2,900,320)	(54,489)	(4,465,972)	(157,789)
Deferred tax effect on realisation of revaluation surplus	-	1,214	-	1,214
Net other comprehensive income not to be reclassified to profit or loss in subsequent periods	(203,901)	2,581,842	(611,295)	5,969,867
OTHER COMPREHENSIVE INCOME FOR THE YEAR, NET OF TAX	2,261,009	(172,467)	1,870,036	3,192,000
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	18,727,799	13,970,939	18,611,432	18,856,962
Total comprehensive income attributable to:				
Equity holders of the Bank	18,727,799	13,970,939	17,784,291	17,865,820
Non-controlling interests	-	-	827,141	991,142
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	18,727,799	13,970,939	18,611,432	18,856,962

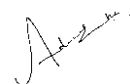
The notes to the financial statements from pages 126 to 246 form an integral part of these financial statements.

Statement of Financial Position

As at 31st December	Note	Bank		Group	
		2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
ASSETS					
Cash and cash equivalents	24	21,739,800	17,511,446	21,924,898	18,668,703
Placements with banks	25	3,182,377	753,050	9,670,125	2,198,446
Balances with Central Bank of Sri Lanka	26	38,610,940	33,777,614	38,610,940	33,777,614
Reverse repurchase agreements	27	-	4,303,460	772,002	5,756,794
Derivative financial instruments	28	615,357	289,989	615,357	289,989
Financial investments - fair value through profit or loss	29	120,486	544,915	266,538	716,009
Non-current assets held for sale	30	-	-	-	-
Loans and receivables to customers	31	639,102,061	584,412,727	655,612,938	597,467,460
Financial investments - loans and receivables	32	122,199,048	99,260,698	125,031,671	102,063,229
Financial investments - available-for-sale	33	95,403,820	89,915,153	101,742,985	95,797,142
Financial investments - held to maturity	34	-	-	1,565,603	465,081
Investment in joint venture	35	755,000	755,000	1,689,263	1,450,806
Investment in subsidiaries	36	3,017,285	3,017,285	-	-
Investment properties	37	327,464	403,959	1,146,564	1,054,300
Property, plant and equipment	38	17,905,320	13,945,002	34,635,034	29,844,234
Intangible assets and goodwill	39	815,381	789,648	1,237,829	1,180,269
Other assets	40	11,083,242	9,283,490	13,038,222	10,810,117
Total assets		954,877,581	858,963,436	1,007,559,969	901,540,193
LIABILITIES					
Due to banks	41	62,463,497	69,219,302	62,464,391	69,254,893
Derivative financial instruments	28	1,305,900	665,890	1,305,900	665,890
Securities sold under repurchase agreements	42	5,064,360	13,458,127	5,064,360	13,458,127
Due to customers	43	701,519,297	623,494,969	718,770,051	635,371,097
Dividends payable	44	975,371	1,007,075	986,880	1,015,463
Other borrowings	45	27,258,006	27,839,845	27,258,006	27,839,845
Debt securities issued	46	4,540,259	4,653,057	5,035,958	5,115,801
Current tax liabilities	48	3,974,624	6,223,943	4,066,087	6,425,379
Deferred tax	49	5,082,636	231,364	7,309,283	824,778
Insurance provision - life	50	-	-	10,915,858	8,747,856
Insurance provision - general	51	-	-	2,384,908	1,921,567
Other provisions		3,015,875	3,158,444	3,416,332	3,407,050
Other liabilities	52	5,720,896	5,840,718	7,359,236	7,279,639
Subordinated term debts	47	25,809,261	26,153,476	25,564,596	25,901,110
Total liabilities		846,729,982	781,946,210	881,901,846	807,228,495
EQUITY					
Stated capital	54	31,409,119	15,340,158	31,409,119	15,340,158
Statutory reserve	55	5,460,000	4,560,000	5,460,000	4,560,000
Other reserves	57	56,084,895	47,592,832	67,058,017	58,569,401
Retained earnings	56	15,193,585	9,524,236	18,082,284	12,821,116
Total equity attributable to equity holders of the Bank		108,147,599	77,017,226	122,009,420	91,290,675
Non-controlling interests	58	-	-	3,648,703	3,021,023
Total equity		108,147,599	77,017,226	125,658,123	94,311,698
Total liabilities and equity		954,877,581	858,963,436	1,007,559,969	901,540,193
Contingent liabilities and commitments	59	598,364,726	502,372,909	598,364,726	502,372,909
Net assets value per share (Rs)	63	221.36	186.11	249.74	220.61

The notes to the financial statements from pages 126 to 246 form an integral part of these financial statements.

I certify that these financial statements are in compliance with the requirements of Companies Act No 7 of 2007.



Anusha Gallage

Chief Financial Officer

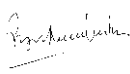
The Board of Directors is responsible for these Financial Statements.

Approved and signed for and on behalf of the Board.



Jonathan Alles

Managing Director / Chief Executive Officer



Rienzie Arseculeratne

Chairman



K A L Thushari Ranaweera (Mrs)

Deputy General Manager (Legal) / Company Secretary

20th February 2018
Colombo

Statement of Changes in Equity

Bank	Stated Capital		Other Reserves				Total		
	Voting Shares Rs 000	Non-Voting Shares Rs 000	Statutory Reserve Rs 000	Capital Reserve Rs 000	Available-for-Sale Reserve Rs 000	General Reserve Rs 000		ESOP Reserve Rs 000	Retained Earnings Rs 000
Balance as at 1st January 2016	11,110,689	2,716,184	3,760,000	6,435,410	4,455,566	31,100,000	202,356	5,270,848	65,051,053
Total comprehensive income for the year									
Net profit for the year 2016	-	-	-	-	-	-	-	14,143,406	14,143,406
Other comprehensive income, net of tax	-	-	-	2,218,908	(2,754,309)	-	-	362,934	(172,467)
Total comprehensive income for the year	-	-	-	2,218,908	(2,754,309)	-	-	14,506,340	13,970,939
Transactions with equity holders, recognised directly in equity									
Contributions by and distributions to equity holders									
Final dividend 2015 - Cash	-	-	-	-	-	-	-	(1,421,200)	(1,421,200)
Final dividend 2015 - Scrip	1,022,473	256,607	-	-	-	-	-	(1,421,200)	(142,120)
Interim dividend 2016 - Cash	-	-	-	-	-	-	-	(620,387)	(620,387)
Issue of shares under ESOP	157,128	21,813	-	-	-	-	-	-	178,941
Total contributions by and distributions to equity holders	1,179,601	278,420	-	-	-	-	-	(3,462,787)	(2,004,766)
Transfers during the year 2016	48,444	6,820	800,000	(9,835)	-	6,000,000	(55,264)	(6,790,165)	-
Balance as at 31st December 2016	12,338,734	3,001,424	4,560,000	8,644,483	1,701,257	37,100,000	147,092	9,524,236	77,017,226
Balance as at 1st January 2017	12,338,734	3,001,424	4,560,000	8,644,483	1,701,257	37,100,000	147,092	9,524,236	77,017,226
Total comprehensive income for the year									
Net profit for the year 2017	-	-	-	-	-	-	-	16,466,790	16,466,790
Other comprehensive income, net of tax	-	-	-	81,059	2,464,910	-	-	(284,960)	2,261,009
Total comprehensive income for the year	-	-	-	81,059	2,464,910	-	-	16,181,830	18,727,799
Transactions with equity holders, recognised directly in equity									
Contributions by and distributions to equity holders									
Final dividend 2016 - Cash	-	-	-	-	-	-	-	(1,451,296)	(1,451,296)
Final dividend 2016 - Scrip	1,044,073	262,093	-	-	-	-	-	(1,451,296)	(145,130)
Interim dividend 2017 - Cash	-	-	-	-	-	-	-	(732,745)	(732,745)
Proceeds from rights issue	12,326,592	2,218,619	-	-	-	-	-	-	14,545,211
Issue of shares under ESOP	143,110	20,568	-	-	-	-	-	-	163,678
Total contributions by and distributions to equity holders	13,513,775	2,501,280	-	-	-	-	-	(3,635,337)	12,379,718
Transfer of unclaimed dividends	-	-	-	-	-	-	-	22,856	22,856
Transfers during the year 2017	47,516	6,390	900,000	-	-	6,000,000	(53,906)	(6,900,000)	-
Balance as at 31st December 2017	25,900,025	5,509,094	5,460,000	8,725,542	4,166,167	43,100,000	93,186	15,193,585	108,147,599

Statement of Changes in Equity

Group

	Attributable to Equity Holders of the Bank										Total Rs 000	
	Stated Capital		Other Reserves					Retained Earnings	Non Controlling Interests	Rs 000		Rs 000
	Voting Shares	Non-Voting Shares	Statutory Reserve	Capital Reserve	Available- for-Sale	General Reserve	Life Policy Holder Reserve Fund					
Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000		
Balance as at 1st January 2016	11,110,689	2,716,184	3,760,000	14,263,234	4,518,441	31,100,000	(56,350)	202,356	7,949,848	2,179,288	77,743,690	
Total comprehensive income for the year	-	-	-	-	-	-	-	-	14,755,634	909,328	15,664,962	
Net profit for the year 2016	-	-	-	-	(2,776,906)	-	-	-	368,586	81,814	3,192,000	
Other comprehensive income, net of tax	-	-	-	5,518,506	(2,776,906)	-	-	-	-	-	-	
Total comprehensive income for the year	-	-	-	5,518,506	(2,776,906)	-	-	-	15,124,220	991,142	18,856,962	
Transactions with equity holders, recognised directly in equity	-	-	-	-	-	-	-	-	-	-	-	
Contributions by and distributions to equity holders	-	-	-	-	-	-	-	-	(1,421,200)	(149,407)	(1,570,607)	
Final dividend 2015 - Cash	-	-	-	-	-	-	-	-	(1,421,200)	-	(1,421,200)	
Final dividend 2015 - Scrip	1,022,473	256,607	-	-	-	-	-	-	(620,387)	-	(620,387)	
Interim dividend 2016 - Cash	-	-	-	-	-	-	-	-	-	-	-	
Issue of shares under ESOP	157,128	21,813	-	-	-	-	-	-	-	-	178,941	
Total contributions by and distributions to equity holders	1,179,601	278,420	-	-	-	-	-	-	(3,462,787)	(149,407)	(2,154,173)	
Transfer to life policy holder reserve fund	-	-	-	-	-	-	(134,781)	-	-	-	(134,781)	
Transfers during the year 2016	48,444	6,820	800,000	(9,835)	-	6,000,000	-	(55,264)	(6,790,165)	-	-	
Balance as at 31st December 2016	12,338,734	3,001,424	4,560,000	19,771,905	1,741,535	37,100,000	(191,131)	147,092	12,821,116	3,021,023	94,311,698	

Group

	Attributable to Equity Holders of the Bank										
	Stated Capital			Other Reserves							Total
	Voting Shares	Non-Voting Shares	Statutory Reserve	Capital Reserve	Available-for-Sale Reserve	General Reserve	Life Policy Holder Reserve Fund	ESOP Reserve	Retained Earnings	Non Controlling Interests	
Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	
Balance as at 1st January 2017	12,338,734	3,001,424	4,560,000	19,771,905	1,741,535	37,100,000	(191,131)	147,092	12,821,116	3,021,023	94,311,698
Total comprehensive income for the year											
Net profit for the year 2017											
Other comprehensive income, net of tax	-	-	-	(338,076)	2,466,196	-	-	-	15,946,989	794,407	16,741,396
Total comprehensive income for the year	-	-	-	(338,076)	2,466,196	-	-	-	(290,818)	32,734	1,870,086
Transactions with equity holders, recognised directly in equity Contributions by and distributions to equity holders											
Final dividend 2016 - Cash	-	-	-	-	-	-	-	-	(1,451,296)	(199,461)	(1,650,757)
Final dividend 2016 - Scrip	1,044,073	262,093	-	-	-	-	-	-	(1,451,296)	-	(145,130)
Interim dividend 2017 - Cash	-	-	-	-	-	-	-	-	(732,745)	-	(732,745)
Proceeds from rights issue	12,326,592	2,218,619	-	-	-	-	-	-	-	-	14,545,211
Issue of shares under ESOP	143,110	20,568	-	-	-	-	-	-	-	-	163,678
Total contributions by and distributions to equity holders	13,513,775	2,501,280	-	-	-	-	-	-	(3,635,337)	(199,461)	12,180,257
Transfer to life policy holder reserve fund	-	-	-	-	-	-	414,402	-	-	-	414,402
Deemed disposal gain through joint venture	-	-	-	-	-	-	-	-	117,478	-	117,478
Transfer of unclaimed dividends	-	-	-	-	-	-	-	-	22,856	-	22,856
Transfers during the year 2017	47,516	6,390	900,000	-	-	6,000,000	-	(53,906)	(6,900,000)	-	-
Balance as at 31st December 2017	25,900,025	5,509,094	5,460,000	19,433,829	4,207,731	43,100,000	223,271	93,186	18,082,284	3,648,703	125,658,123

The notes to the financial statements from page 126 to 246 form an integral part of these financial statements.

Statement of Cash Flows

Accounting Policy

The statement of cash flows has been prepared using the direct method of preparing cash flows in accordance with Sri Lanka Accounting Standard - LKAS 7 on "Statement of Cash Flows" whereby gross cash receipts and gross cash payments of operating activities, financing activities and investing activities have been recognised. 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 change in value.

The cash and cash equivalents include cash in hand, balances with banks, placements with banks, money at call and short notice.

For the year ended 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Cash flows from operating activities				
Interest and commission receipts	103,092,069	77,766,617	111,625,788	84,142,896
Interest payments	(52,956,382)	(36,874,859)	(54,672,229)	(37,989,919)
Cash payments to employees	(8,427,884)	(8,610,079)	(10,224,168)	(10,255,904)
Cash payments to other operating activities	(14,491,891)	(12,385,159)	(19,086,981)	(16,156,447)
Receipts from other operating activities	(501,325)	3,152,693	6,250,173	9,035,322
Recovery of loans written off in prior years	34,082	34,014	34,082	52,881
Operating profit before changes in operating assets and liabilities [Note (a)]	26,748,669	23,083,227	33,926,665	28,828,829
(Increase) / decrease in operating assets				
Deposits held for regulatory or monetary control purpose	(4,833,326)	(13,681,524)	(4,833,326)	(13,681,524)
Loans and receivables to customers	(58,931,158)	(85,148,644)	(62,659,442)	(89,595,887)
Reverse repurchase agreements	4,301,421	567,579	4,167,210	2,043,130
Other short term assets	(1,383,507)	(343,355)	(1,765,867)	(1,090,556)
	(60,846,570)	(98,605,944)	(65,091,425)	(102,324,837)
Increase / (decrease) in operating liabilities				
Deposits from customers	74,318,613	91,722,310	79,519,452	94,514,994
Securities sold under repurchase agreements	(8,106,159)	(3,446,549)	(8,106,159)	(3,446,549)
Other liabilities	28,301	(479,327)	(66,004)	(300,488)
	66,240,755	87,796,434	71,347,289	90,767,957
Net cash generated from operating activities before income tax	32,142,854	12,273,717	40,182,529	17,271,949
Income taxes paid	(5,897,548)	(3,447,705)	(6,673,342)	(3,949,092)
Net cash generated from operating activities	26,245,306	8,826,012	33,509,187	13,322,857
Cash flows from investing activities				
Dividend income	2,022,028	886,229	173,486	145,082
Dividend income received from joint venture	-	-	33,220	30,200
Net proceeds from sale, maturity and purchase of financial investments	(24,124,866)	(28,227,265)	(25,120,964)	(30,271,537)
Proceeds from deemed disposal of subsidiary company by joint venture	-	-	117,478	-
Investment in joint venture company	-	(100,000)	-	(100,000)
Proceeds from sale of non-current assets held for sale	-	23,734	-	23,734
Proceeds from sale of property, plant and equipment	2,600	12,151	23,801	11,577
Purchase of intangible assets	(281,741)	(350,477)	(367,328)	(441,837)
Purchase of property, plant and equipment	(1,712,689)	(975,198)	(1,888,965)	(1,285,867)
Proceeds from sale of investment properties	-	-	-	3,650
Improvements to investment properties	(2,399)	(22,787)	(39,942)	(21,516)
Net cash used in investing activities	(24,097,065)	(28,753,613)	(27,069,214)	(31,906,514)
Cash flows from financing activities				
Proceeds from issue of shares	14,545,211	-	14,545,211	-
Share issue expenses	(6,346)	-	(6,346)	-
Dividends paid	(2,338,019)	(1,941,403)	(2,534,359)	(2,082,422)
Debt issue expenses	-	(35,233)	-	(35,233)
Increase / (decrease) in subordinated term debts	(500,000)	13,000,000	(490,500)	12,750,000
Increase / (decrease) in long term borrowings	(7,355,084)	12,053,368	(7,389,783)	12,045,541
Proceeds from issue of shares under ESOP	163,678	178,940	163,678	178,940
Net cash generated from financing activities	4,509,440	23,255,672	4,287,901	22,856,826
Net increase/ (decrease) in cash and cash equivalents	6,657,681	3,328,071	10,727,874	4,273,169
Cash and cash equivalents at the beginning of the year	18,264,496	14,936,425	20,867,149	16,593,980
Cash and cash equivalents at the end of the year [Note (b)]	24,922,177	18,264,496	31,595,023	20,867,149

For the year ended 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Note (a) - Reconciliation of operating profit before changes in operating assets and liabilities				
Profit before income tax	22,050,211	20,145,829	23,103,012	22,498,647
Amortisation of intangible assets	256,008	220,138	309,768	260,357
Accrual for interest payable	3,549,944	7,035,640	3,762,635	7,017,836
Accrual for interest receivable	(862,415)	(4,047,724)	(785,890)	(4,326,631)
Accrual for other payable	388,954	234,917	715,847	587,249
Accrual for other receivable	479,882	(92,289)	479,882	(92,289)
Depreciation of investment property	1,616	5,471	22,937	4,813
Depreciation of property, plant and equipment	871,178	810,321	1,224,138	1,128,658
Share issue expenses	6,346	-	6,346	-
Debenture issue expenses	-	35,233	-	35,233
Dividend income	(2,052,535)	(888,352)	(237,213)	(145,007)
[Gain] / loss on FCBU revaluation	(44,207)	25,080	(44,207)	25,080
Gain on disposal from sale of non-current assets held for sale	-	(3,556)	-	(3,556)
Loss on disposal of investment properties	-	-	-	550
Gain on disposal of property, plant and equipment	(7,800)	(4,379)	(14,178)	(1,807)
Impairment charge for loans and other losses	3,035,468	237,160	3,926,149	508,159
Increase in insurance contract liabilities - life	-	-	2,168,002	1,740,775
Movement in general insurance reserve fund	-	-	463,341	375,301
Net capital (gain) / loss from financial investments - available-for-sale	-	-	(30,632)	14,466
Net capital (gain) / loss from financial investments - fair value through profit or loss	(6,152)	(4,712)	(8,048)	12,719
Net loss from marked to market valuation of financial investments - fair value through profit or loss	(7,106)	44,604	(16,391)	63,732
Notional tax credit and WHT credit	(910,723)	(670,154)	(943,217)	(726,666)
Share of profits of associate and joint venture	-	-	(175,616)	(148,790)
	26,748,669	23,083,227	33,926,665	28,828,829

As at 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Note (b) - Cash and cash equivalents at the end of the year				
Cash and cash equivalents (Note 24)	21,739,800	17,511,446	21,924,898	18,668,703
Placements with banks (Note 25)	3,182,377	753,050	9,670,125	2,198,446
	24,922,177	18,264,496	31,595,023	20,867,149

The notes to the financial statements from pages 126 to 246 form an integral part of these financial statements.

Notes to the Financial Statements

1 REPORTING ENTITY

1.1 Corporate Information

Hatton National Bank PLC (the "Bank") is a public quoted company incorporated on 5th March 1970 with limited liability and domiciled in Sri Lanka. It is a licensed commercial bank registered under the Banking Act No. 30 of 1988 and amendments thereto. The Bank was re-registered under the Companies Act No. 07 of 2007. The registered office of the Bank is situated at No 479, T B Jayah Mawatha, Colombo 10. The shares of the Bank have a primary listing on the Colombo Stock Exchange. The staff strength of the Bank as at 31st December 2017 was 4,348 (2016 - 4,190).

1.2 Consolidated Financial Statements

The consolidated financial statements of the Group for the year ended 31st December 2017 include the Bank and its subsidiaries (together referred to as the "Group" and individually as "Group entities") and the Group's interest in its joint venture. The financial statements of all companies in the Group have a common financial year which ends on December 31st except for Lanka Ventures PLC, a subsidiary of Acuity Partners (Pvt) Limited, the joint venture, whose financial year ends on March 31st.

Hatton National Bank PLC is the ultimate parent of the Group.

There were no significant changes in the nature of principal activities of the Group during the financial year under review.

1.3 Principal Activities and Nature of Operations

Entity	Principal business activities
Bank	Banking and related activities such as deposit acceptance, corporate and retail banking, personal financial services, off shore banking, foreign currency operations, trade services, investment banking, development banking, rural finance, project finance, dealing in government securities, leasing, islamic banking etc.
Subsidiaries	
HNB Assurance PLC Life insurance	Life insurance
HNB General Insurance Ltd (Held through HNB Assurance PLC)	General insurance
Sithma Development (Pvt) Ltd	Construction and letting of premises for commercial purposes and related services
HNB Grameen Finance Ltd	Micro finance facilities and deposit acceptance
Joint Venture	
Acuity Partners (Pvt) Ltd	Operating as an investment company and providing financial services

2 BASIS OF PREPARATION AND OTHER SIGNIFICANT ACCOUNTING POLICIES

2.1 Basis of Preparation

2.1.1 Statement of Compliance

The consolidated financial statements of the Group and the separate financial statements of the Bank which comprise of the statement of financial position, statement of profit or loss, statement of comprehensive income, statement of changes in equity, statement of cash flows and notes thereto, have been prepared in accordance with Sri Lanka Accounting Standards (commonly referred as "SLFRS" / "LKAS") laid down by the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka) and comply with the requirements of Companies Act No 7 of 2007, Banking Act No 30 of 1988, Insurance Industry Act No 43 of 2000 and Finance Business Act No 42 of 2011 and amendment thereto.

2.1.2 Responsibility for Financial Statements

The Board of Directors is responsible for the preparation and presentation of the financial statements of the Group and the Bank as per Sri Lanka Accounting Standards and the provisions of the Companies Act No 07 of 2007.

2.1.3 Approval of Financial Statements by Directors

The financial statements of the Group and the Bank were authorised for issue by the Board of Directors in accordance with the resolution of the directors on 20th February 2018.

2.1.4 Basis of Measurement

The financial statements have been prepared on the historical cost basis and applied consistently except for the following items in the statement of financial position.

Item	Basis of measurement
Derivative financial instruments	Fair value
Financial instruments classified as fair value through profit or loss	Fair value
Available-for-sale financial assets	Fair value
Freehold land and buildings	Measured at cost at the time of acquisition and subsequently at revalued amounts (except investment properties), which are the fair values on the date of revaluation
Non-current assets held for sale	Measured at lower of its carrying amount and fair value less costs to sell
Defined benefit obligations	Liability for defined benefit obligations is recognised as the present value of the defined benefit obligation less the fair value of the plan assets.

2.1.5 Functional and Presentation Currency

The financial statements of the Group are presented in Sri Lankan Rupees (LKR), which is the currency of the primary economic environment in which the Group operates (Group's functional currency). Financial information presented in Sri Lankan Rupees has been rounded to the nearest thousand unless indicated otherwise.

Each entity in the Group determines its own functional currency and items included in the financial statements of each individual entity are measured using that functional currency. There was no change in the Group's presentation and functional currency during the year under review.

2.1.6 Presentation of Financial Statements

The assets and liabilities of the Group presented in the statement of financial position are grouped by nature and listed in an order that reflects their relative liquidity and maturity pattern. An analysis on recovery or settlement within 12 months after the reporting date (current) and more than 12 months after the reporting date (non-current) is presented in Note 61 to the financial statements.

Financial assets and financial liabilities are offset and the net amount is 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 settle the liabilities simultaneously. Income and expenses are not offset in the statement of profit or loss unless required or permitted by an accounting standard or interpretation, and as specifically disclosed in the accounting policies of the Group.

Each material class of similar items is presented separately in the financial statements. Items of dissimilar nature or function are presented separately unless they are immaterial as permitted by the Sri Lanka Accounting Standard - LKAS 1 on "Presentation of Financial Statements".

2.1.7 Changes in Accounting Policies

There were no changes in accounting policies and the accounting policies adopted are consistent with those of the previous financial year.

2.1.8 Comparative Information

The comparative information is re-classified wherever necessary to conform with the current year's classification in order to provide a better presentation. The details of such re-classifications have been provided in Note 65 to the financial statements.

2.2 Significant Accounting Judgements, Estimates and Assumptions

The preparation of financial statements in conformity with Sri Lanka Accounting Standards requires management to make judgements, estimates and assumptions that affects the reported amounts of revenues, expenses, assets, liabilities, and the accompanying disclosures, as well as the disclosure of contingent liabilities. Uncertainty about these assumptions and estimates

could result in outcomes that require a material adjustment to the carrying amount of assets or liabilities affected in future periods.

The areas of estimation uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amounts recognised in the financial statements of the Group are as follows.

2.2.1 Going Concern

The directors have made an assessment of the Group's ability to continue as a going concern and are satisfied that it has the resources to continue in business for the foreseeable future. Furthermore, Board is not aware of any material uncertainties that may cast significant doubt upon the Group's ability to continue as a going concern and they do not intend either to liquidate or to cease operations of the Group. Therefore, the financial statements continue to be prepared on the going concern basis.

2.2.2 Fair Value of Financial Instruments

Where the fair values of financial assets and financial liabilities recorded in the statement of financial position cannot be derived from active markets, those are determined using a variety of valuation techniques that include the use of mathematical models. The inputs to these models are derived from observable market data where possible, but if this is not available, judgement is required to establish fair values. The valuation of financial instruments is described in more detail in Note 5 to the financial statements

2.2.3 Impairment Losses on Loans and Advances

Individual impairment assessment

The Group reviews their individually significant loans and advances at each reporting date to assess whether an impairment loss should be recorded in the statement of profit or loss. In particular, management judgement is required in the estimation of the amount and timing of future cash flows when determining the impairment loss. These estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the impairment allowance made.

Collective impairment assessment

Loans and advances that have been assessed individually and found not to be impaired and all individually insignificant loans and advances are then assessed collectively, by categorising those into groups of assets with similar credit risk characteristics, to determine whether a provision should be made due to incurred loss events for which there is an objective evidence, but the effects of which are not yet evident. The collective assessment takes account of data from the loan portfolio such as number of days in arrears and judgements on the effect of concentrations of risks and economic data (including levels of unemployment, inflation, interest rates, exchange rates, effect of regulatory changes), and trends in non-performing loans.

The impairment loss on loans and advances is disclosed in Note 31 (b) to the financial statements.

Notes to the Financial Statements

2.2.4 Impairment losses on Available for Sale Investments

Debt securities

The Group reviews debt securities classified as available-for-sale investments at each reporting date to assess whether those are impaired. This requires application of similar judgements as applied to individual assessment of loans and advances.

Equity investments

The Group also records impairment charges on available-for-sale equity investments when there has been a significant or prolonged decline in the fair value below the cost. The determination of what is 'significant' or 'prolonged' requires judgement. In making this judgement, the Group evaluates, among other factors, historical share price movements, duration and extent to which the fair value of an investment is less than its cost.

The impairment losses on available-for-sale investments are disclosed in Note 33 to the financial statements.

2.2.5 Impairment of Investments in Subsidiaries and Other Financial Assets

The Group follows the guidance of Sri Lanka Accounting Standard - LKAS 36 on "Impairment of Assets" and Sri Lanka Accounting Standard - LKAS 39 on "Financial Instruments : Recognition and Measurement" in determining whether an investment or a financial asset is impaired. This determination requires significant judgement. The Group evaluates, among other factors, the duration and extent to which the fair value of an investment or a financial asset is less than its cost and the financial health of the near-term business outlook of the investment or the financial asset, including factors such as industry and sector performance, changes in technology and operational and financing cash flows.

2.2.6 Impairment of Goodwill

The Group estimates the value in use of the Cash Generating Units (CGU) to which goodwill has been allocated in order to determine whether goodwill is impaired. The value in use calculation requires the entity to estimate the future cash flows expected to arise from the CGU and a suitable discount rate in order to calculate present value. The carrying amount of goodwill as at 31st December 2017 is Rs 122.9 Mn [2016 :Rs 122.9 Mn].

The details on assessment of goodwill impairment is given in Note 39 (a) i.

2.2.7 Deferred Tax Assets

Deferred tax assets are recognised in respect of loan impairment allowances which will be recovered in the foreseeable future and tax losses to the extent that it is probable that future taxable profit will be available against which the losses can be utilised. Judgement is required to determine the amount of deferred tax assets that can be recognised, based on the likely timing and level of future taxable profits, together with future tax planning strategies.

Details on deferred tax assets are disclosed in Note 49 (b) to the financial statements.

2.2.8 Defined Benefit Obligation

The cost of the defined benefit pension plan is determined using an actuarial valuation. The actuarial valuation involves making assumptions about discount rates, expected rates of return on assets, future salary increases, mortality rates, increase in cost of living allowances and future pension increases. Due to the long term nature of these plans, such estimates are subject to significant uncertainty. All assumptions are reviewed at each reporting date.

In determining the appropriate discount rate, management considers the interest rates of Government of Sri Lanka Treasury Bonds with maturities corresponding to the expected duration of defined benefit obligation. Future salary increases and pension increases are based on expected future inflation rates and expected future salary increment rate of the Bank.

Details of the key assumptions used in the estimates are contained in Note 53 (a) vii to the financial statements.

2.2.9 Fair Value of Freehold Land and Buildings

The freehold land and buildings of the Group are reflected at fair value. The Group engaged independent valuers to determine the fair value of freehold land and buildings in terms of Sri Lanka Accounting Standard - SLFRS 13 on "Fair Value Measurement".

The methods used to determine the fair value of the freehold land and buildings, are further explained in Note 38 to the financial statements.

2.2.10 Useful Life time of Property, Plant and Equipment, Investment Properties and Intangible Assets

The Group reviews the residual values, useful lives and methods of depreciation of property, plant and equipment, investment properties and intangible assets at each reporting date. Management exercises judgement in the estimation of these values, rates, methods and hence those are subject to uncertainty.

2.2.11 Classification of Investment Properties

Management uses its judgment to determine whether a property qualifies as an investment property. The Group has developed criteria so it can exercise its judgment consistently.

A property that is held to earn rentals or for capital appreciation or both, and which generates cash flows largely independent of the other assets held by the Group are accounted for as investment properties. On the other hand, a property that is used for operations or in the process of providing services or for administrative purposes and which do not directly generate cash flows as a standalone asset, are accounted for as property, plant and equipment. The Group assesses on an annual basis, the accounting classification of its properties, taking into consideration the current use of such properties.

2.2.12 Valuation of Life Insurance Contract Liabilities of Subsidiary HNB Assurance PLC (HNBA)

The liability for life insurance contracts with Discretionary Participation Features (DPF) is either based on current assumptions or on assumptions established at the inception of the contract, reflecting the best estimate at the time, increased with a margin for risk and adverse deviation. All contracts are subject to a liability adequacy test, which reflect management's best current estimate of future cash flows.

The main assumptions used relate to mortality, morbidity, longevity, investment returns, expenses, lapse and surrender rates and discount rates. For those contracts that insure risk related to longevity, prudent allowance is made for expected future mortality improvements, as well as wide ranging changes to life style, which could result in significant changes to the expected future mortality exposure.

Estimates are also made as to future investment income arising from the assets backing life insurance contracts. These estimates are based on current market returns, as well as expectations about future economic and financial developments.

Assumptions on future expense are based on current expense levels, adjusted for expected expense inflation, if appropriate.

Lapse and surrender rates are based on HNBA's historical experience of lapses and surrenders. Discount rates are based on current industry risk rates, adjusted for the HNBA's own risk exposure.

2.2.13 Valuation of General Insurance Contract Liabilities of Subsidiary HNB Assurance PLC (HNBA)

The estimates of general insurance contracts have to be made, both for the expected ultimate cost of claims reported at the reporting date and for the expected ultimate cost of claims Incurred But Not yet Reported (IBNR), at the reporting date. It can take a significant period of time before the ultimate claims cost can be established with certainty. The main assumption underlying estimating the amounts of outstanding claims is the past claims development experience.

Large claims are usually separately addressed, either by being reserved at the face value of loss adjusted estimates or separately projected in order to reflect their future development. In most cases, no explicit assumptions are made regarding future rates of claims, inflation or loss ratios.

2.2.14 Deferred Acquisition Expenses

Acquisition expenses, representing commissions, which vary with and are directly related to the production of business, are deferred and amortised over the period in which the related written premiums are earned. Reinsurance commission is also treated in the same manner with deferred acquisition costs.

2.2.15 Taxation

The Group is subject to income tax and judgement is required to determine the total provision for current, deferred and other taxes due to the uncertainties that exist with respect to interpretation of the applicability of tax laws, at the time of preparation of these financial statements.

Uncertainties also exist with respect to the interpretation of complex tax regulations and the amount and timing of future taxable income. Given the wide range of business relationships and the long term nature and complexity of existing contractual agreements, differences arising between the actual results and the assumptions made, or future changes to such assumptions, could necessitate future adjustments to tax income and expense amounts that were initially recorded, and deferred tax amounts in the period in which the determination is made.

2.2.16 Notional Tax Credit of Subsidiary, HNB Assurance PLC (HNBA)

HNBA has carried out an assessment on the taxable profits in future and according to the new Inland Revenue Act No 24 of 2017 it will have taxable profits. Accordingly, HNBA is eligible to set off notional tax paid against the future tax liability. Based on this assessment no impairment provision is recognised as it will have adequate tax liability to utilise the notional tax credit.

2.2.17 Share-Based Payments

The Group measures the cost of equity settled transactions with employees by reference to the fair value of the equity instruments on the date on which those are granted. Estimating fair value for share based payment transactions require determination of the most appropriate valuation model, which is dependent on the terms and conditions of the grant.

This estimate also requires determination of the most appropriate inputs to the valuation model including the expected life of the share option, volatility and dividend yield and making assumptions about those.

2.2.18 Commitments and Contingencies

All discernible risks are accounted for in determining the amount of all known liabilities.

Contingent liabilities are possible obligations whose existence will be confirmed only by uncertain future events or present obligations where the transfer of economic benefit is not probable or cannot be reliably measured. Contingent liabilities are not recognised in the statement of financial position but are disclosed unless those are remote.

Details on commitments and contingencies are given in Note 59 to the financial statements.

2.2.19 Provisions for Liabilities and Contingencies

The Group receives legal claims against it in the normal course of business. Management has made judgements 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

Notes to the Financial Statements

3 SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies set out below have been applied consistently to all periods presented in the financial statements of the Group, unless otherwise indicated. The accounting policies have been consistently applied by the Group entities where applicable and deviations if any have been disclosed accordingly.

3.1 Basis of Consolidation

The Bank's financial statements comprise the amalgamation of the financial statements of the Domestic Banking Unit (DBU) and the Foreign Currency Banking Unit (FCBU). The Group's financial statements comprise consolidation of the financial statements of the Bank, its subsidiaries in terms of the Sri Lanka Accounting Standard - SLFRS 10 on "Consolidated Financial Statements" and the proportionate share of the profit or loss and net assets of its joint venture [equity method] in terms of the Sri Lanka Accounting Standard - SLFRS 11 on "Joint Arrangements".

3.1.1 Business Combinations and Goodwill

Business combinations are accounted for using the acquisition method as per the requirements of Sri Lanka Accounting Standard - SLFRS 3 on "Business Combinations". When the Group acquires a business, it assesses the financial assets acquired and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions as at the acquisition date.

The Group measures goodwill as the fair value of the consideration transferred including the recognised amount of any non-controlling interest in the acquiree, less the net recognised amount (generally fair value) of the identifiable assets acquired and liabilities assumed, all measured as of the acquisition date. When the excess is negative, a bargain purchase gain is recognised immediately in the statement of profit or loss. Acquisition related costs are expensed as incurred and are included in other expenses. Goodwill is initially measured at cost and subsequently at cost less any accumulated impairment losses in accordance with the Sri Lanka Accounting Standard - SLFRS 3 on "Business Combinations".

Goodwill has to be reviewed for impairment annually or more frequently if events or circumstances indicate that the carrying value may be impaired.

The Group elects on a transaction by transaction basis whether to measure non-controlling interest at its fair value, or at its proportionate share of the recognised amount of identifiable net assets, at the acquisition date.

The consideration transferred does not include amounts related to the settlement of pre-existing relationships. Such amounts are generally recognised in the statement of profit or loss.

3.1.2 Transactions Eliminated on Consolidation

Intra-group balances, transactions and income and expenses arising from intra-group transactions are eliminated in preparing the consolidated financial statements. Un-realised gains arising from transactions with equity accounted investees are eliminated to the extent of the Group's interest in the investee. Un-realised losses are eliminated in the same way as un-realised gains,

except that those are only eliminated to the extent that there is no evidence of impairment.

3.1.3 Material Gains or Losses, Provisional Values or Error Corrections

There were no material gains or losses, provisional values or error corrections recognised during the year in respect of business combinations that took place in previous periods.

3.2 Foreign Currency

3.2.1 Foreign Currency Transactions and Balances

Transactions in foreign currencies are translated into the functional currency, which is Sri Lankan Rupees (LKR), using the middle rates of exchange prevailing at the dates on which the transactions were affected.

Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to Sri Lankan Rupees using the middle rates of exchange prevailing at that date. All differences arising on non-trading activities are taken to "other operating income" in the statement of profit or loss as foreign exchange gain/[loss].

The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period and the amortised cost in foreign currency translated at the middle rates of exchange prevailing at the end of the reporting period. Foreign currency differences arising on retranslation are recognised in the statement of profit or loss, except for differences arising on the retranslation of available-for-sale equity instruments, a financial liability designated as a hedge of the net investment in a foreign operation, or qualifying cash flow hedges, which are recognised in other comprehensive income.

Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to Sri Lankan Rupees at the exchange rates on the date that the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates at the date of the transaction.

Foreign exchange differences arising on the settlement or reporting of monetary items at rates different from those which were initially recorded are dealt in the statement of profit or loss.

Forward exchange contracts are valued at the forward market rates prevailing on the reporting date. Resulting net unrealised gains or losses are dealt in the statement of profit or loss.

3.3 Financial Instruments – Initial Recognition, Classification and Subsequent Measurement

3.3.1 Date of Recognition

All financial assets and liabilities are initially recognised on the trade date, i.e., the date that the Group becomes a party to the contractual provisions of the instrument. This includes “regular way trades”. Regular way trades means purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place.

3.3.2 Recognition and Initial Measurement of Financial Instruments

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 instruments, except in the case of financial assets and financial liabilities held at fair value through profit or loss according to Sri Lanka Accounting Standard - LKAS 39 on “Financial Instruments: Recognition and Measurement”. Transaction costs in relation to financial assets and financial liabilities at fair value through profit or loss are dealt with through the statement of profit or loss.

In respect of financial assets and liabilities held at fair value through profit or loss, any changes in fair value from the trade date to settlement date are accounted in the statement of profit or loss, while for available-for-sale financial assets, any changes in fair value from the trade date to settlement date are accounted in the other comprehensive income.

3.3.2 [a] “Day 1” Profit or Loss

When the transaction price differs from the fair value of other observable current market transactions in the same instrument, or based on a valuation technique whose variables include only data from observable markets, the Group recognises the difference between the transaction price and fair value (a Day 1 profit or loss) over the tenor of the financial instrument using the Effective Interest Rate (EIR) method. In cases where fair value is determined using data which is not observable, the difference between the transaction price and model value is only recognised in the statement of profit or loss when the inputs become observable, or when the instrument is de-recognised.

3.3.3 Classification and Subsequent Measurement of Financial Instruments

(i) At inception, a financial asset is classified in one of the following categories:

- Financial assets at fair value through profit or loss
 - Financial assets held for trading
 - Financial assets designated at fair value through profit or loss
- Loans and receivables
- Held to maturity financial assets
- Available-for-sale financial assets

(ii) At inception, a financial liability is classified in one of the following categories:

- Financial liabilities at fair value through profit or loss
 - Financial liabilities held for trading
 - Financial liabilities designated at fair value through profit or loss
- Financial liabilities at amortised cost

The subsequent measurement of financial assets and liabilities depends on the classification.

Financial Liabilities at Fair Value through Profit or Loss

Financial liabilities at fair value through profit or loss include financial liabilities held for trading and financial liabilities designated upon initial recognition as at fair value through profit or loss. Subsequent to initial recognition, financial liabilities at fair value through profit or loss are measured at fair value and changes therein are recognised in the statement of profit or loss.

Financial Liabilities Held for Trading

Financial liabilities are classified as held for trading if they are acquired principally for the purpose of selling or repurchasing in the near term or holds as a part of a portfolio that is managed together for short term profit or position taking. This category includes derivative financial instruments entered into by the Group that are not designated as hedging instruments in hedge relationships.

Separated embedded derivatives are also classified as held for trading, unless they are designated as effective hedging instruments.

Gains or losses in liabilities held for trading are recognised in the statement of profit or loss.

Financial Liabilities Designated at Fair Value through Profit or Loss

The Group designates financial liabilities at fair value through profit or loss in the following circumstances:

- Such designation eliminates or significantly reduces measurement or recognition inconsistency that would otherwise arise from measuring the liabilities
- The liabilities are part of a group of financial liabilities, financial assets or both, which are managed and their performance evaluated on a fair value basis, in accordance with a documented risk management or investment strategy
- The liability contains one or more embedded derivatives that significantly modify the cash flows that would otherwise have been required under the contract.

The Group has not designated any financial liabilities upon initial recognition as at fair value through profit or loss as at the reporting date.

Notes to the Financial Statements

Financial Liabilities at Amortised Cost

Financial liabilities issued by the Group that are not designated as at fair value through profit or loss are classified as liabilities under 'due to banks', 'due to customers', 'other borrowings', 'debt securities issued' and 'subordinated term debts' as appropriate, where the substance of the contractual arrangement results in the Group having an obligation either to deliver cash or another financial asset to another entity, or to exchange financial assets or financial liabilities with another entity, under conditions that are potentially un-favourable to the entity or settling the obligation by delivering variable number of entity's own equity instruments.

The details of financial liabilities measured at amortised cost are given in Note 41, 42, 43, 45, 46 and 47 to the financial statements.

3.3.4 Reclassifications of Financial Instruments

The Group does not reclassify any financial instrument into the 'fair value through profit or loss' category after initial recognition. Further the Group does not reclassify any financial instrument out of the 'fair value through profit or loss' category if upon initial recognition it was designated as at fair value through profit or loss. The Group reclassifies non-derivative financial assets out of the 'held-for-trading' category and into the 'available-for-sale', 'loans and receivables', or 'held-to-maturity' categories as permitted by the Sri Lanka Accounting Standard - LKAS 39 on "Financial Instruments: Recognition and Measurement". Further, in certain circumstances, the Group is permitted to reclassify financial instruments out of the 'available-for-sale' category and into the 'loans and receivables' or 'held-to-maturity' category.

Reclassifications are recorded at fair value at the date of reclassification, which becomes the new amortised cost.

For a financial asset reclassified out of the available-for-sale category, any previous gain or loss on that asset that has been recognised in equity is amortised to profit or loss over the remaining life of the investment using the Effective Interest Rate [EIR]. Any difference between the new amortised cost and the expected cash flows is also amortised over the remaining life of the asset using the EIR. If the asset is subsequently determined to be impaired, then the amount recorded in equity is recycled to the statement of profit or loss.

The Group may reclassify a non-derivative trading asset out of the 'held for trading' category and into the 'loans and receivables' category if it meets the definition of loans and receivables and the Group has the intention and ability to hold the financial asset for the foreseeable future or until maturity. If a financial asset is reclassified and if the Group subsequently increases its estimates of future cash receipts as a result of increased recoverability of those cash receipts, the effect of that increase is recognised as an adjustment to the EIR from the date of the change in estimate.

Reclassification is at the election of management and is determined on an instrument by instrument basis.

3.3.5 De-recognition of Financial Instruments

(i) Financial Assets

A financial asset [or, where applicable a part of a financial asset or part of a group of similar financial assets] is de-recognised when:

- the rights to receive cash flows from the asset have expired
- the Group 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:
- the Group has transferred substantially all the risks and rewards of the asset

or

- the Group has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset

On de-recognition 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 consideration received [including any new asset obtained less, any new liability assumed] and any cumulative gain or loss that had been recognised in other comprehensive income is recognised in statement of profit or loss.

When the Group has transferred its rights to receive cash flows from an asset or has entered into a pass-through arrangement and has neither transferred nor retained substantially all of the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Group's continuing involvement in the asset. In that case, the Group also recognises an associated liability. The transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the Group has retained.

Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to repay.

(ii) Financial Liabilities

A financial liability is de-recognised when the obligation under the liability is discharged, cancelled or expired. Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as de-recognition of the original liability and the recognition of a new liability. The difference between the carrying value of the original financial liability and the consideration paid is recognised in the statement of profit or loss.

3.3.6 Impairment of Financial Assets

At each reporting date, the Group assesses whether there is an objective evidence that financial assets not carried at fair value through profit or loss are impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is an objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset (an incurred loss event), and that the loss event has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated.

Objective evidence that financial assets (including equity securities) are impaired can include and not limited to: significant financial difficulty of the borrower or issuer, default or delinquency by a borrower, restructuring of a loan or advance by the Group on terms that the Group would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the Group, or economic conditions that correlate with defaults in the Group. In addition, for an investment in an equity security, a significant or prolonged decline in its fair value below its cost is an objective evidence of impairment.

3.4 Impairment of Non-financial Assets

The carrying amounts of the Group's non-financial assets, other than deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, or when annual impairment testing for an asset is required, the Group estimates the asset's recoverable amount. For goodwill and intangible assets that have indefinite useful lives or that are not yet available for use, the recoverable amount is estimated each year at the same time. An impairment loss is recognised if the carrying amount of an asset or its Cash Generating Unit (CGU) exceeds its estimated recoverable amount.

The recoverable amount of an asset or CGU 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 or CGU.

For the purpose of impairment testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generate cash inflows from continuing use that are largely independent of the cash inflows of other assets or CGU. Subject to an operating segment ceiling test, for the purposes of goodwill impairment testing, CGUs to which goodwill has been allocated are aggregated so that the level at which impairment testing is performed reflects the lowest level at which goodwill is monitored for internal reporting purposes. Goodwill acquired in a business combination is allocated to groups of CGUs that are expected to benefit from the synergies of the combination.

The Group's corporate assets do not generate separate cash inflows and are utilised by more than one CGU. Corporate assets are allocated to CGUs on a reasonable and consistent basis and

tested for impairment as part of the testing of the CGU to which the corporate asset is allocated.

Impairment losses are recognised in the statement of profit or loss, except for property previously revalued where the gain or loss on revaluation was taken to equity. In this case, the impairment is also recognised in equity up to the extent of any previously recognised revaluation gains. Impairment losses recognised in respect of CGUs are allocated first to reduce the carrying amount of any goodwill allocated to the CGU (group of CGUs) and then to reduce the carrying amount of the other assets in the CGU (group of CGUs) on a pro rata basis.

An impairment loss in respect of goodwill is not reversed. In respect of other assets, 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.

Notes to the Financial Statements

4 FINANCIAL RISK MANAGEMENT

4.1 Introduction and Overview

The Bank manages its exposure to the risks integral to its activities through a process of proper risk identification, analysis, measurement and continuous monitoring. The Bank is exposed to the following risks arising from financial instruments:

- Credit risk
- Liquidity risk
- Market risk

The Bank's exposure to each of the above risks, objectives, policies and processes associated with measuring and managing such risks, and its strategy on capital management is detailed below.

4.2 Risk Management Framework

The Board of Directors has overall responsibility for the establishment and oversight of the Bank's risk management framework. In discharging its governance responsibility it operates through two key committees, the Board Integrated Risk Management Committee (BIRMC) and the Board Audit Committee (BAC).

The BIRMC provides the Board, the assurance that risk management strategies, policies and processes are in place to manage events / outcomes that have the potential to impact significantly on earnings performance, reputation and capital. The approach entails active monitoring of the level of risk exposure against the parameters set in the risk appetite. The BIRMC also assists the Board by assessing significant credit and other transactions beyond the discretion of executive management.

The following executive management sub - committees, each with specialised focus, support the BIRMC and are responsible for the co-ordination of risk matters for each of the areas pertaining to risk management;

- Operational Risk Steering Committee
- Asset and Liability Committee
- Credit Policy Committee
- Investment Committee
- IT Steering Committee
- Executive Risk Management Committee

Internal Audit Department undertakes both regular and ad-hoc reviews of risk management controls and procedures, the results of which are reported to the BAC.

The BAC provides its assessment on the effectiveness of internal audit and external disclosure of accounting policies and financial reporting to the Board.

Risk management policies and systems are reviewed regularly to reflect changes in market conditions, products and services offered.

4.3 Credit Risk

Credit risk is the risk of financial loss to the Bank if a customer or a counterparty to a financial instrument fails to meet its contractual obligations and arises principally from the Bank's loans and advances to customers, investment in debt and equity securities. For risk management reporting purposes, the Bank considers and consolidates all elements of credit risk exposure (such as individual obligor default risk, industry risk and geographical risk etc.).

For risk management purposes, credit risk arising on trading assets is managed independently and information thereon is disclosed below.

The credit risk policy plays a central role in managing daily business activities. The Bank has developed a policy which defines the principles encompassing client selection, due diligence, early warning signals identification, watch listing, tolerable levels of concentration risk and portfolio monitoring in line with Bank's risk appetite. The approach is to avoid a large credit risk on a counterparty or portfolio level by applying stringent underwriting standards combined with sound collateralisation where feasible. The policy is reviewed at least annually and approved by the Board Credit Committee (BCC) ensuring consistency with the Bank's business strategy.

A monthly Credit Policy meeting chaired by the Managing Director / Chief Executive Officer, drives policy decisions and implementation plans.

4 FINANCIAL RISK MANAGEMENT (Contd.)

4.3 Credit Risk (Contd.)

Bank manages credit risk by focusing on following stages;

The loan origination process comprises initial screening and credit appraisal. The evaluation focuses on the borrower's ability to meet its obligations in a timely manner. Efforts are made to ensure consistent standards are maintained in credit approval. Collateral and guarantees form an important part of the credit risk mitigation process and internal policy dictates margins in Bank's favour by type of security offered, standards for periodic valuations and assessment of realisable value of collateral.

A suite of internal risk rating models are in place for corporate and retail customer segments. The internal risk rating is an important part of the risk assessment of customers and is incorporated in the credit decision process. Significant strides have been made in internalising this approach with a view to giving due prominence to lending based on cash flow repayment ability as distinct from collateral based lending.

The Bank has established clear guidelines for loan approvals / renewals by adopting a committee based approval structure, where all approval signatories carry equal responsibility for credit risk. Individual credit facilities beyond a minimum threshold require an independent risk signatory with no revenue targets, in respective committees.

Bank's corporate banking loan portfolio is administered through a centralised credit administration division which ensures efficient and effective post sanction customer support including disbursement, settlements, processing renewal notices and advising customers on interest rate amendments. This division independently reports to the risk management unit to ensure the availability of clear segregation of duties from business origination. The unit further ensures that the disbursements happen only after stipulated conditions are met and relevant security documents are obtained.

To safeguard the Bank against possible losses, problem loans need to be identified early. The credit risk management division measures and tracks the status of the credit portfolio, undertakes impact studies and detects early warning signals and watch listing pointing to deterioration in the financial health of a borrower.

A credit risk dashboard is prepared monthly to review high level credit portfolio concentration and assesses performance against internal limits (board risk appetite) and regulatory requirements. An internally developed business intelligence system ('KPI Wizard') is in place to evaluate credit risk indicators at branch, regional, zonal and bank level. Accountability for credit risk performance is vested with individual business units and unhealthy trends addressed at all levels.

Problem loans are managed by the Credit Supervision and Recoveries Division. This unit is responsible for all aspects of an overdue facility, restructuring of the credit, monitoring the value of the applicable collateral and liquidation, scrutiny of legal documents and liaising with the customer until all recovery matters are finalised. This division's activities are seamlessly integrated with credit administration and credit risk management to ensure effective follow up and learning transfer.

Back office recovery functions representing problem loans classification, rescheduling, provisioning and valuation of collateral on delinquent assets is centralised to ensure standardisation and accuracy. The Bank strictly conforms to regulatory requirements in problem loan classification and management.

Regular audits of business units are undertaken by Internal Audit Division in order to ensure smooth functioning of each of these stages.

Impairment assessment

The methodology adopted by the Bank in respect of impairment assessment is given in Note 31 [b].

Derivative financial instruments

Credit risk arising from derivative financial instruments is, at any time, limited to those with positive fair values, as recorded on the statement of financial position. With gross-settled derivatives, the Bank is also exposed to a settlement risk, being the risk that the Bank honours its obligation, but the counterparty fails to deliver the counter value.

Credit related commitment risks

The Bank makes available to its customers, guarantees which may require that the Bank makes payments on their behalf and enters into commitments to extend credit lines to secure their liquidity needs. Letters of credit and guarantees (including standby letters of credit) commit the Bank to make payments on behalf of customers in the event of a specific act, generally related to the import or export of goods. Such commitments expose the Bank to risks similar to loans and are mitigated by the same control processes and policies.

Notes to the Financial Statements

4 FINANCIAL RISK MANAGEMENT (Contd.)

4.3 Credit Risk (Contd.)

4.3.1 [a] Maximum Exposure to Credit Risk

The following table shows the maximum exposure to credit risk and net exposure to credit risk by class of financial asset.

As at 31st December	Bank				Group			
	2017		2016		2017		2016	
	Maximum exposure to credit risk	Net exposure to credit risk	Maximum exposure to credit risk	Net exposure to credit risk	Maximum exposure to credit risk	Net exposure to credit risk	Maximum exposure to credit risk	Net exposure to credit risk
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Placements with banks	3,182,377	3,182,377	753,050	753,050	9,670,125	9,670,125	2,198,446	2,198,446
Reverse repurchase agreements	-	-	4,303,460	118,045	772,002	-	5,756,794	118,045
Derivative financial instruments	615,357	615,357	289,989	289,989	615,357	615,357	289,989	289,989
Financial investments								
- fair value through profit or loss	120,486	120,486	544,915	544,915	266,538	266,538	716,009	716,009
Loans and receivables to customers (gross)	649,547,067	264,132,296	595,513,919	216,949,035	666,768,376	276,509,429	608,965,683	228,566,110
Financial investments - available-for-sale	95,403,820	95,403,820	89,915,153	89,915,153	101,742,985	101,742,985	95,797,142	95,797,142
Financial investments - loans and receivables	122,199,048	122,199,048	99,260,698	99,260,698	125,031,671	125,031,671	102,063,229	102,063,229
Other assets	2,124,947	2,124,947	2,308,521	2,308,521	3,170,937	3,170,937	2,308,521	2,308,521
	873,193,102	487,778,331	792,889,705	410,139,407	908,037,991	517,007,042	792,889,705	410,139,407
Guarantees, letters of credit and acceptances	170,594,808	168,722,698	149,358,306	147,824,644	170,594,808	168,722,698	149,358,306	147,824,644

Collateral and other credit enhancements

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty. Guidelines are in place covering the acceptability and valuation of each type of collateral.

The general creditworthiness of customers tends to be the most relevant indicator of credit quality of a loan. However, collateral provides additional security and the Bank generally requests large borrowers to provide same. The Bank may take collateral in the form of a first charge over real estate and residential properties, floating charges over all corporate assets and other liens and guarantees.

The Bank's policy is to pursue timely realisation of the collateral in an orderly manner. The proceeds are used to reduce or repay the outstanding claim. The Bank generally does not use non-cash collateral for its own operations.

4.3.1 [b] Credit Quality by Class of Financial Assets

The Bank manages the credit quality of loans and receivables based on an internal credit rating system while the other financial assets are managed based on the external credit ratings of the counterparty. The table below shows the credit quality by class of asset for all financial assets exposed to credit risk based on the credit ratings.

Bank As at 31st December 2017	Neither Past Due nor Impaired								
	High Grade	Standard Grade	Sub-Standard Grade	Unrated	Exposures not Subject to Rating	Past Due but not Impaired	Past Due and Impaired	Individually Impaired	Total
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Financial Assets									
Cash and cash equivalents	21,739,800	-	-	-	-	-	-	-	21,739,800
Placements with banks	2,175,681	1,006,696	-	-	-	-	-	-	3,182,377
Balances with Central Bank of Sri Lanka	38,610,940	-	-	-	-	-	-	-	38,610,940
Derivative financial instruments	436,662	157,914	125	20,656	-	-	-	-	615,357
Financial investments									
- fair value through profit or loss									
Equity securities	55,101	9,405	-	55,980	-	-	-	-	120,486

4 FINANCIAL RISK MANAGEMENT (Contd.)

4.3 Credit Risk (Contd.)

Bank

As at 31st December 2017

	Neither Past Due nor Impaired					Exposures not Subject to Rating Rs 000	Past Due but not Impaired Rs 000	Past Due and Impaired Rs 000	Individually Impaired Rs 000	Total Rs 000
	High Grade	Standard Grade	Sub-Standard Grade	Unrated						
	Rs 000	Rs 000	Rs 000	Rs 000						
Loans and receivables to customers (gross)	159,803,360	128,325,115	20,376,117	124,089,606	50,968,145	150,936,342	7,234,335	7,814,047	649,547,067	
Financial investments - available-for-sale										
Government securities	89,770,656	-	-	-	-	-	-	-	89,770,656	
Equity securities - quoted	4,912,813	-	-	276,300	-	-	-	-	5,189,113	
Equity securities - unquoted	-	-	-	444,051	-	-	-	-	444,051	
Financial investments - loans and receivables										
Government securities	108,844,057	-	-	-	-	-	-	-	108,844,057	
Debt securities - quoted	9,317,062	4,037,929	-	-	-	-	-	-	13,354,991	
Other assets	-	-	-	-	2,124,947	-	-	-	2,124,947	
	435,666,132	133,537,059	20,376,237	124,886,593	53,093,092	150,936,342	7,234,335	7,814,047	933,543,837	

Bank

As at 31st December 2016

	Neither Past Due nor Impaired					Exposures not Subject to Rating Rs 000	Past Due but not Impaired Rs 000	Past Due and Impaired Rs 000	Individually Impaired Rs 000	Total Rs 000
	High Grade	Standard Grade	Sub-Standard Grade	Unrated						
	Rs 000	Rs 000	Rs 000	Rs 000						
Financial Assets										
Cash and cash equivalents	17,511,446	-	-	-	-	-	-	-	17,511,446	
Placements with banks	-	-	-	753,050	-	-	-	-	753,050	
Balances with Central Bank of Sri Lanka	33,777,614	-	-	-	-	-	-	-	33,777,614	
Reverse repurchase agreements	4,303,460	-	-	-	-	-	-	-	4,303,460	
Derivative financial instruments	260,927	11,387	26	17649	-	-	-	-	289,989	
Financial investments - fair value through profit or loss										
Equity securities	235,944	-	-	308,971	-	-	-	-	544,915	
Loans and receivables to customers (gross)	114,696,550	92,172,162	4,143,986	205,201,496	49,959,359	113,391,068	7,060,081	8,889,217	595,513,919	
Financial investments - available-for-sale										
Government securities	84,295,103	-	-	-	-	-	-	-	84,295,103	
Equity securities - quoted	4,936,537	-	-	270,000	-	-	-	-	5,206,537	
Equity securities - unquoted	-	-	-	413,513	-	-	-	-	413,513	
Financial investments - loans and receivables										
Government securities	84,786,208	-	-	-	-	-	-	-	84,786,208	
Debt securities - quoted	12,338,128	2,136,363	-	-	-	-	-	-	14,474,491	
Other assets	-	-	-	-	2,308,521	-	-	-	2,308,521	
	357,141,917	94,319,912	4,144,012	207,865,379	51,367,180	113,391,068	7,060,081	8,889,217	844,178,766	

Notes to the Financial Statements

4 FINANCIAL RISK MANAGEMENT (Contd.)

4.3 Credit Risk (Contd.)

Group

As at 31st December 2017

	Neither Past Due nor Impaired					Past Due but not Impaired	Past Due and Impaired	Individually Impaired	Total
	High Grade	Standard Grade	Sub-Standard Grade	Unrated	Exposures not Subject to Rating				
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000				
Financial Assets									
Cash and cash equivalents	21,924,898	-	-	-	-	-	-	-	21,924,898
Placements with banks	8,663,429	1,006,696	-	-	-	-	-	-	9,670,125
Balances with									
Central Bank of Sri Lanka	38,610,940	-	-	-	-	-	-	-	38,610,940
Reverse repurchase agreements	772,002	-	-	-	-	-	-	-	772,002
Derivative financial instruments	436,662	157,914	125	20,656	-	-	-	-	615,357
Financial investments - fair value through profit or loss									
Equity securities	137,330	9405	-	119,803	-	-	-	-	266,538
Loans and receivables to customers	159,803,360	127,889,878	20,376,112	138,615,425	50,968,145	153,357,200	7,455,196	8,303,060	666,768,376
Financial investments - available-for-sale									
Government securities	96,019,316	-	-	-	-	-	-	-	96,019,316
Equity securities - quoted	4,952,726	-	-	301,032	-	-	-	13,430	5,267,188
Equity securities - unquoted	-	-	-	456,481	-	-	-	-	456,481
Financial investments - loans and receivables									
Government securities	108,844,057	-	-	-	-	-	-	-	108,844,057
Debt securities - quoted	11,256,271	4,624,230	-	-	-	-	-	-	15,880,501
Other loans and receivables	-	-	-	307,113	-	-	-	-	307,113
Other assets	-	-	-	-	3,170,937	-	-	-	3,170,937
	451,420,991	133,688,123	20,376,237	139,820,510	54,139,082	153,357,200	7,455,196	8,316,490	968,573,829

Group

As at 31st December 2016

	Neither Past Due nor Impaired					Past Due but not Impaired	Past Due and Impaired	Individually Impaired	Total
	High Grade	Standard Grade	Sub-Standard Grade	Unrated	Exposures not Subject to Rating				
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000				
Financial Assets									
Cash and cash equivalents	18,668,703	-	-	-	-	-	-	-	18,668,703
Placements with banks	1,445,396	-	-	753,050	-	-	-	-	2,198,446
Balances with									
Central Bank of Sri Lanka	33,777,614	-	-	-	-	-	-	-	33,777,614
Reverse repurchase agreements	5,756,794	-	-	-	-	-	-	-	5,756,794
Derivative financial instruments	260,927	11,387	26	17,649	-	-	-	-	289,989
Financial investments - fair value through profit or loss									
Equity securities	318,510	-	-	397,497	-	-	-	-	716,007

4 FINANCIAL RISK MANAGEMENT (Contd.)

4.3 Credit Risk (Contd.)

Group

As at 31st December 2016

	Neither Past Due nor Impaired				Exposures not Subject to Rating Rs 000	Past Due but not Impaired Rs 000	Past Due and Impaired Rs 000	Individually Impaired Rs 000	Total Rs 000
	High Grade	Standard Grade	Sub-Standard Grade	Unrated					
	Rs 000	Rs 000	Rs 000	Rs 000					
Loans and receivables to customers (gross)	114,696,550	91,597,588	4,143,986	218,275,259	50,225,081	113,684,450	7,374,251	8,968,518	608,965,683
Financial investments - available-for-sale									
Government securities	90,021,722	-	-	-	-	-	-	-	90,021,722
Equity securities - quoted	5,000,009	-	-	337,412	-	-	12,056	-	5,349,477
Equity securities - unquoted	-	-	-	425,943	-	-	-	-	425,943
Financial investments - loans and receivables									
Government securities	84,786,208	-	-	-	-	-	-	-	84,786,208
Debt securities - quoted	14,514,804	2,762,220	-	-	-	-	-	-	17,277,024
Other assets	-	-	-	-	2,308,521	-	-	-	2,308,521
	357,141,917	94,319,912	4,144,012	207,865,379	51,367,180	113,391,068	7,060,081	8,889,217	844,178,766

4.3.1 (c) Loans and Receivables to Customers

Allowances for impairment

The Bank established an allowance for impairment losses on assets carried at amortised cost and financial investments - available-for-sale that represents its estimate of incurred losses in its loans and investments in debt/equity securities portfolio. The main components of this allowance are a specific loss component that relates to individually significant exposures and for assets measured at amortised cost, a collective loan loss allowance established for groups of homogeneous assets, as well as for individually significant exposures that were subject to individual assessment for impairment, but not found to be individually impaired and exposures found to be impaired but not provided. Assets carried at fair value through profit or loss are not subject to impairment testing as the measure of fair value reflects the credit quality of each asset.

The Bank regards an individually significant loan and advance or a debt security as impaired, where there is an objective evidence that a loss event has occurred since initial recognition and such loss event has an impact on future estimated cash flows from the asset.

Movement of the impairment provision during the year, is given in Note 31 (b) to the financial statements.

Past due but not impaired loans

Past due but not impaired loans are those for which contractual interest or principal payments are past due, but the Bank believes that impairment is not appropriate on the basis of the stage of collection of amounts owed to the Bank.

4.3.1 (d) Age Analysis of Financial Assets that are Past Due but not Impaired

As at 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Past due but not impaired				
1-30 days	110,897,015	87,031,345	111,280,682	87,211,785
31-60 days	36,369,846	24,050,226	37,248,739	24,126,128
61-90 days	2,151,494	1,376,933	2,361,006	1,399,596
91-120 days	671,734	439,232	1,146,571	449,803
121-150 days	437,283	239,126	504,731	242,932
151-180 days	408,968	254,206	815,472	254,206
	150,936,341	113,391,068	153,357,200	113,684,450

Notes to the Financial Statements

4 FINANCIAL RISK MANAGEMENT (Contd.)

4.3 Credit Risk (Contd.)

Rescheduled loans

Rescheduled loans are loans that have been restructured due to deterioration in the borrower's financial position, where the Bank has made concessions, by agreeing to terms and conditions that are more favourable to the borrower compared to the original contract. The Bank implements forbearance policy in order to maximise collection opportunities and minimise the risk of default. Under the Bank's forbearance policy, loan forbearance is granted on a selective basis in situations where the debtor is currently in default on its debt, or where there is a high risk of default, there is evidence that the debtor made all the reasonable efforts to pay under the original contractual terms and they are expected to be able to meet the revised terms. The revised terms usually include extending maturity, changing timing of interest payments and amendments to the terms of loan covenants. Both retail and corporate loans are subject to the forbearance policy. Once the loan is rescheduled, it remains in this category independent of satisfactory performance after restructuring. At the time of rescheduling the loan, the Bank determines the fair value of the loan and carrying value is brought down to reflect the fair value charging the difference if any, to the statement of profit or loss under impairment for loans and other losses.

During the year ended 31st December 2017, the Bank rescheduled loans and advances with a carrying value of Rs 8,126.84 Mn (2016 - Rs 8,428.81 Mn) and recognised a net impairment reversal of Rs 1.9 Mn (2016 - impairment charge of Rs 9.66 Mn) in the statement of profit or loss.

4.3.1 [e] Concentration of Credit Risk

The Bank monitors concentration of credit risk by sector and by geographic location. An analysis of risk concentration of financial asset by industry is given below.

4.3.1 [e] i Concentration by Sector

As at 31st December 2017	Agriculture and fishing	Manufacturing	Tourism	Transport	Construction	Traders	New Economy	Financial and Business	Infrastructure	Other Services	Other	Total
Bank	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Financial Assets												
Cash and cash equivalents	-	-	-	-	-	-	-	21,739,800	-	-	-	21,739,800
Placements with banks	-	-	-	-	-	-	-	3,182,377	-	-	-	3,182,377
Balances with												
Central Bank of Sri Lanka	-	-	-	-	-	-	-	38,610,940	-	-	-	38,610,940
Reverse repurchase agreements	-	-	-	-	-	-	-	-	-	-	-	-
Derivative financial instruments	-	-	-	-	-	-	-	615,357	-	-	-	615,357
Financial investments - fair value through profit or loss	34,497	-	27,926	-	-	2,604	-	33,446	4	22,008	-	120,485
Loans and receivables to customers (gross)	59,681,649	77,827,018	75,649,970	46,560,612	82,385,162	7,845,252	12,063,403	61,664,687	37,681,482	47,951,418	140,236,414	649,547,067
Financial investments - available-for-sale	-	-	-	-	-	-	-	95,403,820	-	-	-	95,403,820
Financial investments - loans and receivables	-	2,025,049	-	-	-	500,616	-	117,962,215	1,518,534	192,634	-	122,199,048
Other assets	-	-	-	-	-	-	-	2,124,947	-	-	-	2,124,947
	59,716,145	79,852,067	75,677,896	46,560,612	82,385,162	8,348,472	12,063,403	341,337,589	39,200,020	48,166,059	140,236,414	933,543,841

4 FINANCIAL RISK MANAGEMENT (Contd.)

4.3 Credit Risk (Contd.)

As at 31st December 2016	Agriculture and fishing	Manufacturing	Tourism	Transport	Construction	Traders	New Economy	Financial and Business	Infrastructure	Other Services	Other	Total
Bank	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Financial Assets												
Cash and cash equivalents	-	-	-	-	-	-	-	17,511,446	-	-	-	17,511,446
Placements with banks	-	-	-	-	-	-	-	753,050	-	-	-	753,050
Balances with Central Bank of Sri Lanka	-	-	-	-	-	-	-	33,777,614	-	-	-	33,777,614
Reverse repurchase agreements	-	-	-	-	-	-	-	4,303,460	-	-	-	4,303,460
Derivative financial instruments	-	-	-	-	-	-	-	289,989	-	-	-	289,989
Other financial assets held for trading	50,855	52,240	36,622	-	354	17,253	-	179,435	47,355	160,801	-	544,915
Loans and receivables to customers	54,101,769	69,188,984	43,708,242	11,645,488	85,885,286	117,378,942	6,560,378	71,151,207	41,002,795	57,842,020	37,048,808	595,513,919
Financial investments - available-for-sale	-	-	-	-	-	-	-	89,915,153	-	-	-	89,915,153
Financial investments - loans and receivables	-	3,144,562	-	-	-	500,738	-	93,904,248	1,518,534	192,616	-	99,260,698
Other assets	-	-	-	-	-	-	-	2,308,521	-	-	-	2,308,521
	54,152,624	72,385,786	43,744,864	11,645,488	85,885,640	117,896,933	6,560,378	314,094,123	42,568,684	58,195,437	37,048,808	844,178,765

As at 31st December 2017	Agriculture and fishing	Manufacturing	Tourism	Transport	Construction	Traders	New Economy	Financial and Business	Infrastructure	Other Services	Other	Total
Group	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Financial Assets												
Cash and cash equivalents	-	-	-	-	-	-	-	21,924,898	-	-	-	21,924,898
Placements with banks	-	-	-	-	-	-	-	9,670,125	-	-	-	9,670,125
Balances with Central Bank of Sri Lanka	-	-	-	-	-	-	-	38,610,940	-	-	-	38,610,940
Reverse repurchase agreements	-	-	-	-	-	-	-	772,002	-	-	-	772,002
Derivative financial instruments	-	-	-	-	-	-	-	615,357	-	-	-	615,357
Other financial assets held for trading	38,336	34,469	27,926	-	-	2,604	-	123,904	4	39,295	-	266,538
Loans and receivables to customers	63,631,994	81,269,468	75,902,385	46,629,071	81,704,426	12,660,421	12,063,404	61,087,791	37,681,482	48,914,392	145,223,542	666,768,376
Financial investments - available-for-sale	-	22,199	-	-	13,611	-	-	101,704,823	-	2,352	-	101,742,985
Financial investments - loans and receivables	-	2,119,820	-	-	-	606,733	-	120,353,068	1,645,043	307,007	-	125,031,671
Other assets	-	-	-	-	-	-	-	3,170,937	-	-	-	3,170,937
	63,670,330	83,445,956	75,930,311	46,629,071	81,718,037	13,269,758	12,063,404	358,033,845	39,326,529	49,263,046	145,223,542	968,573,829

Notes to the Financial Statements

4 FINANCIAL RISK MANAGEMENT (Contd.)

4.3 Credit Risk (Contd.)

As at 31st December 2016	Agriculture and fishing	Manufacturing	Tourism	Transport	Construction	Traders	New Economy	Financial and Business	Infrastructure	Other Services	Other	Total
Group	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Financial Assets												
Cash and cash equivalents	-	-	-	-	-	-	-	17,511,446	-	-	-	17,511,446
Placements with banks	-	-	-	-	-	-	-	753,050	-	-	-	753,050
Balances with Central Bank of Sri Lanka	-	-	-	-	-	-	-	33,777,614	-	-	-	33,777,614
Reverse repurchase agreements	-	-	-	-	-	-	-	4,303,460	-	-	-	4,303,460
Derivative financial instruments	-	-	-	-	-	-	-	289,989	-	-	-	289,989
Other financial assets held for trading	50,855	52,240	36,622	-	354	17,253	-	179,434	47,355	160,801	-	544,914
Loans and receivables to customers	54,101,769	69,188,984	43,708,242	11,645,488	85,885,286	117,378,942	6,560,378	71,151,207	41,002,795	57,842,020	37,048,808	595,513,919
Financial investments - available-for-sale	-	-	-	-	-	-	-	89,915,153	-	-	-	89,915,153
Financial investments - loans and receivables	-	3,144,562	-	-	-	500,738	-	93,904,249	1,518,534	192,616	-	99,260,699
Other assets	-	-	-	-	-	-	-	2,308,521	-	-	-	2,308,521
	54,152,624	72,385,786	43,744,863	11,645,488	85,885,640	117,896,934	6,560,378	314,094,124	42,568,684	58,195,438	37,048,808	844,178,766

4.3.1 [e] ii Concentration by Location

Concentration of loans and advances by location is given below.

As at 31st December	Bank				Group			
	2017		2016		2017		2016	
	Rs 000	%	Rs 000	%	Rs 000	%	Rs 000	%
Western	472,561,107	72.75	428,736,278	71.99	479,746,617	71.92	433,265,995	71.15%
Southern	28,350,100	4.36	27,501,951	4.62	29,790,031	4.47	28,668,456	4.71%
Uva	8,808,193	1.36	8,504,380	1.43	9,869,321	1.48	9,438,318	1.55%
North Central	9,744,839	1.50	10,023,284	1.68	10,631,130	1.60	10,892,070	1.79%
North Western	30,501,479	4.70	28,081,752	4.72	32,013,863	4.81	29,364,495	4.82%
Eastern	14,913,571	2.30	15,892,029	2.67	16,496,774	2.48	17,125,373	2.81%
Northern	17,164,352	2.64	16,016,453	2.69	18,533,843	2.78	17,346,084	2.85%
Sabaragamuwa	13,300,461	2.05	12,761,719	2.14	14,268,868	2.14	13,503,214	2.22%
Central	35,566,168	5.48	32,209,039	5.41	36,781,131	5.52	33,574,644	5.51%
Overseas	18,636,797	2.87	15,787,034	2.65	18,636,797	2.80	15,787,034	2.59%
	649,547,067	100	595,513,919	100.00	666,768,376	100	608,965,683	100.00%

Concentration by location for loans and advances is measured based on the location of the customer centre that granted the facility, which has a high correlation with the location of the borrower, except for loans granted by the Foreign Currency Banking Unit (FCBU).

4 FINANCIAL RISK MANAGEMENT (Contd.)

4.3 Credit Risk (Contd.)

Significant foreign exposures

Gross and net carrying values of significant foreign lending are given below. All these loans have been considered as significant loans and analysed individually. When the Bank has identified objective evidence of impairment of these loans, future cash flows have been estimated giving due consideration for specific industry, country risk factors etc. and availability of collateral.

As at 31st December	Cambodia		Maldives	
	2017	2016	2017	2016
	Rs 000	Rs 000	Rs 000	Rs 000
Gross carrying value	8,572,868	6,371,813	9,017,744	5,338,160
Impairment allowance	(19,237)	(17,399)	(17,979)	(387,418)
Net carrying value	8,553,632	6,354,414	8,999,766	4,950,742

Total unutilised overdrafts approved to above customers as at 31st December 2017 amounts to Rs 672.96 Mn (2016 : Rs 899.55 Mn).

4.3.1 (f) Commitments and Guarantees

The Bank enters into various irrevocable commitments and assumes contingent liabilities in order to meet the financial needs of the customer. These obligations contain credit risk and form part of the overall risk of the Bank even though those are not recognised on the statement of financial position.

As at 31st December	2017	2016
	Rs 000	Rs 000
Acceptances	17,913,826	15,827,724
Documentary credit	28,291,149	24,629,974
Guarantees	124,389,833	108,900,608
Undrawn commitments to lend - direct facilities	165,822,760	114,244,896
Undrawn commitments to lend - indirect facilities	142,969,759	100,901,909
	479,387,327	364,505,111

Notes to the Financial Statements

4 FINANCIAL RISK MANAGEMENT (Contd.)

4.4 Liquidity Risk

Liquidity risk is the risk that the Bank is unable to meet its debt obligations associated with its financial liabilities due to lack of funds or having to meet these obligations at excessive cost.

4.4.1 Management of Liquidity Risk

The Bank manages liquidity risk, in accordance with regulatory guidelines and international best practices. The objective of the Bank's liquidity and funding framework is to ensure that funding commitments and deposit withdrawals can be met when due and that market access remains cost effective. A Board approved liquidity policy to manage liquidity on a day-to-day basis and a contingency funding plan to deal with crisis situations are in place. Contractual maturity of assets and liabilities, key liquidity ratios and monthly liquidity forecasts and gaps are reviewed at Assets and Liability Committee (ALCO) meetings. The main sources of the Bank's funding are capital, core deposits from retail and commercial clients, wholesale deposits and access to borrowed funds from the interbank money market. The Bank also maintains a portfolio of readily marketable securities to further strengthen its liquidity position. Liquidity risk exposure is managed by treasury with limits and triggers set to ensure that sufficient liquidity surplus and reserves are available to meet daily business requirements and also to deal with a sudden liquidity shock. Treasury reports the Bank's overall liquidity position to management on a daily basis.

4.4.1 (a) Exposure to Liquidity Risk

The Bank monitors the following liquidity ratios to assess funding requirements.

	2017	2016
Net loans / total assets	66.93%	68.04%
Gross loans / customer deposits	92.59%	95.51%
Liquid Asset Ratio (LAR)		
As at 31st December	26.29%	24.23%
Average for the year	24.81%	23.64%
Maximum for the year	27.60%	24.51%
Minimum for the year	22.30%	21.96%

Components of the Bank's liquid assets portfolio used for the purpose of calculating statutory liquid asset ratio as at 31st December 2017 (average balance for the month of December) is given below.

As at 31st December	2017 Rs 000	2016 Rs 000
Cash	19,085,747	15,994,207
Balances with licensed commercial banks	463,466	156,486
Money at call in Sri Lanka	4,753,419	1,096,323
Treasury bills and securities issued or guaranteed by the Government of Sri Lanka which have a maturity not exceeding one year	188,418,351	154,671,263
Import Bills	980	-
Export bills	2,071,335	1,733,589
Cash items in the process of collection	1,037,160	1,008,177
Balances with banks abroad	1,601,368	1,706,249
Total average liquid assets for the month of December	217,431,826	176,366,293

Monthly liquidity gap is reported to ALCO by Treasury for each currency, together with the overall gap position. Liquidity gap is based on the expected realisation of assets and liabilities which have been determined based on historical behaviour. Net liquidity position reported for the month is monitored against the pre-set limits which have been approved by the ALCO.

The Bank also holds debt and equity securities which are not considered as liquid assets but for which there is an active and liquid market. These assets can be readily sold to meet any unexpected liquidity requirements. Detailed analysis of the debt and equity securities held by the Bank as at 31st December 2017 is presented under credit risk. No assets have been pledged as collateral for borrowings other than treasury bills and bonds which are pledged against repurchase transactions. Details of treasury bills and bonds pledged as collateral against repurchase transactions are disclosed under Note 33 (k) to the financial statements.

4 FINANCIAL RISK MANAGEMENT (Contd.)

4.4 Liquidity Risk (Contd.)

4.4.1 [b] Analysis of Financial Assets and Liabilities by Remaining Contractual Maturities

The table below summarises the maturity profile of undiscounted cash flows of the Bank's financial assets and liabilities as at 31st December. Repayments which are subject to notice are treated as if notice were to be given immediately. However, the Bank expects that many customers will not request repayment on the earliest date it could be required to pay and the table does not reflect the expected cash flows indicated by its deposit retention history.

Contractual maturities of undiscounted cash flows of financial assets and financial liabilities

31st December 2017	Up to 3 months Rs 000	3 - 12 months Rs 000	1 - 3 years Rs 000	3 - 5 years Rs 000	More than 5 years Rs 000	Total Rs 000
Bank						
Financial Assets						
Cash and cash equivalents	21,739,800	-	-	-	-	21,739,800
Placements with banks	3,191,117	-	-	-	-	3,191,117
Balances with Central Bank of Sri Lanka	-	-	-	-	38,610,940	38,610,940
Derivative financial instruments	447,570	167,787	-	-	-	615,357
Financial investments - fair value through profit or loss	120,486	-	-	-	-	120,486
Loans and receivables to customers	268,886,797	144,831,674	209,713,474	92,876,440	80,543,193	796,851,578
Financial investments - loans and receivables	7,670,864	14,916,277	77,938,407	41,351,493	57,839	141,934,880
Financial investments - available-for-sale	11,346,276	39,262,285	25,845,470	20,467,935	12,875,813	109,797,779
Other assets	-	172,279	1,952,668	-	-	2,124,947
Total undiscounted financial assets	313,402,910	199,350,302	315,450,019	154,695,868	132,087,785	1,114,986,884
Financial Liabilities						
Due to banks	14,636,087	13,151,151	32,963,399	6,119,609	546,530	67,416,776
Derivative financial instruments	486,790	813,267	5,843	-	-	1,305,900
Securities sold under repurchase agreements	4,712,068	381,838	-	-	-	5,093,906
Due to customers	475,541,780	224,091,038	9,086,501	9,634,299	5,947	718,359,565
Dividends payable	975,371	-	-	-	-	975,371
Other borrowings	2,831,212	4,888,494	14,392,759	6,854,763	1,766,333	30,733,561
Debt securities issued	-	380,687	3,294,975	334,001	2,257,716	6,267,379
Other liabilities	22,984	-	-	-	-	22,984
Subordinated term debts	787,500	5,895,541	7,965,232	14,670,287	5,882,800	35,201,360
Total undiscounted financial liabilities	499,993,792	249,602,016	67,708,709	37,612,959	10,459,326	865,376,802
Net undiscounted financial assets/(liabilities)	(186,590,882)	(50,251,714)	247,741,310	117,082,909	121,628,459	249,610,082

The table below shows the contractual expiry by maturity of the Bank's contingent liabilities and commitments.

	Up to 3 months Rs 000	3 - 12 months Rs 000	1 - 3 years Rs 000	3 - 5 years Rs 000	More than 5 years Rs 000	Total Rs 000
Acceptances	13,412,451	4,436,330	65,045	-	-	17,913,826
Documentary credit	26,186,188	2,103,735	1,226	-	-	28,291,149
Guarantees	21,049,706	48,443,528	39,649,411	8,111,542	7,135,646	124,389,833
Undrawn commitments to lend						
- direct facilities	165,822,760	-	-	-	-	165,822,760
Undrawn commitments to lend						
- indirect facilities	142,969,759	-	-	-	-	142,969,759
	369,440,864	54,983,593	39,715,682	8,111,542	7,135,646	479,387,327

Notes to the Financial Statements

4 FINANCIAL RISK MANAGEMENT (Contd.)

4.4 Liquidity Risk (Contd.)

31st December 2016	Up to 3 months Rs 000	3 - 12 months Rs 000	1 - 3 years Rs 000	3 - 5 years Rs 000	More than 5 years Rs 000	Total Rs 000
Bank						
Financial Assets						
Cash and cash equivalents	17,511,446	-	-	-	-	17,511,446
Placements with banks	753,050	-	-	-	-	753,050
Balances with Central Bank of Sri Lanka	-	-	-	-	33,777,614	33,777,614
Reverse repurchase agreements	4,304,494	-	-	-	-	4,304,494
Derivative financial instruments	152,566	137,423	-	-	-	289,989
Other financial assets held for trading	544,915	-	-	-	-	544,915
Loans and receivables to customers	248,793,756	121,203,976	186,798,226	89,217,633	83,139,982	729,153,573
Financial investments - available-for-sale	6,652,784	34,901,127	33,636,104	22,771,358	13,837,326	111,798,699
Financial investments - loans and receivables	18,445,161	26,949,649	27,342,764	39,660,236	49,979	112,447,789
Other assets	-	-	2,455,967	-	-	2,455,967
Total undiscounted financial assets	297,158,172	183,192,175	250,233,061	151,649,227	130,804,901	1,013,037,536
Financial Liabilities						
Due to banks	25,135,863	18,587,927	20,352,562	10,892,549	594,016	75,562,917
Derivative financial instruments	429,084	236,806	-	-	-	665,890
Securities sold under repurchase agreements	8,733,218	4,910,733	-	-	-	13,643,951
Due to other customers	445,559,576	173,725,972	14,615,437	6,298,701	-	640,199,686
Dividends payable	1,007,075	-	-	-	-	1,007,075
Other borrowings	1,062,167	3,019,231	14,080,343	11,209,294	1,708,333	31,079,368
Debt securities issued	-	549,818	3,508,661	334,001	2,424,716	6,817,196
Other liabilities	403,851	-	-	-	-	403,851
Subordinated term debts	793,973	2,459,759	8,761,185	19,071,077	7,229,821	38,315,815
Total undiscounted financial liabilities	483,124,807	203,490,246	61,318,188	47,805,622	11,956,886	807,695,749
Net undiscounted financial assets/(liabilities)	(185,966,635)	(20,298,071)	188,914,873	103,843,605	118,848,015	205,341,787

The table below shows the contractual expiry by maturity of the Bank's contingent liabilities and commitments.

	Up to 3 months Rs 000	3 - 12 months Rs 000	1 - 3 years Rs 000	3 - 5 years Rs 000	More than 5 years Rs 000	Total Rs 000
Acceptances	11,111,376	4,650,939	65,409	-	-	15,827,724
Documentary credit	19,771,633	4,836,075	22,266	-	-	24,629,974
Guarantees	18,094,646	35,573,737	39,747,563	10,820,265	4,664,397	108,900,608
Undrawn commitments to lend						
- direct facilities	114,244,896	-	-	-	-	114,244,896
Undrawn commitments to lend						
- indirect facilities	100,901,909	-	-	-	-	100,901,909
	264,124,460	45,060,751	39,835,238	10,820,265	4,664,397	364,505,111

The Bank expects that not all of the contingent liabilities or commitments will be drawn before expiry of the commitments.

4 FINANCIAL RISK MANAGEMENT (Contd.)

4.5 Market Risk

Market risk is the risk that changes in market prices, such as interest rates, equity prices, foreign exchange rates and credit spreads (not relating to changes in the obligor's or issuer's credit standing) will affect the Bank's income or the value of its holdings of financial instruments. The objective of the Bank's market risk management is to manage and control market risk exposures within acceptable parameters in order to ensure the Bank's solvency while optimising the return on risk.

4.5.1 Management of Market Risk

The Bank separates its exposure to market risk between trading and non-trading portfolios. Trading portfolio includes financial assets and liabilities that are managed on a fair value basis. All foreign exchange positions within the Bank are treated as part of the Bank's trading portfolios for risk management purposes. Non trading portfolio is managed in accordance with the purpose and strategic benefits of such investments, rather than purely on fair value basis.

The Bank has a board approved treasury policy. Treasury middle office monitors the Bank's compliance with the above policy and ensures that the Bank's market risk limits are in line with the level of risk acceptable to the Board. The Bank employs a range of tools to monitor and limit market risk exposures which are discussed below.

4.5.2 Exposure to Market Risk

The principal tool used to measure and control market risk exposure within the Bank is Value at Risk (VaR). The VaR of a portfolio is the estimated loss that will arise on the portfolio over a specified period of time [holding period] from an adverse market movement with a specified probability [confidence level]. The VaR model used, by the Bank is based upon a 99 percent confidence level and assumes 1-day and a 10-day holding period. The VaR model used is based mainly on historical simulation. Taking account of market data from the previous two years and observed relationships between different markets and prices, the model generates a wide range of plausible future scenarios for market price movements.

Although VaR is an important tool for measuring market risk, the assumptions on which the model is based give rise to some limitations, including the following:

- The 1-day and 10-day holding periods assumes that it is possible to hedge or dispose of positions within those periods. This may not be the case for illiquid assets or in situations in which there is severe general market liquidity.
- A 99 percent confidence level does not reflect losses that may occur beyond this level. Even within the model used, there is a one percent probability that losses could exceed the VaR.
- VaR is calculated on an end-of-day basis and does not reflect exposures that may arise on positions during the trading day.
- The use of historical data as a basis for determining the possible range of future outcomes, may not always cover all possible scenarios, especially those of an exceptional nature.
- The VaR measure is dependent upon the Bank's position and the volatility of market prices. The VaR of an unchanged position reduces if market price volatility declines and vice versa.
- The Bank uses VaR limits for foreign exchange and equity risks. The overall structure of VaR limits is subject to review and approval by ALCO. VaR limits are allocated to portfolios. VaR is measured at least monthly and reported to ALCO.
- The Bank's VaR models are subject to regular validation by Treasury Mid Office (TMO) to ensure that they continue to perform as expected and that assumptions used in model development are still appropriate.

A summary of the VaR position of the Bank as at 31st December and during the period is as follows:

	As at 31st December	Average	Maximum	Minimum
	Rs 000	Rs 000	Rs 000	Rs 000
2017				
Foreign currency risk (USD NOP)*	2,900	8,480	17,785	2,900
Equity risk	4,262	13,481	27,089	4,262
2016				
Foreign currency risk (USD NOP)*	16,639	13,324	17,592	7,416
Equity risk	32,280	30,176	32,710	26,150

* Only USD exposure has been considered as it represents over 98.52% of the foreign currency transactions.

Notes to the Financial Statements

4 FINANCIAL RISK MANAGEMENT (Contd.)

4.5 Market Risk (Contd.)

4.5.2 Exposure to Market Risk (Contd.)

The limitations of the VaR methodology are recognised by supplementing VaR limits with other risk measures. The Bank uses a wide range of stress tests to model the financial impact of a variety of exceptional market scenarios such as changes in exchange rates, interest rates and prices of financial instruments such as equities and bonds. The results of the stress tests are reviewed by ALCO.

4.5.3 Exposure to Interest Rate Risk

The principal risk to which non-trading portfolios are exposed is the risk of loss from fluctuations in the future cash flows or fair values of financial instruments because of a change in market interest rates. The Bank manages the interest rate risk against interest rate gap limits, which is supplemented by monitoring the sensitivity of the Bank's financial assets and liabilities to various rate scenarios. Net interest yields are also calculated for each product, to ensure adequate margins are kept.

The Bank holds treasury bills and bonds with shorter maturities, thus the impact of interest rate changes on treasury bill and bond prices are very minimal. Modified duration of both the trading and non-trading portfolios as at 31st December is given below.

As at 31st December	2017	2016
Trading	-	-
Non trading	2,9968	2,5166

Modified duration follows the concept that the interest rates and bond prices move in opposite directions. This determines the effect that a 100 basis point [1%] change in interest rates will have on the price of a bond.

An analysis of the Bank's sensitivity to an increase or decrease in market interest rates based on rate sensitive assets and rate sensitive liabilities as at 31st December 2017 is as follows.

	Decrease of 100 bps	Decrease of 200 bps	Increase of 100 bps	Increase of 200 bps
LKR Portfolio (Rs 000)	(2,515,086)	(5,051,608)	2,466,834	4,866,901
USD Portfolio (USD 000)	(4,627)	(9,615)	4,298	8,295

4.6 Capital Management

The Bank's capital management objectives can be summarised as follows:

- Maintain sufficient capital to meet minimum regulatory capital requirements
- Hold sufficient capital to support the Bank's risk appetite
- Allocate capital to businesses to support the Bank's strategic objectives
- Ensure that the Bank maintains capital in order to achieve debt rating objectives and to withstand the impact of potential stress events

Regulatory capital

The Bank manages its capital considering regulatory capital requirements. The Central Bank of Sri Lanka (CBSL) sets and monitors capital requirements for licensed banks in Sri Lanka based on the Basel Framework. Thus the Bank's operations are directly supervised by CBSL. Basel II guidelines were effective till 30th June 2017 and since 1st July 2017, the Bank is required to comply with the provisions of the Basel III framework in respect of regulatory capital and capital to cover any additional risk. All Domestic Systemically Important Banks (D-SIBs) in Sri Lanka including HNB need to maintain a minimum Capital Adequacy Ratio (CAR) of 11.75% and a Tier 1 Ratio of at least 6% for year 2017. As per the CBSL road map in implementing Basel III directive, all D-SIBs are required to maintain a minimum CAR of 14% by year 2019.

5 FAIR VALUE OF ASSETS AND LIABILITIES

Accounting Policy

Determination of Fair Value

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

All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorised within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

- Level 1 - Valuation technique using quoted market price: financial instruments with quoted prices for identical instruments in active markets
- Level 2 - Valuation technique using observable inputs: financial instruments with quoted prices for similar instruments in active markets or quoted prices for identical or similar instruments in inactive markets and financial instruments valued using models where all significant inputs are observable.
- Level 3 - Valuation technique with significant unobservable inputs: financial instruments valued using valuation techniques where one or more significant inputs are unobservable

Level 1

When available, the Group measures the fair value of an instrument using quoted prices in an active market for that instrument or dealer price quotations (assets and long positions are measured at a bid price, liabilities and short positions are measured at an asking price), without any deduction for transaction costs.

A market is regarded as active if quoted prices are readily and regularly available and represent actual and regularly occurring market transactions on an arm's length basis.

Level 2

If a market for a financial instrument is not active, then the Group establishes fair value using a valuation technique. Valuation techniques include using recent arm's length transactions between knowledgeable, willing parties (if available), reference to the current fair value of other instruments that are substantially the same, discounted cash flow analysis and option pricing models. The chosen valuation technique makes maximum use of market inputs, relies as little as possible on estimates specific to the Group, incorporates all factors that market participants would consider in setting a price and is consistent with accepted economic methodologies for pricing financial instruments. Inputs to valuation techniques reasonably represent market expectations and measures of the risk-return factors inherent in the financial instrument. The Group calibrates valuation techniques and tests them for validity using prices from observable current market transactions in the same instrument, or based on other available observable market data.

The best evidence of the fair value of a financial instrument at initial recognition is the transaction price, i.e. the fair value of the consideration given or received, unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument, i.e. without modification or repackaging, or based on a valuation technique whose variables include only data from observable markets. When a transaction price provides the best evidence of fair value at initial recognition, the financial instrument is initially measured at the transaction price and any difference between this price and the value initially obtained from a valuation model, is subsequently recognised in profit or loss on an appropriate basis over the life of the instrument, but not later than when the valuation is supported wholly by observable market data or the transaction is closed out.

Level 3

Certain financial instruments are recorded at fair value using valuation techniques, in which current market transactions or observable market data are not available. Their fair value is determined using a valuation model that has been tested against prices or inputs to actual market transactions and using the Bank's best estimate of the most appropriate model assumptions. Models are adjusted to reflect the spread for bid and ask prices to reflect costs to close out positions, credit and debit valuation adjustments, liquidity spread and limitations in the models. Also, profit or loss calculated when such financial instruments are first recorded (day-1 profit or loss) is deferred and recognised only when the inputs become observable or on de-recognition of the instrument.

Fair values reflect the credit risk of the instrument and include adjustments to take account of the credit risk of the Group entity and the counterparty where appropriate. Fair value estimates obtained from models are adjusted for any other factors, such as liquidity risk or model uncertainties; to the extent that the Group believes a third-party market participant would take them into account in pricing a transaction.

Notes to the Financial Statements

5 FAIR VALUE OF ASSETS AND LIABILITIES [Contd.]

5.1 Assets and Liabilities Recorded at Fair Value

A description of how fair values are determined for assets and liabilities that are recorded at fair value using valuation techniques is summarised below, which incorporates the bank's estimate of assumptions that a market participant would make when valuing the instruments.

Derivative financial instruments

Derivative financial instruments such as forward foreign exchange contracts and currency swaps are valued, using a valuation technique with market observable inputs [Level 2]. The most frequently applied valuation technique is forward pricing model which incorporates various inputs, including foreign exchange spot and forward premiums.

Financial investments - available for sale

Government debt securities classified as financial investments - available-for-sale are valued using current yield rates or market rates published by the Central Bank of Sri Lanka. Quoted equities and units classified as financial investments - available-for-sale are valued using quoted market prices in the active markets as at the reporting date [Level 1]. Unquoted units classified as financial investments - available-for-sale are valued using manager's selling price. Unquoted shares classified as financial investments - available-for-sale are valued at cost.

Financial investments fair value through profit or loss

Government debt securities classified as financial investments fair value through profit or loss are valued using yield curves published by the Central Bank of Sri Lanka, while quoted equities classified as financial investments fair value through profit or loss are valued using quoted market prices in active markets as at the reporting date [Level 1]. Unquoted units classified as financial investments fair value through profit or loss are valued using manager's selling price.

Freehold land and buildings

Fair value of freehold land and buildings (revalued amount) is determined using the depreciated replacement cost basis of valuation and market comparable method [Level 3], which as a basis of valuation is the sum of;

- 1) The open market value of the land for its existing use plus
- 2) The current gross replacement cost of the buildings and their site works less an allowance for all appropriate factors such as age, condition, functional and environmental obsolescence which result in the existing property being worthless than a new replacement.

5.2 Valuation Model

The fair values are measured using the fair value hierarchy.

For all financial instruments where fair values are determined by reference to externally quoted prices or observable pricing inputs to models, independent price determination or validation is obtained. In an inactive market, direct observation of a traded price may not be possible. In these circumstances, the Bank uses alternative market information to validate the financial instrument's fair value, with greater weight given to information that is considered to be more relevant and reliable.

The fair values of the Bank's freehold land and buildings are determined by independent valuers at least once in every three years according to the Bank's policy. The Bank carried out a revaluation of its freehold land and buildings in 2017. The methods used to determine the fair value of freehold land and buildings are explained in Note 38 (b) to the financial statements.

5 FAIR VALUE OF ASSETS AND LIABILITIES (Contd.)

5.3 Assets and Liabilities Measured at Fair Value – Fair Value Hierarchy

The following table shows an analysis of assets and liabilities recorded at fair value by level of fair value hierarchy. The amounts are based on the values recognised in the statement of financial position.

As at 31st December 2017	Bank				Group			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Financial assets measured at fair value								
Derivative financial instruments								
Currency swaps	-	321,253	-	321,253	-	321,253	-	321,253
Forward foreign exchange contracts	-	294,104	-	294,104	-	294,104	-	294,104
	-	615,357	-	615,357	-	615,357	-	615,357
Financial investments - fair value through profit or loss								
Quoted shares	120,485	-	-	120,485	238,529	-	-	238,529
Quoted units	-	-	-	-	12,241	-	-	12,241
Government of Sri Lanka treasury bonds	-	-	-	-	15,768	-	-	15,768
	120,485	-	-	120,485	266,538	-	-	266,538
Financial investments available-for-sale								
Quoted shares	4,912,813	-	-	4,912,813	4,990,887	-	-	4,990,887
Quoted units	276,300	-	-	276,300	276,300	-	-	276,300
Unquoted shares	-	-	25,405	25,405	-	-	37,835	37,835
Unquoted units	-	418,646	-	418,646	-	418,646	-	418,646
Government of Sri Lanka treasury bills	34,516,140	-	-	34,516,140	34,733,447	-	-	34,733,447
Government of Sri Lanka treasury bonds	55,254,516	-	-	55,254,516	61,285,870	-	-	61,285,870
	94,959,769	418,646	25,405	95,403,820	101,286,504	418,646	37,835	101,742,985
Non-financial assets measured at fair value								
Freehold land and buildings	-	-	14,838,402	14,838,402	-	-	29,750,358	29,750,358
	-	-	14,838,402	14,838,402	-	-	29,750,358	29,750,358
Financial liabilities measured at fair value								
Derivative financial instruments								
Currency swaps	-	1,238,991	-	1,238,991	-	1,238,991	-	1,238,991
Forward foreign exchange contracts	-	66,909	-	66,909	-	66,909	-	66,909
	-	1,305,900	-	1,305,900	-	1,305,900	-	1,305,900
As at 31st December 2016								
Financial assets measured at fair value								
Derivative financial instruments								
Currency swaps	-	255,902	-	255,902	-	255,902	-	255,902
Forward foreign exchange contracts	-	34,087	-	34,087	-	34,087	-	34,087
	-	289,989	-	289,989	-	289,989	-	289,989
Financial investments								
fair value through profit or loss								
Quoted shares	544,915	-	-	544,915	690,094	-	-	690,094
Quoted units	-	-	-	-	10,296	-	-	10,296
Unquoted units	-	-	-	-	-	1,036	-	1,036
Government of Sri Lanka treasury bonds	-	-	-	-	14,583	-	-	14,583
	544,915	-	-	544,915	714,973	1,036	-	716,009

Notes to the Financial Statements

5 FAIR VALUE OF ASSETS AND LIABILITIES [Contd.]

5.3 Assets and Liabilities Measured at Fair Value - Fair Value Hierarchy [Contd.]

As at 31st December 2016	Bank				Group			
	Level 1 Rs 000	Level 2 Rs 000	Level 3 Rs 000	Total Rs 000	Level 1 Rs 000	Level 2 Rs 000	Level 3 Rs 000	Total Rs 000
Financial investments								
available-for-sale								
Quoted shares	4,936,537	-	-	4,936,537	5,079,477	-	-	5,079,477
Quoted units	270,000	-	-	270,000	270,000	-	-	270,000
Unquoted shares	-	-	25,405	25,405	-	-	37,835	37,835
Unquoted units	-	388,108	-	388,108	-	388,108	-	388,108
Government of Sri Lanka treasury bills	31,579,089	-	-	31,579,089	32,881,462	-	-	32,881,462
Government of Sri Lanka treasury bonds	52,716,014	-	-	52,716,014	57,140,260	-	-	57,140,260
	89,501,640	388,108	25,405	89,915,153	95,371,199	388,108	37,835	95,797,142
Non-financial assets								
measured at fair value								
Freehold land and buildings	-	-	11,413,989	11,413,989	-	-	25,374,381	25,374,381
	-	-	11,413,989	11,413,989	-	-	25,374,381	25,374,381
Financial liabilities								
measured at fair value								
Derivative financial instruments								
Currency swaps	-	586,229	-	586,229	-	586,229	-	586,229
Forward foreign exchange contracts	-	79,661	-	79,661	-	79,661	-	79,661
	-	665,890	-	665,890	-	665,890	-	665,890

5.4 Fair Value Measurement of Assets Classified as Level 3

5.4.1 Property, Plant and Equipment

The reconciliation of property, plant and equipment is given in Note 38 to the financial statements.

5.4.2 Unobservable Inputs used in Measuring Fair Value

The information about significant unobservable inputs used in measuring non financial assets categorised as Level 3 in the fair value hierarchy as at 31st December 2017 is given in Note 38 (b) to the financial statements.

5.5 Fair value of assets and liabilities not measured at fair value

The following table summarises the carrying amounts and the Group's estimate of fair values of those assets and liabilities not presented in the statement of financial position at fair value. The fair values in the table below may be different from the actual amounts that will be received / paid on the settlement or maturity of the asset or liability. For certain instruments, the fair value may be determined, using assumptions which are not observable in the market.

As at 31st December 2017	Bank					Group				
	Carrying Value Rs 000	Level 1 Rs 000	Level 2 Rs 000	Level 3 Rs 000	Fair Value Total Rs 000	Carrying Value Rs 000	Level 1 Rs 000	Level 2 Rs 000	Level 3 Rs 000	Fair Value Total Rs 000
Assets										
Loans and receivables to customers	639,102,061	-	634,274,319	-	634,274,319	655,722,822	-	16,539,243	-	16,539,243
Financial investments - Held to maturity	-	-	-	-	-	1,565,603	1,569,757	-	-	1,569,757
Financial investments - Loans and receivables	122,199,048	-	122,579,818	-	122,579,818	125,031,671	-	125,391,888	-	125,391,888
Investment properties	327,464	-	-	3,197,575	3,197,575	1,146,564	-	-	2,474,005	2,474,005
Liabilities										
Due to customers	701,519,297	-	701,102,245	-	701,102,245	718,770,047	-	718,371,457	-	718,371,457
Debt securities issued	4,540,259	-	4,329,624	-	4,329,624	5,035,958	-	4,831,199	-	4,831,199
Subordinated term debts	25,809,261	-	25,776,122	-	25,776,122	25,564,596	-	25,897,151	-	25,897,151

5 FAIR VALUE OF ASSETS AND LIABILITIES (Contd.)

5.5 Fair value of assets and liabilities not measured at fair value (Contd.)

As at 31st December 2016	Bank					Group				
	Carrying Value	Level 1	Level 2	Level 3	Fair Value Total	Carrying Value	Level 1	Level 2	Level 3	Fair Value Total
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Assets										
Loans and receivables to customers	584,412,727	-	556,802,087	-	556,802,087	597,467,460	-	569,792,300	-	569,792,300
Financial investments - Held to maturity	-	-	-	-	-	465,081	468,138	-	-	468,138
Financial investments - Loans and receivables	99,260,699	-	98,772,966	-	98,772,966	102,063,229	-	101,288,303	-	101,288,303
Investment properties	403,959	-	-	3,538,583	3,538,583	1,054,300	-	-	2,097,500	2,097,500
Liabilities										
Due to customers	623,494,969	-	622,724,013	-	624,724,013	635,371,097	-	635,598,540	-	635,598,540
Debt securities issued	4,653,057	-	4,244,179	-	4,244,179	5,115,801	-	5,102,460	-	5,102,460
Subordinated term debts	26,153,476	-	26,215,790	-	26,215,790	25,901,110	-	25,889,460	-	25,889,460

Fair values of the following assets and liabilities are estimated for the purpose of disclosure as described below:

Loans and receivables to customers

The loans and receivables to customers comprise of both fixed rate loans and floating rate loans. Majority of the floating rate loans can be re-priced either quarterly or semi-annually while for fixed rate loans, the loan contract allows the Bank to change the contracted rate if there is a material difference between the contracted rate and the market rate. The carrying value of floating rate loans generally approximates the fair value due to the effect of re-pricing while the fair value of loans and receivables to customers with a residual maturity of less than one year generally approximates the carrying value, subject to any significant movement in credit spreads.

The estimated fair value of loans and receivables with a residual maturity of more than one year, is the present value of future cash flows expected to be received from such loans and receivables calculated based on interest rates at the reporting date for similar types of loans and receivables.

Financial investments - Loans and receivables

Financial investments - loans and receivables comprise of investments in Sri Lanka development bonds, Sri Lanka sovereign bonds, quoted and unquoted debentures.

Sri Lanka development bonds are variable rate instruments where the re-pricing happens semi-annually. Thus the carrying value of these bonds approximates to their fair value as at the reporting date. The fair values of Sri Lanka sovereign bonds are valued using quoted market prices while the fair value of unquoted debentures are estimated as the present value of future cash flows expected to be received from such investments calculated based on interest rates at the reporting date for similar instruments.

Financial investments - Held to maturity

Financial investments - Held to maturity comprise of Government debt securities. These are valued using current yield rates or market rates published by the Central Bank of Sri Lanka.

Due to customers

The fair value of customer deposits which are repayable on demand or have a remaining contractual maturity of less than one year, approximates to the carrying value of such deposits.

The fair value of customer deposits with a contractual maturity of more than one year, is estimated as the present value of future cash flows expected from such deposits calculated based on interest rates at the reporting date for similar types of deposits.

Debt securities issued

The fair value of debt securities issued has been determined by discounting the future cash flows by the interest rates prevailing as at the reporting date for similar instruments.

Notes to the Financial Statements

5 FAIR VALUE OF ASSETS AND LIABILITIES [Contd.]

5.5 Fair value of assets and liabilities not measured at fair value [Contd.]

Subordinated term debts

The subordinated loan has a variable interest rate, resulting in a carrying value approximating to fair value as at the reporting date. In respect of fixed rate subordinated debentures, fair value has been determined by discounting the future cash flows by the interest rates prevailing as at the reporting date for similar instruments.

Investment properties

Fair value of the investment properties is determined using the income approach, market comparable method and depreciated replacement cost basis.

The carrying values of assets and liabilities listed below are reasonable approximation of their fair values since, those are short term in nature or re-priced to current market rates frequently:

Assets	Liabilities
Cash and cash equivalents	Due to banks
Balances with Central Bank of Sri Lanka	Securities sold under repurchase agreements
Placements with banks	Other borrowings
Securities purchased under resale agreements	Dividends payable
Other assets	Other liabilities

Reclassification of financial assets

There have been no reclassifications during 2017 and 2016.

6 NEW ACCOUNTING STANDARDS ISSUED BUT NOT EFFECTIVE AS AT REPORTING DATE

The following new accounting standards/amendments were issued by the Institute of Chartered Accountants of Sri Lanka [CA Sri Lanka], which are not yet effective as at 31st December 2017. Accordingly, these accounting standards have not been applied in the preparation of financial statements for the year ended 31st December 2017.

Sri Lanka Accounting Standard - SLFRS 9 "Financial Instruments"

Sri Lanka Accounting Standard - SLFRS 9 "Financial Instruments" will replace Sri Lanka Accounting Standard - LKAS 39 "Financial Instruments - Recognition and Measurement" for annual periods beginning on or after 1st January 2018 with early adoption permitted. In 2017 the Bank set up a multidisciplinary implementation team with members from its Risk, Finance and Operations teams to prepare for SLFRS 9 implementation. The Project is jointly sponsored by the Chief Financial Officer and Chief Risk officer.

Classification and Measurement

From a classification and measurement perspective, SLFRS 9 requires all financial assets, except equity instruments and derivatives, to be assessed based on a combination of the Bank's business model for managing the assets and the instruments' contractual cash flow characteristics.

Business Model Assessment

Bank determines its business model at the level that best reflects how it manages the financial assets to achieve its objectives. The Bank's business model is not assessed on an instrument by instrument basis, but at a higher level of aggregated portfolios and is based on observable factors such as :

- How the performance of the business model and the financial asset held within that business model are evaluated and reported to the entity's key management personnel
- The risks that affect the performance of the business model (and the financial assets held within that business model) and, in particular, the way those risks are managed
- How managers of the business are compensated (for example, whether the compensation is based on the fair value of the assets managed or on the contractual cash flow collected)
- The expected frequency, value and timing of sales

The business model assessment is based on reasonably expected scenarios without taking "worse case" or "stress case" scenarios into account. If cash flows after initial recognition are realized in a way that is different from the Bank's original expectation, the Bank does not change the classification of the remaining financial assets held in that business model, but incorporates such information when assessing newly originated or newly purchased financial assets.

6 NEW ACCOUNTING STANDARDS ISSUED BUT NOT EFFECTIVE AS AT REPORTING DATE [Contd.]

Contractual Cash flow Characteristic Test

As the second test of the classification process the Bank assesses the contractual terms of the financial asset to identify whether those meet "Solely the Payment of Principal and Interest" (SPPI) criteria.

Principal for the purpose of this test is defined as the fair value of the financial asset at initial recognition which may change over the life of the financial asset (for example, if there are repayments of principal or amortisation of the premium/discount).

The most significant elements of interest within a lending arrangement are typically the consideration for the time value of money and credit risk.

To make SPPI assessment, the Bank applies judgments and considers relevant factors such as currency in which the financial asset is denominated and the period for which the interest rate is set.

In contrast to contractual exposures that introduce a more than de minimis exposure to risk or volatility in the contractual cash flows that are unrelated to a basic lending arrangement do not give rise to contractual cash flows that are solely the payment of principal and interest on the amount outstanding.

In such cases the financial asset is required to be measured at "Fair Value through Profit or Loss".

Impairment of Financial Assets

Overview of Expected Credit Loss Principle (ECL)

SLFRS 9 principally changes the Bank's loan loss provision method by replacing the incurred loss approach as per LKAS 39 with a forward looking ECL Approach.

ECL allowance is based on credit losses expected to arise over the life of the asset (Lifetime expected credit loss or LTECL), unless there has been no significant increase in credit risk since origination in which case the loss allowance will be 12 month expected credit loss (12mECL).

12mECL is the portion of LTECL that represents the ECL which results from default events of a financial instrument which may arise within 12 months after the reporting date

The Bank has established a policy to perform an assessment, at the end of each reporting period to identify whether a financial instrument's credit risk has increased significantly since initial recognition. Based on such process Bank groups loans into stage 1, stage 2, stage 3 as described below :

- Stage 1 : When loans are first recognised, the Bank recognises an allowance based on 12mECL. Stage 1 loans also include the facilities which are reclassified from Stage 2 since the credit risk has improved. Assessment of Stage 1 is performed collectively.
- Stage 2 : When a loan has shown a significant increase in credit risk since origination, the Bank records an allowance for the LTECL. Stage 2 loans also include facilities, which are reclassified from stage 3 since the credit risk has improved. Assessment of stage 2 is performed collectively.
- Stage 3 : When a loan is considered to be credit impaired/contain objective evidences of incurred loss, the Bank records an allowance for the LTECL. Stage 3 assessment will be performed either individually or collectively.

Significant Increase in Credit Risk

The Bank continuously monitors all assets subject to ECL, in order to determine whether there has been a significant increase in credit risk since initial recognition and whether the instrument or a portfolio of instruments is subject to 12mECL or LTECL. The Bank considers an exposure to have a significant increase in credit risk when either the facility exceeds 30 days past due or at the point of reschedulement.

Individually Significant Impairment Assessment and Loans which are Not Impaired Individually

Bank will individually assess all significant customer exposures to identify whether there are any indicators of impairment. Loans with objective evidence of incurred losses are classified as Stage 3. Loans which are individually significant but not impaired will be assessed collectively for impairment under either Stage 1 or Stage 2, based on the above specified criteria to identify whether there have been a significant credit deterioration since origination.

While establishing significant credit deterioration, Bank will consider the following criteria :

- Other changes in the rates or terms of an existing financial instrument that would be significantly different if the instrument was newly originated
- Significant changes in external market indicators of credit risk for a particular financial instrument or similar financial instrument
- Other Information related to the borrower, such as changes in the price of a borrower's debt/equity instrument
- An actual/expected internal credit rating downgrade for the borrower or decrease in behavioural score used to assess credit risk internally
- Existing or forecast adverse changes in business, financial or economic conditions that are expected to cause a significant change in the borrower's ability to meet it's obligation
- An actual or expected significant change in the operating results of the borrower in relation to actual/expected decline in revenue, increase in operational risk, working capital deficiency, decrease in asset quality, increase in gearing and liquidity management problems

Notes to the Financial Statements

6 NEW ACCOUNTING STANDARDS ISSUED BUT NOT EFFECTIVE AS AT REPORTING DATE (Contd.)

- Significant increase in credit risk on other financial instruments of the same borrower
- An actual or expected significant adverse change in the regulatory, economic or technological environment of the borrower that results in a significant change in borrower's ability to meet the debt obligation

Grouping Financial Assets Measured on a Collective Basis

As explained above, Bank calculates ECL either on collective or individual basis. Asset classes where Bank calculates ECL on an individual basis includes all individually significant assets which belong to stage 3. All assets which belong to stage 1 and 2 will be assessed collectively for Impairment.

Bank groups smaller homogeneous exposures based on a combination of internal and external characteristics such as product type, customer type, days past due etc.

Calculation of ECL

The Bank calculates ECL based on 3 probability weighted scenarios to measure expected cash shortfalls, discounted at an approximation to the Effective Interest Rate (EIR).

A cash shortfall is the difference between the cash flows that are due to an entity in accordance with the contract and the cash flows that the entity expects to receive.

The mechanics of the ECL calculation are outlined below and the key elements are as follows :

- Probability of Default (PD) : PD is an estimate of the likelihood of default over a given time horizon. A default may only happen at a certain time over the assessed period, if the facility has not been previously derecognised and is still in the portfolio.
- Exposure at Default (EAD) : EAD is the estimate of the exposure at a future default date, taking into account expected changes in the exposure after the reporting date, including repayments of the principal and interest, whether scheduled by contract or otherwise and expected draw downs on committed facilities.
- Loss Given Default (LGD) : LGD is an estimate of the loss arising, where a default occurs at a given time calculated based on historical recovery data. It is usually expressed as a percentage of the EAD.

When estimating ECL, Bank considers 3 scenarios (base case, best case and worse case). Each of these scenarios are associated with different loss rates. For all products, Bank considers the maximum period over which the credit losses are determined as the contractual life of a financial instrument.

Forward Looking Information

Bank relies on broad range of qualitative/quantitative forward looking information as economic inputs such as the following in its ECL model.

Quantitative inputs	Qualitative inputs
• GDP growth	• Government policies
• Inflation	• Status of the industry business
• Unemployment	• Regulatory impact
• Interest rates	
• Exchange rates	

Bank completed the diagnostic phase (preliminary impact assessment exercise) and implementation phase (solution development) on SLFRS 9. Significant analysis was undertaken to identify the method of implementing SLFRS 9 and tentative accounting policy decisions have been made. The preliminary assessment of Day 1 impact was carried out based on the process described above. Currently the Bank is in the process of refining these models and the inputs which are expected to be completed by mid 2018.

Further, CA Sri Lanka has granted an option to prepare the interim financial statements in 2018 by continuing the application of LKAS 39 with disclosures on impact to the statement of comprehensive income for the period if SLFRS 9 has been applied during the financial year commencing on or after 1st January 2018. If that determination of impact is impracticable, that fact has to be disclosed.

Temporary Exemption from SLFRS 9 for Subsidiary, HNB Assurance PLC

SLFRS 9 addresses the accounting for financial instruments and is effective for annual periods beginning on or after 1st January 2018. However, for an insurer that meets the criteria in paragraph 20B of SLFRS 9 it provides a temporary exemption that permits, but does not require, the insurer to apply LKAS 39 rather than SLFRS 9 for annual periods beginning before 1st January 2021.

An insurer may apply the temporary exemption from SLFRS 9 if, and only if:

- (a) it has not previously applied any version of SLFRS 9, other than only the requirements for the presentation of gains and losses on financial liabilities designated at fair value through profit or loss in paragraphs 5.7.1(c), 5.7.7 – 5.7.9, 7.2.14 and B5.7.5 – B5.7.20 of SLFRS 9; and

6 NEW ACCOUNTING STANDARDS ISSUED BUT NOT EFFECTIVE AS AT REPORTING DATE [Contd.]

(b) its activities are predominantly connected with insurance, as described in paragraph 20D, at its annual reporting date that immediately precedes 1st April 2016, or at a subsequent annual reporting date as specified in paragraph 20G of SLFRS 9.

Since HNB Assurance PLC and HNB General Insurance Limited are predominantly connected with Insurance activities, having considering the above criteria, both the companies may continue to apply LKAS 39 rather than SLFRS 9 for annual periods beginning before 1st January 2021.

Amendments to Sri Lanka Accounting Standard - LKAS 28 "Investments in Associates and Joint Ventures"

The amendments address the conflict between Sri Lanka Accounting Standard - SLFRS 10 "Consolidated Financial Statements" and LKAS 28 in dealing with the loss of control of a subsidiary that is sold or contributed to an associate or joint venture. The amendments clarify that the gain or loss resulting from the sale or contribution of assets that constitute a business, as defined in Sri Lanka Accounting Standard - SLFRS 3 "Business Combinations" between an investor and its associate or joint venture, is recognised in full. Any gain or loss resulting from the sale or contribution of assets that do not constitute a business, however, is recognised only to the extent of unrelated investors' interests in the associate or joint venture. The effective date of these amendments were deferred indefinitely, but an entity that early adopts the amendments must apply them prospectively. The Group will apply these amendments when they become effective.

Sri Lanka Accounting Standard - SLFRS 15 "Revenue from Contracts with Customers"

SLFRS 15 is effective for periods beginning on or after 1st January 2018 with early adoption permitted. SLFRS 15 defines principles for recognising revenue and will be applicable to all contracts with customers. However, interest and fee income integral to financial instruments and leases will continue to fall outside the scope of SLFRS 15 and will be regulated by the other applicable standards [e.g., SLFRS 9 and SLFRS 16].

Revenue under SLFRS 15 will need to be recognised as goods and services are transferred, to the extent that the transferor anticipates entitlement to goods and services. The standard will also specify a comprehensive set of disclosure requirements regarding the nature, extent and timing, as well as any uncertainty of revenue and corresponding cash flows with customers. The Group does not anticipate early adoption of SLFRS 15.

A preliminary evaluation of the existing contracts which falls mainly under fee and commission income of the bank has been performed in relation to the adoption of SLFRS 15. The Group's current assessment has not revealed a significant change to the revenue recognition pattern. However, the Group is currently in the process of evaluating and quantifying the accounting impact and the current systems and processes will be modified where necessary.

Sri Lanka Accounting Standard - SLFRS 16 "Leases"

SLFRS 16 provides a single lessee accounting model, requiring lessees to recognise assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value even though lessor's accounting remains similar to current practice. This supersedes: Sri Lanka Accounting Standard LKAS 17 "Leases", IFRIC 4 "Determining whether an Arrangement Contains a Lease", SIC 15 "Operating Leases - Incentives"; and SIC 27 "Evaluating the substance of Transactions Involving the Legal form of a Lease". Earlier application is permitted for entities that apply SLFRS 15 "Revenue from Contracts with Customers".

SLFRS 16 is effective for annual reporting periods beginning on or after 1st January 2019. The impact on the implementation of the above standard has not been quantified yet by the Group.

Amendments to Sri Lanka Accounting Standard - SLFRS 2, Classification and Measurement of Share-based Payment Transactions

CA Sri Lanka issued amendments to SLFRS 2 "Share based Payments" that address three main areas: the effects of vesting conditions on the measurement of a cash-settled share-based payment transaction; the classification of a share-based payment transaction with net settlement features for withholding tax obligations; and accounting where a modification to the terms and conditions of a share-based payment transaction changes its classification from cash settled to equity settled.

On adoption, entities are required to apply the amendments without restating prior periods, but retrospective application is permitted if elected for all three amendments and other criteria are met. The amendments are effective for annual periods beginning on or after 1st January 2018, with early application permitted. The impact on the implementation of the above standard has not been quantified yet by the Bank.

IFRIC Interpretation 23 "Uncertainty over Income Tax Treatment"

This interpretation addresses the accounting for income taxes when tax treatments involve uncertainty that affects the application of Sri Lanka Accounting Standard - LKAS 12 "Income tax" and does not apply to taxes or levies outside the scope of LKAS 12, nor does it specifically include requirements relating to interest and penalties associated with uncertain tax treatments. The interpretation specifically addresses the following:

- Whether an entity considers uncertain tax treatments separately
- The assumptions an entity makes about the examination of tax treatments by taxation authorities
- How an entity determines taxable profit [tax loss], tax bases, unused tax losses, unused tax credits and tax rates
- How an entity considers changes in facts and circumstances An entity must determine whether to consider each uncertain tax treatment separately or together with one or more other uncertain tax treatments. The approach that better predicts the resolution of the uncertainty should be followed. The interpretation is effective for annual reporting periods beginning on or after 1st January 2019, the Group may need to establish processes and procedures to obtain information that is necessary to apply the Interpretation on a timely basis.

6.1 Amendments to Existing Accounting Standards Effective from 1st January 2017

Amendments to existing accounting standards effective from 1st January 2017 as published by the Institute of Chartered Accountants of Sri Lanka did not have any material impact on the financial statements of the Group.

Notes to the Financial Statements

7 GROSS INCOME

Accounting Policy

Gross revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. The specific recognition criteria, for each type of gross income, are given under the respective income notes.

For the year ended 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Interest income [Note 8 (a)]	96,175,453	75,608,193	103,908,195	81,533,502
Fee and commission income [Note 9]	8,415,579	7,139,253	9,227,529	7,905,879
Net gain / (loss) from trading [Note 10]	(3,711,203)	(1,795,691)	(3,695,658)	(1,824,452)
Net gain from financial investments [Note 11]	212,129	111,713	247,166	103,165
Net insurance premium income [Note 12]	-	-	6,326,292	5,490,712
Other operating income [Note 13]	5,203,236	3,287,355	3,745,582	2,781,965
	106,295,194	84,350,823	119,759,106	95,990,771

8 NET INTEREST INCOME

Accounting Policy

Interest income and expenses are allocated over the relevant period using the Effective Interest Rate (EIR) method, for all financial instruments measured at amortised cost, interest bearing financial assets classified as available-for-sale and financial instruments at fair value through profit or loss.

The EIR is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, an entity shall estimate cash flows considering all contractual terms of the financial instrument but will not consider future credit losses. The calculation includes all fees and points received or paid between parties to the contract that are an integral part of EIR.

The carrying amount of the financial asset or financial liability is adjusted, if the Bank revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original EIR and the change in carrying amount is recorded as interest income for financial assets and interest expense for financial liabilities. However, for a reclassified financial asset for which the Bank subsequently increases its estimates of future cash receipts as a result of increased recoverability of those cash receipts, the effect of that increase is recognised as an adjustment to the EIR from the date of the change in estimate.

Once the recorded value of a financial asset or a group of similar financial assets has been reduced due to an impairment loss, interest income continues to be recognised, using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

8 (a) Interest Income

For the year ended 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Cash and cash equivalents	24,311	17,355	86,471	38,062
Securities purchased under resale agreements	198,392	172,388	290,213	336,660
Placements with banks	156,826	150,222	625,538	272,508
Loans and receivables to customers	78,912,222	61,127,471	84,859,754	65,912,111
Interest income accrued on impaired financial assets	40,326	25,202	40,326	25,202
Financial investments - loans and receivables	7,009,086	5,396,078	7,339,101	5,697,782
Other financial assets - fair value through profit or loss	4	18	1,724	7,828
Financial investments - available for sale	9,781,219	8,664,720	10,569,776	9,164,289
Financial investments - held to maturity	-	-	95,108	76,253
Other interest income	53,067	54,739	184	2,807
	96,175,453	75,608,193	103,908,195	81,533,502

8 NET INTEREST INCOME [Contd.]

8 (b) Interest Expenses

For the year ended 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Securities sold under repurchase agreements	1,076,289	2,222,760	1,076,289	2,222,760
Due to banks	3,233,113	2,654,793	3,233,113	2,655,424
Deposits from customers [due to customers]	47,511,413	32,622,175	49,350,749	33,705,430
Debt securities issued	442,556	437,802	544,288	544,907
Other borrowings	1,437,027	1,282,050	1,437,099	1,282,050
Subordinated term debts	2,825,639	2,004,159	2,805,289	2,021,206
Other interest expenses	101	12,866	101	12,866
	56,526,138	41,236,605	58,446,928	42,444,643

8 (c) Net Interest Income from Sri Lanka Government Securities

For the year ended 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Interest income	15,567,143	13,034,389	16,458,457	13,846,507
Less : Interest expenses	1,076,289	2,222,760	1,076,289	2,222,760
Net interest income from Sri Lanka Government Securities	14,490,854	10,811,629	15,382,168	11,623,747

Notional tax credit for withholding tax on government securities on secondary market transactions

Section 137 of the Inland Revenue Act No 10 of 2006 provides that a company which derives interest income from the secondary market transactions in government securities (treasury bills, treasury bonds and Central Bank securities) be entitled to a notional tax credit (being one ninth of the net interest income) provided such interest income forms part of the statutory income of the company for that year of assessment.

Accordingly, net income earned from secondary market transactions in government securities for the year by the Bank / Group has been grossed up in the financial statements and the resulting notional tax credit amounted to Rs 907 Mn [2016 : Rs 664 Mn] for the Bank and Rs 984 Mn [2016 : Rs 734 Mn] for the Group.

As per the new Inland Revenue Act No 24 of 2017, there is no specific provision to claim tax credit on government securities w.e.f. 1st April 2018. However, transitional provisions are yet to be finalised.

9 NET FEE AND COMMISSION INCOME

Accounting Policy

The Group earns fee and commission income from a diverse range of services it provides to its customers which can be divided in to the following two categories.

- Fee and commission income earned from services that are provided over a certain period of time
Fee and commission earned for the provision of services over a period of time are accrued over that period.
- Fee and commission income from providing transaction services
Fee and commission income arising from renegotiating or participating in the negotiation of a transaction for a third party are recognised on completion of the underlying transaction. Fees or components of fees that are linked to a certain performance are recognised as the related services are performed.

Fees and commission expenses relating to transaction and service fees are expensed as the services are received. Fee and commission expenses are recognised on an accrual basis.

Notes to the Financial Statements

9 NET FEE AND COMMISSION INCOME (Contd.)

For the year ended 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Fee and commission income	8,415,579	7,139,253	9,227,529	7,905,879
Less: Fee and commission expenses	105,482	90,594	213,143	180,531
Net fee and commission income	8,310,097	7,048,659	9,014,386	7,725,348
Comprising				
Loans	1,615,869	1,379,067	2,301,429	2,007,816
Cards	2,452,506	1,952,300	2,452,506	1,952,300
Trade and remittances	1,720,104	1,467,683	1,720,104	1,467,683
Deposits	962,266	759,647	851,893	667,772
Guarantees	1,015,770	850,965	1,015,770	850,965
Currency	76,146	77,975	76,146	77,975
Others	467,436	561,022	596,538	700,837
Net fee and commission income	8,310,097	7,048,659	9,014,386	7,725,348

10 NET GAIN / [LOSS] FROM TRADING

Accounting Policy ↘

Results arising from trading activities include all gains and losses from realised and unrealised fair value changes, related capital gains and losses, dividend income from financial assets "held for trading" and gains/(losses) from revaluation of derivative financial instruments.

Dividend income is recognised when the Group's right to receive the dividend is established.

Derivative financial instruments are fair valued at each reporting date. Gains and losses arising from changes in fair value are included in the statement of profit or loss in the period in which they arise.

For the year ended 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Financial investments - Held for trading				
Fixed income				
Net marked to market gain / [loss]	-	-	1,185	[11,000]
Net capital gain	146	323	146	323
Equities				
Net marked to market gain / [loss]	7,106	[44,604]	15,206	[52,732]
Net capital gain	6,006	4,389	7,902	[13,042]
Dividend income	16,315	19,578	20,679	27,376
Derivative financial instruments				
Gain / [loss] on revaluation of foreign currency derivatives				
- With banks	[3,740,180]	[1,789,930]	[3,740,180]	[1,789,930]
- With customers	[596]	14,553	[596]	14,553
Total net gain / [loss] from trading	[3,711,203]	[1,795,691]	[3,695,658]	[1,824,452]

11 NET GAIN FROM FINANCIAL INVESTMENTS

Accounting Policy

Net gain from financial investments includes capital gains / [losses] and dividend income of financial investments - available-for-sale. Dividend income is recognised when the Group's right to receive the dividend is established.

For the year ended 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Fixed income				
Net capital gain / (loss)	-	-	16,070	[14,466]
Equities				
Net capital gain / (loss)	-	-	14,562	-
Dividend income	212,129	111,713	216,534	117,631
Total net gain from financial investments	212,129	111,713	247,166	103,165

12 NET INSURANCE PREMIUM INCOME

Accounting Policy

Insurance Premiums

Life Insurance Business

Gross Written Premiums on life insurance contracts are recognised as revenue when a premium is due from a policyholder. (policies within the 30 day grace period are considered as due). Premiums received in advance, are not recorded as revenue but recorded as liability until the premium is due, unless otherwise the relevant policy conditions require such premiums to be recognised as revenue. Benefits and expenses are provided against such revenue to recognise profits over the estimated life of the policies.

For single premium business, revenue is recognised on the date on which the policy is effective.

General Insurance Business

Gross Written Premiums on General Insurance comprise the total premiums received / receivable for the whole period of cover provided by contracts entered into during the accounting period. Premiums are generally recognised upon the inception of the policy as written and are earned primarily on a pro-rata basis over the term of the related policy coverage.

Gross Written Premium (GWP) is deferred over the term of the underlying policies' risk attached period according to the Regulation of Insurance Industry Act, No. 43 of 2000 and Unearned premiums are the proportion of premiums that relate to the period of risk after the respective reporting period. Company uses 1/24th basis to defer the GWP of all policies except for the Marine Insurance policies and Title Insurance policies, where Marine Insurance premiums are deferred based on 60 : 40 basis and total premiums on Title Insurance are transferred to Title Insurance Reserve for the reporting period.

Reinsurance Premiums

Gross reinsurance premiums on insurance contracts are recognised as an expense on the earlier of the date when premiums are payable or when the policy becomes effective. Value of the Reinsurance premiums are decided based on rates agreed with reinsurers.

Unearned reinsurance premiums are those proportions of premiums written in a year, that relate to periods of risk after the reporting date. Unearned reinsurance premiums are deferred over the term of the underlying direct insurance policies for risks-attaching contracts (using 1/24th basis except for the marine policies which are computed on a 60-40 basis in accordance with the Regulation of Insurance Industry Act, No 43 of 2000).

Notes to the Financial Statements

12 NET INSURANCE PREMIUM INCOME [Contd.]

For the year ended 31st December	Group	
	2017 Rs 000	2016 Rs 000
Gross insurance premium income	7,755,683	6,549,527
Reinsurers' share of gross insurance premium income	(1,100,573)	(877,713)
Net written premium	6,655,110	5,671,814
Net change in reserves for unearned premium	(328,818)	(181,102)
Net insurance premium income	6,326,292	5,490,712

13 OTHER OPERATING INCOME

Accounting Policy

Other operating income includes rental income, dividend income from group entities, gains on disposal of property, plant and equipment and foreign exchange gains and losses.

Rental income

Rental income is recognised on an accrual basis.

Dividend income from subsidiaries and joint venture

Dividend income from subsidiaries and joint venture is recognised when the Bank's right to receive the dividend is established.

Gains and losses on disposal of assets

Net gains and losses of a revenue nature arising from the disposal of property, plant and equipment and other non-current assets including investments in subsidiaries, joint ventures and associates are accounted for, in the statement of profit or loss after deducting from the proceeds on disposal, the carrying amount of such assets and the related selling expenses.

Foreign exchange gain

Foreign currency positions are revalued at each reporting date. Gains and losses arising from changes in fair value are included in the statement of profit or loss in the period in which they arise.

For the year ended 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Auditorium hire income	1,831	3,550	1,831	3,550
Dividend income from subsidiaries and joint venture	1,824,091	757,061	-	-
Foreign exchange gain / [loss]				
- With banks	1,932,575	1,142,176	1,936,632	1,150,994
- With customers	1,315,940	1,219,536	1,315,940	1,219,536
Gain on disposal of non-current assets held for sale	-	3,556	-	3,556
Gain on disposal of property, plant and equipment [net]	7,800	4,379	14,178	1,807
Loss on disposal of investment properties	-	-	-	(550)
Rental income	9,583	8,821	202,736	190,821
Rental income from investment properties	60,023	92,293	118,720	112,697
Recovery of loans written off in prior years	34,082	34,014	46,776	52,881
Recovery of operational losses provided for in prior years	2,156	788	2,156	788
Miscellaneous	15,155	21,181	106,613	45,885
	5,203,236	3,287,355	3,745,582	2,781,965

14 IMPAIRMENT CHARGE / (REVERSAL) FOR LOANS AND OTHER LOSSES

Accounting Policy

The Group recognises the changes in the impairment provisions for loans and receivables, which are assessed as per Sri Lanka Accounting Standard - LKAS 39 on "Financial Instruments : Recognition and Measurement". The methodology adopted for impairment is explained in Note 31 (b) to the financial statements. The Group also makes provisions/(write-backs) for impairment of financial investments - available-for-sale and financial investments - loans and receivables when there is a permanent diminution in the carrying value of these investments. Further, Group recognises an impairment loss when the carrying amount of a non-financial asset exceeds the estimated recoverable amount from that asset.

For the year ended 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Loans and receivables to customers				
Individual impairment	4,397,848	250,783	4,397,848	250,783
Collective impairment	(1,470,163)	12,333	(1,047,317)	278,959
Direct write offs	5	727	5	727
Others	(1,990)	9,669	(1,990)	9,669
Financial investments - available-for-sale	94,359	-	96,215	4,373
Financial investments - loans and receivables	7,860	397	473,839	397
Property, plant and equipment [Note 38]	(64,178)	(41,219)	(64,178)	(41,219)
Other charges for impairment	71,727	4,470	71,727	4,470
	3,035,468	237,160	3,926,149	508,159

15 PERSONNEL EXPENSES

Accounting Policy

Personnel expenses include salaries and bonus, terminal benefit charges and other related expenses. 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 or profit-sharing plans, if the Group 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.

Employees are eligible for Employees' Provident Fund (EPF) contributions and Employees' Trust Fund (ETF) contributions in accordance with the respective statutes and regulations.

Defined benefit plan contributions and changes in the liabilities for EPF interest guarantee and accumulated leave are recognised in the statement of profit or loss based on actuarial valuations carried out in accordance with Sri Lanka Accounting Standard - LKAS 19 on "Employee Benefits".

The Group's net obligation to the pension fund, gratuity, EPF interest guarantee and unutilised accumulated annual leave is disclosed under Note 53 to the financial statements.

For the year ended 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Salaries and bonus	7,401,523	7,238,790	9,196,844	8,733,832
Contributions to Employees' Provident Fund	577,269	542,246	730,384	666,323
Contributions to Employees' Trust Fund	143,981	138,681	181,889	169,661
Contribution to defined benefit plan [Note 15 (a)]	345,806	419,438	418,104	475,863
Increase in liability for EPF interest guarantee	1,518	3,197	1,518	3,197
Increase in liability for accumulated leave	3,678	4,030	3,678	4,030
Others	392,867	357,193	383,867	363,193
	8,866,842	8,703,575	10,916,284	10,416,099

Notes to the Financial Statements

15 PERSONNEL EXPENSES (Contd.)

15 (a) Contribution to Defined Benefit Plan

For the year ended 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Current service cost	587,759	527,676	587,759	527,676
Net interest on defined benefit asset	(241,953)	(108,238)	(241,953)	(108,238)
Provision for gratuities	-	-	72,298	56,425
	345,806	419,438	418,104	475,863

16 BENEFITS, CLAIMS AND UNDERWRITING EXPENDITURE

Accounting Policy

Gross Benefits and Claims

Life Insurance Business

Claims by death and maturity are charged on notification of death or on expiry of the term. The interim payments and surrenders are accounted for only at the time of settlement.

General Insurance Business

General insurance claims include all claims occurred during the year, whether reported or not, together with claims handling costs that are directly related to the processing and settlement of claims, a reduction for the value of salvage and other recoveries, and any adjustments to claims outstanding from previous years. Claims outstanding are assessed by review of individual claim files and estimating changes in the ultimate cost of settling claims.

The provision in respect of Claims Incurred But Not Reported (IBNR) and Claims Incurred But Not Enough Reported (IBNER) are actuarially valued to ensure a more realistic estimation of the future liability, based on the past experience and trends. Actuarial valuations are performed on a quarterly basis.

Whilst the directors of HNB Assurance PLC, subsidiary of the Bank consider that the provisions for claims are fairly stated on the basis of information currently available, the ultimate liability will vary as a result of subsequent information and events. This may result in adjustments to the amounts provided. Such amounts are reflected in the financial statements for the relevant period.

The methods used to estimate claims and the estimates made are reviewed regularly.

Reinsurance Claims

Reinsurance claims are recognised when the related gross insurance claims are recognised according to the terms of the relevant contract.

Deferred Acquisition Expenses

Acquisition expenses, representing commissions, which vary with and are directly related to the production of business, are deferred and amortised over the period in which the related written premiums are earned.

Reinsurance commission is also treated in the same manner within deferred acquisition costs.

For the year ended 31st December	Group	
	2017 Rs 000	2016 Rs 000
Net insurance benefits and claims paid	2,178,556	1,966,759
Net change in insurance claims outstanding	114,850	(19,114)
Change in contract liabilities - Life fund	2,166,427	1,708,285
Underwriting and net acquisition costs	1,026,031	915,459
	5,485,864	4,571,389

17 OTHER EXPENSES

Accounting Policy

Other operating 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 and maintaining the property, plant and equipment in a state of efficiency has been charged to the statement of profit or loss in arriving at the profit of the year. Provisions in respect of other expenses are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

17 OTHER EXPENSES [Contd.]

For the year ended 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Advertising and related expenses	251,319	263,156	312,371	305,483
Auditors' remuneration [Note 17 (a)]	22,153	18,906	32,818	27,070
Amortisation of intangible assets [Note 39]	256,008	220,138	309,768	260,357
Business promotion and product expenses	765,997	631,952	775,989	631,952
Depreciation of investment property [Note 37]	1,616	5,471	22,937	4,813
Depreciation of property, plant and equipment [Note 38]	871,178	810,321	1,224,138	1,128,658
Direct operating expenses on investment property	-	1,257	7,760	7,380
Debenture issue expenses	-	35,233	-	35,233
Share issue expenses	6,346	-	6,346	-
Deposit insurance premium	621,468	664,611	644,073	680,775
Directors' emoluments [Note 17(b)]	119,102	95,514	147,562	110,090
Donations	10,363	20,451	11,374	24,751
Crop insurance levy	201,630	113,473	221,710	133,541
Legal expenses and professional fees	83,830	88,814	98,037	98,662
Operational risk event losses	76,792	28,526	76,792	28,526
Office administration and establishment expenses	6,218,958	5,562,306	6,535,343	5,600,631
Other overhead expenses	1,183,047	1,024,175	1,980,696	1,707,222
	10,689,807	9,584,304	12,407,714	10,785,144

17 [a] Auditors' Remuneration

Audit fees and expenses	11,360	10,899	20,448	18,410
Audit related fee and expenses	1,954	2,262	3,006	2,915
Non-audit expenses	8,839	5,745	9,364	5,745
	22,153	18,906	32,818	27,070

17 [b] The composition of directors' emoluments consists of the following:

Emoluments p.a.	Number of directors
	[Executive and non-executive]
Rs 3 Mn and below	9
Above Rs 3 Mn	3

18 VALUE ADDED TAX (VAT) AND NATION BUILDING TAX (NBT) ON FINANCIAL SERVICES

The base of the calculation of Value Added Tax (VAT) and Nation Building Tax (NBT) on financial services is the operating profit before VAT and NBT on financial services adjusted for emoluments of employees and economic depreciation.

VAT rate applied during 2017 is 15%, while the VAT rates applied during 2016 were as follows:

Period	Rate
1st January 2016 - 1st May 2016	11%
2nd May 2016 - 11th July 2016	15%
12th July 2016 - 30th October 2016	11%
1st November 2016 - 31st December 2016	15%

The NBT rate applied in 2017 is 2% (2016 - 2%)

For the year ended 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Value Added Tax on financial services	4,417,660	3,787,448	4,784,030	4,114,963
Nation Building Tax on financial services	603,786	565,308	651,598	619,986
	5,021,446	4,352,756	5,435,628	4,734,949

19 SHARE OF PROFIT OF JOINT VENTURE (NET OF INCOME TAX)

Accounting Policy

The aggregate of the Group's share of profit or loss of the joint venture is shown on the face of the statement of profit or loss outside operating profit and represents profit or loss after tax and non-controlling interests in the subsidiaries of the joint venture.

For the year ended 31st December	Group	
	2017 Rs 000	2016 Rs 000
Share of profit of joint venture before income tax	191,236	165,967
Income tax on share of operating results of joint venture	(15,620)	(17,177)
Share of profit of joint venture (net of income tax) [Note 35 (b)]	175,616	148,790

20 INCOME TAX EXPENSE

Accounting Policy

As per Sri Lanka Accounting Standard - LKAS 12 on "Income taxes", tax expense is the aggregate amount included in determination of profit or loss for the period in respect of current and deferred taxes. Income tax expense is recognised in the statement of profit or loss, except to the extent it relates to items recognised directly in Other Comprehensive Income (OCI), in which case it is recognised in OCI.

Current Taxation

Current tax assets and liabilities consist of amounts expected to be recovered from or paid to the taxation authorities in respect of the current as well as prior years. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted on the reporting date.

Current income tax relating to items recognised directly in equity, is recognised in equity and not in the statement of profit or loss.

Management periodically evaluates positions taken in the tax returns, with respect to situations in which applicable tax regulations are subject to interpretation and establishes provisions where appropriate.

Management has used its judgement on the application of tax law including transfer pricing regulation involving identification of associated undertaking, estimation of respective arm's length prices and selection of appropriate pricing mechanism.

Economic Service Charges (ESC)

ESC was payable at 0.25% on exempt turnover of the Bank until 31st March 2016. From 1st April 2016 onwards ESC is payable at 0.50% on total turnover of the Bank. ESC is deductible from the income tax payable.

Deferred Tax

Deferred tax is provided on temporary differences at the reporting date between the tax base of assets and liabilities and their carrying amounts for financial reporting purposes for all group entities.

Deferred tax liabilities are recognised for all taxable temporary differences, except:

- When the deferred tax liability arises from the initial recognition of goodwill or an asset or liability in a transaction that is not a business combination and at the time of the transaction, affects neither the accounting profit nor taxable profit or loss
- In respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, when the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.
- Deferred tax assets are recognised for all deductible temporary differences, carry forward of unused tax credits and unused tax losses (if any), to the extent that it is probable that taxable profit will be available against which the deductible temporary differences and the unused tax credits and unused tax losses carried forward can be utilised except;
- When the deferred tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction, that is not a business combination and at the time of the transaction, affects neither the accounting profit nor taxable profit or loss
- In respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred tax assets are recognised only to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

20 INCOME TAX EXPENSE [Contd.]

Accounting Policy

The carrying amount of deferred tax asset is reviewed at each reporting date, and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Un-recognised deferred tax assets are re-assessed at each reporting date and are recognised to the extent that it has become probable that future taxable profits will allow the deferred tax asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates, that are expected to apply in the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the reporting date. The rates applicable as at reporting date are given below.

Deferred tax relating to items recognised directly in equity are also recognised in equity, through other comprehensive income and not in the statement of profit or loss deferred taxation.

Deferred tax assets and deferred tax liabilities are offset if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

Accordingly, provision for taxation is made on the basis of the accounting profit for the year as adjusted for taxation purposes in accordance with the provisions of the Inland Revenue Act No 10 of 2006 and the amendments thereto, at the rates specified below.

Applicable Income Tax Rates

Hatton National Bank PLC	28%
HNB Assurance PLC and its subsidiary HNB General Insurance Ltd	28%
HNB Grameen Finance Ltd	28%

Sithma Development (Pvt) Ltd

In accordance with the BOI agreement dated 18th June 1999, the profits and income of Sithma Development (Pvt) Ltd (company) are exempt from income tax until 24th January 2018. After the expiration of the said tax exemption period, the provisions of the Inland Revenue regulations for the time being in force shall apply to the company. However the company paid tax for the other income and interest income earned from its investments at the rate of 28% during the year.

The deferred tax liabilities / assets are disclosed under Note 49 to the financial statements.

New Inland Revenue Act No 24 of 2017 (Act)

The above Act will be effective from 1st April 2018. Accordingly, the income tax liability of the Bank for Y/A 2018/19 will be computed based on above. The impact on deferred tax assets and liabilities from this Act is discussed in Note 49 to the financial statements.

20 (a) Current Tax Expense

For the year ended 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Current tax on profit for the year	5,472,063	5,798,826	6,170,141	6,341,495
Under / (over) provision in previous years	(913,112)	-	(912,493)	(3,064)
	4,558,951	5,798,826	5,257,648	6,338,431

20 (b) Deferred Tax Expense

Recognition of deferred tax liability [Note 49 (a) i and 49 (a) ii]	273,830	174,698	673,579	357,834
Recognition / (realisation) of deferred tax asset [Note 49 (b)]	750,640	28,899	430,389	137,420
	1,024,470	203,597	1,103,968	495,254
Total income tax expense [Note 20 (d)]	5,583,421	6,002,423	6,361,616	6,833,685
Effective tax rate	25.32%	29.79%	27.54%	30.37%
Effective tax rate (excluding deferred tax)	20.68%	28.78%	22.76%	28.17%

Notes to the Financial Statements

20 INCOME TAX EXPENSE [Contd.]

20 (c) Current Tax on Profit for the year - Subsidiaries

For the year ended 31st December	Group	
	2017 Rs 000	2016 Rs 000
Sithma Development (Pvt)Ltd	6,022	5,437
HNB Assurance PLC	35,221	59,812
HNB Grameen Finance Ltd	657,454	474,356
Total	698,697	539,605

20 (d) Reconciliation of Effective Tax Rate

For the year ended 31st December	Bank				Group			
	2017		2016		2017		2016	
	%	Rs 000	%	Rs 000	%	Rs 000	%	Rs 000
Profit before income tax		22,050,211		20,145,829		23,103,012		22,498,647
Tax using the corporate tax rate	28.00	6,174,060	28.00	5,640,832	28.00	6,468,843	28.00	6,299,622
Disallowable expenses	11.52	2,540,822	12.03	2,422,898	15.51	3,583,157	15.22	3,423,507
Tax effects on:								
Allowable expenses	(21.31)	(4,698,500)	(20.61)	(4,151,094)	(22.06)	(5,095,419)	(21.10)	(4,748,215)
Tax exempt income	(12.20)	(2,689,350)	(9.21)	(1,856,408)	(12.61)	(2,912,883)	(10.02)	(2,253,918)
Adjustments for leasing	18.80	4,145,031	18.58	3,742,598	17.94	4,145,031	16.63	3,742,598
Tax loss utilised	-	-	-	-	(0.08)	(18,588)	(0.54)	(122,099)
Current tax on profits for the year	24.82	5,472,063	28.78	5,798,826	26.71	6,170,141	28.19	6,341,495
Under / (over) provision in prior years	(4.14)	(913,112)	-	-	(3.95)	(912,493)	(0.01)	(3,064)
Current tax expense [Note 20 (a)]	20.68	4,558,951	28.78	5,798,826	22.76	5,257,648	28.17	6,338,431
Recognition of deferred tax liability								
on temporary differences	1.24	273,830	0.87	174,698	2.92	673,579	1.59	357,834
Recognition of deferred tax asset								
on temporary differences	3.40	750,640	0.14	28,899	1.86	430,389	0.61	137,420
Total income tax expense [Note 20 (b)]	25.32	5,583,421	29.79	6,002,423	27.54	6,361,616	30.37	6,833,685

20 (e) Tax Losses Brought Forward and Utilised during the Year

For the year ended 31st December	Group	
	2017 Rs 000	2016 Rs 000
Balance as at 1st January	4,708,101	4,223,016
Adjustment for brought forward tax losses	182,524	(53,644)
Tax losses incurred during the year	881,859	974,797
Tax losses utilised during the year	(66,386)	(436,068)
Tax losses carried forward	5,706,098	4,708,101

21 EARNINGS PER SHARE

The Bank/Group presents basic and diluted Earnings per Share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss for the year attributable to ordinary shareholders of the Bank by the weighted average number of ordinary shares outstanding during the year. Diluted EPS is determined by adjusting the profit or loss attributable to the ordinary shareholders and the weighted average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares, which comprise share options granted to employees as per Sri Lanka Accounting Standard - LKAS 33 on "Earnings per Share".

21 (a) Basic Earnings per Share

For the year ended 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Amount used as the numerator				
Profit attributable to equity holders of the Bank (Rs 000)	16,466,790	14,143,406	15,946,989	14,755,634
Number of ordinary shares used as the denominator				
Weighted average number of ordinary shares outstanding during the year used as the denominator for basic EPS ('000)	449,227	421,765	449,227	421,765
Basic earnings per ordinary share (Rs)	36.66	33.53	35.50	34.99

21 (b) Diluted Earnings per Share

Amount used as the numerator				
Profit attributable to equity holders of the Bank (Rs 000)	16,466,790	14,143,406	15,946,989	14,755,634
Number of ordinary shares used as the denominator				
Weighted average number of ordinary shares outstanding during the year used as the denominator for basic EPS ('000)	449,227	421,765	449,227	421,765
Effect of dilution:				
Weighted average number of potential ordinary shares outstanding under ESOP ('000)	946	2,730	946	2,730
Weighted average number of potential ordinary shares that would have been issued at average market price ('000)	(558)	(1,786)	(558)	(1,786)
Weighted average number of potential ordinary shares that would have been issued for zero consideration under ESOP	388	944	388	944
Weighted average number of ordinary shares outstanding during the year used as the denominator for diluted EPS ('000)	449,615	422,709	449,615	422,709
Diluted earnings per ordinary share (Rs)	36.62	33.46	35.47	34.91

Notes to the Financial Statements

22 DIVIDENDS PAID AND PROPOSED

For the year ended 31st December	Gross Dividend Rs 000	2017 Dividend Tax Rs 000	Net Dividend Rs 000	Gross Dividend Rs 000	2016 Dividend Tax Rs 000	Net Dividend Rs 000
Interim dividends paid						
Rs 1.50 cash dividend per share declared and paid in 2016	-	-	-	620,387	10,721	609,666
Rs 1.50 cash dividend per share declared and paid in 2017	732,745	-	732,745	-	-	-
Final dividends paid						
Rs 3.50 cash dividend per share declared in 2015 and paid in 2016	-	-	-	1,421,200	79,122	1,342,078
Rs 3.50 scrip dividend per share declared in 2015 and paid in 2016	-	-	-	1,421,200	142,120	1,279,080
Rs 3.50 cash dividend per share declared in 2016 and paid in 2017	1,451,296	107,698	1,343,598	-	-	-
Rs 3.50 scrip dividend per share declared in 2016 and paid in 2017	1,451,296	144,577	1,306,719	-	-	-
Total dividends paid	3,635,337	252,275	3,383,062	3,462,787	231,963	3,230,824

22 [a] Proposed dividends

The directors recommend that a second interim dividend of Rs 5.00 per share (cash) and a final dividend of Rs 2.00 per share (in the form of scrip) [2016 : final dividend of Rs 7.00 per share by way of Rs 3.50 cash and Rs 3.50 scrip] on both voting and non-voting shares of the Bank, be paid for the financial year ended 31st December 2017.

The final dividend is to be approved at the Annual General Meeting to be held on 28th March 2018. In accordance with Sri Lanka Accounting Standard - LKAS 10 on "Events after the reporting period", this proposed second interim and final dividends have not been recognized as a liability as at 31st December 2017. The first interim dividend of Rs 1.50 per share [2016 : Rs 1.50] was paid to the shareholders on 21st December 2017. Second interim dividend proposed amounts to Rs 2,442.8 Mn while final dividend proposed amounts to Rs 977 Mn [2016 final dividend proposed : Rs 2,842.4 Mn].

23 ANALYSIS OF FINANCIAL INSTRUMENTS BY MEASUREMENT BASIS

The carrying amounts of financial instruments by category as defined in Sri Lanka Accounting Standard - LKAS 39 on "Financial Instruments - Recognition and Measurement" under headings of the statement of financial position are summarised below.

23 ANALYSIS OF FINANCIAL INSTRUMENTS BY MEASUREMENT BASIS [Contd.]

23 [a] Analysis of Financial Instruments by Measurement Basis - Bank

As at 31st December 2017	Fair Value Through Profit or Loss Rs 000	Loans and Receivable Rs 000	Available- for-Sale Rs 000	Total Carrying Amount Rs 000
Assets				
Cash and cash equivalents	-	21,739,800	-	21,739,800
Placements with banks	-	3,182,377	-	3,182,377
Balances with Central Bank of Sri Lanka	-	38,610,940	-	38,610,940
Derivative financial instruments	615,357	-	-	615,357
Financial investments - fair value through profit or loss	120,486	-	-	120,486
Loans and receivables to customers	-	639,102,061	-	639,102,061
Financial investments - loans and receivables	-	122,199,048	-	122,199,048
Financial investments - available-for-sale	-	-	95,403,820	95,403,820
Other assets	-	2,124,947	-	2,124,917
Total financial assets	735,843	826,959,173	95,403,820	923,098,836
Liabilities				
Due to banks	-	62,463,497	-	62,463,497
Derivative financial instruments	1,305,900	-	-	1,305,900
Securities sold under repurchase agreements	-	5,064,360	-	5,064,360
Due to customers	-	701,519,297	-	701,519,297
Dividends payable	-	975,371	-	975,371
Other borrowings	-	27,258,006	-	27,258,006
Debt securities issued	-	4,540,259	-	4,540,259
Other liabilities	-	22,984	-	22,984
Subordinated term debts	-	25,809,261	-	25,809,261
Total financial liabilities	1,305,900	827,653,035	-	828,958,935
As at 31st December 2016				
	Fair Value Through Profit or Loss Rs 000	Loans and Receivable Rs 000	Available- for-Sale Rs 000	Total Carrying Amount Rs 000
Assets				
Cash and cash equivalents	-	17,511,446	-	17,511,446
Placements with banks	-	753,050	-	753,050
Balances with Central Bank of Sri Lanka	-	33,777,614	-	33,777,614
Reverse repurchase agreements	-	4,303,460	-	4,303,460
Derivative financial instruments	289,989	-	-	289,989
Financial investments - fair value through profit or loss	544,915	-	-	544,915
Loans and receivables to customers	-	584,412,727	-	584,412,727
Financial investments - loans and receivables	-	99,260,698	-	99,260,698
Financial investments - available-for-sale	-	-	89,915,153	89,915,153
Other assets	-	2,308,521	-	2,308,521
Total financial assets	834,904	742,327,516	89,915,153	833,077,573
Liabilities				
Due to banks	-	69,219,302	-	69,219,302
Derivative financial instruments	665,890	-	-	665,890
Securities sold under repurchase agreements	-	13,458,127	-	13,458,127
Due to customers	-	623,494,969	-	623,494,969
Dividends payable	-	1,007,075	-	1,007,075
Other borrowings	-	27,839,845	-	27,839,845
Debt securities issued	-	4,653,057	-	4,653,057
Other liabilities	-	403,851	-	403,851
Subordinated term debts	-	26,153,476	-	26,153,476
Total financial liabilities	665,890	766,229,702	-	766,895,592

Notes to the Financial Statements

23 ANALYSIS OF FINANCIAL INSTRUMENTS BY MEASUREMENT BASIS (Contd.)

23 (b) Analysis of Financial Instruments by Measurement Basis - Group

As at 31st December 2017	Fair Value Through Profit or Loss Rs 000	Held to Maturity Rs 000	Loans and Receivable Rs 000	Available- for-Sale Rs 000	Total Carrying Amount Rs 000
Assets					
Cash and cash equivalents	-	-	21,924,898	-	21,924,898
Placements with banks	-	-	9,670,125	-	9,670,125
Balances with Central Bank of Sri Lanka	-	-	38,610,940	-	38,610,940
Reverse repurchase agreements	-	-	772,002	-	772,002
Derivative financial instruments	615,357	-	-	-	615,357
Financial investments - fair value through profit or loss	266,538	-	-	-	266,538
Loans and receivables to customers	-	-	655,612,938	-	655,612,938
Financial investments - loans and receivables	-	-	125,031,671	-	125,031,671
Financial investments - available-for-sale	-	-	-	101,742,985	101,742,985
Financial investments - held to maturity	-	1,565,603	-	-	1,565,603
Other assets	-	-	3,170,939	-	3,170,939
Total financial assets	881,895	1,565,603	854,793,513	101,742,985	958,983,996
Liabilities					
Due to banks	-	-	62,464,391	-	62,464,391
Derivative financial instruments	1,305,900	-	-	-	1,305,900
Securities sold under repurchase agreements	-	-	5,064,360	-	5,064,360
Due to customers	-	-	718,770,051	-	718,770,051
Dividends payable	-	-	986,880	-	986,880
Other borrowings	-	-	27,258,006	-	27,258,006
Debt securities issued	-	-	5,035,958	-	5,035,958
Other liabilities	-	-	1,268,066	-	1,268,066
Subordinated term debts	-	-	25,564,596	-	25,564,596
Total financial liabilities	1,305,900	-	846,412,308	-	847,718,208
As at 31st December 2016					
	Fair Value Through Profit or Loss Rs 000	Held to Maturity Rs 000	Loans and Receivable Rs 000	Available- for-Sale Rs 000	Total Carrying Amount Rs 000
Assets					
Cash and cash equivalents	-	-	18,668,703	-	18,668,703
Placements with banks	-	-	2,198,446	-	2,198,446
Balances with Central Bank of Sri Lanka	-	-	33,777,614	-	33,777,614
Reverse repurchase agreements	-	-	5,756,794	-	5,756,794
Derivative financial instruments	289,989	-	-	-	289,989
Financial investments - fair value through profit or loss	716,009	-	-	-	716,009
Loans and receivables to customers	-	-	597,467,460	-	597,467,460
Financial investments - loans and receivables	-	-	102,063,229	-	102,063,229
Financial investments - available-for-sale	-	-	-	95,797,142	95,797,142
Financial investments - held to maturity	-	465,081	-	-	465,081
Other assets	-	-	3,175,431	-	3,175,431
Total financial assets	1,005,998	465,081	763,107,677	95,797,142	860,375,898
Liabilities					
Due to banks	-	-	69,254,893	-	69,254,893
Derivative financial instruments	665,890	-	-	-	665,890
Securities sold under repurchase agreements	-	-	13,458,127	-	13,458,127
Due to customers	-	-	635,371,097	-	635,371,097
Dividends payable	-	-	1,015,463	-	1,015,463
Other borrowings	-	-	27,839,845	-	27,839,845
Debt securities issued	-	-	5,115,801	-	5,115,801
Other liabilities	-	-	1,295,848	-	1,295,848
Subordinated term debts	-	-	25,901,110	-	25,901,110
Total financial liabilities	665,890	-	779,252,184	-	779,918,074

24 CASH AND CASH EQUIVALENTS

Accounting Policy

Cash and cash equivalents include cash in hand and balances with banks. These are subject to an insignificant risk of changes in fair value and are used by the Group in the management of its short term commitments. These are brought to financial statements at the face values or gross values. Cash and cash equivalents are carried at amortised cost in the statement of financial position.

As at 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Local currency in hand	19,724,781	15,856,178	19,790,818	15,910,825
Foreign currency in hand	1,087,729	786,709	1,087,729	786,709
Balances with banks	927,290	868,559	1,046,351	1,971,169
	21,739,800	17,511,446	21,924,898	18,668,703

All cash and cash equivalent balances held by the group entities were available for use by the Group.

25 PLACEMENTS WITH BANKS

Placements with banks include money at call and short notice that are subject to an insignificant risk of changes in the fair value, and are used by the Group and the Bank in the management of its short term commitments. These are brought to financial statements at the face values or gross values.

As at 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Placements - within Sri Lanka	3,182,377	-	9,670,125	1,445,396
Placements - outside Sri Lanka	-	753,050	-	753,050
	3,182,377	753,050	9,670,125	2,198,446

26 BALANCES WITH CENTRAL BANK OF SRI LANKA

Balances with Central Bank of Sri Lanka represent the cash balance that is required to be maintained as per the provisions of Section 93 of the Monetary Law Act. The minimum cash reserve requirement on rupee deposit liabilities was 7.5% as at 31st December 2017 (2016 : 7.5%).

There is no reserve requirement for deposit liabilities of the Foreign Currency Banking Unit (FCBU) and foreign currency deposit liabilities in the Domestic Banking Unit (DBU).

As at 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Statutory balance with Central Bank of Sri Lanka	38,610,940	33,777,614	38,610,940	33,777,614
	38,610,940	33,777,614	38,610,940	33,777,614

27 REVERSE REPURCHASE AGREEMENTS

Accounting Policy

Securities purchased under agreements to resell at a specified future date are not recognised in the statement of financial position. The consideration paid, including accrued interest, is recorded in the statement of financial position, within "reverse repurchase agreements", reflecting the transaction's economic substance as a loan by the Group. The difference between the purchase and resale prices is recorded in net interest income and is accrued over the life of the agreement using the Effective Interest Rate (EIR).

As at 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Securities purchased under reverse repurchase agreements				
With banks	-	4,119,909	-	4,146,527
With customers	-	183,551	772,002	1,610,267
	-	4,303,460	772,002	5,756,794

Notes to the Financial Statements

28 DERIVATIVE FINANCIAL INSTRUMENTS

Accounting Policy

Derivatives are financial instruments that derive their value in response to changes in interest rates, financial instrument prices, commodity prices, foreign exchange rates, credit risk and indices. Derivatives are categorised as trading unless they are designated as hedging instruments. The Bank uses derivatives such as forward foreign exchange contracts and currency swaps. Bank has not designated any derivatives as hedging instruments and has not followed hedge accounting as at the reporting date. All derivatives are initially recognised and subsequently measured at fair value, with all revaluation gains or losses recognised in the statement of profit or loss under "Net gain / [loss] from trading" (Note 10). Derivatives are recorded at fair value and carried as assets when their fair value is positive and as liabilities when their fair value is negative. Fair value is determined using the forward market rates ruling on the reporting date.

The table below shows the fair values of derivative financial instruments, recorded as assets or liabilities.

As at 31st December	Bank/Group			
	2017		2016	
	Assets Rs 000	Liabilities Rs 000	Assets Rs 000	Liabilities Rs 000
Currency swaps				
Sales	13,454	1,682	3,389	14,548
Purchases	307,799	1,237,309	252,513	571,681
Forward foreign exchange contracts				
Sales	273,613	29,771	20,090	75,248
Purchases	20,491	37,138	13,997	4,413
	615,357	1,305,900	289,989	665,890

29 FINANCIAL INVESTMENTS - FAIR VALUE THROUGH PROFIT OR LOSS

Accounting Policy

A financial asset is classified as fair value through profit or loss if it is held for trading or is designated at fair value through profit or loss.

Financial assets are classified as held for trading if they are acquired principally for the purpose of selling or repurchasing in the near term or holds as a part of a portfolio that is managed together for short term profit or position taking.

Financial assets held for trading are recorded in the statement of financial position at fair value. Changes in fair value are recognised in "net gain / [loss] from trading" (Note 10). Interest income is recorded in "Interest income" and dividend income is recorded in "net gain / [loss] from trading" (Note 10) according to the terms of the contract, or when the right to receive the payment has been established.

The Group evaluates its financial assets held for trading, other than derivatives, to determine whether the intention to sell them in the near term is still appropriate. When the Group is unable to trade these financial assets due to inactive markets and management's intention to sell them in the foreseeable future significantly changes, the Group may elect to reclassify these financial assets.

Financial assets held for trading include instruments such as government securities, equity instruments etc. that have been acquired principally for the purpose of selling or repurchasing in the near term.

As at 31st December	2017 Fair Value Rs 000	2016 Fair Value Rs 000
Quoted shares - Bank [Note 29 (a)]	120,486	544,915
Total financial investments - fair value through profit or loss - Bank	120,486	544,915
Quoted shares - Subsidiaries [Note 29 (b)]	118,043	145,179
Government of Sri Lanka treasury bonds - Subsidiaries [Note 29 (c)]	15,768	14,583
Quoted units in unit trusts - Subsidiaries [Note 29 (d)]	12,241	10,296
Unquoted units in unit trusts - Subsidiaries [Note 29 (e)]	-	1,036
Total financial investments - fair value through profit or loss - Subsidiaries	146,052	171,094
Total financial investments - fair value through profit or loss - Group	266,538	716,009

29 FINANCIAL INVESTMENTS - FAIR VALUE THROUGH PROFIT OR LOSS [Contd.]

29 (a) Quoted Shares Held by the Bank

As at 31st December	2017				2016			
	No of Ordinary Shares	Cost of Investment Rs 000	% of Total Cost	Fair Value Rs 000	No of Ordinary Shares	Cost of Investment Rs 000	% of Total Cost	Fair Value Rs 000
Banks, Finance and Insurance								
Ceylinco Insurance PLC	34,000	23,035	12.49	28,053	34,000	23,035	3.79	24,820
Commercial Bank of Ceylon PLC	-	-	-	-	195,779	30,793	5.06	28,388
National Development Bank PLC	39,535	10,264	5.56	5,393	250,000	65,925	10.84	39,000
Peoples Insurance PLC	-	-	-	-	363,600	5,454	0.9	6,908
Peoples Leasing and Finance PLC	-	-	-	-	1,000,000	21,000	3.45	17,200
Sampath Bank PLC	-	-	-	-	242,389	59,750	9.83	63,118
Sector Total		33,299		33,446		205,957		179,434
Beverage, Food and Tobacco								
Cargills [Ceylon] PLC	-	-	-	-	73,982	12,207	2.01	14,382
Sector Total		-		-		12,207		14,382
Chemicals and Pharmaceuticals								
Chemical Industries (Colombo) PLC	556,396	47,850	25.94	34,497	556,396	47,850	7.87	50,855
Sector Total		47,850		34,497		47,850		50,855
Construction and Engineering								
Access Engineering PLC	175	6	-	4	14,275	472	0.08	354
Sector Total		6		4		472		354
Diversified Holdings								
Aitken Spence PLC	278,515	30,625	16.60	15,207	360,030	39,588	6.51	23,402
CT Holdings PLC	-	-	-	-	25,000	4,013	0.66	3,130
Expolanka Holdings PLC	-	-	-	-	1,687,000	11,941	1.96	10,628
John Keells Holdings PLC	-	-	-	-	220,606	42,749	7.03	31,988
Melstacorp Ltd	-	-	-	-	900,076	53,352	8.78	53,375
Softlogic Holdings PLC	544,065	8,275	4.49	6,801	544,065	8,275	1.36	7,073
Sunshine Holdings PLC	-	-	-	-	669,661	31,809	5.23	31,206
Sector Total		38,900		22,008		191,727		160,802
Footwear and Textiles								
Hayleys Fabrics PLC	-	-	-	-	82,657	1,496	0.25	1,240
Sector Total		-		-		1,496		1,240
Hotels and Travels								
Aitken Spence Hotel Holdings PLC	575,301	45,998	24.93	16,971	575,301	45,998	7.57	24,795
Asian Hotels & Properties PLC	207,476	14,918	8.09	10,955	207,476	14,917	2.45	11,826
Sector Total		60,916		27,926		60,915		36,621
Manufacturing								
Alumex PLC	-	-	-	-	740,000	13,095	2.15	14,948
Tokyo Cement Company (Lanka) PLC - Non-voting	-	-	-	-	200,000	6,755	1.11	10,300
Tokyo Cement Company (Lanka) PLC - Voting	-	-	-	-	435,000	15,789	2.6	25,752
Sector Total		-		-		35,639		51,000
Motors								
United Motors Lanka PLC	33,385	3,522	1.91	2,605	33,385	3,522	0.58	2,871
Sector Total		3,522		2,605		3,522		2,871
Telecommunication								
Dialog Axiata PLC	-	-	-	-	4,510	48,195	7.93	47,356
Sector Total		-		-		48,195		47,356
Total		184,493	100	120,486		607,980	100	544,915
Unrealised loss from marked to market valuation		[64,007]				[63,065]		
Total quoted shares - Bank		120,486		120,486		544,915		544,915

Notes to the Financial Statements

29 FINANCIAL INVESTMENTS - FAIR VALUE THROUGH PROFIT OR LOSS [Contd.]

29 (b) Quoted shares Held by Subsidiaries

As at 31st December	2017				2016			
	No of Ordinary Shares	Cost of Investment Rs 000	% of Total Cost	Fair Value Rs 000	No of Ordinary Shares	Cost of Investment Rs 000	% of Total Cost	Fair Value Rs 000
Banks, Finance and Insurance								
National Development Bank PLC	11,729	1,600	1.69	1,600	11,299	1,600	1.69	1,763
Sampath Bank PLC	59,087	11,925	12.57	18,654	82,657	17,088	18.01	21,524
Nations Trust Bank PLC	87,261	6,083	6.41	6,806	97,674	6,768	7.13	7,902
Peoples Leasing & Finance PLC	721,543	12,988	13.69	12,266	721,543	12,988	13.69	12,411
Seylan Bank PLC - [Non-Voting]	316,216	11,243	11.85	17,708	315,283	11,633	12.26	18,602
Sector Total		43,839		57,034		50,077		62,202
Chemicals and Pharmaceuticals								
CIC Holdings PLC	61,920	4,363	4.60	3,839	163,085	12,817	13.51	14,906
Sector Total		4,363		3,839		12,817		14,906
Diversified Holdings								
John Keells Holdings PLC	38,274	5,622	5.92	5,684	48,274	7,865	8.29	7,000
Richard Peiris and Company PLC	312,851	4,351	4.58	4,067	722,851	10,342	10.90	5,783
Vallibel One PLC	305,925	5,521	5.82	5,415	375,000	6,764	7.13	6,975
Melstacorp Limited	195,000	11,559	12.18	11,603	240,000	14,226	14.99	14,232
Sector Total		27,053		26,769		39,197		33,990
Manufacturing								
Royal Ceramic Lanka PLC	28,000	4,317	4.55	3,205	51,550	7,901	8.33	5,954
Dipped Products PLC	-	-	-	-	5,798	545	0.57	503
ACL Cables PLC	126,400	3,053	3.22	5,359	186,800	7,570	7.98	11,301
Tokyo Cement Company (Lanka) PLC	330,869	12,278	12.94	21,837	275,724	12,278	12.94	16,323
Sector Total		19,648		30,402		28,294		34,081
Total		94,903	-	118,043		130,385	-	145,179
Unrealised gain								
from marked to market valuation		23,140				14,794		
Total quoted shares - Subsidiaries		118,043		118,043		145,179		145,179

29 FINANCIAL INVESTMENTS - FAIR VALUE THROUGH PROFIT OR LOSS [Contd.]

29 [c] Government of Sri Lanka Treasury Bonds Held by Subsidiaries

As at 31st December		2017		2016	
Year of Maturity		Cost of Investment Rs 000	Fair Value Rs 000	Cost of Investment Rs 000	Fair Value Rs 000
2021		16,370	15,768	16,370	14,583
Unrealised loss from marked to market valuation		[602]	-	[1,787]	-
Total Government of Sri Lanka treasury bonds - Subsidiaries		15,768	15,768	14,583	14,583

29 [d] Quoted Units in Unit Trusts Held by Subsidiaries

As at 31st December		2017		2016		
	No of Units	Cost of Investment Rs 000	Fair Value Rs 000	No of Units	Cost of Investment Rs 000	Fair Value Rs 000
Namal Acuity Value Fund	114,400	7,203	12,241	114,400	7,203	10,296
Unrealised gain from marked to market valuation		5,038	-	3,093	-	-
Total quoted units - Subsidiaries		12,241	12,241	10,296	10,296	10,296

29 [e] Unquoted Units in Unit Trusts Held by Subsidiaries

As at 31st December		2017		2016		
	No of Units	Cost of Investment Rs 000	Fair Value Rs 000	No of Units	Cost of Investment Rs 000	Fair Value Rs 000
Comtrust ADL Mudarbah Fund	-	-	-	96,781	1,000	1,036
Total	-	-	-	-	1,000	1,036
Unrealised gain from marked to market valuation	-	-	-	-	36	-
Total unquoted units in unit trusts - Subsidiaries		-	-		1,036	1,036

Notes to the Financial Statements

30 NON CURRENT ASSETS HELD FOR SALE

Accounting Policy

Non-current assets that are expected to be recovered primarily through sale rather than through continuing use are classified as “held-for-sale”. These are assets which are available for immediate sale in their present condition, subject to only the terms that are usual and customary for sale of such assets. Their sale is highly probable and the management has committed to the sale and the sale is expected to be completed within one year from the date of classification.

Non-current assets held for sale are presented separately on the statement of financial position at the lower of its carrying amount and fair value less costs to sell. Thereafter, the Group assesses at each reporting date or more frequently, if events or changes in circumstances indicate that the investment is impaired. The Group recognises an impairment loss for any initial or subsequent write down of the assets to fair value less cost to sell while a gain for any subsequent increase in fair value less cost to sell of an asset is recognised, only to the extent of the cumulative impairment losses that have been recognised previously. Impairment losses on initial classification as held for sale and subsequent gains and losses on re-measurement are recognised in the statement of profit or loss.

Assets classified as non-current assets held for sale are neither amortised nor depreciated.

In the statement of profit or loss, income and expenses from discontinued operations (if any) are reported separately from income and expenses from continued operations, down to the level of profit after taxes, even when the Group retains a non-controlling interest in the subsidiary after the sale. The resulting profit or loss (after taxes) is reported separately in the statement of profit or loss.

As at 31st December	Bank/Group	
	2017 Rs 000	2016 Rs 000
Balance as at 1st January	-	20,151
Disposed during the year	-	(20,151)
Balance as at 31st December	-	-

31 LOANS AND RECEIVABLES TO CUSTOMERS

Accounting Policy

Loans and receivables include non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than:

- Those that the Group intends to sell immediately or in the near term and those that the Group, upon initial recognition, designates as at fair value through profit or loss
- Those that the Group, upon initial recognition, designates as available-for-sale
- Those for which the Group may not recover substantially all of its initial investment, other than due to credit deterioration

After initial measurement, loans and receivables are subsequently measured at amortised cost using the Effective Interest Rate (EIR), less allowance for impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees and costs that are an integral part of the EIR. The amortisation is included in ‘interest income’ in the statement of profit or loss. The losses arising from impairment are recognised in ‘impairment charge for loans and other losses’ in the statement of profit or loss.

Write-off of loans and receivables

Loans (and the related impairment allowance accounts) are normally written off, either partially or in full, when there is no realistic prospect of recovery and all possible steps have been exhausted in recovering dues. Where loans are secured, this is generally after receipt of any proceeds from the realisation of security. If a write-off is later recovered, the recovery is credited to “other operating income”.

Collateral Valuation

The Group seeks to use collateral, where possible, to mitigate its risks on financial assets. The collateral comes in various forms such as cash, gold, securities, letters of credit, guarantees, real estate, receivables, inventories, other non-financial assets and credit enhancements such as netting arrangements. The fair value of collateral is generally assessed, at a minimum, at inception and based on the Bank’s approved valuation policy.

To the extent possible, the Group uses active market data for valuing financial assets, held as collateral. Other financial assets which do not have a readily determinable market value are valued using models. Non-financial collateral, such as real estate, is valued based on data provided by third parties such as independent professional valuers.

31 LOANS AND RECEIVABLES TO CUSTOMERS (Contd.)

Accounting Policy

Collaterals repossessed

The Bank / Group's policy is to sell the repossessed assets at the earliest possible opportunity. Such collaterals repossessed are held on a memorandum basis without de-recognising the underlying receivable.

Rescheduled Loans

Loans where original terms have been modified including those subject to forbearance strategies are considered as rescheduled loans. This may involve extending the payment arrangements and the agreement of new loan conditions. If the renegotiations are on terms that are not consistent with those readily available in the market, this provides objective evidence of impairment. Once the terms have been renegotiated, any impairment is measured using the EIR as calculated before the modification of terms and the loan/advance is no longer considered past due. Management continually reviews renegotiated loans and advances to ensure that all criteria are met and the future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the original EIR of the loan.

As at 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Gross loans and receivables [Note 31 (a)]	649,547,067	595,513,919	666,768,376	608,965,683
Less: Individual impairment [Note 31 (b) i]	5,390,947	3,366,278	5,390,947	3,366,278
Collective impairment [Note 31 (b) ii]	5,054,059	7,734,914	5,764,491	8,131,945
Net loans and receivables	639,102,061	584,412,727	655,612,938	597,467,460

31 (a) Analysis of Loans and Advances

31 (a) i By Product

As at 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Overdrafts	111,332,217	91,093,180	111,190,557	91,085,039
Bills of exchange	3,171,579	2,913,620	3,171,579	2,913,620
Commercial papers	154,365	153,972	154,365	153,972
Short term loans	50,852,930	60,562,111	51,015,215	60,682,052
Credit cards	7,072,669	6,061,567	7,072,669	6,061,567
Pawning advances	15,529,655	14,010,152	15,529,655	14,010,152
Trust receipts	32,738,671	24,885,713	32,738,671	24,885,713
Packing credit loans	13,972,361	10,893,772	13,972,361	10,893,772
Staff loans	12,038,721	11,430,637	12,716,383	11,975,374
Term loans	324,665,313	296,741,917	337,379,808	308,370,722
Lease and hire purchase receivable [Note 31 (c)]	42,982,671	42,621,900	46,791,198	43,788,322
Housing loans	34,466,310	33,966,019	34,466,310	33,966,019
Lease backed securities	569,605	179,359	569,605	179,359
Total gross loans and receivables [Note 31]	649,547,067	595,513,919	666,768,376	608,965,683

31 (a) ii By Currency

As at 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Sri Lankan Rupees	572,606,594	527,288,700	589,827,903	540,740,464
United States Dollars	74,984,565	66,722,374	74,984,565	66,722,374
Great Britain Pounds	528,595	388,411	528,595	388,411
Euros	1,339,934	1,018,384	1,339,934	1,018,384
Other currencies	87,379	96,050	87,379	96,050
Total gross loans and receivables [Note 31]	649,547,067	595,513,919	666,768,376	608,965,683

31 LOANS AND RECEIVABLES TO CUSTOMERS [Contd.]

31 [b] Allowance for Impairment Losses

Accounting Policy

The Group considers objective evidence of impairment for loans and advances to customers and held to maturity investments at both specific asset and collective level. All individually significant loans and advances to customers and held to maturity investments are first assessed for specific impairment. All individually significant loans and advances to customers and held to maturity investments found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Assets that are individually assessed for impairment and for which an impairment loss is recognised are not included in a collective assessment of impairment. Loans and advances to customers and held to maturity investments that are not individually significant are collectively assessed for impairment by grouping together loans and advances to customers and held to maturity investments with similar risk characteristics.

If there is an objective evidence that an impairment loss has been incurred, impairment losses on assets carried at amortised cost are measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at original effective interest rate of the asset. If the loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate. If the Group has reclassified trading assets to loans and receivables, the discount rate for measuring any impairment loss is the new effective interest rate which is determined at the date of reclassification. The impairment allowances on individually significant accounts are reviewed more regularly when circumstances require. This normally encompasses re-assessment of the enforceability of any collateral held and the timing and amount of actual and anticipated receipts. Individually assessed impairment allowances are only released when there is a reasonable and objective evidence of a reduction in the established loss estimate. Interest on impaired assets continues to be recognised through the unwinding of the discount.

The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from the foreclosure less costs of obtaining and selling the collateral, whether or not foreclosure is probable. The methodology and the assumptions used for estimating future cash flows are reviewed regularly to reduce any difference between loss estimates and actual loss experience.

The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the statement of profit or loss. Interest income continues to be accrued on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows, for the purpose of measuring the impairment loss and recorded as part of 'interest income'.

For the purpose of collective evaluation of impairment, financial assets are grouped on a basis, which takes into consideration credit risk characteristics such as asset type, industry, past due status and other relevant factors.

Future cash flows on a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the Group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions on which, the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently.

Estimates of changes in future cash flows reflect and are directionally consistent with, changes in related observable data from year to year (such as changes in unemployment rates, property prices, commodity prices, payment status, or other factors that are indicative of incurred losses in the Group and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between estimated loss and actual loss experience.

Details of impairment losses on financial assets carried at amortised cost are given in Note 14 to the financial statements.

Bank ceases the recognition of interest income on assets which are collectively impaired, when it is probable that the economic benefit associated will not continue to flow to the Bank.

Reversal of Impairment

If the amount of an impairment loss decreases in a subsequent period, and the decrease can be related objectively to an event occurring after the impairment was recognised, the excess is written back to the statement of profit or loss by reducing the financial asset impairment allowance account accordingly.

31 LOANS AND RECEIVABLES TO CUSTOMERS (Contd.)

31 (b) i Movement in Individual Impairment Allowance for Loans and Advances

As at 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Balance as at 1st January	3,366,278	3,345,714	3,366,278	3,345,714
Net impairment charge for the year	4,680,044	225,581	4,680,044	225,581
Write-offs during the year	(2,373,179)	(230,219)	(2,373,179)	(230,219)
Interest accrued on impaired loans and receivables	(282,196)	25,202	(282,196)	25,202
Balance as at 31st December	5,390,947	3,366,278	5,390,947	3,366,278

31 (b) ii Movement in Collective Impairment Allowance for Loans and Advances

As at 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Balance as at 1st January	7,734,914	7,838,125	8,131,945	7,996,134
Net impairment charge for the year	(1,470,163)	12,333	(1,047,317)	278,959
Write-offs during the year	(1,210,692)	(115,544)	(1,320,137)	(143,148)
Balance as at 31st December	5,054,059	7,734,914	5,764,491	8,131,945

31 (b) iii Product wise Movement in Allowance for Impairment Losses - Bank

As at 31st December	2017			Total Rs 000	2016 Total Rs 000
	Lease and Hire Purchases Rs 000	Loans and Receivables Rs 000	Pawning Rs 000		
Balance as at 1st January	1,003,996	10,053,840	43,356	11,101,192	11,183,839
Net impairment charge for the year	(408,956)	3,650,394	(31,557)	3,209,881	237,914
Write-offs during the year	(313,245)	(3,270,626)	-	(3,583,871)	(345,763)
Interest accrued on impaired loans and receivables	-	(282,196)	-	(282,196)	25,202
Balance as at 31st December	281,795	10,151,412	11,799	10,445,006	11,101,192

31 (b) iv Product wise Movement in Allowance for Impairment Losses - Group

As at 31st December	2017			Total Rs 000	2016 Total Rs 000
	Lease and Hire Purchases Rs 000	Loans and Receivables Rs 000	Pawning Rs 000		
Balance as at 1st January	1,003,996	10,450,871	43,356	11,498,223	11,341,848
Net impairment charge for the year	(366,927)	4,031,211	(31,557)	3,632,727	504,539
Write-offs during the year	(313,245)	(3,380,071)	-	(3,693,316)	(373,366)
Interest accrued on impaired loans and receivables	-	(282,196)	-	(282,196)	25,202
Balance as at 31st December	323,824	10,819,815	11,799	11,155,438	11,498,223

Notes to the Financial Statements

31 LOANS AND RECEIVABLES TO CUSTOMERS (Contd.)

31 [c] Lease and Hire Purchase Receivables

Accounting Policy

Assets leased to customers which transfer substantially all the risks and rewards associated with ownership other than legal title, are classified as finance leases. Amounts receivable under finance leases are classified as lease and hire purchase receivables and presented within loans and receivables to customers in the statement of financial position after deduction of unearned lease income and the impairment for rentals doubtful of recovery. Lease receivables are collectively assessed for impairment in accordance with "allowance for impairment losses" policy as given in Note 31 [b] to the financial statements.

As at 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Total lease and hire purchase rentals receivable	51,845,102	50,841,718	57,242,525	52,537,430
Unearned lease income	[8,862,431]	[8,219,818]	[10,451,327]	[8,749,108]
Gross lease and hire purchase receivable	42,982,671	42,621,900	46,791,198	43,788,322
Impairment allowance for lease and hire purchase receivable - ISL	[20,979]	-	[20,979]	-
Impairment allowance for lease and hire purchase receivable - Collective	[260,817]	[1,003,996]	[302,846]	[1,003,996]
Net lease and hire purchase receivable	42,700,875	41,617,904	46,467,373	42,784,326
Net lease and hire purchase receivables within one year [Note 31 [c] [i]]	16,079,225	14,540,693	17,024,939	14,820,410
Net lease and hire purchase receivables from one to five years [Note 31 [c] [ii]]	26,541,791	26,934,823	29,359,113	27,815,881
Net lease and hire purchase receivables after five years [Note 31 [c] [iii]]	79,859	142,388	83,321	148,035
	42,700,875	41,617,904	46,467,373	42,784,326

31 [c] i Net Lease and Hire Purchase Receivables within one year

As at 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Total lease and hire purchase rentals receivable within one year from the reporting date	20,603,880	18,901,797	22,235,958	19,385,149
Unearned lease and hire purchase income	[4,426,156]	[4,010,322]	[5,088,254]	[4,213,942]
Impairment allowance for lease and hire purchase receivables	[98,499]	[350,782]	[122,765]	[350,797]
	16,079,225	14,540,693	17,024,939	14,820,410

31 [c] ii Net Lease and Hire Purchase Receivables from one to five years

As at 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Total lease and hire purchase rentals receivables from one to five years from the reporting date	31,154,423	31,782,286	34,916,033	32,965,906
Unearned lease and hire purchase income	[4,429,822]	[4,197,684]	[5,356,348]	[4,500,261]
Impairment allowance for lease and hire purchase receivables	[182,810]	[649,779]	[200,572]	[649,764]
	26,541,791	26,934,823	29,359,113	27,815,881

31 [c] iii Net Lease and Hire Purchase Receivables after five years

As at 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Total lease and hire purchase rentals receivable after five years from the reporting date	86,800	157,635	90,533	163,577
Unearned lease and hire purchase income	[6,453]	[11,812]	[6,724]	[12,107]
Impairment allowance for lease and hire purchase receivables	[488]	[3,435]	[488]	[3,435]
	79,859	142,388	83,321	148,035

32 FINANCIAL INVESTMENTS - LOANS AND RECEIVABLES

Accounting Policy

Financial investments - loans and receivables are initially recognised and subsequently measured based on the accounting policy described in Note 31 to the financial statements. These assets are tested for impairment in accordance with the criteria given in Note 31 (b) to the financial statements.

As at 31st December	2017 Rs 000	2016 Rs 000
Sri Lanka development bonds - Bank [Note 32 (a)]	100,214,581	76,443,803
Sri Lanka sovereign bonds - Bank [Note 32 (b)]	8,629,476	8,342,404
Foreign government bonds - Bank [Note 32 (c)]	-	-
Quoted debentures - Bank [Note 32 (d)]	13,354,991	14,474,491
Total financial investments - loans and receivables - Bank	122,199,048	99,260,698
Quoted debentures - Subsidiaries [Note 32 (e)]	2,525,510	2,802,531
Other loans and receivables held by subsidiaries [Note 32 (f)]	307,113	-
Total financial investments - loans and receivables - Subsidiaries	2,832,623	2,802,531
Total financial investments - loans and receivables - Group	125,031,671	102,063,229

32 (a) Sri Lanka Development Bonds Held by the Bank

As at 31st December Year of Maturity	2017 Rs 000	2016 Rs 000
2017	-	40,095,572
2018	13,987,225	13,653,532
2020	53,324,591	22,694,699
2021	17,320,171	-
2022	15,582,594	-
Total Sri Lanka development bonds - Bank	100,214,581	76,443,803

32 (b) Sri Lanka Sovereign Bonds Held by the Bank

As at 31st December Year of Maturity	2017 Rs 000	2016 Rs 000
2019	5,226,414	5,065,452
2021	3,403,062	3,276,952
Total Sri Lanka sovereign bonds - Bank	8,629,476	8,342,404

32 (c) Foreign Government Bonds Held by the Bank

As at 31st December Year of Maturity	2017 Rs 000	2016 Rs 000
2042	57,839	49,980
Allowance for impairment*	(57,839)	(49,980)
Total foreign government bonds - Bank	-	-

*These bonds were issued by the Government of Greece.

Notes to the Financial Statements

32 FINANCIAL INVESTMENTS - LOANS AND RECEIVABLES (Contd.)

32 [d] Quoted Debentures Held by the Bank

As at 31st December	2017		2016	
	No of Debentures	Carrying Value Rs 000	No of Debentures	Carrying Value Rs 000
Abans PLC [9% debentures redeemable on 26th December 2019]	5,000,000	500,616	5,000,000	500,738
Access Engineering PLC [10.25% debentures redeemable on 18th November 2020]	15,000,000	1,518,534	15,000,000	1,518,534
Alliance Finance Company PLC [9.35% debentures redeemable on 29th December 2019]	3,000,000	328,050	3,000,000	328,203
Central Finance PLC [9.52% debentures redeemable on 01st June 2020]	2,000,000	219,040	2,000,000	219,040
Commercial Leasing & Finance PLC [9.75% debentures redeemable on 21st July 2020]	10,000,000	1,097,500	10,000,000	1,097,500
DFCC Bank PLC [9.10% debentures redeemable on 10th June 2020]	5,000,000	525,430	5,000,000	525,361
Hayleys PLC [7.85% debentures redeemed on 06th March 2020]	5,000,000	512,582	5,000,000	512,582
Lanka Orix Leasing Company PLC [9% debentures redeemable on 24th November 2019]	5,000,000	511,342	5,000,000	511,311
LB Finance PLC [14% debentures redeemable on 28th November 2018]	4,408,600	446,102	4,408,600	446,088
Lion Brewery Ceylon PLC [7.85% debentures redeemable on 08th December 2019]	4,686,000	477,872	4,686,000	477,872
Mercantile Investment and Finance PLC [10.5% debentures redeemable on 05th November 2018]	418,650	42,539	418,650	42,539
MTD Walkers PLC [10.25% debentures redeemable on 30th September 2020]	5,000,000	512,918	5,000,000	512,918
Nawaloka Hospitals PLC [14.15% debentures redeemable on 30th September 2018]	1,860,000	192,634	1,860,000	192,616
Orient Finance PLC [9.05% debentures redeemable on 26th December 2019]	2,500,000	261,405	2,500,000	261,374
People's Leasing and Finance PLC [9.625% debentures redeemable on 23rd September 2018]	201,200	22,057	201,200	22,057
People's Leasing and Finance PLC [9.95% debentures redeemable on 12th November 2020]	20,000,000	2,026,715	20,000,000	2,026,715
People's Leasing and Finance PLC [12.60% debentures redeemable on 16th November 2021]	20,000,000	2,031,759	20,000,000	2,031,759
Richard Pieris and Company PLC [10.75% debentures redeemed on 16th May 2017]	-	-	1,409,900	144,810
Sanasa Development Bank PLC [9.6% debentures redeemable on 31st December 2018]	9,433,700	989,024	9,433,700	988,899
Senkadagala Finance PLC [13.75% debentures redeemable on 09th November 2020]	3,000,000	305,877	3,000,000	305,877
Singer (Sri Lanka) PLC [8.25% debentures redeemed on 22nd December 2017]	-	-	9,000,000	974,250
Singer (Sri Lanka) PLC [8.60% debentures redeemable on 07th June 2018]	5,000,000	521,677	5,000,000	522,130
Siyapatha Finance PLC [13.5% debentures redeemable on 20th September 2021]	3,000,000	311,318	3,000,000	311,318
Quoted debentures - Bank				
		13,354,991		14,474,491

32 FINANCIAL INVESTMENTS - LOANS AND RECEIVABLES (Contd.)

32 [e] Quoted Debentures Held by Subsidiaries

As at 31st December	2017		2016	
	No of Debentures	Carrying Value Rs 000	No of Debentures	Carrying Value Rs 000
Abans PLC				
[14.25% debentures redeemed on 20th December 2017]	-	-	750,000	80,373
[14.50% debentures redeemable on 20th December 2018]	550,000	59,020	550,000	59,009
[09.00% debentures redeemable on 26th December 2019]	450,000	47,097	450,000	47,092
		106,117		186,474
Access Engineering PLC				
[10.25% debentures redeemable on 18th November 2020]	1,250,000	126,509	1,250,000	126,509
		126,509		126,509
Bank of Ceylon				
[16.00% debentures redeemed on 29th November 2017]	-	-	1,100,000	111,783
[08.00% debentures redeemable on 21st September 2019]	140,000	14,310	140,000	14,310
[13.25% debentures redeemable on 29th December 2021]	400,000	45,329	400,000	40,029
		59,639		166,122
Central Finance Company PLC				
[14.75% debentures redeemable on 17th June 2018]	29,000	30,078	29,000	30,078
		30,078		30,078
Commercial Bank of Ceylon PLC				
[12.00% debentures redeemable on 27th October 2021]	289,500	29,559	289,500	29,559
[12.25% debentures redeemable on 27th October 2026]	135,700	13,861	135,700	13,861
		43,420		43,420
Commercial Credit and Finance PLC				
[10.50% debentures redeemable on 01st June 2020]	1,100,000	112,911	1,100,000	112,903
[10.40% debentures redeemable on 10th December 2020]	1,000,000	100,598	1,000,000	100,598
		213,509		213,501
Commercial Leasing and Finance PLC				
[9.75% debentures redeemable on 21st July 2020]	600,000	65,850	600,000	65,850
		65,850		65,850
DFCC Bank PLC				
[08.50% debentures redeemed on 18th August 2017]	-	-	427,700	44,115
[09.40% debentures redeemable on 10th June 2020]	405,500	42,680	405,500	42,680
[12.15% debentures redeemable on 09th June 2021]	100,000	10,173	100,000	10,173
[12.75% debentures redeemable on 09th June 2023]	700,000	71,272	700,000	71,272
		124,125		168,240
HDFC Bank				
[15.50% debentures redeemable on 23rd October 2018]	600,000	69,300	600,000	69,300
		69,300		69,300
Hemas Holdings PLC				
[11.00% debentures redeemable on 29th April 2019]	557,900	57,433	557,900	57,504
		57,433		57,504
Lanka Orix Leasing Company PLC				
[09.00% debentures redeemable on 24th November 2019]	550,000	56,248	550,000	56,244
		56,248		56,244

Notes to the Financial Statements

32 FINANCIAL INVESTMENTS - LOANS AND RECEIVABLES [Contd.]

As at 31st December	2017		2016	
	No of Debentures	Carrying Value Rs 000	No of Debentures	Carrying Value Rs 000
LB Finance PLC				
[15.00% debentures redeemable on 28th November 2018]	851,000	97,865	851,000	97,865
[12.75% debentures redeemable on 11th December 2022]	170,000	17,119	-	-
		114,984		97,865
Lion Brewery (Ceylon) PLC				
[13.75% debentures redeemed on 17th June 2017]	-	-	28,800	29,806
[14.00% debentures redeemable on 17th June 2018]	38,400	39,770	38,400	39,766
		39,770		69,572
Mercantile Investment & Finance PLC				
[10.50% debentures redeemable on 05th November 2018]	114,100	11,597	114,100	11,597
		11,597		11,597
Merchant Bank of Sri Lanka & Finance PLC				
[14.25% debentures redeemed on 16th December 2017]	-	-	400,000	47,123
[17.50% debentures redeemable on 27th March 2018]	112,600	13,230	112,600	13,231
[16.70% debentures redeemable on 27th March 2018]	112,600	11,730	112,600	11,729
[08.75% debentures redeemable on 12th November 2019]	150,000	15,660	150,000	15,658
[09.00% debentures redeemable on 12th November 2019]	410,000	44,690	410,000	44,690
		85,310		132,431
National Development Bank PLC				
[13.00% debentures redeemable on 19th December 2018]	125,900	13,415	125,900	13,413
[13.40% debentures redeemable on 19th December 2018]	84,200	9,496	84,200	9,496
[09.40% debentures redeemable on 24th June 2020]	217,200	16,727	217,200	15,845
[09.40% debentures redeemable on 24th June 2020]	253,000	28,099	253,000	27,678
[13.90% debentures redeemable on 19th December 2023]	187,500	21,409	187,500	21,409
		89,146		87,841
Nations Trust Bank PLC				
[13.00% debentures redeemable on 19th December 2018]	331,500	35,322	331,500	35,317
[12.65% debentures redeemable on 08th December 2021]	357,400	36,396	357,400	36,396
[12.80% debentures redeemable on 08th December 2021]	210,200	21,411	210,200	21,411
		93,129		93,124
Nawaloka Hospitals PLC				
[14.15% debentures redeemable on 30th September 2018]	550,000	56,940	550,000	56,940
		56,940		56,940
Pan Asia Banking Corporation PLC				
[09.52% debentures redeemable on 30th October 2019]	207,340	21,069	207,340	21,069
[09.75% debentures redeemable on 30th October 2019]	458,517	46,611	458,517	46,611
		67,680		67,680
People's Leasing & Finance PLC				
[08.75% debentures redeemed on 23rd September 2017]	-	-	16,300	1,773
[17.00% debentures redeemable on 26th March 2018]	300,000	35,100	300,000	35,100
[09.625% debentures redeemable on 23rd September 2018]	59,400	6,512	59,400	6,512
[09.60% debentures redeemable on 12th November 2019]	450,000	45,580	450,000	45,580
[09.95% debentures redeemable on 12th November 2020]	290,000	29,387	290,000	29,387

32 FINANCIAL INVESTMENTS - LOANS AND RECEIVABLES (Contd.)

As at 31st December	2017		2016	
	No of Debentures	Carrying Value Rs 000	No of Debentures	Carrying Value Rs 000
[12.60% Debentures redeemable on 16th November 2021]	500,000	50,777	500,000	50,777
		167,356		169,129
Richard Pieris and Company PLC				
[10.75% debentures redeemed on 16th May 2017]	-	-	31,100	3,194
[11.00% debentures redeemable on 16th May 2018]	124,000	12,744	124,000	12,744
[11.25% debentures redeemable on 16th May 2019]	408,800	42,258	408,800	42,403
		55,002		58,341
Sampath Bank PLC				
[16.50% debentures redeemed on 11th October 2017]	-	-	283,100	33,451
[13.40% debentures redeemable on 04th December 2018]	363,400	41,210	363,400	41,210
[08.25% debentures redeemable on 14th December 2019]	750,000	81,188	750,000	81,187
[09.90% debentures redeemable on 18th November 2020]	1,642,200	166,180	1,642,200	166,180
[12.50% debentures redeemable on 21st December 2022]	800,000	80,274	-	-
		368,852		322,028
Seylan Bank PLC				
[15.50% debentures redeemable on 21st February 2018]	900,000	101,963	900,000	101,963
[08.60% debentures redeemable on 22nd February 2019]	300,000	32,644	300,000	32,644
[08.75% debentures redeemable on 23rd December 2020]	500,000	54,483	500,000	54,483
[13.00% debentures redeemable on 15th July 2021]	215,800	22,879	215,800	22,879
		211,969		211,969
Singer [Sri Lanka] PLC				
[08.25% debentures redeemable on 23rd December 2019]	-	-	270,000	29,227
		-		29,227
Siyapatha Finance PLC				
[08.90% debentures redeemable on 24th December 2019]	1,000,000	108,900	1,000,000	108,900
[13.50% debentures redeemable on 20th September 2021]	244,200	25,341	244,200	25,341
		134,241		134,241
Softlogic Finance PLC				
[10.00% debentures redeemable on 29th August 2019]	303,900	31,156	303,900	31,154
		31,156		31,154
Vallibel Finance PLC				
[10.25% debentures redeemable on 31st March 2020]	450,000	46,150	450,000	46,150
		46,150		46,150
Total quoted debentures - Subsidiaries		2,525,510		2,802,531

32 [f] Other Loans and Receivables Held by Subsidiaries

As at 31st December	2017 Carrying Value Rs 000	2016 Carrying Value Rs 000
Other loans and receivables	773,091	-
Allowance for impairment	(465,978)	-
	307,113	-

Notes to the Financial Statements

33 FINANCIAL INVESTMENTS - AVAILABLE-FOR-SALE

Accounting Policy

Available-for-sale investments include equity and debt securities. Equity investments classified as 'available-for-sale' are those which are neither classified as 'held for trading' nor 'designated at fair value through profit or loss'. Debt securities in this category are intended to be held for an indefinite period of time and may be sold in response to needs for liquidity or in response to changes in the market conditions. The Group has not designated any loans or receivables as available-for-sale.

After initial measurement, available-for-sale financial investments are subsequently measured at fair value.

Unrealised gains and losses are recognised directly in equity via 'other comprehensive income' in the 'available-for-sale reserve'. When the investment is disposed of, the cumulative gain or loss previously recognised in equity is recognised in the statement of profit or loss in 'net gain / (loss) from financial investments'. Where the Bank holds more than one investment in the same security, they are deemed to be disposed of on a first in first out basis. Interest earned whilst holding available-for-sale financial investments is reported as 'interest income' using the Effective Interest Rate [EIR]. Dividends earned whilst holding available-for-sale financial investments are recognised in the statement of profit or loss as 'net gain / (loss) from financial investments' when the right to receive the dividend has been established. The losses arising from impairment of such investments are recognised in the statement of profit or loss in 'impairment losses on financial investments' and are removed from the 'available-for-sale reserve'.

Impairment of Financial Investments - Available-for-sale

For available-for-sale financial investments, the Group assesses at each reporting date whether there is an objective evidence that an investment is impaired.

In case of debt instruments classified as available-for-sale, the Group assesses individually whether there is an objective evidence of impairment based on the same criteria as used for the measurement of impairment relating to loans and advances as mentioned in Note 31 (b) to the financial statements. However, the amount recorded for impairment is the cumulative loss measured as the difference between the amortised cost and the current fair value, less any impairment loss on that investment previously recognised in the statement of profit or loss. Future interest income is based on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. The interest income is recorded as part of interest income as 'financial investments - available-for-sale'. If, in a subsequent period, the fair value of a debt instrument increases and the increase could be objectively related to a credit event occurring after the impairment loss was recognised in the statement of profit or loss, the impairment loss is reversed through the statement of profit or loss.

In the case of equity investments classified as available-for-sale, objective evidence would also include a 'significant' or 'prolonged' decline in the fair value of the investment below its cost. Where there is an evidence of impairment, the cumulative loss measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognised in the statement of profit or loss is removed from equity and recognised in the statement of profit or loss. Impairment losses on equity investments are not reversed through the statement of profit or loss, increases in the fair value after impairment are recognised in 'other comprehensive income'.

The Group writes off certain financial investments - available-for-sale when they are determined to be uncollectible.

As at 31st December	Fair Value 2017 Rs 000	Fair Value 2016 Rs 000
Quoted shares - Bank [Note 33 (a)]	4,912,813	4,936,537
Quoted units - Bank [Note 33 (b)]	276,300	270,000
Unquoted shares - Bank [Note 33 (c)]	25,405	25,405
Unquoted units - Bank [Note 33 (d)]	418,646	388,108
Government of Sri Lanka treasury bonds - Bank [Note 33 (e)]	55,254,516	52,716,014
Government of Sri Lanka treasury bills - Bank [Note 33 (f)]	34,516,140	31,579,089
Total financial investments - available-for-sale - Bank	95,403,820	89,915,153
Government of Sri Lanka treasury bonds - Subsidiaries [Note 33 (g)]	6,031,354	4,424,246
Government of Sri Lanka treasury bills - Subsidiaries [Note 33 (h)]	217,307	1,302,373
Quoted shares - Subsidiaries [Note 33 (i)]	78,074	142,940
Unquoted shares - Subsidiaries [Note 33 (j)]	12,430	12,430
Total financial investments - available-for-sale - Subsidiaries	6,339,165	5,881,989
Total financial investments - available-for-sale - Group	101,742,985	95,797,142

33 FINANCIAL INVESTMENTS - AVAILABLE-FOR-SALE [Contd.]

33 [a] Quoted Shares Held by the Bank

As at 31st December	2017			2016		
	No of Ordinary Shares	Cost of Investment Rs 000	Fair Value Rs 000	No of Ordinary Shares	Cost of Investment Rs 000	Fair Value Rs 000
DFCC Bank	32,396,140	942,651	4,017,122	32,396,140	942,651	3,968,527
National Development Bank PLC	4,445,523	719,458	606,814	4,282,200	694,519	668,023
Nations Trust Bank PLC*	3,703,543	383,236	288,877	3,703,543	383,236	299,987
Allowance for impairment		(94,359)	-		-	-
Total quoted shares - Bank		1,950,986	4,912,813		2,020,406	4,936,537

* Directors carried out an impairment assessment of the quoted share investments held by the Bank as at 31st December 2017 and recognised an impairment provision of Rs 94.4 Mn in respect of the investment in Nations Trust Bank PLC (2016 - Nil).

33 [b] Quoted Units in Unit Trusts Held by the Bank

As at 31st December	2017			2016		
	No of Ordinary Shares	Cost of Investment Rs 000	Fair Value Rs 000	No of Ordinary Shares	Cost of Investment Rs 000	Fair Value Rs 000
Namal Acuity Value Fund	3,000,000	150,000	276,300	3,000,000	150,000	270,000
Total quoted units in unit trusts - Bank		150,000	276,300		150,000	270,000

33 [c] Unquoted Shares Held by the Bank

As at 31st December	2017			2016		
	No of Ordinary Shares	Cost of Investment Rs 000	Fair Value Rs 000	No of Ordinary Shares	Cost of Investment Rs 000	Fair Value Rs 000
Credit Information Bureau of Sri Lanka	5,300	530	530	5,300	530	530
Fitch Ratings Lanka Ltd	62,500	625	625	62,500	625	625
Lanka Clear [Pvt] Ltd	2,200,000	22,000	22,000	2,200,000	22,000	22,000
Lanka Financial Services Bureau	225,000	2,250	2,250	225,000	2,250	2,250
Lanka Rating Agency Limited	1,379,182	16,550	-	1,379,182	16,550	-
Magpek Exports Ltd	359,000	14,360	-	359,000	14,360	-
S.W.I.F.T	27	5,196	-	27	5,196	-
Allowance for impairment*		(36,106)	-		(36,106)	-
		25,405	25,405		25,405	25,405

Directors carried out an impairment assessment of the unquoted share investments held by the Bank as at 31st December 2017 and concluded that no further impairment provision is required (2016 - Nil).

* Allowance for impairment of Rs 36.106 Mn has been recognised in respect of the investments in Lanka Rating Agency Limited, Magpek Exports Ltd and S.W.I.F.T. Shares of Magpek Exports Ltd are delisted.

33 [d] Unquoted Units in Unit Trusts Held by the Bank

As at 31st December	2017			2016		
	No of Ordinary Shares	Cost of Investment Rs 000	Fair Value Rs 000	No of Ordinary Shares	Cost of Investment Rs 000	Fair Value Rs 000
JB Vantage Value Equity Fund	19,455,327	400,000	418,646	19,455,327	400,000	388,108
Total unquoted units in unit trusts - Bank		400,000	418,646		400,000	388,108

Notes to the Financial Statements

33 FINANCIAL INVESTMENTS - AVAILABLE-FOR-SALE (Contd.)

33 [e] Government of Sri Lanka Treasury Bonds Held by the Bank

As at 31st December Year of Maturity	2017		2016	
	Cost of Investment	Fair Value	Cost of Investment	Fair Value
	Rs 000	Rs 000	Rs 000	Rs 000
2017	-	-	3,943,085	3,921,073
2018	10,261,100	10,338,205	10,116,422	9,919,799
2019	16,421,382	16,516,167	15,262,833	14,576,141
2020	3,025,896	3,026,043	3,016,946	2,826,830
2021	17,346,557	18,277,287	15,352,639	15,058,456
2022	277,520	274,881	280,525	252,941
2023	3,272,324	3,256,113	3,300,389	2,950,166
2024	2,557,000	2,788,274	2,542,757	2,523,189
2025	760,594	777,546	758,881	687,419
Total government of Sri Lanka treasury bonds - Bank	53,922,373	55,254,516	54,574,477	52,716,014

33 [f] Government of Sri Lanka Treasury Bills Held by the Bank

As at 31st December Year of Maturity	2017		2016	
	Cost of Investment	Fair Value	Cost of Investment	Fair Value
	Rs 000	Rs 000	Rs 000	Rs 000
2017	-	-	31,526,681	31,579,089
2018	34,376,903	34,516,140	-	-
Total government of Sri Lanka treasury bills - Bank	34,376,903	34,516,140	31,526,681	31,579,089

33 [g] Government of Sri Lanka Treasury Bonds Held by Subsidiaries

As at 31st December Year of Maturity	2017		2016	
	Cost of Investment	Fair Value	Cost of Investment	Fair Value
	Rs 000	Rs 000	Rs 000	Rs 000
2017	-	-	360,253	361,528
2018	116,389	125,139	116,389	120,773
2019	550,781	572,601	500,308	490,960
2020	373,472	404,315	421,653	425,409
2021	1,246,550	1,315,968	1,089,786	1,071,214
2022	646,373	672,016	646,373	611,859
2023	303,373	326,326	253,697	247,214
2024	715,959	805,374	474,639	478,171
2026	469,765	528,254	166,179	166,336
2028	48,755	56,005	48,755	48,558
2029	135,191	119,712	135,191	103,644
2030	717,582	741,448	-	-
2044	143,435	131,221	143,435	101,954
2045	222,302	232,975	222,302	196,626
Total government of Sri Lanka treasury bonds - Subsidiaries	5,689,927	6,031,354	4,578,960	4,424,246

33 FINANCIAL INVESTMENTS - AVAILABLE-FOR-SALE [Contd.]

33 [h] Government of Sri Lanka Treasury Bills Held by Subsidiaries

As at 31st December	2017		2016	
	Cost of Investment Rs 000	Fair Value Rs 000	Cost of Investment Rs 000	Fair Value Rs 000
2017	-	-	1,224,348	1,302,373
2018	213,602	217,307	-	-
Total government of Sri Lanka treasury bills - Subsidiaries	213,602	217,307	1,224,348	1,302,373

33 [i] Quoted Shares Held by Subsidiaries

As at 31st December	2017			2016		
	No of Ordinary Shares	Cost of Investment Rs 000	Fair Value Rs 000	No of Ordinary Shares	Cost of Investment Rs 000	Fair Value Rs 000
Banks, Finance and Insurance						
Seylan Bank PLC - (Non Voting)	249,355	12,347	13,964	241,000	12,347	14,219
Sampath Bank PLC	37,831	6,834	11,943	109,749	24,877	28,579
Central Finance Company PLC	151,743	11,464	14,006	206,743	25,370	20,674
Sector Total		30,645	39,913		62,594	63,472
Diversified Holdings						
Melstacorp Limited	39,532	2,343	2,352	39,532	2,343	2,344
Sector Total		2,343	2,352		2,343	2,344
Manufacturing						
Tokyo Cement Company (Lanka) PLC	249,602	10,692	16,474	388,568	22,074	23,003
Royal Ceramic Lanka PLC	50,000	6,067	5,725	83,000	10,072	9,586
Textured Jersey Lanka PLC		-	-	453,681	10,817	19,418
Sector Total		16,759	22,199		42,963	52,007
Chemicals and Pharmaceuticals						
CIC Holdings PLC - (Non Voting)	-	-	-	141,915	9,698	9,650
Sector Total		-	-		9,698	9,650
Land and Property						
Overseas Reality (Ceylon) PLC	773,335	19,640	13,610	773,335	19,640	15,467
Sector Total		19,640	13,610		19,640	15,467
Total quoted shares - Subsidiaries		69,387	78,074		137,238	142,940

Notes to the Financial Statements

33 FINANCIAL INVESTMENTS - AVAILABLE-FOR-SALE (Contd.)

33 (j) Unquoted Shares Held by Subsidiaries

As at 31st December	2017			2016		
	No of Ordinary Shares	Cost of Investment Rs 000	Fair Value Rs 000	No of Ordinary Shares	Cost of Investment Rs 000	Fair Value Rs 000
Credit Information Bureau of Sri Lanka	100	234	234	100	234	234
UB Finance	1,742,326	12,196	12,196	1,742,326	12,196	12,196
Standard Credit Lanka (Formerly Ceylinco Investment and Reality Ltd)	38,458,474	38,692	-	38,458,474	38,692	-
Allowance for impairment		(38,692)			(38,692)	
Total unquoted shares - Subsidiaries		12,430	12,430		12,430	12,430

33 (k) Assets Pledged as Security

The following amounts of financial investments - available-for-sale are pledged as security for re-purchase agreements entered into by the Bank/Group.

As at 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Treasury bills	5,367,011	9,384,179	5,367,011	9,384,179
Treasury bonds	331,010	4,926,410	331,010	4,926,410
	5,698,021	14,310,589	5,698,021	14,310,589

34 FINANCIAL INVESTMENTS - HELD-TO-MATURITY

Accounting Policy

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity that the Group has the positive intention and ability to hold till maturity and which are not designated as at fair value through profit or loss or as available-for-sale.

After initial measurement held-to-maturity investments are subsequently measured at amortised cost using the Effective Interest Rate (EIR) less impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the EIR. The amortisation is included in 'interest income' in the statement of profit or loss. The losses arising from impairment of such investments are recognised in 'impairment charge for loans and other losses' in the statement of profit or loss.

A sale or a reclassification of more than an insignificant amount of held-to-maturity investments would result in the reclassification of all held-to-maturity investments as available-for-sale, and would prevent the Group from classifying investment securities as held-to-maturity for the current and the following two financial years. However, sales and reclassifications in any of the following circumstances would not trigger a reclassification:

- sales or reclassifications that are so close to maturity that changes in the market rate of interest would not have a significant effect on the financial asset's fair value
- sales or reclassifications after the Group has collected substantially all of the asset's original principal and
- sales or reclassifications attributable to non-recurring isolated events beyond the Group's control that could not have been reasonably anticipated.

As at 31st December	Group	
	2017 Rs 000	2016 Rs 000
Government of Sri Lanka treasury bills - Subsidiaries [Note 34 (a)]	1,385,143	291,056
Government of Sri Lanka treasury bonds - Subsidiaries [Note 34 (b)]	180,460	174,025
Total financial investments - Held-to-maturity - Group	1,565,603	465,081

34 [a] Government of Sri Lanka Treasury Bills Held by Subsidiaries

As at 31st December	Group	
	2017 Rs 000	2016 Rs 000
2017	-	291,056
2018	1,385,143	-
Total government of Sri Lanka treasury bills - Subsidiaries	1,385,143	291,056

34 [b] Government of Sri Lanka Treasury Bonds Held by Subsidiaries

As at 31st December	Group	
	2017 Rs 000	2016 Rs 000
2018	180,460	174,025
Total government of Sri Lanka treasury bonds - Subsidiaries	180,460	174,025

Notes to the Financial Statements

35 INVESTMENT IN JOINT VENTURE

Accounting Policy

Joint venture is a type of joint arrangement, whereby the parties that have joint control of the arrangement have rights to the net assets of the joint venture. Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require unanimous consent of the parties sharing control.

The Group determines joint control, by taking into account similar considerations necessary, to determine control over subsidiaries.

The Group's investment in a joint venture is accounted for, using the equity method and is recognised initially at cost. The carrying amount of the investment is adjusted to recognise changes in the Group's share of net assets of the joint venture since the acquisition date. Goodwill relating to a joint venture is included in the carrying amount of the investment and is not tested for impairment individually.

The statement of profit or loss reflects Group's share of the results of operations of the joint venture. Any change in 'other comprehensive income' of the joint venture is presented as part of the Group's 'other comprehensive income'. In addition, when there has been a change recognised directly in the equity of the joint venture, the Group recognises its share of any such change, when applicable, in the statement of changes in equity. Unrealised gains and losses resulting from transactions between the Group and the joint venture are eliminated to the extent of the interest in the joint venture.

The aggregate of the Group's share of profit or loss of a joint venture is shown on the face of the statement of profit or loss outside operating profit.

The financial statements of the joint venture are prepared for the same reporting period as the Group. When necessary, adjustments are made to bring the accounting policies in line with those of the Group.

At each reporting date, the Group determines whether there is an objective evidence that the investment in joint venture is impaired. If there is such evidence, the Group calculates the amount of impairment as the difference between the recoverable amount of the joint venture and its carrying value, and then recognises the loss in impairment for loans and other losses in the statement of profit or loss.

The Group discontinues the use of equity method from the date that it ceases to have joint control over the joint venture and accounts for the investment in accordance with the Group's accounting policy for financial instruments. Any difference between the carrying amount of the joint venture upon loss of joint control and the fair value of the retained investment and proceeds from disposal, is recognised in statement of profit or loss.

35 (a) Investment in Joint Venture - Bank

As at 31st December			2017		2016		
Principal Activity	Principal Place of Business	% Holding	Cost of Investment Rs 000	Directors' Valuation Rs 000	% Holding	Cost of Investment Rs 000	Directors' Valuation Rs 000
Acuity Partners [Pvt] Ltd	Investment banking	50	755,000	755,000	50	755,000	755,000
Total			755,000			755,000	

Bank received Rs 33.22 Mn of dividend income from Acuity Partners [Pvt] Ltd for the year ended 31st December 2017 (2016 : Rs 30.2 Mn).

35 (b) Investment in Joint Venture - Group

As at 31st December	2017 Rs 000	2016 Rs 000
Investment in joint venture (at cost) as at 1st January	755,000	655,000
Group's share of joint venture profit as at 1st January	807,944	710,508
Group's share of net assets of joint venture company as at 1st January	1,562,944	1,365,508
Share of unrealised profit on disposal of investments	(112,138)	(112,138)
Group's share of net assets of joint venture company as at 1st January (net of unrealised profit)	1,450,806	1,253,370
Additional investment during the year	-	100,000
Share of profit of joint venture (net of income tax) (Note 19)	175,616	148,790
Share of other comprehensive income of equity accounted joint venture	(21,417)	(21,154)
Deemed disposal gain through joint venture	117,478	-
Dividend received during the year	(33,220)	(30,200)
Group's share of net assets of joint venture company as at 31st December	1,689,263	1,450,806

35 INVESTMENT IN JOINT VENTURE (Contd.)

35 [c] Summarised Financial Position of Joint Venture - Acuity Partners (Pvt) Ltd and its Subsidiaries

As at 31st December	2017 Rs 000	2016 Rs 000
Current assets	5,241,692	4,085,610
Non-current assets	9,299,826	7,488,395
Current liabilities	(7,688,029)	(6,098,930)
Non-current liabilities	(1,025,766)	(1,063,494)
Non controlling interest	(2,224,925)	(1,285,694)
Equity	3,602,798	3,125,887
Group carrying amount of the investment	1,801,401	1,562,944
Share of unrealised profit on disposal of investments	(112,138)	(112,138)
Group carrying amount of the investment - Net	1,689,263	1,450,806

35 [d] Summarised statement of profit or loss of Joint Venture - Acuity Partners (Pvt) Ltd and its Subsidiaries

As at 31st December	2017 Rs 000	2016 Rs 000
Revenue	1,269,861	1,146,854
Administration and distribution expenses	(402,619)	(381,461)
Finance cost	(248,500)	(166,309)
Profit from operations	618,742	599,084
VAT and NBT on financial services	(3,622)	(2,699)
Profit before tax	615,120	596,385
Income tax expenses	(50,240)	(61,499)
Profit for the year	564,880	534,886
Other comprehensive income	(69,456)	(48,143)
Total comprehensive income for the year	495,424	486,743
Non controlling interest	(187,025)	(230,252)
Total comprehensive income for the year	308,399	256,491
Group's share of comprehensive income for the year	154,200	127,636

36 INVESTMENT IN SUBSIDIARIES

Accounting Policy

Subsidiaries are entities that are controlled by the Group. Control is achieved when the Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect the returns of those investees through its power over the investee. Specifically, the Group controls an investee if, and only if, the Group has:

- power over the investee
- exposure or rights to variable returns from its involvement with the investee
- the ability to use its power over the investee to affect its returns

Generally, there is a presumption that a majority of voting rights results in control. To support this presumption and when the Group has less than a majority of the voting or similar rights of an investee, the Group considers all relevant facts and circumstances in assessing whether it has power over an investee, including:

- the contractual arrangement with other vote holders of the investee
- rights arising from other contractual arrangements
- the Group's voting rights and potential voting rights

The Group reassesses whether or not it controls an investee, if facts and circumstances indicate that there are changes to one or more of the above.

The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences, until the date that control ceases. Where Subsidiaries have been sold or acquired during the year, assets, liabilities, income and expenses of the said subsidiary are included in the consolidated financial statements, from the date the Group gains control until the date the Group ceases to control the subsidiary.

Notes to the Financial Statements

36 INVESTMENT IN SUBSIDIARIES [Contd.]

Accounting Policy

When necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies in line with the Group's accounting policies. All intra-group assets and liabilities, equity, income, expenses and cash flows relating to transactions between members of Group are eliminated in full on consolidation.

Non-controlling interests represent the portion of profit or loss and net assets of the subsidiaries, not owned directly or indirectly by the Bank. The non-controlling interest is presented in the consolidated statement of financial position within equity, separately from the equity attributable to the equity holders of the Bank. Non-controlling interests in the profit or loss of the Group, is disclosed separately in the consolidated statement of profit or loss.

A change in the ownership interest of a subsidiary without a loss of control, is accounted for as an equity transaction. Upon the loss of control, the Group de-recognises the assets (including goodwill) and liabilities of the subsidiary, any non-controlling interests and the other components of equity related to the subsidiary. Any surplus or deficit arising on the loss of control, is recognised in the statement of changes in equity. If the Group retains any interest in the previous subsidiary, then such interest is measured at fair value at the date that control is lost. Subsequently, it is accounted for as an equity-accounted investee or in accordance with the Group's accounting policy for financial instruments depending on the level of influence retained.

There are no significant restrictions on the ability of the subsidiaries to transfer funds to the Bank in the form of cash dividends or repayment of loans and advances. All subsidiaries of the Bank as at the reporting date, have been incorporated in Sri Lanka.

36 [a] Investment in Subsidiary - Quoted

As at 31st December			2017			2016		
Principal Activity	Principal Place of Business	% Holding	Cost of Investment Rs 000	Directors' Valuation Rs 000	% Holding	Cost of Investment Rs 000	Directors' Valuation Rs 000	
HNB Assurance PLC [29,993,000 shares]	Insurance	Sri Lanka	60	384,285	2,174,493	60	384,285	1,778,585
Total quoted subsidiaries				384,285		384,285		

36 [b] Investment in Subsidiary - Unquoted

As at 31st December			2017			2016		
Principal Activity	Principal Place of Business	% Holding	Cost of Investment Rs 000	Directors' Valuation Rs 000	% Holding	Cost of Investment Rs 000	Directors' Valuation Rs 000	
Sithma Development [Pvt] Ltd [206,000,000 ordinary shares]	Property development	Sri Lanka	100	1,973,000	1,973,000	100	1,973,000	1,973,000
HNB Grameen Finance Ltd [724,904,118 ordinary shares]	Micro-finance	Sri Lanka	42.16	660,000	660,000	42.16	660,000	660,000
Total unquoted subsidiaries				2,633,000		2,633,000		
Total for the Bank [36 (a) and 36 (b)]				3,017,285		3,017,285		

HNB Grameen Finance Ltd

Bank holds a stake of 51% in the voting rights of Prime Grameen Micro Finance Ltd [subsequently rebranded as HNB Grameen Finance Ltd]. Accordingly, the said investment is accounted for as an investment in subsidiary. Since the Bank does not hold non-voting shares of HNB Grameen Finance Ltd, Bank's holding in the said company is 42.16%.

36 INVESTMENT IN SUBSIDIARIES (Contd.)

36 (c) Subsidiary Held through HNB Assurance PLC

As at 31st December			2017			2016		
Principal Activity	Principal Place of Business	% Holding	Cost of Investment Rs 000	Directors' Valuation Rs 000	% Holding	Cost of Investment Rs 000	Directors' Valuation Rs 000	
HNB General Insurance Limited (115,000,000 ordinary shares)	General Insurance Sri Lanka	100	1,150,000	1,150,000	100	1,150,000	1,150,000	
			1,150,000	1,150,000				
					1,150,000	1,150,000		

36 (d) Non-Controlling Interests (NCI) in Subsidiaries

Subsidiary	% of Ownership Interest held by NCI	Share of % of Voting Rights held by NCI	Total Comprehensive Income of NCI for the Year Ended 31st December		NCI as at 31st December		Dividends Paid to NCI	
			2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
			HNB Assurance PLC	40.00	40.00	309,523	237,260	1,295,931
HNB Grameen Finance Ltd	57.84	49.00	517,618	753,882	2,352,772	1,934,614	99,461	109,407
			827,141	991,142	3,648,703	3,021,023	199,461	149,407

36 (e) Summarised Financial Information of Subsidiaries

As at 31st December	HNB Assurance PLC		Sithma Development (Pvt) Ltd		HNB Grameen Finance Ltd	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Assets	18,648,935	14,528,854	10,142,140	10,203,235	25,486,912	18,614,934
Liabilities	14,852,436	11,831,797	1,626,680	625,296	21,212,569	15,292,385
Equity	3,796,499	2,697,057	8,515,460	9,577,939	4,274,343	3,322,549
For the year ended 31st December						
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Revenue	8,305,789	6,896,816	987,209	940,575	7,295,792	5,784,350
Profit after tax	909,752	647,413	527,872	555,720	1,084,647	1,280,661
Total comprehensive income	935,040	647,892	527,872	555,720	1,123,753	1,421,778
For the year ended 31st December						
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Cash flows from operating activities	1,509,809	1,292,190	639,616	717,134	3,176,020	(248,916)
Cash flows from investing activities	(1,385,046)	(953,592)	24,964	(84,534)	(3,862,606)	992,446
Cash flows from financing activities	(250,000)	(100,000)	(590,000)	(600,000)	(322,130)	(382,056)

37 INVESTMENT PROPERTIES

Accounting Policy**Basis of Recognition**

An investment property is recognised, if it is probable that future economic benefits that are associated with the investment property will flow to the Group and cost of the investment property can be reliably measured.

When a portion of the property is held to earn rentals or for capital appreciation and another portion is held for use in the production or supply of goods or services or for administrative purposes, the Group accounts for the portions separately if these portions could be sold separately (or leased out separately under a finance lease). If the portions could not be sold separately, the property is treated as investment property, only if an insignificant portion is held for use in the production or supply of goods or services or for administrative purposes.

Where the Group provides ancillary services to the occupants of a property it holds, the Group treats such a property as investment property if the services are insignificant to the arrangement as a whole.

Measurement

An investment property is measured initially at its cost. The cost of a purchased investment property comprises of its purchase price and any directly attributable expenditure. The cost of a self-constructed investment property, is its cost at the date when the construction or development is completed.

The Group applies the cost model for investment properties in accordance with Sri Lanka Accounting Standard - LKAS 40 on "Investment Property". Accordingly, land classified as investment properties are stated at cost less any accumulated impairment losses and buildings classified as investment properties are stated at cost, less any accumulated depreciation and any accumulated impairment loss.

The Group obtains the services of independent valuers who are not connected with the Bank, in order to determine the fair value of its investment properties annually, for disclosure purposes and such fair values have been disclosed as required by Sri Lanka Accounting Standard - LKAS 40 on "Investment Property".

Depreciation

Depreciation is provided on a straight line basis over the estimated life of the class of asset, from the date of purchase up to the date of disposal.

Class of Asset	% per annum
Hatton National Bank PLC	
Freehold buildings [Refer Note 37 (a)]	2.5
Sithma Development [Pvt] Ltd*	
Freehold buildings [Refer Note 37 (b)]	
HNB Tower	1
Others	2.5
Plant, machinery and equipment integral to freehold buildings referred to above	20

* Sithma Development [Pvt] Ltd

The HNB towers which is owned by Sithma Development [Pvt] Ltd ["Sithma"], is leased to occupants including the Bank. Until 2016, this building was classified as property, plant and equipment in the financial statements of Sithma, since the ancillary services provided by Sithma to the occupants of HNB towers, is a significant component of the arrangement as a whole. In 2016, there was a change in the arrangement whereby the ancillary services provided to the occupants became a less significant component of the arrangement as a whole. Accordingly, HNB towers is classified as an investment property in the financial statements of Sithma since 31st December 2016, in accordance with Sri Lanka accounting standard - LKAS 40 on 'Investment property'.

The said building is treated as property, plant and equipment in the consolidated statement of financial position, since a major portion of the building is used by the Bank.

37 INVESTMENT PROPERTIES [Contd.]

Accounting Policy

De-recognition

Investment properties are de-recognised when disposed of, or permanently withdrawn from the use since no future economic benefits are expected. Gains or losses arising from de-recognition of an investment property are measured as the difference between the net disposal proceeds and the carrying amount of the asset and are recognised in the statement of profit or loss.

Transfers are made to and from investment properties only when there is a change in use.

Investment Property Leased within the Group

Any property leased out to the parent or a subsidiary in full or where the parent or subsidiary occupies a significant portion of such a property it is considered as owner-occupied from the perspective of the Group and adjustments are made for consolidation purposes.

As at 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Cost				
Balance as at 1st January	458,229	435,442	1,156,300	1,140,184
Disposal during the year	-	-	-	(5,400)
Transferred to property, plant and equipment [Note 37 (b) iii]	(196,344)	-	-	-
Transferred from property, plant and equipment [Note 37 (b) ii]	83,400	-	75,259	-
Improvements during the year	2,399	22,787	39,942	21,516
Balance as at 31st December	347,684	458,229	1,271,501	1,156,300
Accumulated depreciation				
Balance as at 1st January	54,270	48,799	102,000	98,387
Disposal during the year	-	-	-	(1,200)
Transferred to property, plant and equipment [Note 37 (b) iii]	(35,666)	-	-	-
Charge for the year [Note 17]	1,616	5,471	22,937	4,813
Balance as at 31st December	20,220	54,270	124,937	102,000
Net book value as at 31st December	327,464	403,959	1,146,564	1,054,300

37 [a] Valuation of Investment Properties - Bank

	Building sq.ft	Extent Perches	Cost / Carrying Amount As at 31st December 2017			Fair Value As at 31st December 2017			Fair Value as at 31st December 2016
			Land [Cost] Rs 000	Building [Net Book Value] Rs 000	Total Rs 000	Land Rs 000	Building Rs 000	Total Rs 000	Total Rs 000
23 & 23 1/1, Independence Avenue, Colombo 7 [Note 37 (b) i]	62,518	105.10	37,081	45,614	82,695	-	-	816,525	739,000
479, T B Jayah Mawatha, Colombo 10 [Note 37 (b) ii]	Land	112.96	126,480	-	126,480	1,694,400	-	1,694,400	1,412,000
21, 21A, 23 & 25, Janadhipathi Mawatha, Colombo 1 [Note 37 (b) ii]	Land	26.62	34,889	-	34,889	532,400	-	532,400	465,850
451, Kandy Road, Kegalle [Note 37(b)ii]	Land	61.70	83,400	-	83,400	154,250	-	154,250	154,250
10, Sri Uttarananda Mawatha, Colombo 3 [Note 37 (b) iii]	-	-	-	-	-	-	-	-	921,733
			281,850	45,614	327,464			3,197,575	3,692,833

Notes to the Financial Statements

37 INVESTMENT PROPERTIES (Contd.)

37 (b) Valuation of Investment Properties - Group

	Building sq.ft	Extent Perches	Cost / Carrying Amount As at 31st December 2017			Fair Value As at 31st December 2017			Fair Value as at 31st December 2016
			Land [Cost] Rs 000	Building [Net Book Value] Rs 000	Total Rs 000	Land Rs 000	Building Rs 000	Total Rs 000	Total Rs 000
Through the Bank									
23 & 23 1/1, Independence Avenue, Colombo 7 [Note 37 (b) i]	62,518	105.10	37,081	45,614	82,695	-	-	816,525	739,000
Through the Subsidiary									
- Sithma Development [Pvt] Ltd									
21, 21A, 23 & 25, Janadhipathi Mawatha, Colombo 1 [Note 37 (b) ii]	41,688	-	-	80,260	80,260	-	338,500	338,500	308,900
451, Kandy Road, Kegalle [Note 37 (b) ii]	-	-	-	111,576	111,576	-	138,830	138,830	-
Through the Subsidiary									
- HNB Grameen Finance Ltd [Note 37 (b) iv]									
249, Stanley Thilekaratne Mawatha, Pagoda, Nugegoda	24,952	39.60	151,063	397,738	548,801	271,523	547,477	819,000	687,500
Vihara Road, Rankewatte, Matale	Land	15.00	9,000	-	9,000	9,750	-	9,750	9,000
44/1, Service Road, Puttalam	Land	25.60	12,800	-	12,800	16,000	-	16,000	15,400
465/1, Old Police Station Road, Kahathuduwa, Polgasowita	20,494	182.59	49,008	70,192	119,200	52,152	69,648	121,800	129,600
67/1, Mahinda Place, Kirulapone, Colombo 5	5,786	8.00	25,267	88,465	113,732	33,785	96,215	130,000	130,000
06, Abaya Place, 7th Lane, Anuradapura	Land	13.52	20,000	-	20,000	25,700	-	25,700	25,000
10/11, Galle Road, Moratuwa	Land	23.00	34,500	-	34,500	41,400	-	41,400	36,800
Adampodaivayal, Adampodaimalaikadu, Trincomalee	Land	724.00	14,000	-	14,000	16,500	-	16,500	16,300
		-	352,719	793,845	1,146,564	466,810	1,190,670	2,474,005	2,097,500

The Bank / Group carries investment properties at cost. Market valuations of the above investment properties were carried out as at 31st December 2017. Since the fair values of the investment properties were above the carrying value, the Board of Directors concluded that there was no impairment in investment properties.

37 (b) i Valued as a condominium property.

37 (b) ii Lands situated at No 479, T B Jayah Mw, Colombo 10 on which HNB Towers is built, and No 21, 21A, 23 and 25, Janadhipathi Mawatha, Colombo 01 are leased out to Sithma Development [Pvt] Ltd by the Bank and the Bank receives ground rent. Accordingly, these lands have been classified as investment properties in the statement of financial position of the Bank. Further, the land situated at No. 451, Kandy Road, Kegalle was also leased out to Sithma Development [Pvt] Ltd during the year, resulting in a transfer from property, plant and equipment to investment properties. However, according to Sri Lanka Accounting Standard - LKAS 40 on "Investment Property", the said lands are treated as property, plant and equipment in the consolidated statement of financial position, since these are leased out to a group entity.

37 (b) iii As at 31st December 2016, building situated at No 10, Sri Uttarananda Mw, Colombo 03 was classified as an investment property in the statement of financial position of the Bank since it was leased out to HNB Assurance PLC and Royal Ceramics Lanka PLC. However, during 2017 these tenants vacated the premises and the Bank commenced occupation of this building since July 2017. Accordingly, the said building was transferred to property, plant and equipment during the year.

37 INVESTMENT PROPERTIES (Contd.)

37 (b) iv These properties are held by the subsidiary of the Bank, HNB Grameen Finance Ltd. and valuations of the said properties were carried out by Messer's R.S.Wijesuriya, DIV, FIV (Sri Lanka) a professional independent valuer. All these properties other than the property situated in Trincomalee have been mortgaged to Seylan Bank PLC by HNB Grameen Finance Ltd for the financial facilities obtained by the company. The aggregate mortgage value amounts to Rs 665Mn.

37 (c) Valuation details of Investment Properties

In determining fair value, the current condition of the properties, future usability and associated development requirements have been considered. Further, the valuers have made reference to market evidence of transaction prices for similar properties with appropriate adjustments for size and locations.

37 (c) i Bank

Property	Name of professional Valuer	Method of valuation and significant unobservable inputs	Range of estimates for unobservable inputs
23 & 23 1/1, Independence Avenue, Colombo 07	Mr. J.M.J. Fernando	Income approach - Estimated rent per month - Years since purchase - Outgoing expenses as a percentage of gross annual rent	Rs 3,629,000 25 25%
479, T.B. Jayah Mawatha, Colombo 10	Mr. J.M.J. Fernando	Market comparable method - Rate per perch for land	Rs 15,000,000
21, 21A, 23 & 25, Janadhipathi Mawatha, Colombo 01	Mr. J.M.J. Fernando	Market comparable method - Rate per perch for land	Rs 17,500,000
451, Kandy Road, Kegalle	Mr. N.M. Jayathilake	- Rate per perch for land	Rs. 2,500,000

37 (c) ii Group

Property	Name of professional Valuer	Method of valuation and significant unobservable inputs	Range of estimates for unobservable inputs
Through the Bank 23 & 23 1/1, Independence Avenue, Colombo 07	Mr. J.M.J. Fernando	Income approach - Estimated rent per month - Years since purchase - Outgoing expenses as a percentage of gross annual rent	Rs 3,284,500 25 25%
Through the subsidiary - Sithma Development (Pvt) Ltd. 21, 21A, 23 & 25, Janadhipathi Mawatha, Colombo 01	Mr. J.M.J. Fernando	Depreciated replacement cost basis - Rate per Sq.ft for building	Rs 5,380
451, Kandy Road, Kegalle	Mr. N.M. Jayathilake	Depreciated replacement cost basis - Rate per Sq.ft for building	Rs 6,500 - Rs 8,500
Through the subsidiary - HNB Grameen Finance Ltd No.249, Stanley Thilekerathna Mawatha, Pagoda, Nugegoda	Mr. R.S. Wijesuriya	Income approach - Estimated rent per month - Discount Rate	Rs 2,496,787 20%
Vihara Road, Rakewatta, Matale	Mr. R.S. Wijesuriya	Market comparable method - Rate per perch for land	Rs 650,000
No.44/1, Service Road, Puttalam	Mr. R.S. Wijesuriya	Market comparable method - Rate per perch for land	Rs 625,000

Notes to the Financial Statements

37 INVESTMENT PROPERTIES [Contd.]

37 [c] Valuation details of Investment Properties [Contd.]

Property	Name of professional Valuer	Method of valuation and significant unobservable inputs	Range of estimates for unobservable inputs
No.465/1, Old Police Station Road, Kahathduwa, Polgasowita	Mr. R.S. Wijesuriya	Income approach - Estimated rent per month - Discount rate	Rs 452,540 20%
No. 67/1, Mahinda Place, Kirulapone, Colombo 05	Mr. R.S. Wijesuriya	Income approach - Estimated rent per month - Discount rate	Rs 450,000 20%
No. 06, Abaya Place, 7th Lane, Anuradapura	Mr. R.S. Wijesuriya	Market comparable method - Rate per perch for land	Rs 1,900,000
No. 10/11, Galle Road, Katubedda, Moratuwa	Mr. R.S. Wijesuriya	Market comparable method - Rate per perch for land	Rs 1,800,000
Adamodaivayal, Adamodaimlaikadu, Trincomalee	Mr. R.S. Wijesuriya	Market comparable method - Rate per perch for land	Rs 22,700

Unobservable inputs used in measuring fair value**- Depreciated replacement cost basis/Market comparable method**

Significant increase / [decrease] in estimated price per perch, price per sq.ft and depreciation rate would result in a significantly higher / [lower] fair value.

- Income approach

Significant increase / [decrease] in rent per sq.ft, outgoing expenses and number of years since purchase would result in a significantly higher / [lower] fair value.

38 PROPERTY, PLANT AND EQUIPMENT

Accounting Policy**Basis of Recognition**

Property, plant and equipment are recognised if it is probable that future economic benefits associated with the assets will flow to the Group and cost of the asset can be reliably measured.


Measurement

An item of property, plant and equipment that qualifies for recognition as an asset is initially measured at its cost. Cost includes expenditure that is directly attributable to the acquisition of the asset and cost incurred subsequently to add to, replace part of, or service it. The cost of self-constructed assets includes the cost of materials and direct labour, any other costs directly attributable to bringing the asset to a working condition for its intended use and the costs of dismantling and removing the items and restoring the site on which those are located. Purchased software that is integral to the functionality of the related equipment is capitalised as part of computer equipment.

When parts of an item of property or equipment have different useful lives, those are accounted for as separate items (major components) of property, plant and equipment.

Cost Model

The Group applies cost model to property, plant and equipment except for freehold land and buildings and records at cost of purchase or construction together with any incidental expenses thereon, less accumulated depreciation and any accumulated impairment losses.

Accounting Policy **Revaluation Model**

The Group applies the revaluation model to the entire class of freehold land and buildings. Such properties are carried at a revalued amount, being their fair value at the date of revaluation, less any subsequent accumulated depreciation and subsequent accumulated impairment loss. Freehold land and buildings of the Group are revalued at least once in every three years on a roll over basis, to ensure that the carrying amounts do not differ materially from the fair values at the reporting date. On revaluation of an asset, any increase in the carrying amount is recognised in other comprehensive income and accumulated in equity, under capital reserve, or used to reverse a previous revaluation decrease relating to the same asset, which was charged to the statement of profit or loss. In this circumstance, the increase is recognised as income to the extent of the previous write down. Any decrease in the carrying amount is recognised as an expense in the statement of profit or loss or debited in the other comprehensive income to the extent of any credit balance existing in the capital reserve in respect of that asset. The decrease recognised in other comprehensive income reduces the amount accumulated in equity under capital reserves. Any balance remaining in the revaluation reserve in respect of an asset, is transferred directly to retained earnings on retirement or disposal of the asset.

Reclassification as Investment Property

When the use of a property changes from owner-occupied to investment property, the property is re-measured to fair value and reclassified as an investment property. Any gain arising on re-measurement, is recognised in the statement of profit or loss to the extent that it reverses a previous impairment loss on the specific property, with any remaining gain recognised in other comprehensive income and presented in revaluation reserve in equity. Any loss is recognised immediately in the statement of profit or loss.

Subsequent Costs

The subsequent cost of replacing a component of an item of property, plant and equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within that part will flow to the Group and its cost can be reliably measured. The costs of day to day servicing of property, plant and equipment are charged to the statement of profit or loss as incurred. Costs incurred in using or redeploying an item, is not included under carrying amount of an item.

The HNB towers which is owned by Sithma Development (Pvt) Ltd ("Sithma"), is leased to occupants including the Bank. This building was classified as property, plant and equipment in the financial statements of Sithma, since the ancillary services provided by Sithma to the occupants of HNB towers, was a significant component of the arrangement as a whole: In 2016, there was a change in the arrangements whereby the ancillary services provided to the occupants became a less significant component of the arrangements as a whole. Accordingly, HNB towers is classified as an investment property in the financial statements of Sithma since 31st December 2016, in accordance with Sri Lanka accounting standard - LKAS 40 on 'Investment property'.

The said building is treated as property, plant and equipment in the consolidated statement of financial position, since a major portion of the building is used by the Bank.

De-recognition

The carrying amount of an item of property, plant and equipment is de-recognised on disposal or when no future economic benefits are expected from its use or disposal. The gain or loss arising from the de-recognition of an item of property, plant and equipment which is calculated as the difference between the carrying amount and the net disposal proceeds, is included in the statement of profit or loss when the item is de-recognised.

When replacement costs are recognised in the carrying amount of an item of property, plant and equipment, the remaining carrying amount of the replaced part is de-recognised. Major inspection costs are capitalised. At each such capitalisation, the remaining carrying amount of the previous cost of inspections is de-recognised.

Depreciation

The Group provides depreciation from the date the assets are available for use up to the date of disposal. The assets are depreciated at the following rates on a straight line basis over the periods appropriate to the estimated useful lives, based on the pattern in which the asset's future economic benefits are expected to be consumed by the Group other than disclosed separately. Depreciation of an asset ceases at the earlier of the date that the asset is classified as held for sale or the date that the asset is de-recognised. Depreciation does not cease when the assets become idle or is retired from active use unless the asset is fully depreciated.

Notes to the Financial Statements

38 PROPERTY, PLANT AND EQUIPMENT (Contd.)

Accounting Policy 

Hatton National Bank PLC and its Subsidiary Companies (except for Sithma Development (Pvt) Ltd)

Class of Asset	% per annum
Freehold buildings	2.5
Motor vehicles	25
Computer equipment	16.67
Office equipment	20
Furniture and fittings	10
Fixtures	10
Improvements to leasehold buildings	over the lease period

Depreciation is not provided for freehold land.

Sithma Development (Pvt) Ltd

Class of Asset	% per annum
Generators, generator panels and associated power cables	2
Chillers, cooling towers and associated equipment	4
Lifts and escalator	4
Building management systems	4
Plant and machinery	20
Equipment	20
Furniture and fittings	10

Depreciation methods, useful lives and residual values are reassessed at each reporting date and adjusted if appropriate.

Capital Work-in-Progress

These are expenses of a capital nature directly incurred in the construction of buildings and major plant and machinery awaiting capitalisation. Capital work-in-progress would be transferred to the relevant asset when it is available for use i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Capital work-in-progress is stated at cost less any accumulated impairment losses.

Borrowing Costs

Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset have been capitalised as part of the cost of the asset in accordance with Sri Lanka Accounting Standard - LKAS 23 on "Borrowing Costs". A qualifying asset is an asset which takes substantial period of time to get ready for its intended use or sale. Capitalisation of borrowing costs ceases when substantially all the activities necessary to prepare the qualifying asset for its intended use are completed. Other borrowing costs are recognised in the statement of profit or loss in the period in which they incur.

38 PROPERTY, PLANT AND EQUIPMENT (Contd.)

Bank	Leasehold	Freehold	Computer	Equipment	Motor	Capital	2017	2016
	Buildings	Land and	Equipment	Furniture	Vehicles	Work-in	Total	Total
	Note 38 [c]	Note 38 [a]		and		Progress		
	Rs 000	Rs 000	Rs 000	Fixtures	Rs 000	Rs 000	Rs 000	Rs 000
Cost / valuation as at 1st January	1,568,732	11,413,989	3,537,874	4,587,633	127,917	318,696	21,554,841	18,592,029
Accumulated depreciation								
adjustment on revaluation	-	(148,110)	-	-	-	-	(148,110)	(103,189)
Write-off during the year	-	-	-	-	-	-	-	(9,594)
Revaluation surplus	-	2,981,379	-	-	-	-	2,981,379	2,273,397
Net impairment (charge) / reversal (Note 14)	-	64,178	-	-	-	-	64,178	41,219
Additions and improvements	78,164	114,372	543,435	767,282	-	209,436	1,712,689	975,198
Disposals during the year	(14,709)	-	(88,129)	(174,168)	-	-	(277,006)	(214,219)
Transferred from investment properties	-	196,344	-	-	-	-	196,344	-
Transferred to investment properties	-	(83,400)	-	-	-	-	(83,400)	-
Transferred from capital work-in-progress	45,846	299,650	-	155,248	-	(500,744)	-	-
Cost / valuation as at 31st December	1,678,033	14,838,402	3,993,180	5,335,995	127,917	27,388	26,000,915	21,554,841
Accumulated depreciation as at 1st January	1,327,736	-	2,653,872	3,505,956	122,275	-	7,609,839	7,118,460
Accumulated depreciation adjustment on revaluation	-	(148,110)	-	-	-	-	(148,110)	(103,189)
Accumulated depreciation on written-off assets	-	-	-	-	-	-	-	(5,124)
Charge for the year (Note 17)	95,002	112,444	276,824	381,268	5,640	-	871,178	810,321
Transferred from investment properties	-	35,666	-	-	-	-	35,666	-
Disposals during the year	(12,206)	-	(88,063)	(172,709)	-	-	(272,978)	(210,629)
Accumulated depreciation as at 31st December	1,410,532	-	2,842,633	3,714,515	127,915	-	8,095,595	7,609,839
Net book value as at 31st December 2017	267,501	14,838,402	1,150,547	1,621,480	2	27,388	17,905,320	-
Net book value as at 31st December 2016	240,996	11,413,989	884,002	1,081,677	5,642	318,696	-	13,945,002

The Bank / Group revalued its freehold land and buildings during 2017. The details relating to the revaluation of freehold land and buildings are given in Note 38 [b].

Based on the assessment of potential impairment carried out internally by the Board of Directors as at 31st December 2017, Rs 64.18 Mn (2016 - Rs 41.22 Mn) was recognised as a reversal of impairment losses on property, plant and equipment which is accounted for in Note 14 "impairment charge / (reversal) for loans and other losses".

Notes to the Financial Statements

38 PROPERTY, PLANT AND EQUIPMENT (Contd.)

Group	Leasehold Buildings	Freehold Land and Buildings	Computer Equipment	Equipment Furniture and Fixtures	Motor Vehicles	Capital Work-in- Progress	2017 Total	2016 Total
	Note 38 (c) Rs 000	Note 38 (a) Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Cost / valuation as at 1st January	1,568,732	25,545,920	3,882,274	7,183,469	158,273	394,278	38,732,946	32,049,638
Accumulated depreciation								
adjustment on revaluation	-	(192,106)	-	-	-	-	(192,106)	(137,629)
Revaluation surplus	-	4,146,677	-	-	-	-	4,146,677	5,748,917
Write-off during the year	-	-	-	-	-	-	-	(9,594)
Net Impairment (charge) / reversal (Note 14)	-	64,178	-	-	-	-	64,178	41,219
Additions and improvements	78,164	114,372	608,109	878,884		209,436	1,888,965	1,285,867
Disposals during the year	(14,709)	-	(119,375)	(205,778)	(10,437)	-	(350,299)	(248,523)
Transferred from intangible assets	-	-	-	-	-	-	-	3,051
Transferred to investment properties (Note 37 (b) ii)	-	-	-	-	-	(75,259)	(75,259)	-
Transferred from capital work-in-progress	45,846	299,650	-	155,248	-	(500,744)	-	-
Cost / valuation as at 31st December	1,678,033	29,978,691	4,371,008	8,011,823	147,836	27,711	44,215,102	38,732,946
Accumulated depreciation as at 1st January	1,327,736	171,539	2,860,203	4,385,702	143,532	-	8,888,712	8,140,950
Accumulated depreciation adjustment on revaluation	-	(192,106)	-	-	-	-	(192,106)	(137,629)
Accumulated depreciation on written-off assets	-	-	-	-	-	-	-	(5,124)
Charge for the year (Note 17)	95,002	248,900	326,846	541,789	11,601	-	1,224,138	1,128,658
Transferred from intangible assets	-	-	-	-	-	-	-	610
Disposals during the year	(12,206)	-	(118,643)	(199,576)	(10,251)	-	(340,676)	(238,753)
Accumulated depreciation as at 31st December	1,410,532	228,333	3,068,406	4,727,915	144,882	-	9,580,068	8,888,712
Net book value as at 31st December 2017	267,501	29,750,358	1,302,602	3,283,908	2,954	27,711	34,635,034	-
Net book value as at 31st December 2016	240,996	25,374,381	1,022,071	2,797,767	14,741	394,278	-	29,844,234

38 PROPERTY, PLANT AND EQUIPMENT (Contd.)

38 (a) Information on Freehold Land and Buildings of the Bank - Extents and Locations

	Extent (perches)	Buildings Sq.ft.	Cost / Valuation of Land Rs 000	Cost / Valuation of Buildings Rs 000	Total Value Rs 000	Accumulated Depreciation Rs 000	As at 31st December 2017 Net Book Value Rs 000	As at 31st December 2016 Net Book Value Rs 000
Akkaraipattu Branch 14, Main Street, Akkaraipattu.	19.32	10,080	67,620	68,380	136,000	-	136,000	102,000
Ambalangoda Branch 94/1, New Galle Road, Ambalangoda.	29.90	14,469	97,000	21,500	118,500	-	118,500	108,000
Anuradhapura Branch 30, Maithripala Senanayake Mawatha, Anuradhapura.	58.99	9,510	106,500	31,500	138,000	-	138,000	138,000
Badulla Branch 15, 15 1/1, Udayaraja Mawatha, Badulla.	27.75	5,629	104,063	33,937	138,000	-	138,000	104,000
Bambalapitiya Branch 285, Galle Road, Colombo 04.	20.00	16,170	300,000	74,000	374,000	-	374,000	309,000
Boralesgamuwa Branch 24, Maharagama Road, Boralesgamuwa.	29.55	5,432	103,425	27,575	131,000	-	131,000	115,000
Borella Branch 53/1, D S Senanayake Mawatha, Colombo 08.	28.00	10,102	252,000	96,000	348,000	-	348,000	291,000
Centre of Aspirations 90, Vinayalankara Mawatha, Colombo 10.	249.00	10,250	2,602,050	57,950	2,660,000	-	2,660,000	2,185,581
Centralised Operations*** 10, Sri Uttarananda Mawatha, Colombo 3	40.00	57,197	700,000	346,000	1,046,000	-	1,046,000	-
City Office 16, Janadhipathi Mawatha, Colombo 1.	84.00	44,807	1,470,000	85,900	1,555,900	-	1,555,900	1,342,000
Chavakachcheri Branch 170, Kandy Road, Chavakachcheri .	20.40	5,557	35,420	15,580	51,000	-	51,000	51,000
Dambulla Branch 700B, Anuradhapura Road, Dambulla.	100.00	7,456	140,000	43,000	183,000	-	183,000	163,474
Fruithill Bungalow No 295/6, Dimbula Road, Hatton.	53.08	4,277	18,830	18,170	37,000	-	37,000	26,000
Galle Branch 3, Wakwella Road, Galle.	13.68	7,920	78,000	30,000	108,000	-	108,000	95,000
Gampaha Branch 148, Colombo Road, Gampaha.	25.00	16,682	75,000	171,000	246,000	-	246,000	235,929
Gampola Branch 142, Kandy Road, Gampola.	17.05	12,825	63,937	95,063	159,000	-	159,000	111,000
Grandpass Branch 182, St Joseph Street, Colombo 14.	24.00	11,220	132,000	89,000	221,000	-	221,000	182,000
Gunasinghapura Stores 11, Mohandiram's Road, Colombo 12.	48.30	6,022	255,480	23,520	279,000	-	279,000	150,131

Notes to the Financial Statements

38 PROPERTY, PLANT AND EQUIPMENT (Contd.)

38 (a) Information on Freehold Land and Buildings of the Bank - Extents and Locations (Contd.)

	Extent [perches]	Buildings Sq.ft.	Cost / Valuation of Land Rs 000	Cost / Valuation of Buildings Rs 000	Total Value Rs 000	Accumulated Depreciation Rs 000	As at 31st December 2017 Net Book Value Rs 000	As at 31st December 2016 Net Book Value Rs 000
Ja-Ela Branch 73, Old Negombo Road, Kanuwana, Ja-Ela.	19.00	3,766	28,500	14,000	42,500	-	42,500	43,200
Jaffna Metro Branch 177 & 179, Ponnampalam Road, Jaffna.	61.36	30,694	276,000	282,385	558,385	-	558,385	530,000
Kahawatte Branch 772 A, Main Street, Kahawatte.	16.14	3,298	26,500	21,000	47,500	-	47,500	41,000
Kalmunai Branch 30A, Batticaloa Road, Kalmunai.	25.10	6,123	75,300	41,700	117,000	-	117,000	92,000
Kandy Branch 1, Dalada Veediya, Kandy.	58.00	26,821	691,800	193,200	885,000	-	885,000	715,000
Kegalle Branch**** 451, Kandy Road, Kegalle.	-	-	-	-	-	-	-	83,400
Kuliyapitiya Branch 225, Main Street, Kuliyapitiya.	32.08	4,500	28,400	16,500	44,900	-	44,900	39,800
Kurunegala Branch 6, St. Anne's Street, Kurunegala.	36.25	17,970	145,000	105,828	250,828	-	250,828	250,828
Mount Bungalow 16, Mount Road, Hatton.	160.09	5,074	40,022	19,978	60,000	-	60,000	50,000
Mannar Branch 68, Main Street, Mannar.	23.00	5,866	11,500	19,700	31,200	-	31,200	31,200
Marawila Branch 534, Colombo Road, Marawila.	43.80	7,217	32,150	25,400	57,550	-	57,550	57,550
Maskeliya Branch 7/11, New Town, Maskeliya.	20.32	8,277	30,480	55,520	86,000	-	86,000	62,000
Matara Branch 58D, Esplanade Road, Matara.	26.00	7,242	58,500	37,500	96,000	-	96,000	85,000
Minuwangoda Branch 41, Samarakkody Road, Minuwangoda.	20.51	3,452	41,020	26,480	67,500	-	67,500	46,000
Managers' Bungalow 295, Dimbula Road, Hatton.	42.20	1,976	14,770	10,230	25,000	-	25,000	18,000
Mount Lavinia Branch 605, Galle Road, Mount Lavinia.	22.66	11,350	101,970	72,030	174,000	-	174,000	151,000
Negombo Branch 18, Rajapakse Broadway, Negombo.	8.88	5,450	17,760	19,500	37,260	-	37,260	35,284
Negombo Metro 201, Colombo Road, Negombo.	51.98	28,081	113,400	210,600	324,000	-	324,000	315,000
Nittambuwa Branch 22, Kandy Road, Nittambuwa.	55.69	10,411	128,087	144,413	272,500	-	272,500	260,968

38 PROPERTY, PLANT AND EQUIPMENT (Contd.)

38 (a) Information on Freehold Land and Buildings of the Bank - Extents and Locations (Contd.)

	Extent [perches]	Buildings Sq.ft.	Cost / Valuation of Land Rs 000	Cost / Valuation of Buildings Rs 000	Total Value Rs 000	Accumulated Depreciation Rs 000	As at 31st December 2017 Net Book Value Rs 000	As at 31st December 2016 Net Book Value Rs 000
Nochchiyagama Branch * 10, Puttalam Road, Nochchiyagama.	-	8,652	-	24,500	24,500	-	24,500	24,500
Nugegoda Branch 181, High Level Road, Nugegoda.	16.50	11,096	82,500	70,500	153,000	-	153,000	171,124
Nugegoda Branch 190,190/1, High Level Road, Nugegoda.	39.65		237,900	148,995	386,895	-	386,895	128,863
Nuwara Eliya Branch / Bungalow 42, Queen Elizabeth Drive, Nuwara Eliya.	149.03	12,929	641,605	95,395	737,000	-	737,000	570,000
Panchikawatte Branch 168, Panchikawatta Road, Colombo 10.	22.55	16,366	180,400	103,600	284,000	-	284,000	230,000
Pettah Branch 149-151, Main Street, Colombo 11.	13.03	11,460	234,540	86,460	321,000	-	321,000	274,900
Pettah Metro ** 88, Main Street, Colombo 11.	-	3,708	-	92,000	92,000	-	92,000	83,000
Polonnaruwa Branch * 467, Main Street, Kaduruwela, Polonnaruwa.	-	9,882	-	56,884	56,884	-	56,884	56,884
Pussellawa Branch 510, Nuwara Eliya Road, Pussellawa.	14.30	4,785	28,600	34,400	63,000	-	63,000	50,000
Ratnapura Branch 21 & 23, Senanayake Mawatha, Ratnapura.	43.40	18,777	110,000	137,800	247,800	-	247,800	98,000
Sea Street Branch 60, Sea Street, Colombo 11.	6.93	9,608	103,950	48,050	152,000	-	152,000	128,000
Trincomalee Branch 59, Ehamparam Road, Trincomalee.	31.75	9,156	79,375	49,625	129,000	-	129,000	119,473
Vavuniya Branch * 43, Inner Circular Road, Vavuniya.	-	9,032	-	25,300	25,300	-	25,300	25,300
Wattala Branch 270, 270/1, Negombo Road, Wattala.	53.00	8,579	212,000	57,000	269,000	-	269,000	237,600
Welimada Branch 35, Nuwara Eliya Road, Welimada.	14.37	9,909	50,295	74,705	125,000	-	125,000	95,000
Wellawaya Branch 70, Kumaradasa Mawatha, Wellawaya.	26.60	5,873	7,500	21,000	28,500	-	28,500	21,000
Wellawatte Branch 100 & 102, Galle Road, Colombo 06.	36.05	16,082	504,700	132,300	637,000	-	637,000	484,000
Total freehold land and buildings			10,935,849	3,902,553	14,838,402	-	14,838,402	11,413,989

* Buildings constructed on state land given on lease

** Condominium property

*** Transferred from investment properties

**** Transferred to investment properties

Notes to the Financial Statements

38 PROPERTY, PLANT AND EQUIPMENT (Contd.)

38 [b] Information on Valuations of Freehold Land and Buildings of the Bank

The below table summarises the results of the revaluation carried out in 2017.

	Name of Professional Valuer	Range of Estimates for Unobservable Inputs
Akkaraipattu Branch 14, Main Street, Akkaraipattu.	Mr. M.H.G.Heenbanda	Rs.3,500,000 p.p Rs.6,500 p. sq.ft
Ambalangoda Branch 94/1, New Galle Road, Ambalangoda.	Mr. G.K.D.K. Abeytunga	Rs.3,250,000 p.p Rs.6,000, Rs.6,500 p. sq.ft
Anuradhapura Branch 30, Maithripala Senanayake, Mawatha, Anuradhapura.	Mr. Tissa Weeratne	Rs.1,000,000 to Rs.2,850,000 p.p Rs.3,500 to Rs.5,000 p. sq.ft
Badulla Branch 15, 15 1/1, Udayaraja Mawatha, Badulla.	Mr. M.H.G.Heenbanda	Rs.3,750,000 p.p Rs.6500 p.sq.ft
Bambalapitiya Branch 285, Galle Road, Colombo 4.	Mr. J.M.J. Fernando	Rs.15,000,000 p.p Rs.10,000 p. sq.ft
Boralesgamuwa Branch 24, Maharagama Road, Boralesgamuwa.	Mr. J.M.J. Fernando	Rs.3,500,000 p.p Rs.4,000 to Rs.7,875 p. sq.ft
Borella Branch 53/1, D S Senanayake Mawatha, Borella.	Mr. J.M.J. Fernando	Rs.9,000,000 p.p Rs.4,000 to Rs.13,000 p. sq.ft
Centre of Aspiration 90, Vinayalankara Mawatha, Colombo 10.	Mr. J.M.J. Fernando	Rs.11,000,000 p.p Rs.7,150 p. sq.ft
Chavakachcheri Branch 170, Kandy Road, Chavakachcheri	Mr. Balenthiran B.	Rs.11,000,000 p.p Rs.1,500 to Rs.3,500 p. sq.ft
City Office 16, Janadhipathi Mawatha, Colombo 1.	Mr. J.M.J. Fernando	Rs.17,500,000 p.p Rs.1,900 p. sq.ft
Dambulla Branch 700B, Anuradhapura Road, Dambulla.	Mr. N.M. Jayatilake	Rs.800,000 to 2,000,000 p.p Rs.8,000 to Rs.8,500 p. sq.ft
Fruithill Bungalow No 295/6, Dimbula Road, Hatton.	Mr. W.M.H.G. Heenbanda	Rs.350,000 p.p Rs.5,500 p. sq.ft
Galle Branch 3, Wakwella Road, Galle.	Mr. G.K.D.K. Abeytunga	Rs.5,700,000 p.p Rs.4,500 to Rs.6,500p. sq.ft
Gampaha Branch 148, Colombo Road, Gampaha.	Mr. N.M. Jayatilake	Rs.3,000,000 p.p Rs.8,000 to Rs.15,000 p. sq.ft
Gampola Branch 142, Kandy Road, Gampola.	Mr. W.M.H.G. Heenbanda	Rs.3,750,000 p.p Rs. 6,500 p. sq.ft
Grandpass Branch 182, St Joseph Street, Colombo 14.	Mr. J.M.J. Fernando	Rs.5,500,000 p.p Rs.10,500 p. sq.ft
Gunasinghepura Stores 11, Mohandiram's Road, Colombo 12.	Mr. J.M.J. Fernando	Rs.6,000,000 p.p Rs.2,200 to Rs.5500 p. sq.ft
Ja-Ela Branch 73, Old Negombo Road, Kanuwana, Ja-Ela	Mr. Tissa Weeratne	Rs.1,500,000 p.p Rs.2,500 to Rs.4,600 p. sq.ft
Jaffna Metro Branch 177 & 179, Ponnampalam Road, Jaffna.	Mr. B. Balenthiran	Rs.4,500,000 p.p Rs.9,200 p. sq.ft
Kahawatte Branch 772 A, Main Street, Kahawatte.	Mr. G.K.D.K. Abeytunga	Rs.1,650,000 p.p Rs.3,250 & Rs.4,500 p. sq.ft
Kalmunai Branch 30A, Batticaloa Road, Kalmunai.	Mr. W.M.H.G. Heenbanda	Rs.3,000,000 p.p Rs.6,500 p. sq.ft
Kandy Branch 1, Dalada Veediya, Kandy.	Mr. W.M.H.G. Heenbanda	Rs.1,500,000 p.p Rs.5,500 to Rs.6,500 p.sq.ft

Net book value before revaluation of		Revalued amount of		Revaluation Gain/(Loss) Recognised on	
Land Rs 000	Buildings Rs 000	Land Rs 000	Buildings Rs 000	Land Rs 000	Buildings Rs 000
53,130	47,340	67,620	68,380	14,490	21,040
90,000	17,853	97,000	21,500	7,000	3,647
106,500	30,893	106,500	31,500	-	607
83,250	19,910	104,063	33,937	20,813	14,027
240,000	66,464	300,000	74,000	60,000	7,536
88,650	25,473	103,425	27,575	14,775	2,102
196,000	91,938	252,000	96,000	56,000	4,062
2,128,950	56,494	2,602,050	57,950	473,100	1,456
35,420	15,191	35,420	15,580	-	389
1,260,000	79,121	1,470,000	85,900	210,000	6,779
120,000	42,060	140,000	43,000	20,000	940
12,105	13,460	18,830	18,170	6,725	4,710
75,000	19,487	78,000	30,000	3,000	10,513
65,000	165,776	75,000	171,000	10,000	5,224
46,888	62,403	63,937	95,063	17,049	32,660
102,000	77,404	132,000	89,000	30,000	11,596
127,740	21,459	255,480	23,520	127,740	2,061
29,450	14,525	28,500	14,000	(950)	(525)
276,000	247,642	276,000	282,385	-	34,743
25,000	15,788	26,500	21,000	1,500	5,212
56,475	34,882	75,300	41,700	18,825	6,818
576,500	133,094	691,800	193,200	115,300	60,106

Notes to the Financial Statements

38 PROPERTY, PLANT AND EQUIPMENT (Contd.)

38 [b] Information on Valuations of Freehold Land and Buildings of the Bank (Contd.)

	Name of Professional Valuer	Range of Estimates for Unobservable Inputs
Kuliyapitiya Branch 225, Main Street, Kuliyapitiya.	Mr. Tissa Weeratne	Rs.500,000 to 1,000,000 p.p Rs.4,500 p. sq.ft
Kurunegala Branch 6, St. Anne's Street, Kurunegala.	Mr. N.M. Jayatilake	Rs.4,000,000 p.p Rs.4,000 to Rs.8,500 p. sq.ft
Mount Bungalow No 16, Mount Road, Hatton.	Mr. W.M.H.G. Heenbanda	Rs.250,000 p.p Rs.4,500 p. sq.ft
Mannar Branch 68, Main Street, Mannar.	Mr. Tissa Weeratne	Rs.500,000 p.p Rs.2,750 to Rs.3,550 p. sq.ft
Marawila Branch 534, Colombo Road, Marawila.	Mr. Tissa Weeratne	Rs.500,000 to Rs.1,000,000 p.p Rs.500 to Rs.4,400 p. sq.ft
Maskeliya Branch 7/11, New Town, Maskeliya.	Mr. W.M.H.G. Heenbanda	Rs.1,500,000 p.p Rs.5,500 to Rs.6,500 p. sq.ft
Matara Branch 58D, Esplanade Road, Matara.	Mr. G.K.D.K. Abeytunga	Rs.2,250,000 p.p Rs.6,000 to Rs.6,500 p. sq.ft
Minuwangoda Branch 41, Samarakkody Road, Minuwangoda.	Mr. J.M.J. Fernando	Rs.2,000,000 p.p Rs.1,500 to Rs.6500 p. sq.ft
Manager Bungalow 295, Dimbula Road, Hatton.	Mr. W.M.H.G. Heenbanda	Rs.350,000 p.p Rs.4,000 p. sq.ft
Mount Lavinia Branch 605, Galle Road, Mount Lavinia.	Mr. J.M.J. Fernando	Rs.4,500,000 p.p Rs.10,000 p. sq.ft
Negombo Branch 18, Rajapakse Broadway, Negombo.	Mr. Tissa Weeratne	Rs.2,000,000 p.p Rs.850 to Rs.4,950 p. sq.ft
Negombo Metro Building 201, Colombo Road, Negombo.	Mr. Tissa Weeratne	Rs.2,200,000 p.p Rs.2,500 to Rs.9,500 p. sq.ft
Nittambuwa Branch 22, Kandy Road, Nittambuwa.	Mr. N.M. Jayatilake	Rs.2,300,000 p.p Rs.12,000 to Rs.18,000 p. sq.ft
Nochchiyagama Branch* 10, Puttalam Road, Nochchiyagama.	Mr. Tissa Weeratne	Rs 1,500 to Rs.4,400 p. sq.ft
Nugegoda Branch 181, High Level Road, Nugegoda.	Mr. J.M.J. Fernando	Rs 6,000,000 p.p Rs.10,000p. sq.ft
Nugegoda Branch 190,190/1, High Level Road, Nugegoda	Mr. J.M.J. Fernando	Rs.6,000,000 p.p Rs.2,000 to Rs.10,250 p. sq.ft
Nuwara Eliya Branch / Bungalow 42, Queen Elizabeth Drive, Nuwara Eliya.	Mr. W.M.H.G. Heenbanda	Rs.5,500,000 p.p Rs.6,500 p. sq.ft
Panchikawatta Branch 168, Panchikawatta Road, Colombo 10.	Mr. J.M.J. Fernando	Rs.8,000,000 p.p Rs.3,300 to Rs. 10,000 p. sq.ft
Pettah Branch 149-151, Main Street, Colombo 11.	Mr. J.M.J. Fernando	Rs.18,000,000 p.p Rs.10,500 p. sq.ft
Pettah Metro ** 88, Main Street, Colombo 11.	Mr. J.M.J. Fernando	Rs 200 p.sq.ft
Polonnaruwa Branch * 467, Main Street, Kaduruwela, Polonnaruwa.	Mr. N.M. Jayatilake	Rs.6,500 to Rs.7,500 p. sq.ft
Pussellawa Branch 510, Nuwara Eliya Road, Pussellawa.	Mr. W.M.H.G. Heenbanda	Rs.2,000,000 p.p Rs.6,500 p. sq.ft
Ratnapura Branch 21 & 23, Senanayake Mawatha, Ratnapura.	Mr. J.M.J. Fernando	Rs.2,750,000 p.p Rs.1,500 to Rs.8500 p. sq.ft

Net book value before revaluation of		Revalued amount of		Revaluation Gain/(Loss) Recognised on	
Land Rs 000	Buildings Rs 000	Land Rs 000	Buildings Rs 000	Land Rs 000	Buildings Rs 000
24,000	15,489	28,400	16,500	4,400	1,011
145,000	101,723	145,000	105,828	-	4,105
32,018	17,234	40,022	19,978	8,004	2,744
11,500	19,277	11,500	19,700	-	423
32,150	24,695	32,150	25,400	-	705
22,352	38,691	30,480	55,520	8,128	16,829
54,000	30,197	58,500	37,500	4,500	7,303
30,765	37,508	41,020	26,480	10,255	(11,028)
9,495	8,151	14,770	10,230	5,275	2,079
84,975	62,941	101,970	72,030	16,995	9,089
15,984	18,609	17,760	19,500	1,776	891
103,960	204,286	113,400	210,600	9,426	6,314
111,380	143,365	128,087	144,413	16,707	1,048
-	23,980	-	24,500	-	520
99,000	69,922	82,500	70,500	(16,500)	578
128,863	183,284	237,900	148,995	109,039	(34,289)
514,833	53,358	641,605	95,395	126,772	42,037
135,300	92,035	180,400	103,600	45,100	11,565
195,450	76,145	234,540	86,460	39,090	10,315
-	80,954	-	92,000	-	11,046
-	55,306	-	56,884	-	1,578
25,025	24,241	28,600	34,400	3,575	10,159
86,000	143,661	110,000	137,800	24,000	(5,861)

Notes to the Financial Statements

38 PROPERTY, PLANT AND EQUIPMENT (Contd.)

38 (b) Information on Valuations of Freehold Land and Buildings of the Bank (Contd.)

	Name of Professional Valuer	Range of Estimates for Unobservable Inputs
Sea Street Branch 60, Sea Street, Colombo 11.	Mr. J.M.J. Fernando	Rs.15,000,000 p.p Rs.10,000 p. sq.ft
Trincomalee Branch 59, Ehampraram Road, Trincomalee.	Mr. N.M. Jayatilake	Rs.2,500,000 p.p Rs.6,500 to Rs.8000 p. sq.ft
Vavuniya Branch * 43, Inner Circular Road, Vavuniya.	Mr. Tissa Weeratne	Rs.1,500 to Rs. 4,250 p. sq.ft
Wattala Branch 270, 270/1, Negombo Road, Wattala.	Mr. J.M.J. Fernando	Rs.4,000,000 p.p Rs.4000 to Rs.10,000 p. sq.ft
Wellimada Branch 35, Nuwara Eliya Road, Wellimada.	Mr. W.M.H.G. Heenbanda	Rs.3,500,000 p.p Rs.6,500 p. sq.ft
Wellawaya Branch 70, Kumaradasa Mawatha, Wellawaya.	Mr. G.K.D.K. Abeytunga	Rs.275,000 p.p Rs.3,750 to Rs.4,500 p. sq.ft
Wellawatte Branch 100 & 102, Galle Road, Wellawatte.	Mr. J.M.J. Fernando	Rs.14,000,000 p.p Rs.11,000 p. sq.ft
Centralised Operations Building*** 10, Sri Uttarananda Mawatha, Colombo 3	Mr. J.M.J. Fernando	Rs.17,500,000 p.p Rs.13,750 p. sq.ft

* Buildings constructed on state land given on lease ** Valued as a condominium property

*** Transferred from investment properties

Unobservable inputs used in measuring fair value

- Depreciated replacement cost basis/Market comparable method

Significant increase / [decrease] in estimated price per perch, price per sq.ft and depreciation rate would result in a significantly higher / [lower] fair value.

- Investment method

Significant increase / [decrease] in rent per sq.ft, outgoing expenses and number of years since purchase would result in a significantly higher / [lower] fair value.

38 (c) Leasehold Buildings

As at 31st December	Bank				Group			
	2017	2017	2016	2016	2017	2017	2016	2016
	Cost of Buildings Rs 000	Accumulated Depreciation Rs 000	Net Book Value Rs 000	Net Book Value Rs 000	Cost of Buildings Rs 000	Accumulated Depreciation Rs 000	Net Book Value Rs 000	Net Book Value Rs 000
01 - 05 years	682,583	631,294	51,289	178,518	682,583	631,294	51,289	178,518
06 - 10 years	963,645	758,271	205,374	58,828	963,645	758,271	205,374	58,828
11 - 15 years	23,725	14,200	9,525	3,650	23,725	14,200	9,525	3,650
16 - 20 years	8,080	6,767	1,313	-	8,080	6,767	1,313	-
Total	1,678,033	1,410,532	267,501	240,996	1,678,033	1,410,532	267,501	240,996

38 (d) Temporarily Idle Property, Plant and Equipment - Bank

There was no temporarily idle property, plant and equipment as at 31st December 2017.

38 (e) Compensation from Third Parties for Property, Plant and Equipment - Bank

No compensation was received from third parties for items of property, plant and equipment that were impaired, lost or given up.

Net book value before revaluation of		Revalued amount of		Revaluation Gain/(Loss) Recognised on	
Land Rs 000	Buildings Rs 000	Land Rs 000	Buildings Rs 000	Land Rs 000	Buildings Rs 000
83,160	42,991	103,950	48,050	20,790	5,059
69,850	48,070	79,375	49,625	9,525	1,555
-	24,380	-	25,300	-	920
185,500	50,376	212,000	57,000	26,500	6,624
39,518	53,746	50,295	74,705	10,778	20,959
7,000	18,715	7,500	21,000	500	2,285
360,500	119,275	504,700	132,300	144,200	13,025
72,000	137,947	700,000	346,000	628,000	208,053
8,473,636	3,319,209	10,935,849	3,902,553	2,462,213	583,344

39 INTANGIBLE ASSETS AND GOODWILL

Accounting Policy**Basis of Recognition**

An intangible asset is recognised if it is probable that the future economic benefits that are attributable to the asset will flow to the Group and the cost of the asset can be measured reliably. An intangible asset is initially measured at cost. The cost of intangible assets acquired in a business combination is the fair value as at the date of acquisition.

[a] Goodwill

Goodwill that arises upon the acquisition of subsidiaries is included in intangible assets. Goodwill is measured at initial recognition in accordance with Note 3.1.1.

Subsequent measurement

Goodwill is measured at cost less accumulated impairment losses. In respect of equity accounted investees, the carrying amount of goodwill is included in the carrying amount of the investment, and an impairment loss in such an investment is not allocated to any asset, including goodwill, that forms part of the carrying amount of equity accounted investee.

Any gain on bargain purchase is recognised immediately in the statement of profit or loss.

[b] Software

All computer software costs incurred, licensed for use by the Group, which are not integrally related to associated hardware, which can be clearly identified, reliably measured and it's probable that those will lead to future economic benefits, are included in the statement of financial position under the category 'intangible assets' and are carried at cost less accumulated amortisation and any accumulated impairment losses.

[c] License

The amount that would be required to obtain a license to operate a registered finance business is recognised as license in the financial statements.

Subsequent expenditure

Expenditure incurred on software is capitalised, only when it is probable that this expenditure will enable the asset to generate future economic benefits in excess of its originally assessed standard of performance and this expenditure can be measured and attributed to the asset reliably. All other expenditure is expensed as incurred.

Amortisation

The useful lives of intangible assets are assessed as either finite or infinite. Intangible assets, with finite lives, are amortised on a straight line basis in the statement of profit or loss from the date when the asset is available for use, over the best estimate of the useful economic life based on a pattern in which the asset's economic benefits are consumed by the Group, at 16.67% per annum.

Those assets are assessed for impairment whenever there is an indication that the intangible asset may be impaired.

Expenditure on an intangible item that was initially recognised as an expense by the Group in previous annual financial statements or interim financial statements are not recognised as part of the cost of an intangible asset at a later date. Amortisation methods, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate.

Goodwill and intangible assets with infinite useful lives are not amortised, but are assessed for impairment annually. The assessment of infinite life is reviewed annually to determine whether the infinite life continues to be supportable.

De-recognition

An intangible asset is de-recognised on disposal or when no future economic benefits are expected from its use and subsequent disposal. Gains or losses arising from de-recognition of an intangible asset are measured as the difference between the net disposal proceeds and the carrying amount of the asset and are recognised in the statement of profit or loss.

39 INTANGIBLE ASSETS AND GOODWILL [Contd.]

As at 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Cost				
Balance as at 1st January	3,001,205	2,650,728	3,574,214	3,135,428
Additions and improvements during the year	281,741	350,477	367,328	441,837
Transferred to property, plant and equipment	-	-	-	(3,051)
Balance as at 31st December	3,282,946	3,001,205	3,941,542	3,574,214
Accumulated amortisation				
Balance as at 1st January	2,211,557	1,991,419	2,393,945	2,134,198
Amortisation for the year [Note 17]	256,008	220,138	309,768	260,357
Transferred to property, plant and equipment	-	-	-	(610)
Balance as at 31st December	2,467,565	2,211,557	2,703,713	2,393,945
Net book value as at 31st December	815,381	789,648	1,237,829	1,180,269

39 [a] Analysis of Intangible Assets

As at 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Computer Software	815,381	789,648	1,014,888	957,328
Goodwill *	-	-	122,941	122,941
License	-	-	100,000	100,000
	815,381	789,648	1,237,829	1,180,269

*Goodwill amounting to Rs 122.94 Mn has been recognised in respect of acquisition of HNB Grameen Finance Ltd.

As at 31st December 2017, the Bank carried out an impairment assessment on the goodwill recognised, on acquisition of HNB Grameen Finance Ltd.

39 [a] i Assessment of Goodwill Impairment

The recoverable value of the goodwill has been determined based on the residual income method.

Key assumptions used in residual income calculation

Profit Growth

Profit growth for the next five years was projected at Compound Annual Growth Rate [CAGR]. This was based on a reasonable value growth, taking into account the anticipated growth in micro finance industry and the existing interest margin of the company. Beyond five years terminal growth was assumed to be 0%.

Discount factor

The discount rate used is the risk free rate, adjusted by the addition of an appropriate risk premium.

Inflation

The basis used to determine the value assigned to the budgeted cost inflation is the inflation rate based on projected economic conditions.

Notes to the Financial Statements

40 OTHER ASSETS

As at 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Deposits and prepayments	1,492,547	1,184,065	1,241,578	986,290
Items held for use	111,304	74,442	111,304	74,442
Items in transit	26,950	24,891	26,950	24,891
Receivable from pension fund	1,719,510	1,955,967	1,719,510	1,955,967
Un-amortised cost on staff loans	4,192,733	3,442,399	4,273,500	3,553,722
VAT recoverable	167,013	116,154	167,013	116,154
Other debtors	3,444,909	2,485,572	5,570,091	4,098,651
Allowance for impairment	[71,724]	-	[71,724]	-
	11,083,242	9,283,490	13,038,222	10,810,117

41 DUE TO BANKS

Accounting Policy

Due to banks represents refinance borrowings, call and time deposits and borrowings from banks. Subsequent to initial recognition, these are measured at their amortised cost using the Effective Interest Rate [EIR] method. Amortised cost is calculated by taking into account any discount or premium on the issue and costs that are an integral part of the EIR. The EIR amortisation is included in "interest expenses" in the statement of profit or loss. Gains and losses are recognised in the statement of profit or loss when the liabilities are de-recognised.

As at 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Call and time deposits	711,220	-	711,220	-
Foreign bank borrowings	49,055,803	52,215,707	49,055,803	52,215,707
Local bank borrowings	8,303,649	13,688,878	8,304,543	13,724,469
Refinance borrowings	4,392,825	3,314,717	4,392,825	3,314,717
	62,463,497	69,219,302	62,464,391	69,254,893

42 SECURITIES SOLD UNDER REPURCHASE AGREEMENTS

Accounting Policy

Securities sold under agreements to repurchase at a specified future date are not de-recognised from the statement of financial position, as the Group retains substantially all of the risks and rewards of ownership. The corresponding cash received is recognised in the statement of financial position as an asset and a corresponding obligation to return it with accrued interest, as 'securities sold under repurchase agreements', reflecting the transaction's economic substance as a loan to the Group. The difference between the sale and repurchase price is treated as interest expense and is accrued over the life of the agreement using the Effective Interest Rate [EIR].

As at 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Securities sold under repurchase agreements				
With banks	-	800,372	-	800,372
With customers	5,064,360	12,657,755	5,064,360	12,657,755
	5,064,360	13,458,127	5,064,360	13,458,127

43 DUE TO CUSTOMERS

Accounting Policy

Due to customers include non-interest bearing deposits, savings deposits, term deposits, deposits payable at call, certificate of deposits and margin deposits. Subsequent to initial recognition, deposits are measured at their amortised cost using the Effective Interest Rate (EIR) method, except where the Group designates liabilities at fair value through profit or loss. Amortised cost is calculated by taking into account any discount or premium on the issue and costs that are an integral part of the EIR. The EIR amortisation is included in "interest expenses" in the statement of profit or loss. Gains and losses are recognised in the statement of profit or loss when the liabilities are de-recognised.

As at 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Local currency deposits	576,571,392	522,168,609	593,887,005	534,102,873
Foreign currency deposits	124,947,905	101,326,360	124,883,046	101,268,224
	701,519,297	623,494,969	718,770,051	635,371,097

43 [a] Analysis of Due to Customers

43 [a] i By Product

Current account deposits	39,167,863	36,675,800	55,589,143	36,392,699
Savings deposits	209,750,730	188,845,184	211,701,591	190,211,901
Time deposits	449,772,985	395,482,519	448,651,598	406,275,031
Certificates of deposit	955,609	957,804	955,609	957,804
Margin deposits	1,872,110	1,533,662	1,872,110	1,533,662
	701,519,297	623,494,969	718,770,051	635,371,097

43 [a] ii By Currency

Sri Lankan Rupees	576,571,392	522,168,609	593,887,005	534,102,873
United States Dollars	97,560,173	78,507,427	97,496,110	78,449,617
Great Britain Pounds	8,531,315	7,226,325	8,531,315	7,226,325
Euros	13,218,377	10,730,892	13,217,581	10,730,566
Australian Dollars	4,669,614	3,997,421	4,669,614	3,997,421
Other currencies	968,426	864,295	968,426	864,295
	701,519,297	623,494,969	718,770,051	635,371,097

44 DIVIDENDS PAYABLE

Details of dividends declared for the year after the reporting date are given in Note 22 [a] to the financial statements as an event after the reporting period in accordance with the Sri Lanka Accounting Standard - LKAS 10 on "Events after the reporting period".

As at 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Balance as at 1st January	1,007,075	764,771	1,015,463	764,771
Final cash dividends declared in the prior year	1,596,426	1,563,320	1,795,887	1,712,727
Interim cash dividends declared during the year	732,745	620,387	732,745	620,387
Transfer to retain earning	(22,856)	-	(22,856)	-
Dividends paid during the year	(2,338,019)	(1,941,403)	(2,534,359)	(2,082,422)
Balance as at 31st December	975,371	1,007,075	986,880	1,015,463

Notes to the Financial Statements

45 OTHER BORROWINGS

Accounting Policy

Other borrowings represent refinance borrowings and borrowings from other financial institutions. Subsequent to initial recognition these borrowings are measured at their amortised cost using the Effective Interest Rate (EIR) method. Amortised cost is calculated by taking into account any discount or premium on the issue and costs that are an integral part of the EIR. The EIR amortisation is included in "interest expenses" in the statement of profit or loss. Gains and losses are recognised in the statement of profit or loss when the liabilities are de-recognised.

As at 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Refinance borrowings	851,195	825,265	851,195	825,265
Foreign borrowings	26,406,811	27,014,580	26,406,811	27,014,580
	27,258,006	27,839,845	27,258,006	27,839,845

46 DEBT SECURITIES ISSUED

Accounting Policy

Debt securities issued represent funds borrowed for long term funding purposes. Subsequent to initial recognition debt securities are measured at their amortised cost using the Effective Interest Rate (EIR) method. Amortised cost is calculated by taking into account any discount or premium on the issue and costs that are an integral part of the EIR. The EIR amortisation is included in "interest expenses" in the statement of profit or loss. Gains and losses are recognised in the statement of profit or loss when the liabilities are de-recognised.

	Colombo Stock Exchange Listing	Interest Payment Frequency	Face Value Rs 000	Interest Rate	Repayment Terms	Issue Date	Maturity Date	Bank		Group	
								As at 31.12.2017 Rs 000	As at 31.12.2016 Rs 000	As at 31.12.2017 Rs 000	As at 31.12.2016 Rs 000
(i) Year of issuance 2013	Listed	Annually	2,000,000	8.00%	10 Years	30th Aug 2013	29th Aug 2023	1,587,729	1,536,302	1,565,774	1,515,060
(ii) Year of issuance 2014	Listed	Semi Annually	158,720	6.88%	3 Years	15th Dec 2014	15th Dec 2017	-	164,225	-	164,225
		Semi Annually	2,757,240	7.75%	5 Years	15th Dec 2014	15th Dec 2019	2,864,961	2,864,961	2,832,750	2,832,750
		Semi Annually	84,040	8.33%	10 Years	15th Dec 2014	15th Dec 2024	87,569	87,569	66,729	66,729
(iii) Year of issuance 2011*	Not Listed	Monthly	665,000	1 Yr Avg TB rate	20 Years	30th Jun 2014	30th Jun 2034	-	-	570,705	537,037
Total debt securities issued								4,540,259	4,653,057	5,035,958	5,115,801
Due within one year								165,606	329,831	160,331	329,831
Due after one year								4,374,653	4,323,226	4,875,627	4,785,970
Total debt securities issued								4,540,259	4,653,057	5,035,958	5,115,801

HNB Assurance PLC, subsidiary of the Bank has invested Rs 75 Mn in debt securities issued by the Bank.

* Debt securities issued by HNB Grameen Finance Ltd. Capital repayment will commence from 2024.

47 SUBORDINATED TERM DEBTS

Accounting Policy

Subordinated term debts represent funds borrowed for long term funding purposes which are subordinated to the other claims. Subsequent to initial recognition, subordinated term debts are measured at their amortised cost using the Effective Interest Rate (EIR) method. Amortised cost is calculated by taking into account any discount or premium on the issue and costs that are an integral part of the EIR. The EIR amortisation is included in "interest expenses" in the statement of profit or loss. Gains and losses are recognised in the statement of profit or loss when the liabilities are de-recognised.

As at 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Subordinated debentures [Note 47 (a)]	21,977,327	22,409,926	21,732,662	22,157,560
Subordinated loan [Note 47 (b)]	3,831,934	3,743,550	3,831,934	3,743,550
	25,809,261	26,153,476	25,564,596	25,901,110

47 [a] Subordinated Debentures

	Colombo Stock Exchange Listing	Interest Payment Frequency	Face Value Rs 000	Interest Rate	Repayment Terms	Issue Date	Maturity Date	Bank		Group	
								As at 31.12.2017 Rs 000	As at 31.12.2016 Rs 000	As at 31.12.2017 Rs 000	As at 31.12.2016 Rs 000
(i) Year of issuance 2006	Listed	At maturity	514,345	11.00%	15 Year	1st Apr 2006	31st Mar 2021	366,598	330,287	340,992	307,217
		At maturity	1,362,800	11.25%	18 Year	1st Apr 2006	31st Mar 2024	700,268	629,495	700,268	629,495
(ii) Year of issuance 2007	Listed	Annually	500,000	16.00%	10 Year	1st Aug 2007	31st Jul 2017	-	540,000	-	540,000
		Annually	700,000	16.75%	15 Year	1st Aug 2007	31st Jul 2022	758,625	758,625	758,625	758,625
(iii) Year of issuance 2011	Listed	Semi Annually	2,000,000	11.50%	10 Year	5th Sep 2011	4th Sep 2021	2,115,945	2,115,628	2,115,945	2,115,628
(iv) Year of issuance 2013	Listed	Annually	4,000,000	14.00%	5 Year	13th Jun 2013	12th Jun 2018	4,309,918	4,309,918	4,262,142	4,251,905
(vi) Year of issuance 2016	Listed	Annually	7,000,000	11.25%	5 Year	28th Mar 2016	28th Mar 2021	7,599,795	7,599,795	7,328,512	7,328,512
	Listed	Annually	2,000,000	11.75%	5 Year	1st Nov 2016	1st Nov 2021	2,039,274	2,039,274	2,039,274	2,039,274
	Listed	Annually	4,000,000	13.00%	7 Year	1st Nov 2016	1st Nov 2023	4,086,904	4,086,904	4,086,904	4,086,904
(v) Year of issuance 2013	Not Listed	Monthly	100,000	17.50%	5 Year	17th Jun 2013	16th Jun 2018	-	-	100,000	100,000
Total subordinated debentures								21,977,327	22,409,926	21,732,662	22,157,560
Due within one year								5,210,461	1,250,144	5,267,636	1,250,144
Due after one year								16,766,866	21,159,782	16,465,026	20,907,416
Total subordinated debentures								21,977,327	22,409,926	21,732,662	22,157,560

Subsidiaries of the Bank, HNB Assurance PLC and HNB Grameen Finance Ltd have invested Rs 181.9 Mn and Rs 162.7 Mn respectively, in Subordinated debentures issued by the Bank

47 [b] Subordinated Loan

Subordinated loan represents eight year subordinated loan of USD 25 Mn from German Development Financial Institution (DEG).

48 CURRENT TAX LIABILITIES

As at 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Current tax	3,974,624	6,223,943	4,066,087	6,425,379
	3,974,624	6,223,943	4,066,087	6,425,379

Notes to the Financial Statements

49 DEFERRED TAX

As at 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Deferred tax liabilities [Note 49 (a)]	6,497,772	2,397,140	9,145,091	3,086,438
Deferred tax assets [Note 49 (b)]	(1,415,136)	(2,165,776)	(1,835,808)	(2,261,660)
	5,082,636	231,364	7,309,283	824,778

49 (a) Deferred Tax Liabilities

49 (a) i Deferred Tax Liabilities on Other Temporary Differences

	Bank				Group			
	2017		2016		2017		2016	
	Temporary Difference Rs 000	Tax Effect Rs 000	Temporary Difference Rs 000	Tax Effect Rs 000	Temporary Difference Rs 000	Tax Effect Rs 000	Temporary Difference Rs 000	Tax Effect Rs 000
Balance as at 1st January	8,561,212	2,397,139	9,191,052	2,573,495	9,607,700	2,690,156	9,736,224	2,726,143
Originating during the year								
Recognised in the statement of profit or loss	977,971	273,830	623,921	174,698	1,075,786	301,217	775,746	217,209
Recognised in OCI								
Revaluation surplus recognised on buildings	519,011	145,323	194,604	54,489	3,994,648	1,118,502	550,612	154,171
Revaluation surplus recognised on land*	9,839,275	2,754,997	-	-	11,904,706	3,333,318	-	-
Realisation of revaluation surplus	-	-	(4,336)	(1,214)	-	-	(4,336)	(1,214)
Others	3,308,861	926,483	(1,444,029)	(404,328)	3,333,043	933,254	(1,450,546)	(406,153)
Balance as at 31st December	23,206,330	6,497,772	8,561,212	2,397,140	29,915,883	8,376,447	9,607,700	2,690,156

* Revaluation Surplus on Land

As per section 6 (read together with Chapter iv) of the new Inland Revenue Act No. 24 of 2017, capital gain tax on land will come into effect from 1st April 2018. However, any gains realised on sale of land will not be treated as capital gains in the Group, but as business profits. Accordingly, a deferred tax liability has been recorded in respect of revaluation surplus pertaining to land, outstanding as at 31st December 2017.

49 (a) ii Deferred Tax Liabilities on Undistributed Profits of Subsidiaries

	Bank				Group			
	2017		2016		2017		2016	
	Temporary Difference Rs 000	Tax Effect Rs 000	Temporary Difference Rs 000	Tax Effect Rs 000	Temporary Difference Rs 000	Tax Effect Rs 000	Temporary Difference Rs 000	Tax Effect Rs 000
Balance as at 1st January	-	-	-	-	3,962,820	396,282	2,556,570	255,657
Originating during the year								
Effect of withholding tax rate change	-	-	-	-	-	158,516	-	-
Recognised in the statement of profit or loss	-	-	-	-	1,527,473	213,846	1,406,250	140,625
Balance as at 31st December	-	-	-	-	5,490,293	768,644	3,962,820	396,282
Total deferred tax liabilities [Note 49]	23,206,330	6,497,772	8,561,212	2,397,140	35,406,172	9,145,091	13,570,520	3,086,438

49 (b) Deferred Tax Assets

	Bank				Group			
	2017		2016		2017		2016	
	Temporary Difference Rs 000	Tax Effect Rs 000	Temporary Difference Rs 000	Tax Effect Rs 000	Temporary Difference Rs 000	Tax Effect Rs 000	Temporary Difference Rs 000	Tax Effect Rs 000
Balance as at 1st January	7,734,914	2,165,776	7,838,125	2,194,675	8,077,356	2,261,660	8,581,063	2,402,698
Originating during the year								
Recognised in the statement of profit or loss	(2,680,857)	(750,640)	(103,211)	(28,899)	(1,537,104)	(430,389)	(490,786)	(137,420)
Recognised in OCI					16,204	4,537	(12,921)	(3,618)
Balance as at 31st December [Note 49]	5,054,057	1,415,136	7,734,914	2,165,776	6,556,456	1,835,808	8,077,356	2,261,660

49 DEFERRED TAX [Contd.]

49 (c) Recognised Deferred Tax Assets and Liabilities

49 (c) i Recognised Deferred Tax Assets / [Liabilities] - Bank

	Statement of Financial Position		Statement of Profit or Loss		Other Comprehensive Income	
	As at 31st December		For the year ended		For the year ended	
	2017	2016	2017	2016	2017	2016
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Accelerated depreciation for tax purposes						
- Property, plant and equipment	(624,621)	(514,626)	(108,778)	(27,652)	-	-
- Intangible assets	(120,308)	(137,760)	17,452	(31,175)	-	-
- Assets on leasing business	(2,093,129)	(1,910,626)	(182,504)	(115,871)	-	-
Revaluation of government securities	(410,771)	514,494	-	-	(926,481)	404,328
Capital gain on land revaluation	(2,754,997)	-	-	-	(2,754,997)	-
Revaluation of freehold buildings	(493,946)	(348,622)	-	-	(145,323)	(53,275)
Temporary difference on provisions	1,415,136	2,165,776	(750,640)	(28,899)	-	-
	(5,082,636)	(231,364)	(1,024,470)	(203,597)	(3,826,801)	351,053

49 (c) ii Recognised Deferred Tax Assets / [Liabilities] - Group

Deferred tax assets and liabilities are attributable to the following.

	Statement of Financial Position		Statement of Profit or Loss		Other Comprehensive Income	
	As at 31st December		For the year ended		For the year ended	
	2017	2016	2017	2016	2017	2016
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Accelerated depreciation for tax purposes						
- Property, plant and equipment	(844,056)	(618,637)	(165,673)	(1,830)	-	-
- Intangible assets	(120,308)	(137,760)	17,452	(31,175)	-	-
- Assets on leasing business	(2,131,958)	(1,978,959)	(153,000)	(184,204)	-	-
Revaluation of government securities	(414,430)	517,605	-	-	(933,251)	406,153
Capital gain on land revaluation	(3,333,318)	-	-	-	(3,333,318)	-
Revaluation of freehold buildings	(1,532,380)	(472,406)	-	-	(1,137,191)	(152,957)
Undistributed profits of subsidiaries	(768,640)	(396,282)	(372,358)	(140,625)	-	-
Unutilised tax losses	94,383	43,997	94,383	-	-	-
Temporary difference on provisions	1,741,424	2,217,664	(524,772)	(137,420)	4,537	(3,618)
	(7,309,283)	(824,778)	(1,103,968)	(495,254)	(5,399,222)	249,578

49 (d) Unrecognised tax losses - Subsidiaries

HNB Assurance PLC (company) has recognized a deferred tax asset in respect of unutilised tax losses up to the extent of the deferred tax liability arising from taxable temporary differences in the Company. Even though the company is incurring taxable profit under new Inland Revenue Act in future periods no deferred tax asset is recognised in the financial statements until the transitional provisions are made available with regard to the utilization of tax losses carried forward from the previous act. The unrecognised deferred tax asset as at 31st December 2017 in life business amounted to Rs. 1,431 Mn (2016 - Rs. 1,225 Mn).

However, HNB General Insurance Limited recorded a deferred tax asset amounting to Rs 59.1 Mn (2016 - Rs. 43.9 Mn) as a result of tax losses made in 2015. The unrecognised deferred tax asset on tax losses of HNB General Insurance Limited as at 31st December 2017 in general business amounted to Rs. 14.13 Mn (2016 - Rs. 49.97 Mn).

50 INSURANCE PROVISION - LIFE

Accounting Policy**Insurance Provision - Life Insurance**

The insurance provision - life balance represents the life fund of the subsidiary HNB Assurance PLC, which is carrying out life insurance business.

Life insurance liabilities are recognised when contracts are entered into and premiums are charged. These liabilities are measured by using a prospective actuarial valuation method. The liability is determined as the sum of the present value of future benefits, the expected future management and distribution expenses, less the present value of future gross premiums arising from the policy discounted at the appropriate discount rate as specified by the Insurance Regulatory Commission of Sri Lanka. The liability is based on best estimate assumptions and with due regard to significant recent experience. An appropriate allowance for provision of risk margin for adverse deviation from expected experience is included in the valuation.

Liability Adequacy Test [LAT]

As required by Sri Lanka Accounting Standard - SLFRS 4 on "Insurance Contracts", the entity performed a Liability Adequacy Test [LAT] in respect of Life Insurance contract liabilities with the assistance of an external actuary. In performing the LAT, current best estimates of future contractual cash flows, including related cash flows such as claims handling and policy administration expenses, policyholder options and guarantees, as well as investment income from assets backing such liabilities, are used. Number of valuation techniques are applied including discounting cashflows, interest rate applied is based on the managements expectation of current market interest rates. The liability value is adjusted to the extent that it is insufficient to meet future benefits and expenses.

Insurance provision - life balance represents the amounts attributable to life policy holders included in the Group's net assets. The valuation of the Life Insurance business as at 31st December 2017 was carried out by Mr. Hassan Scott Odierno, of M/S Actuarial Partners Consulting Sdn Bhd.

The life fund stands at Rs 10,915.86 Mn as at 31st December 2017 (2016 : Rs 8,747.86 Mn) and in the opinion of the actuary this amount is adequate to cover the liabilities pertaining to the long term insurance business of HNB Assurance PLC, as per the actuary's report dated 09th February 2018.

51 INSURANCE PROVISION - GENERAL

Accounting Policy**Insurance Provision - General Insurance**

General insurance contract liabilities are recognized when contracts are entered into and premiums are charged. These liabilities comprise claims liabilities and premium liabilities.

Claims liabilities

Claims liabilities are recognized in respect of both with reinsurance and without reinsurance. Claims liabilities refer to the obligation by the insurance company, whether contractual or otherwise to make future payments in relation to all claims that have been incurred as at valuation date. These include provision for claims reported, claims incurred but not reported ("IBNR") together with related claims handling costs. Claims liabilities consist of the best estimate value of the claim liabilities and the Provision of Risk Margin for adverse Deviation ("PRAD") calculated at line of business level.

Premium liabilities

Premium liabilities is the higher of the aggregate of the UPR and the best estimate value of the insurer's unexpired risk reserves ("URR") at the valuation date and the PRAD calculated at line of business level.

The provision for unearned premiums represents premiums received for risks that have not yet expired. Generally the reserve is released over the term of the contract and is recognized as premium income.

Liability Adequacy Test [LAT]

As required by Sri Lanka Accounting Standard - SLFRS 4 on "Insurance Contracts", the entity performed a Liability Adequacy Test [LAT] in respect of general insurance contract liabilities with the assistance of an external actuary.

Title Insurance Reserve

Title insurance reserve is maintained by the Group to pay potential claims arising from the title insurance policies. Title insurance policies are normally issued for a long period such as 5 years or more. Thus, no profit is recognised in the first year of the policy given the higher probability of claims occurring in the first year. From the 2nd year onwards, profit is recognised by amortising the premium received over a five year period using the straight line method. Profit in the first year will be recognised in the 2nd year and thereafter it is periodically recognised.

51 INSURANCE PROVISION - GENERAL [Contd.]

As at 31st December	2017		2016	
	Rs 000	Rs 000	Rs 000	Rs 000
Unearned premium				
Gross		1,956,581		1,596,757
Reinsurance		(364,130)		(317,896)
Net		1,592,451		1,278,861
Deferred acquisition expenses		-		-
Reserve for title insurance		34,840		19,611
Unexpired risk reserve		-		-
		1,627,291		1,298,472
Claims outstanding - gross	663,854		555,807	
Claims incurred but not reported - gross	93,763	757,617	67,288	623,095
Total		2,384,908		1,921,567

52 OTHER LIABILITIES

As at 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Cheques sent on clearing	36,342	32,549	36,342	32,549
Bills payable	1,574,872	1,770,925	1,574,872	1,770,925
Items in transit	43,438	19,887	43,438	19,887
Refundable deposits and advances	-	-	12,211	88,822
Balance held o/a of pension fund	13,618	336,418	13,618	336,418
Balance held o/a of Widows', Widowers' and Orphans' Pension Fund (WW&OP)	1,215	62,530	1,215	62,530
Balance held o/a of Employees' Provident Fund (EPF)	8,152	4,902	8,152	4,902
Liability for EPF interest rate guarantee [Note 53 (b)]	58,952	57,434	58,952	57,434
Liability for leave accrual plan [Note 53 (c)]	118,563	114,885	118,563	114,885
Provision for gratuity benefits	-	-	321,157	253,381
Payable to vendors for lease equipment	708,827	697,620	708,827	697,620
Other creditors	3,156,917	2,743,568	4,461,889	3,840,286
	5,720,896	5,840,718	7,359,236	7,279,639

53 EMPLOYEE RETIREMENT BENEFITS

Accounting Policy

Defined Benefit Plan

A defined benefit plan is a post-employment benefit plan other than a defined contribution plan.

[a] Pension Fund

The Bank operates an approved pension fund to facilitate the following payments for permanent staff of the Bank:

[a] i Pensions to Retiring Staff

Pensionable staff members who are in the permanent cadre are eligible to draw pension from the pension fund as per the trust deed dated 24th September 1981.

[a] ii Benefits to Staff who Opted for the Optional Scheme for Pension introduced in 2005

Staff members who opted for the optional scheme for pension introduced in 2005 are eligible for the payment in accordance with the terms and conditions agreed upon.

53 EMPLOYEE RETIREMENT BENEFITS [Contd.]

Accounting Policy**(a) iii Gratuity**

Gratuity would be the payments to staff who satisfy the criteria as per the Gratuity Act No 12 of 1983 at the time of leaving the services of the Bank without pension rights. Payment of gratuities to employees who have completed more than five years of service under the said act is covered through the Bank's own non-contributory pension scheme which is in force.

The Bank's obligation in respect of defined benefit pension plan is calculated by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods, and discounting that benefit to determine its present value, then deducting the fair value of any plan assets to determine the net amount to be shown in the statement of financial position. The value of any defined benefit asset is restricted to the present value of any economic benefits available in the form of refunds from the plan or reductions in the future contributions to the plan. In order to calculate the present value of economic benefits, consideration is given to any minimum funding requirements that apply to any plan in the Bank. An economic benefit is available to the Bank if it is realisable during the life of the plan, or on settlement of the plan liabilities.

The Bank determines the net interest expense / (income) on the net defined benefit liability / (asset) by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual period to the net defined benefit liability / (asset) at the beginning of the annual period.

The discount rate is the yield at the reporting date on government bonds that have maturity dates approximating to the terms of the Bank's obligations. The calculation is performed by a qualified actuary using the projected unit credit method.

The Bank recognises the total actuarial gains and losses that arise in calculating the Bank's obligation in respect of a plan in other comprehensive income during the period in which it occurs.

The demographic assumptions underlying the valuation are retirement age (55 yrs), early withdrawals from service and retirement on medical grounds, death before and after retirement etc. The assets of the fund are held separately from those of the Bank's assets and are administered independently by the trustees of the fund.

Details of pension fund are given in Note 53 (a) to the financial statements.

(b) Other Long-term Employee Benefits

The Bank's net obligation in respect of long-term employee benefits other than pension fund, is the amount of future benefit that employees have earned in return for their service in the current and prior periods. That benefit is discounted to determine its present value. The discount rate is the yield at the reporting date on government bonds that have maturity dates approximating to the terms of the Bank's obligation. The calculation is performed using the projected unit credit method. Any actuarial gains and losses are recognised in the statement of profit or loss in the period in which they arise. The Bank's liability towards the portion of the accumulated leave which is expected to be utilised beyond one year from the end of the reporting period is treated as other long term employee benefits.

(c) Gratuity Obligation - Group Companies

The subsidiaries of the Bank do not operate pension funds and make a provision for gratuity obligation. These liabilities are assessed either by actuarial valuations or by the use of gratuity formula. Provision for gratuity benefits of group companies is given in Note 52 to the financial statements.

(d) Employees' Provident Fund - Bank

Employees' Provident Fund is an approved private provident fund which has been set up to meet the provident fund liabilities of the Bank to which the Bank and employees contribute at 12% and 8% respectively on the salary of each employee. Staff members who are members of the fund are entitled to receive a minimum interest rate which is the higher of one year fixed deposit rate of HNB or National Savings Bank on their balance on a semi-annual basis. Accordingly this obligation was treated as a defined benefit liability and an actuarial valuation was conducted to value the Bank's obligation of the same.

(e) Widows', Widowers' and Orphans' Pension Fund

The Bank operates a separate Widows', Widowers' and Orphans' Pension Scheme [WW & OP] which was established with effect from 1st September 1995. The contributions are from employees only and the Bank does not have any legal or constructive obligation towards the above scheme.

Details of Widows', Widowers' and Orphans' Pension Fund are given in Note 53 (d) to the financial statements.

53 EMPLOYEE RETIREMENT BENEFITS [Contd.]

Accounting Policy

Defined Contribution Plans

A defined contribution plan is a post-employment plan under which an entity pays fixed contributions into a separate entity (a fund) and will have no legal or constructive obligation to pay a further contribution if the fund does not hold sufficient assets to pay all employee benefits relating to employee services in the current and prior periods. Obligations for contributions to defined contribution plans are recognised as an expense in the statement of profit or loss as and when they are due.

[a] Employees' Trust Fund

The Bank and the Group contribute 3% of the salary of each employee to the Employees' Trust Fund.

[b] Employees' Provident Fund – Group Companies

The Group entities and their employees contribute at 12% and 8% respectively on the salary of each employee to Employees' Provident Fund except for the Bank as explained below.

53 [a] Pension Fund - Bank

An actuarial valuation of the pension fund was carried out as at 31st December 2017 by Mr M Poopalanathan, AIA, M/s Actuarial and Management Consultants (Pvt) Ltd, a firm of professional actuaries. The valuation method used by the actuary to value the fund is the projected unit credit method, the method recommended by the Sri Lanka Accounting Standard - LKAS 19 on "Employee Benefits".

The Bank contributed 8.3% of the basic salary to the pension fund in respect of all employees in 2017. (2016: 20%)

The assets of the fund, which are independently administered by the trustees as per the provision of the Trust Deed are held separately from those of the Bank.

No additional provision has been made in the financial statements of the Bank for gratuities to employees who have completed five or more years of service, payable under the Payment of Gratuity Act No 12 of 1983 as the Bank contributes for all permanent employees to its own non-contributory pension scheme, which is in force.

53 [a] i Net Asset / [Liability] Recognised in the Statement of Financial Position

As at 31st December	2017 Rs 000	2016 Rs 000
Present value of funded obligation [Note 53 [a] iii]	14,338,923	12,543,413
Total present value of obligations	14,338,923	12,543,413
Fair value of plan assets [Note 53 [a] ii]	(16,058,433)	(14,499,380)
Present value of net surplus	(1,719,510)	(1,955,967)
Recognised asset for defined benefit obligations	(1,719,510)	(1,955,967)

The Bank is expecting to recover the above surplus by way of reduced future contributions to the pension fund and accordingly the Bank recognised a net receivable of Rs 1,720 Mn from the pension fund as the present value of the reduction in future contributions.

53 [a] ii Fair Value of Plan Assets consists of the following

As at 31st December	2017 Rs 000	2016 Rs 000
Equity securities and debentures	2,453,469	2,579,854
Government securities	5,163,492	5,155,437
Balance with Hatton National Bank PLC	6,340	335,487
Fixed deposits	8,383,617	6,456,570
Others	51,515	(27,968)
	16,058,433	14,499,380

Notes to the Financial Statements

53 EMPLOYEE RETIREMENT BENEFITS (Contd.)

53 (a) iii Movement in the Present Value of Defined Benefit Obligations

As at 31st December	2017 Rs 000	2016 Rs 000
Liability for defined benefit obligations as at 1st January	12,543,413	12,425,853
Current service cost	587,759	527,676
Interest on obligation	1,551,620	1,230,159
Actuarial (gains) / losses	322,131	(874,585)
Benefits paid by the plan	(666,000)	(765,690)
Liability for defined benefit obligations as at 31st December	14,338,923	12,543,413

53 (a) iv Movement in Fair Value of Plan Assets

As at 31st December	2017 Rs 000	2016 Rs 000
Fair value of plan assets as at 1st January	14,499,380	13,519,157
Expected return on plan assets	1,793,573	1,338,395
Contributions paid into plan	394,309	920,383
Benefits paid by the plan	(666,000)	(765,690)
Actuarial gains / (losses)	37,171	(512,865)
Fair value of plan assets as at 31st December	16,058,433	14,499,380

53 (a) v Net Interest on Defined Benefit Asset

For the year ended 31st December	2017 Rs 000	2016 Rs 000
Interest on obligation	1,551,620	1,230,159
Expected return of plan assets	(1,793,573)	(1,338,395)
Net interest on defined benefit asset	(241,953)	(108,236)

53 (a) vi Actuarial Gains and Losses Recognised in Other Comprehensive Income

For the year ended 31st December	2017 Rs 000	2016 Rs 000
Actuarial gains / (losses) on present value of defined benefit obligations	(322,131)	874,585
Actuarial gains / (losses) on fair value of plan assets	37,171	(512,865)
Actuarial gains / (losses) recognised during the year	(284,960)	361,720

53 (a) vii Actuarial Assumptions

For the year ended 31st December	2017 Rs 000	2016 Rs 000
Discount rate	10.70%	12.37%
Expected return on plan assets as at 1st January	12.37%	9.90%
Future salary increment rate	9.75%	11.25%
Future pension increments	Nil	Nil
Increase in cost of living allowance	9.75%	11.25%
Normal retirement age	55 years	55 years
Mortality	1967-70	1967-70
	Mortality Table issued by the Institute of Actuaries	Mortality Table issued by the Institute of Actuaries

The average duration of the pension fund obligation is 30 years as at 31st December 2017 (2016 - 28 years).

53 EMPLOYEE RETIREMENT BENEFITS [Contd.]

53 (a) viii Sensitivity of Assumptions Employed on Actuarial Valuation

Assumptions regarding discount rate and salary increment rate have a significant effect on the amounts recognised in the statement of comprehensive income and statement of financial position.

The following table demonstrates the sensitivity of a reasonably possible change in such assumptions with all other variables held constant, in the actuarial valuation of the pension fund as at 31st December 2017.

Increase / (decrease) in Discount Rate	Increase / (decrease) in Salary Increment Rate	Sensitivity Effect on Statement of Comprehensive Income Increase / (decrease) in results for the year Rs 000	Sensitivity Effect on Pension Fund Surplus Increase / (decrease) Rs 000
1%		1,249,734	1,249,734
-1%		(1,509,564)	(1,509,564)
	1%	(893,979)	(893,979)
	-1%	796,972	796,972

53 (b) Provision for EPF Interest Rate Guarantee Plan - Bank

EPF is an approved provident fund which has been set up to meet the provident fund liabilities of the Bank. Staff members who are members of the fund are entitled to receive a minimum interest rate which is the higher of one year fixed deposit rate of HNB or National Savings Bank on their balance on a semi-annual basis. Accordingly, this obligation was treated as a defined benefit liability and an actuarial valuation was conducted to value the Bank's obligation on same with the following actuarial assumptions.

Actuarial assumptions

As at 31st December	Bank	
	2017 Rs 000	2016 Rs 000
Discount rate	9.95%	9.95%
Long term interest rate to credit the fund	10.00%	10.00%

Liability for EPF interest rate guarantee

As at 31st December	Bank	
	2017 Rs 000	2016 Rs 000
Present value of obligation as at 1st January	57,434	54,237
Provision made during the year	1,518	3,197
Present value of obligation as at 31st December (Note 52)	58,952	57,434

Notes to the Financial Statements

53 EMPLOYEE RETIREMENT BENEFITS (Contd.)

53 [c] Provision for Leave Accrual Plan - Bank

Employees are entitled to accumulate annual leave up to a maximum of ninety days and such accumulated leave to be utilised prior to their retirement. This has been treated as other long term benefit in terms of Sri Lanka Accounting Standards - LKAS 19 on "Employee benefits" and an actuarial valuation has been conducted on same with the following assumptions.

Actuarial assumptions

As at 31st December	Bank	
	2017 Rs 000	2016 Rs 000
Discount rate	10.70%	12.37%
Future salary increase	9.75%	11.25%

Liability for leave accrual plan

As at 31st December	Bank	
	2017 Rs 000	2016 Rs 000
Present value of obligation as at 1st January	114,885	110,855
Charge / [reversal] of provision during the year	3,678	4,030
Present value of obligation as at 31st December [Note 52]	118,563	114,885

53 [d] Widows', Widowers' and Orphans' Pension Fund

The results of the actuarial valuation of the Widows', Widowers' and Orphans' Pension Fund indicate that the actuarial present value of the promised benefit is Rs 647 Mn and that the fair value of the fund assets is Rs 1,566 Mn resulting in a past service surplus of Rs 919 Mn (2016 : Rs 857 Mn) in the Widows', Widowers' and Orphans' Pension Scheme as at 31st December 2017.

No contribution is made by the Bank and the members' contribution during the period amounted to Rs 85.3 Mn.

54 STATED CAPITAL

In accordance with Section 58 of Companies Act No 7 of 2007, which became effective from 3rd May 2007, share capital and share premium have been classified as stated capital.

54 [a] Stated Capital - Bank / Group

As at 31st December	2017 Rs 000	2016 Rs 000
Voting ordinary shares		
Balance as at 1st January	12,338,734	11,110,689
Issue of shares under ESOP	143,110	157,128
Transfer from ESOP reserve *	47,516	48,444
Issue of shares through scrip dividend	1,044,073	1,022,473
Issue of shares through rights issue**	12,326,592	-
Balance as at 31st December	25,900,025	12,338,734
Non-voting ordinary shares		
Balance as at 1st January	3,001,424	2,716,184
Issue of shares under ESOP	20,568	21,813
Transfer from ESOP reserve *	6,390	6,820
Issue of shares through scrip dividend	262,093	256,607
Issue of shares through rights issue**	2,218,619	-
Balance as at 31st December	5,509,094	3,001,424
Stated capital as at 31st December	31,409,119	15,340,158

54 STATED CAPITAL [Contd.]

54 [b] Reconciliation of Number of Shares

As at 31st December	Bank	
	2017 Rs 000	2016 Rs 000
Voting ordinary shares		
Balance as at 1st January	330,756,782	324,405,445
Issue of shares under ESOP	998,013	1,088,993
Issue of shares through scrip dividend	4,519,797	5,262,344
Issue of shares through rights issue**	56,029,966	-
Balance as at 31st December	392,304,558	330,756,782
Non-voting ordinary shares		
Balance as at 1st January	83,058,692	81,415,925
Issue of shares under ESOP	203,031	225,050
Issue of shares through scrip dividend	1,310,462	1,417,717
Issue of shares through rights issue**	11,676,947	-
Balance as at 31st December	96,249,132	83,058,692
Total number of shares as at 31st December	488,553,690	413,815,474

* Fair value of options on the grant date relating to options exercised during the year has been transferred from the ESOP reserve to stated capital.

**At the Extra Ordinary General Meeting held on 5th July 2017, shareholders approved a resolution to issue 56,029,966 voting shares and 14,093,547 non-voting shares by way of a rights issue to the existing shareholders of the Bank in the proportion of one new ordinary share for every six ordinary shares (1 : 6) held as at the end of trading on 5th July 2017. These shares were to be issued at an issue price of Rs 220/- per each ordinary voting share and at an issue price of Rs 190/- per each ordinary non-voting share. Accordingly, Bank raised Rs 14.5 Bn through the issue of 56,029,966 voting shares and 11,676,947 non-voting shares.

The non-voting shares rank pari passu in respect of all rights with the ordinary shares of the Bank except voting rights on resolutions passed at general meetings. If the Bank fails to pay dividends for three consecutive years, these shares will automatically be converted into voting ordinary shares.

54 [c] Share-Based Payment Transactions

Accounting Policy

Equity Settled Share Based Payment Transactions

Fair value of equity settled share based payment awards granted to employees on the grant date is recognised as an employee expense, with a corresponding increase in equity, over the period in which the employees unconditionally became entitled to the awards. The amount recognised as an expense is adjusted to reflect the number of share awards for which the related service and non-market performance vesting conditions are expected to be met such that, the amount ultimately recognised as an expense is based on the number of share awards that do meet the related service and non-market performance conditions at the vesting date. For share based payment awards with non-vesting conditions, the grant date fair value of the share based payment is measured to reflect such conditions and there is no true-up for difference between expected and actual outcomes.

On 28th March 2008 the Bank established an employee share option scheme that entitled employees in the rank of management and above to purchase shares in the Bank. Holders of vested options are entitled to purchase shares at the given exercise prices. The total number of share options available to the eligible employees per year was 1.25% of shares issued by the Bank up to a maximum limit of 5% of the shares issued [both voting and non-voting] by the Bank in 4 years. The benefits under ESOP are accrued to eligible employees of the Bank in any particular year only if the conditions set out in the ESOP are met.

An eligible employee qualified to receive share options in a particular year by achieving a positive performance rating in the annual performance assessment. The amount of share options granted to each qualified eligible employee depended on his/her seniority in the Bank. This employee share option plan has potential dilutive effect on the earnings per share of the Bank.

The recognition and measurement principles in Sri Lanka Accounting Standard - SLFRS 2 on "Share based payment" have not been applied to the grants made in 2008 and 2010 based on the transitional provisions available in SLFRS 2. The standard is applied for share options granted after 1st January 2012 and have not been vested on the effective date of SLFRS 2.

The Bank made two further grants under the employee share option scheme on 30th March 2012 and 05th June 2013, which were recognised and measured in terms of SLFRS 2.

All options are to be settled by physical delivery of shares.

Notes to the Financial Statements

54 STATED CAPITAL [Contd.]

54 [c] Share-Based Payment Transactions [Contd.]

54 [c] i Employee Share Option Plan [Equity-Settled Share Based Payment Scheme]

	2017		2016	
	Weighted Average Exercise Price Rs	Number of Options	Weighted Average Exercise Price Rs	Number of Options
Outstanding as at 1st January	136.07	1,853,575	136.13	3,266,569
No of options granted in 2017 due to scrip dividend announced in 2016	135.68	48,457	-	-
No of options granted in 2017 due to scrip dividend announced in 2017	135.67	12,332	-	-
Exercised during the year	136.28	(1,201,044)	136.18	(1,314,043)
Expired during the year	134.66	(134,741)	136.51	(98,951)
Outstanding as at 31st December	135.94	578,579	136.07	1,853,575
Exercisable as at 31st December	135.94	578,579	136.07	1,853,575

The options outstanding as at 31st December 2017 have exercise prices in the range of Rs 110.04 to Rs 142.17 [2016: Rs 81.43 to Rs 145.79] and a weighted average contractual life of 0.42 years [2016 : 1.10 years]

The weighted average share price at the date of exercise, for share options exercised during the year ended 31st December 2017 was Rs 233.92 for voting shares and Rs 194.10 for non-voting shares [2016: Rs 217.20 voting and Rs 184.55 non-voting].

55 STATUTORY RESERVES

Statutory Reserve Fund

As at 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Balance as at 1st January	4,560,000	3,760,000	4,560,000	3,760,000
Transfers during the year	900,000	800,000	900,000	800,000
Balance as at 31st December	5,460,000	4,560,000	5,460,000	4,560,000

Statutory reserve fund is maintained as per the statutory requirements in terms of Section 20 [1] and [2] of the Banking Act No 30 of 1988.

This fund is built up by transferring a sum equivalent to not less than 5% of the profit after tax before any dividend is declared or any profits are transferred until the fund equals 50% of the Bank's stated capital. Thereafter a further sum equal to 2% of profit after tax is transferred until the fund equals to the stated capital of the Bank.

56 RETAINED EARNINGS

As at 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Balance as at 1st January	9,524,236	5,270,848	12,821,116	7,949,848
Profit for the year	16,466,790	14,143,406	15,946,989	14,755,634
Other comprehensive income for the year	(284,960)	362,934	(290,818)	368,586
Transfer to other reserves	(6,877,144)	(6,790,165)	(6,877,144)	(6,790,165)
Dividends	(3,635,337)	(3,462,787)	(3,635,337)	(3,462,787)
Deemed disposal gain through joint venture	-	-	117,478	-
Balance as at 31st December	15,193,585	9,524,236	18,082,284	12,821,116

57 OTHER RESERVES

57 [a] 2017

	Bank Opening Balance As at 1st January 2017 Rs 000	Movement/ Transfers Rs 000	Closing Balance As at 31st December 2017 Rs 000	Group Opening Balance As at 1st January 2017 Rs 000	Movement/ Transfers Rs 000	Closing Balance As at 31st December 2017 Rs 000
Capital reserve [Note 57 (c)]	8,644,483	81,059	8,725,542	19,771,905	(338,076)	19,433,829
Available for sale reserve [Note 57 (d)]	1,701,257	2,464,910	4,166,167	1,741,535	2,466,196	4,207,731
General reserve [Note 57 (e)]	37,100,000	6,000,000	43,100,000	37,100,000	6,000,000	43,100,000
ESOP reserve [Note 57 (f)]	147,092	(53,906)	93,186	147,092	(53,906)	93,186
Life policy holder reserve fund [Note 57 (g)]	-	-	-	(191,131)	414,402	223,271
	47,592,832	8,492,063	56,084,895	58,569,401	8,488,616	67,058,017

57 [b] 2016

	Bank Opening Balance As at 1st January 2017 Rs 000	Movement/ Transfers Rs 000	Closing Balance As at 31st December 2017 Rs 000	Group Opening Balance As at 1st January 2017 Rs 000	Movement/ Transfers Rs 000	Closing Balance As at 31st December 2017 Rs 000
Capital reserve [Note 57 (c)]	6,435,410	2,209,073	8,644,483	14,263,234	5,508,671	19,771,905
Available for sale reserve [Note 57 (d)]	4,455,566	(2,754,309)	1,701,257	4,518,441	(2,776,906)	1,741,535
General reserve [Note 57 (e)]	31,100,000	6,000,000	37,100,000	31,100,000	6,000,000	37,100,000
ESOP reserve [Note 57 (f)]	202,356	(55,264)	147,092	202,356	(55,264)	147,092
Life policy holder reserve fund [Note 57 (g)]	-	-	-	(56,350)	(134,781)	(191,131)
	42,193,332	5,399,500	47,592,832	50,027,681	8,541,720	58,569,401

57 [c] Capital Reserve

As at 31st December	Bank 2017 Rs 000	Bank 2016 Rs 000	Group 2017 Rs 000	Group 2016 Rs 000
Balance as at 1st January	8,644,483	6,435,410	19,771,905	14,263,234
Revaluation during the year	2,981,379	2,273,397	4,110,702	5,656,382
Deferred tax effect on				
Revaluation of freehold land and buildings	(2,900,320)	(54,489)	(4,448,778)	(137,876)
Amount transferred to retained earnings				
on disposal of property, plant and equipment	-	(9,835)	-	(9,835)
Balance as at 31st December	8,725,542	8,644,483	19,433,829	19,771,905

Capital reserve relates to revaluation surplus that resulted from the revaluation of freehold land and buildings carried out in 1989, 1993, 2007, 2012, 2015, 2016 and 2017.

Notes to the Financial Statements

57 OTHER RESERVES [Contd.]

57 [d] Available-for-sale Reserve

As at 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Balance as at 1st January	1,701,257	4,455,566	1,741,535	4,518,441
Net change in fair value during the year	3,308,142	(3,158,637)	3,331,781	(3,191,009)
Net amount transferred to profit or loss	83,249	-	64,958	8,680
Deferred tax effect	(926,481)	404,328	(930,543)	405,423
Balance as at 31st December	4,166,167	1,701,257	4,207,731	1,741,535

The available for sale reserve comprises of the cumulative net change in fair value of available-for-sale financial investments until the assets are de-recognised or impaired.

57 [e] General Reserve

As at 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Balance as at 1st January	37,100,000	31,100,000	37,100,000	31,100,000
Transfer during the year	6,000,000	6,000,000	6,000,000	6,000,000
Balance as at 31st December	43,100,000	37,100,000	43,100,000	37,100,000

General reserve comprises of the amounts appropriated by the Board of Directors as a general banking reserve.

57 [f] ESOP Reserve

As at 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Balance as at 1st January	147,092	202,356	147,092	202,356
Transfer to stated capital	(53,906)	(55,264)	(53,906)	(55,264)
Balance as at 31st December	93,186	147,092	93,186	147,092

ESOP reserve consists of the liability recognised on account of the ESOP allocations granted in 2012 and 2013.

57 [g] Life Policy Holder Reserve Fund

As at 31st December	Group	
	2017 Rs 000	2016 Rs 000
Balance as at 1st January	(191,131)	(56,350)
Transfer to / (from) life policy holder reserve fund	414,402	(134,781)
Balance as at 31st December	223,271	(191,131)

58 NON-CONTROLLING INTERESTS

As at 31st December	Group	
	2017 Rs 000	2016 Rs 000
Subsidiaries		
HNB Assurance PLC	1,295,931	1,086,409
HNB Grameen Finance Ltd	2,352,772	1,934,614
Total	3,648,703	3,021,023

59 CONTINGENT LIABILITIES AND COMMITMENTS

Commitments and Contingencies

Contingent liabilities are possible obligations whose existence will be confirmed only by uncertain future events or present obligations where the transfer of economic benefit is not probable or cannot be reliably measured as defined in the Sri Lanka Accounting Standard - LKAS 37 on "Provisions, contingent liabilities and contingent assets".

To meet the financial needs of customers, the Group enters into various irrevocable commitments and contingent liabilities. These consist of financial guarantees, letters of credit and other undrawn commitments to lend. Letters of credit and guarantees (including standby letters of credit) commit the Group to make payments on behalf of customers in the event of a specific act, generally related to the import or export of goods. Guarantees and standby letters of credit carry a similar credit risk to loans. Operating lease commitments of the Bank (as a lessor and as a lessee) and pending legal claims against the Group also form part of commitments of the Group. Contingent liabilities are not recognised in the statement of financial position but are disclosed unless they are remote. But these contingent liabilities do contain credit risk and therefore form part of the overall risk of the Group.

All discernible risks are accounted for in determining the amount of all known liabilities. The Group's share of any contingencies and capital commitments of a subsidiary or joint venture for which the Group is also liable severally or otherwise are also included with appropriate disclosures.

Financial Guarantees

Financial guarantees are initially recognised in the financial statements within 'other liabilities' at fair value, being the premium received. Subsequent to initial recognition, the Group's liability under each guarantee is measured at the higher of the amount initially recognised less cumulative amortisation recognised in the statement of profit or loss, and the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee.

Any increase in the liability relating to financial guarantees is recorded in the statement of profit or loss. The premium received is recognised in the statement of profit or loss in 'net fee and commission income' on a straight line basis over the life of the guarantee.

No material losses are anticipated as a result of these commitments and contingencies.

59 [a] Commitments and Contingent Liabilities - Bank / Group

As at 31st December	2017 Rs 000	2016 Rs 000
Documentary credit	28,291,149	24,629,974
Guarantees	124,389,833	108,900,608
Acceptances	17,913,826	15,827,724
Bills for collection	10,952,695	11,321,870
Forward exchange contracts		
Forward exchange sales	24,743,007	25,559,988
Forward exchange purchases	77,923,587	95,863,030
Cheques sent on clearing	5,358,110	5,122,910
Commitments for unutilised facilities - direct	165,822,760	114,244,896
Commitments for unutilised facilities - indirect	142,969,759	100,901,909
Total - Bank	598,364,726	502,372,909

59 [b] Capital Commitments

Capital expenditure approved by the Board of Directors for which provision has not been made in the accounts amounts to approximately Rs 737 Mn.

As at 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Approved and contracted but not provided for	473,413	592,401	473,413	592,401
Approved and not contracted for	263,470	-	263,470	-
	736,883	592,401	736,883	592,401

Notes to the Financial Statements

59 CONTINGENT LIABILITIES AND COMMITMENTS [Contd.]

59 [c] Operating leases

Operating leases are those leasing arrangements that do not transfer to the Bank, substantially all the risks and rewards incidental to ownership of the leased items.

When the Bank is the lessee, leased assets are not recognised in the statement of financial position. Rentals payable under operating leases are accounted for on a straight line basis over the periods of the leases and are included in the statement of profit or loss.

59 [c] i Future Monthly Commitments on Operating Leases

As at 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Less than 1 year	1,163,762	1,130,976	1,331,417	1,310,875
1-5 years	1,370,318	2,033,164	1,775,442	2,509,080
6-10 years	235,663	256,040	278,109	277,123
11-15 years	30,458	27,570	33,158	35,625
Above 15 years	8,660	-	13,700	-
	2,808,861	3,447,750	3,431,826	4,132,703

59 [d] Litigation against the Bank

Litigation is a common occurrence in the banking industry due to the nature of the business undertaken.

The Bank has formal controls and policies in place for managing legal claims. Once professional advice has been obtained and the amount of loss is reasonably estimated, the Bank makes adjustments to accounts for any adverse effects of such claims on its financial standing.

The Bank confirms that there is no case (including the LT cases) filed against the Bank, which is not disclosed that would have a material impact on the financial position of the Bank.

59 [e] Tax Assessments

59 [e] i Tax assessments against the bank

Assessments to the value of Rs 230.9 Mn on Financial Services VAT (relating to 2003, 2004 and 2012) and assessments to the value of Rs 471.1 Mn on PAYE tax (relating to Y/A 2012/13 and 2013/14) received by the Bank are outstanding and have been duly appealed.

59 [e] ii Tax assessments against group entity - HNB Assurance PLC [Company]

Assessments to the value of Rs 13.3 Mn on VAT on Reinsurance Claims and Commissions (relating to Y/A 2010/11) and assessments to the value of Rs 268 Mn on Income tax (relating to Y/A 2011/12, 2012/13, 2013/14 and 2014/15) received by the Company are outstanding and have been duly appealed.

The Group is of the view that the above assessments will not have any material impact on the financial statements.

60 RELATED PARTY DISCLOSURES

The Bank carries out transactions with parties who are defined as related parties in the Sri Lanka Accounting Standard - LKAS 24 on "Related party disclosures", in the ordinary course of its business. The details of such transactions are reported below. The pricing applicable to such transactions is based on the assessment of risk and pricing model of the Bank and is comparable with what is applied to transactions between the Bank and its unrelated customers.

60 [a] Parent and ultimate controlling party

The Bank does not have an identifiable parent of its own.

60 RELATED PARTY DISCLOSURES (Contd.)

60 (b) Transactions with Key Management Personnel (KMP)

According to Sri Lanka Accounting Standard - LKAS 24 on "Related party disclosures", Key Management Personnel (KMP) are those having authority and responsibility for planning, directing and controlling the activities of the entity.

Accordingly, the Bank's KMP include the Board of Directors (including executive and non-executive directors) and selected key employees who meet the above criteria.

Key Management Personnel (KMP) of the Group

Bank is the ultimate parent of its subsidiaries listed out in Note 36 to the financial statements. Thus the KMP of the Bank have the authority and responsibility for planning, directing and controlling the activities of the Group and have been identified as KMP of the Group as well.

Close Family Members (CFMs) of KMP are those family members who may be expected to influence, or be influenced by that KMP in their dealings with the entity. CFMs may include the domestic partner and children of KMP, the children of KMP's domestic partner and dependents of KMP and the KMP's domestic partner.

60 (b) i Compensation to KMP

As at 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Short term employment benefits				
Board of Directors and other KMP	153,631	122,903	158,748	127,673

60 (b) ii Transactions, Arrangements and Agreements involving Key Management Personnel (KMP) and their Close Family Members (CFMs)

Statement of Financial Position-Bank

As at 31st December	Closing Balance		Average Balance	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Assets				
Loans and receivables to customers	103,198	90,259	92,856	76,193
	103,198	90,259	92,856	76,193
Liabilities				
Securities sold under repurchase agreements		-		7,580
Debt securities issued and subordinated term debt	10,000	10,000	10,000	10,000
Due to customers	349,983	248,200	274,022	198,462
	359,983	258,200	284,022	216,042

As at 31st December	Closing Balance	
	2017 Rs 000	2016 Rs 000
Commitments for unutilised facilities - Direct	55,300	42,237
	55,300	42,237

Notes to the Financial Statements

60 RELATED PARTY DISCLOSURES [Contd.]

60 (b) Transactions with Key Management Personnel [KMP] [Contd.]

60 (b) ii Transactions, Arrangements and Agreements involving Key Management Personnel [KMP] and their Close Family [Contd.]

Statement of Profit or Loss - Bank

For the year ended 31st December	2017 Rs 000	2016 Rs 000
Interest income	9,400	6,203
Interest expenses	24,433	13,746

Details of ESOPs granted to KMP are given below.

For the year ended 31st December	2017	2016
Number of options exercised during the year	50,528	99,926
Number of options remaining as at 31st December	49,398	99,926
Number of shares held by KMP	2017	2016
Voting	199,945	119,395
Non- Voting	45,796	26,369

Dividend paid to KMP amounts to Rs 640,000 in 2017 [2016: Rs 361,884]

60 (b) iii Transactions, Arrangements and Agreements with Entities which are controlled and/or jointly controlled by the KMP or their Close Family Members [CFMs]

Statement of Financial Position - Bank

As at 31st December	Closing Balance		Average Balance	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
Assets				
Loans and receivables to customers	19,292	3,432,032	10,149	3,266,397
	19,292	3,432,032	10,149	3,266,297
Liabilities				
Due to customer	25,870	260,641	26,203	173,904
	25,870	260,641	26,203	173,904

Commitments and contingencies

As at 31st December	Closing Balance	
	2017 Rs 000	2016 Rs 000
Guarantees	68,220	35,080
Documentary credit	-	730,010
Commitments for unutilised facilities		
Direct	9,961	2,579,150
Indirect	7,160	412,860
	85,341	3,757,100

Statement of Profit or Loss - Bank

For the year ended 31st December	2017 Rs 000	2016 Rs 000
Interest income	1,351	359,380
Interest expenses	2,453	8,306

60 RELATED PARTY DISCLOSURES (Contd.)

60 [c] Transactions with Group Entities

The Group entities include subsidiaries and joint venture of the Bank.

60 [c] i Transactions with Subsidiaries

Statement of Financial Position - Bank

As at 31st December	Closing Balance		Average Balance	
	2017	2016	2017	2016
	Rs 000	Rs 000	Rs 000	Rs 000
Assets				
Loans and receivables to customers	1,434,582	586,729	521,660	102,163
Other assets	491,058	495,256	492,370	497,718
	1,925,640	1,081,985	1,014,030	599,881
Liabilities				
Securities sold under repurchase agreements	-	-	165,940	132,860
Debt securities issued and subordinated term debt	385,644	381,073	385,644	414,785
Due to customers	2,058,743	1,197,536	2,111,916	1,300,462
	2,444,387	1,578,609	2,663,500	1,848,107

Commitments and contingencies

As at 31st December	Closing Balance	
	2017	2016
	Rs 000	Rs 000
Commitments for unutilised facilities		
Direct	50,000	50,000
	50,000	50,000

Statement of Profit or Loss - Bank

For the year ended 31st December	2017	2016
	Rs 000	Rs 000
Interest income	120,713	62,608
Interest expenses	195,552	134,589
Other income	2,045,062	884,609
Other expenses	776,283	749,591
Other transactions		
Expenses reimbursed to the bank	38,186	56,294
Expenses reimbursed by the bank	87,252	89,717
Insurance claims received	17,389	8,752

Notes to the Financial Statements

60 RELATED PARTY DISCLOSURES [Contd.]

60 (c) Transactions with Group Entities [Contd.]

60 (c) ii Transactions with the Joint Venture

Statement of Financial Position - Bank

As at 31st December	Closing Balance		Average Balance	
	2017	2016	2017	2016
	Rs 000	Rs 000	Rs 000	Rs 000
Assets				
Loans and receivables to customers	295,313	459,491	367,137	359,497
	295,313	459,491	367,137	359,497
Liabilities				
Due to customers	79,806	50,306	68,644	91,548
Securities sold under repurchase agreements	24,520	13,690	43,940	64,440
	104,326	63,996	112,584	155,988

Commitments and contingencies

As at 31st December	Closing Balance	
	2017	2016
	Rs 000	Rs 000
Commitments for unutilised facilities		
Direct	3,503,440	3,814,270
	3,503,440	3,814,270

Statement of Profit or Loss - Bank

For the year ended 31st December	2017	2016
	Rs 000	Rs 000
Interest income	47,677	41,175
Interest expenses	4,756	13,299
Other income	38,512	36,662
Other expenses	5,809	9,601

60 (d) Transactions with Post Employment Benefit Plans of the Bank

Statement of Financial Position - Bank

As at 31st December	Closing Balance		Average Balance	
	2017	2016	2017	2016
	Rs 000	Rs 000	Rs 000	Rs 000
Liabilities				
Due to customers	13,738,149	13,427,401	12,923,095	12,490,093
Debt securities issued and subordinated term debts	683,429	719,806	683,429	623,618
Securities sold under repurchase agreements	120,000	73,100	154,290	565,590
	14,541,578	14,220,307	13,760,814	13,679,301
Equity				
Stated capital	172,131	139,379	155,068	125,534
	172,131	139,379	155,068	125,534

Statement of profit or loss - Bank

As at 31st December	Closing Balance	
	2017	2016
	Rs 000	Rs 000
Interest expenses	1,834,342	1,278,546
Other Transactions		
Dividends paid	6,663	4,693
Contributions made	1,444,572	1,853,213

60 RELATED PARTY DISCLOSURES (Contd.)

60 (e) Transactions with Government of Sri Lanka/ Entities Controlled, Jointly Controlled, Significantly Influenced by the Government of Sri Lanka

The Government of Sri Lanka indirectly holds more than 25% of the voting rights of the Bank as at 31st December 2017 through Sri Lanka Insurance Corporation Ltd, Employees Provident Fund, National Savings Bank and Employees Trust Fund. Accordingly, the Bank has considered Government of Sri Lanka and other entities which are controlled, jointly controlled or significantly influenced by the Government of Sri Lanka [government related entities] as related parties according to Sri Lanka Accounting Standard - LKAS 24 on "Related party disclosures".

During the year ended 31st December 2017, the Bank has carried out transactions with the Government of Sri Lanka and other government related entities in the ordinary course of its business, the details of which are given below. The pricing applicable to such transactions was based on the assessment of risk and pricing model of the Bank and was comparable with what was applied to transactions between the Bank and its unrelated customers.

Statement of Financial Position - Bank

As at 31st December	Closing Balance		Average Balance	
	2017	2016	2017	2016
	Rs 000	Rs 000	Rs 000	Rs 000
Assets				
Balances with Central Bank of Sri Lanka	38,610,940	33,777,614	35,829,909	29,157,412
Reverse repurchase agreements	-	-	3,267,000	3,062,220
Financial investments - held for trading and available for sale	198,614,713	169,081,310	184,711,928	166,685,751
Loans and receivables to customers (gross)	57,814,676	59,280,341	55,347,797	44,150,907
Placements with banks	2,145,500	118,000	7,291,071	3,243,336
Financial investments - loans and receivables	4,058,120	4,208,320	4,123,350	2,514,510
	301,243,949	266,465,585	290,571,055	248,814,136
Liabilities				
Due to customers	16,961,213	20,034,249	15,688,298	17,673,182
Due to banks	3,373,786	2,144,842	8,470,844	4,421,991
Debt securities issued and subordinated term debts	10,358,942	9,329,233	10,358,942	6,893,026
Securities sold under repurchase agreements	1,611,250	2,887,860	5,555,350	3,267,960
Other borrowings	5,000,000	5,000,000	5,000,000	5,000,000
Taxation	3,974,624	6,223,943	6,194,366	5,657,816
	41,279,815	45,620,127	51,267,800	42,913,975

Commitments and contingencies

As at 31st December	Closing Balance	
	2017	2016
	Rs 000	Rs 000
Forward foreign exchange contracts		
Sales - Rs 000	12,371,250	35,467,025
Documentary credit	233,540	1,158,710
Guarantee	4,375,860	4,788,600
Commitments for unutilised facilities		
Direct - Rs 000	26,242,162	26,749,829
Indirect - Rs 000	2,724,140	1,212,710

Statement of Profit or Loss - Bank

For the year ended 31st December	2017		2016	
	Rs 000		Rs 000	
	Rs 000		Rs 000	
Interest income	20,652,218	16,724,022		
Interest expenses	2,351,803	1,961,706		
Other income	-	7,960		
Impairment charge for loans and other losses	3,177,168	15,559		
Tax expenses (income tax, financial services VAT, NBT)	9,580,397	10,151,582		

Transactions which are not individually significant

Apart from the transactions listed above the Bank has carried out transactions with the Government of Sri Lanka and other government related entities in the form of utility bills, telephone charges, deposit insurance payments, crib charges etc. The total of such payments made during the year ended 31st December 2017 was Rs. 542.63 Mn [2016 - Rs. 473.80 Mn].

In accordance with CSE rules there are no recurrent related party transactions which in aggregate exceeds more than 10% of the gross revenue of the Group, other than the transactions carried out with Government of Sri Lanka and Employees Provident Fund of HNB.

Notes to the Financial Statements

61 MATURITY ANALYSIS

61 [a] As at 31st December 2017

	Within 12 months Rs 000	Bank More than 12 months Rs 000	Total Rs 000	Within 12 months Rs 000	Group More than 12 months Rs 000	Total Rs 000
Assets						
Cash and cash equivalents	21,739,800	-	21,739,800	21,924,898	-	21,924,898
Placements with banks	3,182,377	-	3,182,377	8,536,426	1,133,699	9,670,125
Balances with Central Bank of Sri Lanka	-	38,610,940	38,610,940	-	38,610,940	38,610,940
Reverse repurchase agreements	-	-	-	772,002	-	772,002
Derivative financial instruments	615,357	-	615,357	615,357	-	615,357
Financial investments - fair value through profit or loss	120,486	-	120,486	266,538	-	266,538
Loans and receivables to customers	280,107,227	358,994,834	639,102,061	293,093,769	362,519,169	655,612,938
Financial investments - loans and receivables	17,433,697	104,765,351	122,199,048	18,149,411	106,882,260	125,031,671
Financial investments - available-for-sale	46,375,466	49,028,354	95,403,820	46,717,913	55,025,072	101,742,985
Financial investments - held-to-maturity	-	-	-	1,565,603	-	1,565,603
Investment in joint venture	-	755,000	755,000	-	1,689,263	1,689,263
Investments in subsidiaries	-	3,017,285	3,017,285	-	-	-
Investment properties	-	327,464	327,464	-	1,146,564	1,146,564
Property, plant and equipment	-	17,905,320	17,905,320	-	34,635,034	34,635,034
Intangible assets and goodwill	-	815,381	815,381	-	1,237,829	1,237,829
Other assets	4,301,735	6,781,507	11,083,242	6,241,524	6,796,698	13,038,222
Total assets	373,876,145	581,001,436	954,877,581	397,883,441	609,676,528	1,007,559,969
Liabilities						
Due to banks	25,681,363	36,782,134	62,463,497	25,682,257	36,782,134	62,464,391
Derivative financial instruments	1,305,900	-	1,305,900	1,305,900	-	1,305,900
Securities sold under repurchase agreements	5,064,360	-	5,064,360	5,064,360	-	5,064,360
Due to customers	686,612,698	14,906,599	701,519,297	694,660,070	24,109,981	718,770,051
Dividends payable	975,371	-	975,371	986,880	-	986,880
Other borrowings	6,692,296	20,565,710	27,258,006	6,692,296	20,565,710	27,258,006
Debt securities issued	165,606	4,374,653	4,540,259	170,720	4,865,238	5,035,958
Current tax liabilities	3,974,624	-	3,974,624	4,066,087	-	4,066,087
Deferred tax liabilities	-	5,082,636	5,082,636	-	7,309,283	7,309,283
Insurance provision - life	-	-	-	115,037	10,800,821	10,915,858
Insurance provision - general	-	-	-	2,384,908	-	2,384,908
Other provisions	3,015,875	-	3,015,875	3,416,332	-	3,416,332
Other liabilities	5,357,924	362,972	5,720,896	6,554,532	804,704	7,359,236
Subordinated term debts	5,217,113	20,592,148	25,809,261	5,169,338	20,395,258	25,564,596
Shareholders' funds	-	108,147,599	108,147,599	-	125,658,123	125,658,123
Total liabilities	744,063,130	210,814,451	954,877,581	756,268,717	251,291,252	1,007,559,969
Maturity gap	(370,186,985)	370,186,985		(358,385,276)	358,385,276	
Cumulative gap	(370,186,985)	-		(358,385,276)	-	

61 MATURITY ANALYSIS [Contd.]

61 [b] As at 31st December 2016

	Bank			Group		
	Within	More than	Total	Within	More than	Total
	12 months	12 months		12 months	12 months	
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Assets						
Cash and cash equivalents	17,511,446	-	17,511,446	18,668,703	-	18,668,703
Placements with banks	753,050	-	753,050	1,391,274	807,172	2,198,446
Balances with Central Bank of Sri Lanka	-	33,777,614	33,777,614	-	33,777,614	33,777,614
Reverse repurchase agreements	4,303,460	-	4,303,460	5,756,794	-	5,756,794
Derivative financial instruments	289,989	-	289,989	289,989	-	289,989
Financial investments - fair value through profit or loss	544,915	-	544,915	716,009	-	716,009
Loans and receivables to customers	322,385,348	262,027,379	584,412,727	334,291,542	263,175,918	597,467,460
Financial investments -						
Loans and receivables	42,366,749	56,893,949	99,260,698	42,714,722	59,348,507	102,063,229
Financial investments - available-for-sale	37,062,483	52,852,670	89,915,153	38,726,384	57,070,758	95,797,142
Financial investments - held-to-maturity	-	-	-	291,056	174,025	465,081
Investment in joint venture	-	755,000	755,000	-	1,450,806	1,450,806
Investments in subsidiaries	-	3,017,285	3,017,285	-	-	-
Investment properties	-	403,959	403,959	-	1,054,300	1,054,300
Property, plant and equipment	-	13,945,002	13,945,002	-	29,844,234	29,844,234
Intangible assets and goodwill	-	789,648	789,648	-	1,180,269	1,180,269
Other assets	3,145,664	6,048,215	9,193,879	4,737,377	5,983,130	10,720,507
Total assets	428,363,104	430,510,721	858,873,825	447,583,850	453,866,733	901,450,583
Liabilities						
Due to banks	41,680,338	28,248,451	69,928,789	41,702,893	28,261,487	69,964,380
Derivative financial instruments	665,890	-	665,890	665,890	-	665,890
Securities sold under repurchase agreements	13,458,127	-	13,458,127	13,458,127	-	13,458,127
Due to customers	606,310,053	17,184,916	623,494,969	613,320,466	22,050,631	635,371,097
Dividends payable	1,007,075	-	1,007,075	1,015,463	-	1,015,463
Other borrowings	3,045,640	24,084,718	27,130,358	2,900,657	24,229,701	27,130,358
Debt securities issued	329,831	4,323,226	4,653,057	318,862	4,796,939	5,115,801
Current tax liabilities	6,223,943	-	6,223,943	6,425,379	-	6,425,379
Deferred tax liabilities	-	231,364	231,364	-	824,778	824,778
Insurance provision - life	-	-	-	902,525	7,845,331	8,747,856
Insurance provision - general	-	-	-	1,921,567	-	1,921,567
Other provisions	3,158,444	-	3,158,444	3,407,050	-	3,407,050
Other liabilities	5,338,092	413,015	5,751,107	6,648,756	541,272	7,190,028
Subordinated term debts	1,255,750	24,897,726	26,153,476	1,214,726	24,686,384	25,901,110
Shareholders' funds	-	77,017,226	77,017,226	-	94,311,698	94,311,698
Total liabilities	682,473,183	176,400,642	858,873,825	693,902,361	207,548,221	901,450,582
Maturity gap	(254,110,079)	254,110,079		(246,318,511)	246,318,512	
Cumulative gap	(254,110,079)	-		(246,318,511)	-	

Accounting Policy

An operating segment is a component of the Group that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of the Group's other components, whose operating results are reviewed regularly by the chief operating decision maker to make decisions about resources allocated to each segment and assess its performance, and for which discrete financial information is available.

Group's activities have been segregated into five different segments (banking, leasing / hire purchase, property, insurance and others) based on the business activities that each unit is engaged for the purpose of reviewing the operating results of the Group as well as to make decisions about resource allocation. The operating results of the Bank is split between banking and leasing / hire purchase activities. Property and insurance represent the operating results and financial position of the subsidiaries, Sithma Development (Pvt) Ltd and HNB Assurance PLC respectively. Operating results and financial position of HNB Grammeen Finance Ltd is presented as others.

Management monitors the operating results of its business units separately for the purpose of making decisions about resource allocation and performance assessment. Segment performance is evaluated based on operating profits or losses which, in certain respects, are measured differently from operating profits or losses in the consolidated financial statements.

Inter segment transactions are accounted for at fair market prices, charged to inter-bank counterparts for similar services on an arm's length basis. Such transfers are eliminated on consolidation.

Income taxes are not allocated to operating segments. Other expenses which cannot be directly identified against a particular business segment have been treated as consolidation adjustments.

No revenue from transactions with a single external customer or counter party amounted to 10% or more of the Bank's total revenue in 2017 or in 2016.

Segment information is presented in respect of the Group's business segments. The Group's primary format for segment reporting is based on business segments. The business segments are determined based on the Group's management and internal reporting structure.

	Banking		Leasing/Hire purchase		Property		Insurance		Others*		Eliminations / Unallocated		Consolidated	
	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Net interest income	37,461,688	32,246,731	2,286,276	2,185,546	-	-	1,636,150	1,130,726	4,116,056	3,559,806	(38,903)	(33,950)	45,461,267	39,088,859
Net fee and commission income	8,307,388	7,046,721	-	-	-	-	129,099	139,815	577,899	598,812	-	-	9,014,386	7,725,348
Net gain/(loss) from trading	(3,711,203)	(1,795,691)	-	-	-	-	14,360	(17,761)	1,185	(11,000)	-	-	(3,695,658)	(1,824,452)
Net gain from financial investments	212,129	111,713	-	-	-	-	34,772	(8,548)	265	-	-	-	247,166	103,165
Net insurance premium income	-	-	-	-	-	-	6,326,292	5,490,712	-	-	-	-	6,326,292	5,490,712
Other operating income	5,193,106	3,251,305	-	-	217,902	193,836	50,792	19,063	238,422	238,122	(1,954,640)	(820,361)	3,745,582	2,781,965
Operating income by segment	47,463,108	40,860,779	2,286,276	2,185,546	217,902	193,836	8,191,465	6,754,007	4,933,827	4,325,740	(1,993,543)	(854,311)	61,099,035	53,365,597
Inter-segment revenue	(85,810)	(22,701)	-	-	769,307	746,739	114,324	142,809	81,618	63,050	(879,499)	(929,897)	-	-
Total operating income	47,377,298	40,838,078	2,286,276	2,185,546	987,209	940,575	8,305,789	6,896,816	5,015,445	4,388,790	(2,872,982)	(1,884,208)	61,099,035	53,365,597
Impairment charge for loans and other losses	3,444,423	278,785	(408,955)	(41,625)	-	-	(1,114)	4,434	891,795	266,565	-	-	3,926,149	508,159
Net operating income	43,932,875	40,559,293	2,695,231	2,227,171	987,209	940,575	8,306,903	6,892,382	4,123,650	4,122,225	(2,872,982)	(1,884,208)	57,172,886	52,857,438
Segment result	20,532,754	19,004,565	2,646,262	2,177,194	697,242	726,669	997,734	770,509	1,624,538	2,031,957	(2,042,690)	(967,209)	24,455,840	23,743,685

	Banking		Leasing/Hire purchase		Property		Insurance		Others*		Eliminations / Unallocated		Consolidated	
	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Unallocated operating expenses													(1,528,444)	(1,393,828)
Operating profit													22,927,396	22,349,857
Share of profit of joint venture													175,616	148,790
Income tax expense													(6,361,616)	(6,893,685)
Profit for the year													16,741,396	15,664,962
Non-controlling interests													(794,407)	(909,328)
Profit attributable to the Equity Holders of the Bank													15,946,989	14,755,634
Profit for the year													16,741,396	15,664,962
Other comprehensive income, net of tax	2,261,009	(172,467)	-	-	-	479	25,288	141,117	(455,367)	3,222,871	1,870,036	3,192,000	18,611,432	18,858,962
Total Comprehensive income													(827,141)	(991,142)
Non-controlling interests													17,784,291	17,865,820
Total comprehensive income attributable to the Equity Holders of the Bank	878,273,014	789,151,149	42,700,875	41,617,904	10,142,140	14,528,854	18,614,934	1,421,686	2,247,019	976,673,582	876,363,095	1,689,263	1,450,806	
Investment in joint venture													29,197,144	23,726,292
Unallocated assets													100,559,969	901,540,193
Total Assets	785,259,705	723,866,782	42,700,875	41,617,904	1,626,680	11,831,797	14,852,436	15,292,385	(2,467,193)	863,132,444	790,766,951	18,769,402	16,461,544	
Segment liabilities													881,901,846	807,228,495
Unallocated liabilities														
Total liabilities														
Cash flows from operating activities	18,389,344	11,575,535	7855,962	(2,891,643)	639,616	1,292,190	1,509,809	(248,916)	1,938,436	2,878,557	33,509,187	13,322,857		
Cash flows from investing activities	(24,097,065)	(28,753,613)	-	-	24,964	(953,592)	(1,385,046)	992,446	2,250,539	(3,107,221)	27,069,214	(31,906,514)		
Cash flows from financing activities	4,509,440	23,397,792	-	-	(590,000)	(100,000)	(250,000)	382,056	940,591	(223,022)	4,287,901	22,856,826		
Capital Expenditure	1,860,436	1,344,022	136,392	4,440	38,300	111,362	80,839	204,865	-	71,756	2,296,235	1,749,220		
Depreciation	872,654	815,620	140	172	163,281	44,882	51,770	104,156	36,635	3,196	1,247,075	1,133,471		
Amortisation	236,381	200,413	19,627	19,725	67	20,106	18,937	20,046	-	-	309,768	260,357		

* Business of HNB Grameen Finance Limited

Notes to the Financial Statements

63 NET ASSETS VALUE PER ORDINARY SHARE

As at 31st December	Bank		Group	
	2017 Rs 000	2016 Rs 000	2017 Rs 000	2016 Rs 000
<i>Amount used as the numerator:</i>				
Equity holders funds [Rs 000]	108,147,599	77,017,226	122,009,420	91,290,675
<i>Number of ordinary shares used as the denominator:</i>				
Total number of shares	488,553,690	413,815,474	488,553,690	413,815,474
Net assets value per share [Rs]	221.36	186.11	249.74	220.61

64 EVENTS OCCURRING AFTER THE REPORTING PERIOD

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

There are no events occurring after the reporting date which require adjustments to or disclosure in the financial statements, other than those disclosed below:

64 [a] Proposed Dividends

Refer Note 22 [a].

65 COMPARATIVE INFORMATION

The presentation and classification of the following items in these financial statements are amended to ensure the comparability with the current year.

	Note	As disclosed previously Rs 000	Bank Current Presentation Rs 000	Adjustment Rs 000	As disclosed previously Rs 000	Group Current Presentation Rs 000	Adjustment Rs 000
<i>Statement of Financial Position</i>							
Other assets	65 [a]	9,193,878	9,283,489	(89,611)	10,720,506	10,810,117	(89,611)
Other liabilities	65 [a]	5,751,107	5,840,718	(89,611)	7,190,028	7,279,639	(89,611)
Due to banks	65 [b]	69,928,789	69,219,302	709,487	69,964,380	69,254,893	709,487
Other borrowings	65 [b]	27,130,358	27,839,845	(709,487)	27,130,358	27,839,845	(709,487)

65 [a] Withholding tax payable of Rs 89 Mn classified in "other assets" has been reclassified as "other liabilities".

65 [b] Refinance borrowings from other institutions classified as "due to banks" has been reclassified as "other borrowings".

66 DIRECTORS' RESPONSIBILITY STATEMENT

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

Please refer to page 116 for the statement of the Directors' Responsibility for Financial Reporting.

Statement of Profit or Loss in US Dollars

For the year ended 31st December	Bank		Group	
	2017 US\$ 000	2016 US\$ 000	2017 US\$ 000	2016 US\$ 000
Gross income	693,606	562,620	781,463	640,259
Interest income	627,572	504,307	678,031	543,829
Less: Interest expenses	368,849	275,048	381,383	283,106
Net interest income	258,723	229,259	296,648	260,723
Fee and commission income	54,914	47,619	60,212	52,732
Less: Fee and commission expenses	688	604	1,391	1,204
Net fee and commission income	54,226	47,015	58,821	51,528
Net interest, fee and commission income	312,949	276,274	355,469	312,251
Net gain/(loss) from trading	(24,217)	(11,977)	(24,115)	(12,169)
Net gain from financial investments	1,384	744	1,613	688
Net insurance premium income	-	-	41,281	36,623
Other operating income	33,953	21,927	24,441	18,556
Total operating income	324,069	286,968	398,689	355,949
Less: Impairment charge for loans and other losses	19,807	1,582	25,620	3,390
Net operating income	304,262	285,386	373,069	352,559
Less : Operating expenses				
Personnel expenses	57,858	58,053	71,232	69,475
Benefits, claims and underwriting expenditure	-	-	35,797	30,491
Other expenses	69,754	63,927	80,964	71,937
Total operating expenses	127,612	121,980	187,993	171,903
Operating profit before Value Added Tax (VAT) and Nation Building Tax (NBT) on financial services	176,650	163,406	185,076	180,656
Less: Value Added Tax (VAT) and Nation Building Tax (NBT) on financial services	32,766	29,033	35,469	31,582
Operating profit after Value Added Tax (VAT) and Nation Building Tax (NBT) on financial services	143,884	134,373	149,607	149,074
Share of profit of joint venture (net of income tax)	-	-	1,146	992
PROFIT BEFORE INCOME TAX	143,884	134,373	150,753	150,066
Less: Income tax expense	36,433	40,036	41,511	45,581
PROFIT FOR THE YEAR	107,451	94,337	109,242	104,485
Profit attributable to:				
Equity holders of the Bank	107,451	94,337	104,058	98,420
Non-controlling interests	-	-	5,184	6,065
PROFIT FOR THE YEAR	107,451	94,337	109,242	104,485
Earnings per share				
Basic earnings per ordinary share (\$)	0.24	0.22	0.23	0.23
Diluted earnings per ordinary share (\$)	0.24	0.22	0.23	0.23
Dividend per share				
Dividend per share: Gross (\$)	*0.06	0.06	*0.06	0.06

Exchange rate of US\$ 1 was Rs 153.25 as at 31st December 2017 (Rs 149.925 as at 31st December 2016)

The statement of profit or loss given on this page is solely for the convenience of the stakeholders of financial statements and do not form part of the audited financial statements.

*Calculated on interim dividend paid and final dividend proposed, which is to be approved at the Annual General Meeting.

Statement of Comprehensive Income in US Dollars

For the year ended 31st December	Bank		Group	
	2017 US\$ 000	2016 US\$ 000	2017 US\$ 000	2016 US\$ 000
PROFIT FOR THE YEAR	107,451	94,337	109,242	104,485
OTHER COMPREHENSIVE INCOME FOR THE YEAR, NET OF TAX				
Other comprehensive income to be reclassified to profit or loss in subsequent periods				
Available-for-sale financial assets:				
Net change in fair value during the year	21,587	(21,068)	24,781	(22,092)
Transfer to life policy holder reserve fund	-	-	(2,704)	899
Net amount transferred to profit or loss [available-for-sale financial assets]	543	-	345	96
Deferred tax effect on above	(6,046)	2,697	(6,090)	2,709
Share of other comprehensive income of equity accounted joint venture	-	-	(140)	(141)
Net other comprehensive income to be reclassified to profit or loss in subsequent periods	16,084	(18,371)	16,192	(18,529)
Other comprehensive income not to be reclassified to profit or loss in subsequent periods				
Re-measurement gains/(losses) on defined benefit plans	(1,859)	2,413	(1,905)	2,518
Revaluation of freehold land and buildings	19,453	15,163	27,058	38,345
Deferred tax effect on above	(18,925)	(363)	(29,142)	(1,052)
Deferred tax effect on realisation of revaluation surplus	-	8	-	8
Net other comprehensive income not to be reclassified to profit or loss in subsequent periods	(1,331)	17,221	(3,989)	39,819
OTHER COMPREHENSIVE INCOME FOR THE YEAR, NET OF TAX	14,753	(1,150)	12,203	21,290
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	122,204	93,187	121,445	125,775
Total comprehensive income attributable to:				
Equity holders of the Bank	122,204	93,187	116,048	119,165
Non-controlling interests	-	-	5,397	6,610
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	122,204	93,187	121,445	125,775

Exchange rate of US\$ 1 was Rs 153.25 as at 31st December 2017 (Rs 149.925 as at 31st December 2016)

The statement of comprehensive income given on this page is solely for the convenience of the stakeholders of financial statements and do not form part of the audited financial statements.

Statement of Financial Position in US Dollars

As at 31st December	Bank		Group	
	2017 US\$ 000	2016 US\$ 000	2017 US\$ 000	2016 US\$ 000
ASSETS				
Cash and cash equivalents	141,858	116,801	143,066	124,520
Placements with banks	20,766	5,023	63,100	14,664
Balances with Central Bank of Sri Lanka	251,947	225,297	251,948	225,297
Reverse repurchase agreements	-	28,704	5,038	38,398
Derivative financial instruments	4,015	1,934	4,015	1,934
Financial investments - fair value through profit or loss	786	3,635	1,739	4,776
Non-current assets held for sale	-	-	-	-
Loans and receivables to customers	4,170,323	3,898,034	4,278,062	3,985,109
Financial investments - loans and receivables	797,384	662,069	815,867	680,762
Financial investments - available-for-sale	622,537	599,734	663,902	638,967
Financial investments - held to maturity	-	-	10,216	3,102
Investment in joint venture	4,927	5,036	11,023	9,677
Investment in subsidiaries	19,689	20,125	-	-
Investment properties	2,137	2,694	7,482	7,032
Property, plant and equipment	116,837	93,013	226,004	199,061
Intangible assets and goodwill	5,321	5,267	8,077	7,872
Other assets	72,321	61,921	85,078	72,103
Total assets	6,230,848	5,729,287	6,574,617	6,013,274
LIABILITIES				
Due to banks	407,592	461,693	407,598	461,930
Derivative financial instruments	8,521	4,441	8,521	4,442
Securities sold under repurchase agreements	33,046	89,766	33,046	89,766
Due to customers	4,577,614	4,158,712	4,690,180	4,237,926
Dividends payable	6,365	6,717	6,440	6,773
Other borrowings	177,866	185,691	177,866	185,692
Debt securities issued	29,626	31,036	32,861	34,123
Current tax liabilities	25,936	41,514	26,532	42,857
Deferred tax liabilities	33,166	1,543	47,695	5,501
Insurance provision - life	-	-	71,229	58,348
Insurance provision - general	-	-	15,562	12,817
Other provisions	19,679	21,067	22,293	22,725
Other liabilities	37,330	38,958	48,022	48,555
Subordinated term debts	168,413	174,444	166,817	172,760
Total liabilities	5,525,154	5,215,582	5,754,662	5,384,215
EQUITY				
Stated capital	204,953	102,319	204,953	102,319
Statutory reserve	35,628	30,415	35,628	30,415
Other reserves	365,970	317,444	437,573	390,658
Retained earnings	99,143	63,527	117,992	85,517
Total equity attributable to equity holders of the Bank	705,694	513,705	796,146	608,909
Non-controlling interests	-	-	23,809	20,150
Total equity	705,694	513,705	819,955	629,059
Total liabilities and equity	6,230,848	5,729,287	6,574,617	6,013,274
Contingent liabilities and commitments	3,904,501	3,350,828	3,904,501	3,350,828
Net assets value per share [\$]	1.44	1.24	1.63	1.47

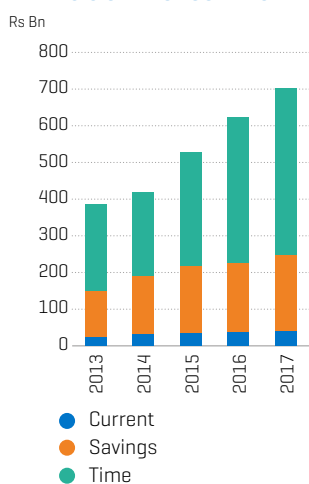
Exchange rate of US\$ 1 was Rs 153.25 as at 31st December 2017 (Rs 149.925 as at 31st December 2016)

The statement of financial position given on this page is solely for the convenience of the stakeholders of financial statements and do not form part of the audited financial statements.

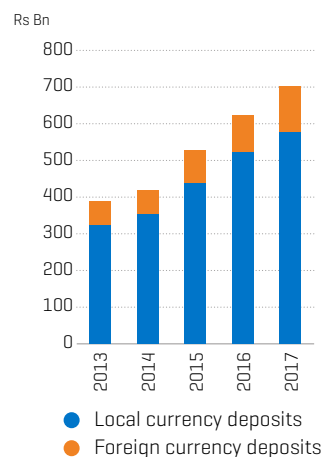
Analysis of Deposits

	2013 Rs 000	2014 Rs 000	2015 Rs 000	2016 Rs 000	2017 Rs 000
Analysis of Total Deposits					
Local currency deposits	323,925,015	352,732,715	438,253,261	522,168,609	576,571,392
Foreign currency deposits	63,233,375	66,594,408	88,872,920	101,326,360	124,947,905
	387,158,390	419,327,123	527,126,181	623,494,969	701,519,297
Product wise analysis of Deposits					
Current	23,837,932	32,608,645	33,958,697	36,675,800	39,167,863
Savings	124,510,240	157,946,623	184,204,894	188,845,184	209,750,730
Time	238,810,218	228,771,855	308,962,590	397,973,985	452,600,704
	387,158,390	419,327,123	527,126,181	623,494,969	701,519,297

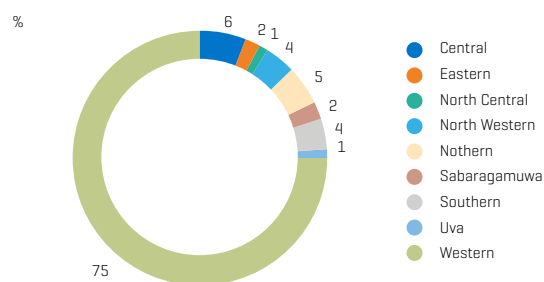
ANALYSIS OF PRODUCT-WISE DEPOSITS



ANALYSIS OF TOTAL DEPOSITS



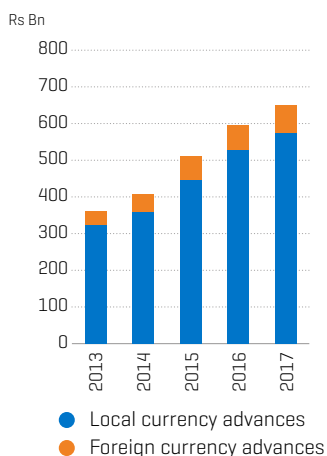
PROVINCE WISE DEPOSITS



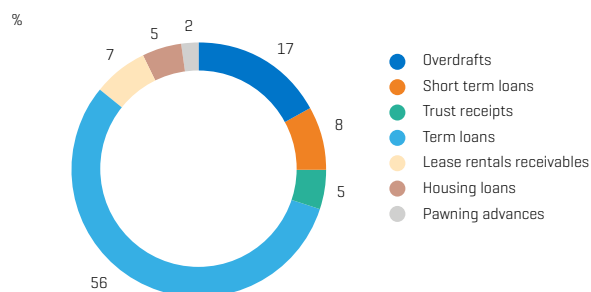
Analysis of Loans and Receivables

	2013 Rs 000	2014 Rs 000	2015 Rs 000	2016 Rs 000	2017 Rs 000
Analysis of Loans and Receivables to customers [Gross]					
Local currency advances	321,888,416	359,217,435	446,394,387	527,288,700	572,598,725
Foreign currency advances	40,691,142	47,714,009	63,131,080	68,225,219	76,948,342
Total advances [Gross]	362,579,558	406,931,444	509,525,467	595,513,919	649,547,067
Product wise analysis of loans and receivables to customers [Gross]					
Overdrafts	62,458,953	69,118,967	71,566,434	91,093,180	111,332,217
Short term loans	36,200,888	40,664,653	50,881,880	60,562,111	50,852,930
Trust receipts	13,820,841	17,867,491	23,669,721	24,885,713	32,738,671
Term loans	155,626,639	204,143,947	275,817,905	328,374,844	361,644,613
Lease rentals receivables	23,152,822	24,482,873	40,341,596	42,621,900	42,982,671
Housing loans	25,084,496	27,622,481	30,808,329	33,966,019	34,466,310
Pawning advances	46,234,919	23,031,032	16,439,602	14,010,152	15,529,655
	362,579,558	406,931,444	509,525,467	595,513,919	649,547,067

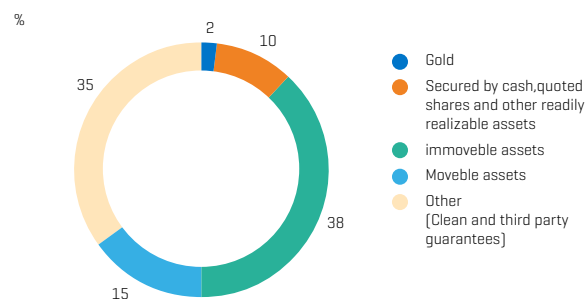
ANALYSIS OF TOTAL ADVANCES



PRODUCT WISE ANALYSIS OF LOANS AND RECEIVABLES [GROSS]



ANALYSIS OF ADVANCES BY SECURITIES

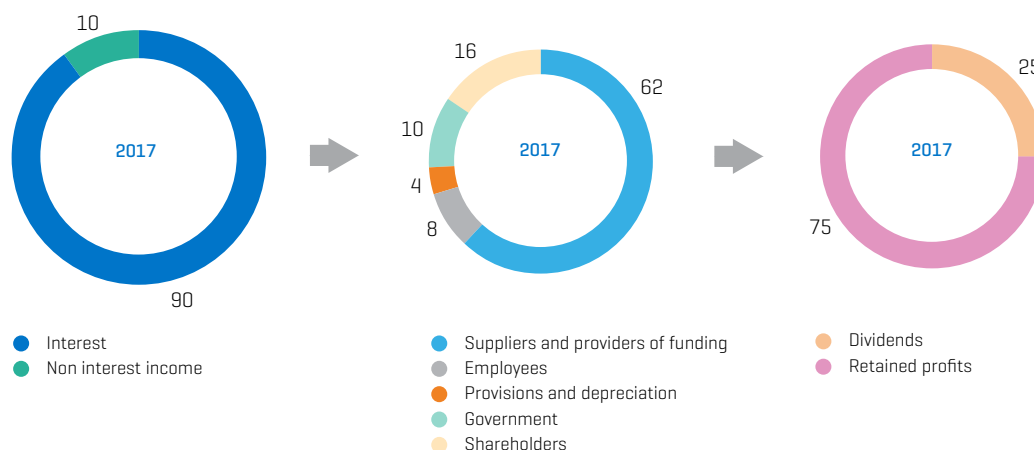


Sources and Utilisation of Income

	2013 Rs 000	2014 Rs 000	2015 Rs 000	2016 Rs 000	2017 Rs 000
Sources of Income					
Interest	56,770,713	51,868,333	52,615,463	75,608,193	96,175,453
Non interest income	4,235,701	7,632,162	8,538,003	8,742,630	10,119,741
Total	61,006,414	59,500,495	61,153,466	84,350,823	106,295,194
Utilisation of income					
Employees					
Salaries and other payment to Staff	5,453,778	7,407,015	7,927,695	8,703,575	8,866,642
Suppliers and providers of funding					
Interest paid	31,423,945	26,966,826	26,279,934	41,236,605	56,526,138
Other expenses	6,759,719	6,824,411	6,967,804	8,501,199	9,419,591
	38,183,664	33,791,237	33,247,738	49,737,804	65,945,729
Provisions and depreciation					
Depreciation and amortisation	1,084,256	1,126,995	966,596	1,035,930	1,128,802
Impairment for loans and other losses	4,513,900	2,502,835	1,013,322	237,160	3,035,468
	5,598,156	3,629,830	1,979,918	1,273,090	4,164,270
Net Income before Government Taxes and Levies	11,770,816	14,672,413	17,998,115	24,636,354	27,318,553
Government					
Income Tax, VAT, SGT, NBT, Crop Insurance [Incl. Deferred Tax]	4,760,710	5,667,139	9,623,577	10,492,948	10,851,763
Shareholders					
Dividends - Cash	3,400,244	3,430,715	2,028,923	2,071,683	3,175,514
Retained through Scrip Dividend	-	-	1,420,375	1,451,296	977,107
Retained profits	3,609,862	5,574,559	4,923,590	10,620,427	12,314,169
Total	61,006,414	59,500,495	61,153,466	84,350,823	106,295,194

SOURCES AND UTILISATION OF INCOME

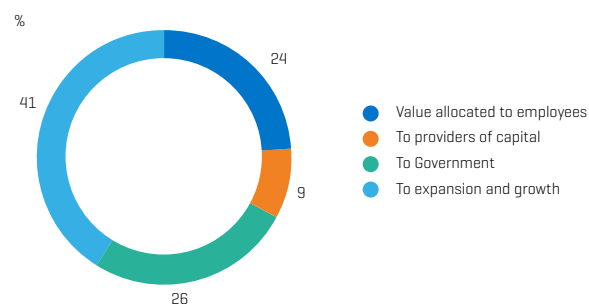
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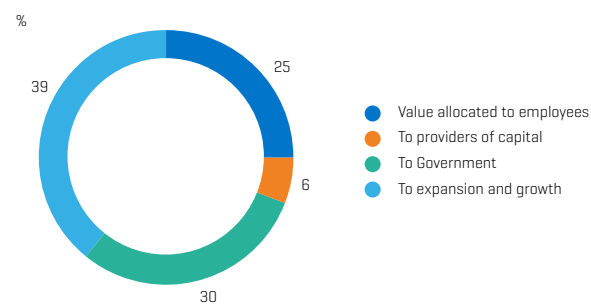
Value Added Statement

	2017		2016	
	Rs 000	%	Rs 000	%
Value added				
Income earned by providing banking services	107,873,629		85,143,172	
Cost of services	65,945,729		49,737,804	
Value added by banking services	41,927,900		35,405,368	
Non-banking income	1,920,639		891,629	
Net Gain/(loss) from trading & Financial investment	[3,499,074]		[1,683,978]	
Impairment for loans and other losses	[3,035,468]		[237,160]	
	37,313,997		34,375,859	
Value allocated to employees				
Salaries, wages and other benefits	8,866,642	23.76	8,703,575	25.32
To providers of capital				
Dividends to shareholders - cash	3,175,514	8.51	2,071,683	6.03
To Government				
Income Tax	4,558,951		5,798,826	
Value Added Tax on financial services	4,417,660		3,787,448	
Nation Building Tax	603,786		565,308	
Crop Insurance Levy	201,630		113,473	
Local taxes	14,838		13,296	
Stamp Duty	30,428	9.827,293	11,000	10,289,351
		26.34		29.93
To expansion and growth				
Retained income	12,314,169	33.00	10,620,427	30.91
Retained through scrip dividend	977,107	2.62	1,451,296	4.22
Depreciation and amortization	1,128,802	3.03	1,035,930	3.01
Deferred Taxation	1,024,470	2.75	203,597	0.59
	37,313,997	100.00	34,375,859	100.00

ANALYSIS OF VALUE ADDITION 2017



ANALYSIS OF VALUE ADDITION 2016



Ten Year Statistical Summary

Year ended 31st December (Rs Mn)	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
OPERATING RESULTS										
Income	36,615	38,811	34,870	37,066	51,539	61,006	59,500	61,153	84,351	106,295
Interest income	32,431	34,620	30,249	33,176	47,326	56,771	51,868	52,615	75,608	96,175
Interest expense	19,752	20,040	14,703	16,530	25,368	31,424	26,967	26,280	41,237	56,526
Non interest income	4,184	4,191	4,621	3,890	4,213	4,236	7,633	8,538	8,743	10,120
Operating expenses [Incl. financial VAT & NBT]	12,078	12,853	13,436	12,148	16,294	19,575	20,470	19,824	22,968	27,719
Profit before income tax	4,785	5,918	6,731	8,388	9,876	10,008	12,064	15,050	20,146	22,050
Income tax on profit	1,566	1,566	2,267	2,123	2,342	2,998	3,059	4,601	6,002	5,583
Profit after taxation	3,219	4,352	4,464	6,265	7,534	7,010	9,005	10,449	14,143	16,467
LIABILITIES AND SHAREHOLDERS' FUNDS										
Customer deposits	186,770	210,507	239,034	291,357	341,424	387,158	419,327	527,126	623,495	701,519
Refinance borrowings	6,424	6,169	6,435	7,045	6,429	5,615	4,889	4,227	4,140	5,244
Other liabilities	42,064	38,773	42,572	42,923	50,496	66,084	87,736	128,424	154,080	134,884
Deferred tax liabilities	872	939	891	1,175	1,111	-	-	379	231	5,083
Shareholders' funds	20,581	23,900	30,775	37,984	46,899	51,454	60,899	65,051	77,017	108,148
Total	256,711	280,289	319,708	380,484	446,358	510,310	572,851	725,208	858,963	954,878
ASSETS										
Loans and receivables to customers [Net]	174,808	169,639	202,253	257,198	302,761	351,965	396,277	498,342	584,413	639,102
Cash, short term funds and statutory deposits with the Central Bank of Sri Lanka	35,149	38,216	30,600	33,446	39,024	29,238	33,838	35,033	52,042	63,533
Property, plant and equipment	6,866	7,180	7,428	7,835	9,418	9,521	9,305	11,474	13,945	17,905
Deferred tax assets	-	-	506	314	-	768	287	-	-	-
Other assets	39,888	65,254	78,921	81,690	95,155	118,818	133,144	180,360	208,564	234,337
Total	256,711	280,289	319,708	380,484	446,358	510,310	572,851	725,208	858,963	954,878
RATIOS										
Return on average shareholders funds (%)	17	20	16	18	18	14	16	17	20	18
Income growth (%)	24	6	(10)	6	39	18	(2)	3	38	26
Return on average assets (%)	1.3	1.6	1.5	1.8	1.8	1.5	1.7	1.6	1.8	1.8
Dividend cover [Times]	3.4	2.8	2.7	2.1	2.2	2.1	2.6	3.0	4.0	4.0
Property, plant and equipment to shareholders' funds (%)	33	30	24	21	20	19	15	18	18	17
Total assets to shareholders' funds [Times]	12	12	10	10	10	10	9	11	11	9
Liquid assets to liabilities (%)	22	29	24	22	22	23	23	24	24	24
SHARE INFORMATION										
Market value per share [Rs]										
-Voting	69.75	170.25	399.90	151.30	148.00	147.00	194.90	210.60	225.00	249.00
-Non Voting	32.00	104.75	214.60	83.20	112.50	119.00	152.90	177.90	190.00	195.00
Earnings per share [Rs]	13.67	18.47	18.84	16.60	18.94	17.59	22.47	25.41	33.53	36.66
Earnings per share [Adjusted] [Rs] *	7.17	9.69	9.94	13.95	16.77	15.60	20.05	23.26	31.48	36.66
Price earnings ratio	5.10	9.22	21.23	9.11	7.81	8.36	8.67	8.29	6.71	6.79
Net assets per share [Adjusted] [Rs] **	42.13	48.92	62.99	77.75	96.00	105.32	124.65	133.15	157.64	221.36
Dividend per share [Rs]	4.00	6.50	7.00	7.50	8.50	8.50	8.50	8.50	8.50	8.50
Gross dividends [Rs Mn]	942	1,533	1,650	2,915	3,379	3,400	3,431	3,451	3,523	4,153
OTHER INFORMATION										
No of employees	4,395	4,302	4,352	4,584	4,679	4,604	4,451	4,285	4,190	4,348
No of customer centres	177	186	205	240	247	250	249	249	251	251
No of student banking centres	152	153	159	164	166	168	168	168	150	152

* Earnings per share has been adjusted for weighted Average number of shares outstanding during the current year.

** Net Assets per share has been computed for the current number of shares issued as at 31st December 2017

Highlighted Information is based on LKASs/SLFRSs.

Quarterly Statistics

For the three months ended	* 2017				* 2016											
	December 31st	September 30th	June 30th	March 31st	December 31st	September 30th	June 30th	March 31st								
Statement of financial position (Rs. Million)																
Total assets	954,878	953,347	921,544	902,261	858,963	818,639	793,124	760,059								
Loans and receivables to customers	639,102	625,061	627,048	614,120	584,413	544,008	525,586	513,508								
Due to customers	701,519	699,901	672,987	638,363	623,495	580,487	556,949	530,506								
Shareholders' funds	108,148	103,204	83,947	78,592	77,017	72,047	67,235	63,275								
Average assets	933,008	909,029	894,256	880,612	807,696	774,258	759,463	742,633								
Statement of profit or loss (Rs 000)																
Net interest income	10,043,669	10,491,304	9,822,432	9,291,910	9,431,217	9,080,937	8,479,771	7,379,663								
Net fee and commission income	2,178,704	2,049,782	2,097,869	1,983,742	1,954,498	1,734,634	1,647,120	1,712,407								
Net gain/(loss) from trading	[948,652]	[1,873,222]	[1,431,036]	541,707	[544,869]	[727,494]	[2,594,611]	2,071,283								
Net gain from financial investments	13,551	14,985	394	183,199	4,600	342	3,990	102,781								
Other operating income	2,424,988	1,451,979	1,580,323	[254,054]	1,142,180	1,000,378	2,663,660	[1,518,863]								
Total operating income	13,712,260	12,134,828	12,069,982	11,746,504	11,987,626	11,088,797	10,199,930	9,747,271								
Less :Impairment charge for loans and other losses	748,555	834,528	970,745	481,640	90,322	9,680	31,264	105,894								
Net operating income	12,963,705	11,300,300	11,099,237	11,264,864	11,897,304	11,079,117	10,168,666	9,641,377								
Less : Operating expenses	4,997,326	4,693,768	4,948,482	4,916,873	4,744,598	4,523,345	4,577,119	4,442,817								
VAT & NBT on financial services	1,320,363	1,232,258	1,230,504	1,238,321	1,497,985	1,176,298	866,235	812,238								
Provision for income tax	1,076,628	1,612,834	1,436,606	1,457,353	1,608,625	1,690,953	1,408,320	1,294,525								
Profit for the quarter ended	5,569,388	3,761,440	3,483,645	3,652,317	4,046,096	3,688,521	3,316,992	3,091,797								
Other comprehensive income for the quarter ended	93,837	942,858	1,836,726	[612,412]	1,480,842	1,072,866	610,134	[3,336,309]								
Total comprehensive income for the quarter ended	5,663,225	4,704,298	5,320,371	3,039,905	5,526,938	4,761,387	3,927,126	[244,512]								
Ordinary share information																
Market price per share (Rs)	V	NV	V	NV	V	NV	V	NV	V	NV	V	NV	V	NV		
High	259.80	205.00	244.50	198.90	250.00	210.00	236.50	203.90	235.00	202.00	228.00	194.00	216.60	180.00	207.00	176.50
Low	247.00	192.60	220.00	185.00	220.00	184.10	221.00	185.00	185.00	165.50	206.00	170.00	197.00	169.00	185.00	165.50
Closing	249.00	195.00	235.00	190.30	241.20	197.80	225.30	185.00	225.00	190.00	224.80	190.50	212.00	172.50	199.30	171.00
V- Voting NV - Non Voting																
Book value per ordinary share	221.36		211.27		199.52		186.91		186.11		174.30		162.81		153.31	
Financial measures																
Profitability																
Return on average shareholders' equity [annualised] (%)	17.62		16.96		17.87		18.78		20.24		20.12		19.66		19.27	
Productivity																
Non interest expenses to total operating income (%)	36.44		38.68		41.00		41.86		39.58		40.79		44.87		45.58	
Capital																
Risk weighted capital ratios																
BASEL II																
Tier I (%)	N/A		N/A		9.83		10.24		11.22		10.40		9.77		10.05	
Total (Tier II) (%)	N/A		N/A		13.07		13.85		15.27		13.44		12.97		13.48	
BASEL III																
Common Equity Tier I Capital (%)	13.72		12.91		N/A		N/A		N/A		N/A		N/A		N/A	
Tier I Capital (%)	13.72		12.91		N/A		N/A		N/A		N/A		N/A		N/A	
Total Capital (%)	17.04		16.42		N/A		N/A		N/A		N/A		N/A		N/A	
Asset quality																
Gross NPA ratio (%) **	2.28		2.64		2.20		1.85		1.80		2.18		2.25		2.41	
Net NPA ratio (%) **	0.77		1.23		0.86		0.48		0.46		0.76		0.80		0.86	

Note

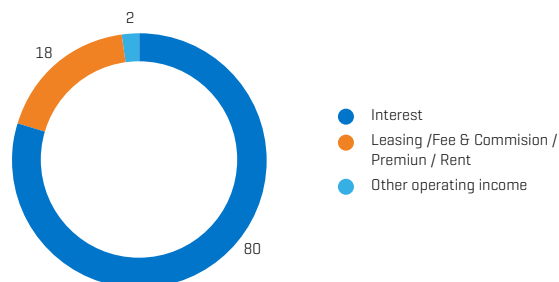
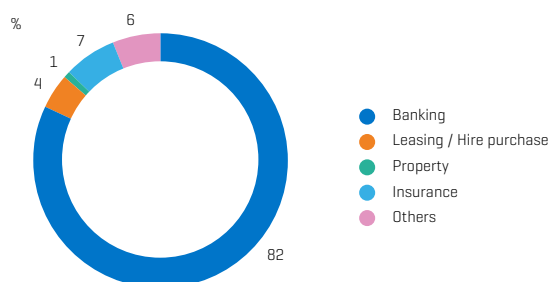
* Quarterly information has been amended based on classification changes made in 2017.

N/A - Not Applicable

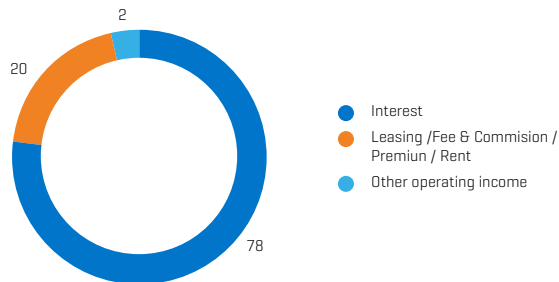
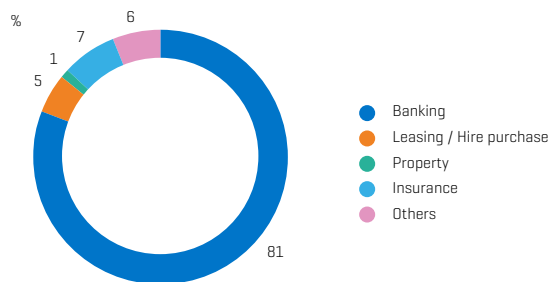
Segmental Analysis

Business Segments	Banking		Leasing/Hirepurchase		Property		Insurance		Others		Total	
	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Interest	90,629,742	70,800,583	-	-	21,508	19,418	1,684,689	1,166,368	6,367,518	4,921,053	98,703,457	76,907,422
Leasing /Fee & Commission / Premium / Rent	8,487,016	7,243,917	5,545,711	4,807,610	964,450	919,957	6,521,171	5,737,694	733,730	681,994	22,252,078	19,391,172
Net Gain/[loss] from Trading & financial investment	(3,499,074)	(1,683,978)	-	-	-	-	49,132	(26,309)	1,450	(11,000)	(3,448,492)	(1,721,287)
Other operating income	5,131,799	3,182,691	-	-	1,251	1,200	50,792	19,063	193,094	192,304	5,376,936	3,395,258
Total Revenue	100,749,483	79,543,213	5,545,711	4,807,610	987,209	940,575	8,305,784	6,896,816	7,295,792	5,784,350	122,883,979	97,972,564

SEGMENTS ANALYSIS 2017



SEGMENTS ANALYSIS 2016



Investor Relations

1 STOCK EXCHANGE LISTING

The issued ordinary shares of Hatton national Bank PLC are listed with the Colombo Stock Exchange. The audited Income Statement for the year ended 31st December 2017 and the audited Balance Sheet of the Bank as at date have been submitted to the Colombo Stock Exchange within three months of the Balance Sheet date.

Stock Exchange code for Hatton national Bank PLC shares is "HNB". Reuter code of Hatton national Bank PLC is "HNBL"

2 ORDINARY SHAREHOLDERS

SHARE INFORMATION - VOTING

There were 4,505 registered Voting Shareholders as at 31st December 2017 (2016 - 4,593) distributed as follows.

			Resident			Non-Resident			Total		
			No of Share holders	No of Shares	%	No of Share holders	No of Shares	%	No of Share holders	No of Shares	%
1	-	1,000	2,577	623,935	0.25	40	14,784	0.01	2,617	638,719	0.17
1,001	-	10,000	1,207	3,866,382	1.56	44	158,207	0.13	1,251	4,024,589	1.08
10,001	-	100,000	474	14,391,643	5.82	31	1,020,932	0.81	505	15,412,575	4.13
100,001	-	1,000,000	62	17,154,562	6.94	25	9,326,972	7.41	87	26,481,534	7.10
Over		1,000,000	15	211,154,152	85.42	30	115,347,004	91.64	45	326,501,156	87.52
			4,335	247,190,674	100.00	170	125,867,899	100.00	4,505	373,058,573	100.00

ANALYSIS OF SHAREHOLDERS

Resident / Non-Resident

	31st December 2017			31st December 2016		
	No of Share holders	No of Shares	%	No of Share holders	No of Shares	%
Resident	4,335	247,190,674	66.26	4,428	221,575,544	71.07
Non-Resident	170	125,867,899	33.74	165	90,194,167	28.93
Total	4,505	373,058,573	100.00	4,593	311,769,711	100.00

Individuals / Institutions

	31st December 2017			31st December 2016		
	No of Share holders	No of Shares	%	No of Share holders	No of Shares	%
Individuals	4,180	63,246,273	16.95	4,255	56,257,435	18.04
Institutions	325	309,812,300	83.05	338	255,512,276	81.96
Total	4,505	373,058,573	100.00	4,593	311,769,711	100.00

As at 31/12/2017 the average size of holding of ordinary shareholding was 82,810 voting shares. (31/12/2016 - 67,879 voting shares)

As per the rule No. 7.6 (iv) of the Listing Rules of the Colombo Stock Exchange, percentage of public holding of voting shares as at 31st December 2017 was 64% approximately. (61% as at 31st December 2016).

As per the rule No. 7.13.1 of the Listing Rules of the Colombo Stock Exchange, No. of shareholders representing public holding as at 31st December 2017 - 4,483. (4,571 as at 31st December 2016).

19,245,985 aggregate of shares remain unregistered arising from a direction given by the CBSL dated 26th August 2010 in terms of Sec. 12(IC) (c) of the Banking Act, and these unregistered shares are not included herein.

Investor Relations

SHARE INFORMATION - NON VOTING

There were 10,368 registered Non Voting Shareholders as at 31st December 2017 (2016 - 10,329) distributed as follows.

			Resident			Non-Resident			Total		
			No of Share holders	No of Shares	%	No of Share holders	No of Shares	%	No of Share holders	No of Shares	%
1	-	1,000	6,347	2,083,532	4.03	42	14,375	0.03	6,389	2,097,907	2.18
1,001	-	10,000	3,279	10,124,028	19.58	55	191,222	0.43	3,334	10,315,250	10.72
10,001	-	100,000	547	14,358,953	27.77	16	430,580	0.97	563	14,789,533	15.37
100,001	-	1,000,000	56	15,536,168	30.04	11	3,455,790	7.76	67	18,991,958	19.73
Over		1,000,000	6	9,610,048	18.58	9	40,444,436	90.81	15	50,054,484	52.00
			10,235	51,712,729	100.00	133	44,536,403	100.00	10,368	96,249,132	100.00

ANALYSIS OF SHAREHOLDERS

Resident / Non-Resident

	31st December 2017			31st December 2016		
	No of Share holders	No of Shares	%	No of Share holders	No of Shares	%
Resident	10,235	51,712,729	53.73	10,206	47,735,834	57.47
Non-Resident	133	44,536,403	46.27	123	35,322,858	42.53
Total	10,368	96,249,132	100.00	10,329	83,058,692	100.00

Individuals / Institutions

	31st December 2017			31st December 2016		
	No of Share holders	No of Shares	%	No of Share holders	No of Shares	%
Individuals	10,093	33,291,329	34.59	10,061	32,439,339	39.06
Institutions	275	62,957,803	65.41	268	50,619,353	60.94
Total	10,368	96,249,132	100.00	10,329	83,058,692	100.00

As at 31/12/2017 the average size of holding of ordinary shareholding was 9,283 non-voting shares. (31/12/2016 - 8,041 non-voting shares)

As per the rule No. 7.6 (iv) of the Listing Rules of the Colombo Stock Exchange, percentage of public holding as at 31st December 2017 was 99% approximately. (99% as at 31st December 2016).

As per Rule No. 7.13.1 of the Listing Rules of the Colombo Stock Exchange, No. of shareholders representing public holding as at 31st December 2017 - 10,358. (10,317 as at 31st December 2016).

3 SHARE TRADING

Voting	2017	2016
Number of transactions	4,709	4,573
Number of shares traded [Mn]	27	20
Value of shares traded [Rs Mn]	6,608	4,230
Non Voting	2017	2016
Number of transactions	3,302	3,654
Number of shares traded [Mn]	6	12
Value of shares traded [Rs Mn]	1,181	2,187

4 DIVIDENDS

	2017		2016	
1st Interim (Rs) - Cash Dividend	1.50	Paid in December 2017	1.50	Paid in December 2016
2nd Interim (Rs) - Cash Dividend	5.00	Propose to be paid in March 2018	3.50	Paid in April 2017
Final (Rs) - Scrip Dividend	2.00	Propose to be paid in April 2018	3.50	Paid in April 2017
Cash Dividend payout ratio (%)	19.28		14.65	

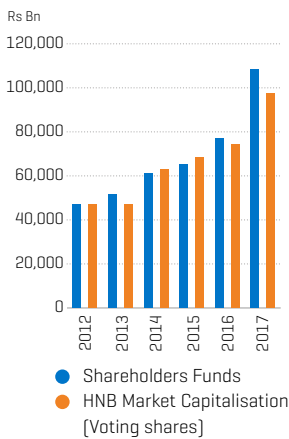
5 EARNINGS

Earnings per share (Rs)	36.66	33.53
Price earnings ratio(Times)-Voting Shares	6.79	6.71

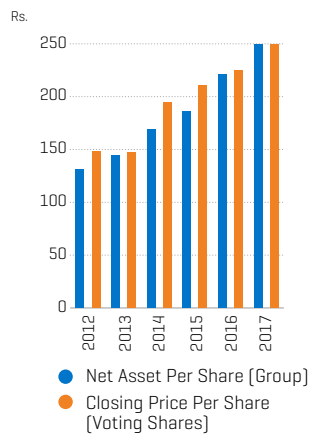
6 MARKET VALUE

	Highest Rs.	Lowest Rs.	Year End Rs.
2013 - Voting	176.00	140.00	147.00
- Non Voting	132.50	108.20	119.00
2014 - Voting	205.00	145.10	194.90
- Non Voting	153.20	116.60	152.90
2015 - Voting	242.00	192.00	210.60
- Non Voting	187.00	150.00	177.90
2016 - Voting	235.00	185.00	225.00
- Non Voting	202.00	165.50	190.00
2017 - Voting	271.00	220.00	249.00
- Non Voting	214.00	184.10	195.00

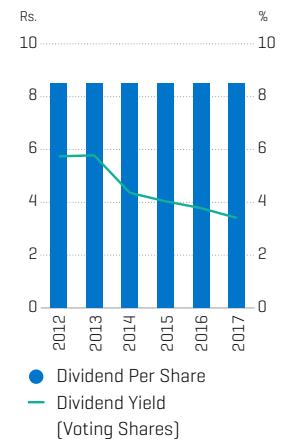
SHAREHOLDERS FUNDS AND HNB MARKET CAPITALISATION



NET ASSET PER SHARE AND CLOSING PRICE PER SHARE



DIVIDEND PER SHARE AND DIVIDEND YIELD



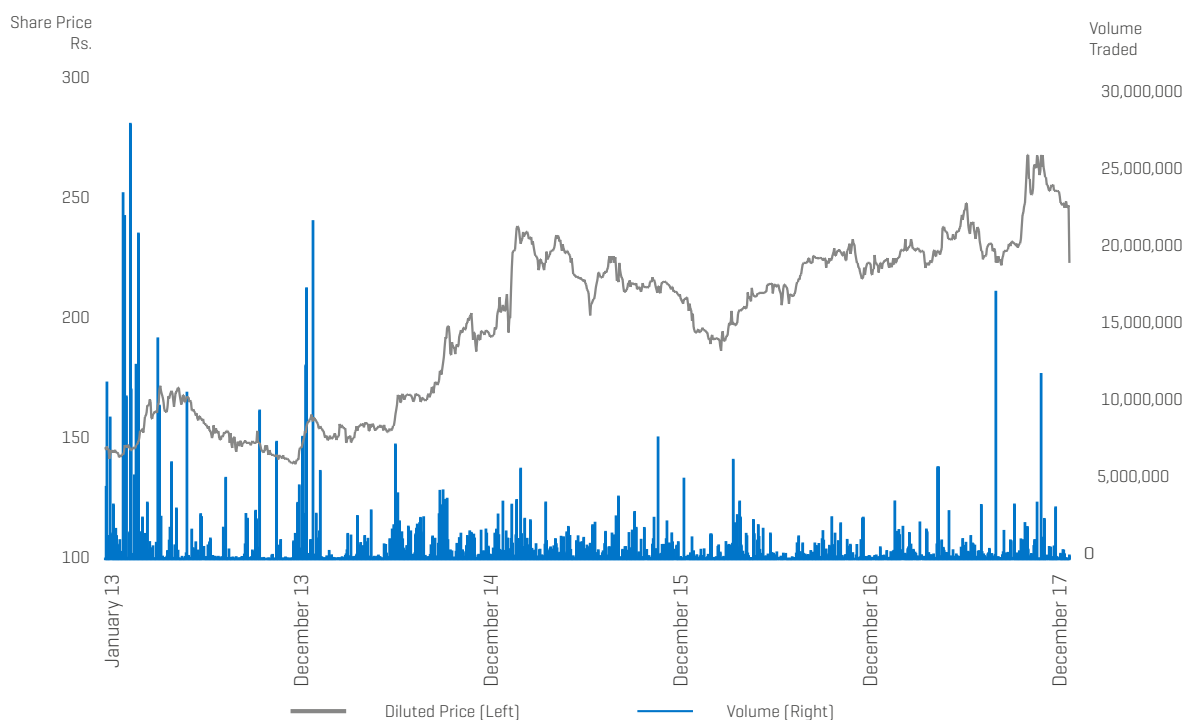
7 MARKET CAPITALISATION (AS AT 31ST DECEMBER)

	Capital & Reserves Rs Mn	HNB Market Capitalization Rs Mn	CSE Market Capitalization Rs Mn	HNB Market Capitalization as a % of CSE Market Capitalization	Market Capitalization Ranking
2013	51,454	46,945	2,459,897	1.91	11
2014	60,899	62,706	3,104,863	2.02	11
2015	65,051	68,320	2,937,998	2.33	9
2016	77,017	74,420	2,745,410	2.71	7
2017	108,148	97,684	2,899,290	3.37	5

HNB Market Capitalization includes only Voting shares

8 INFORMATION ON MOVEMENT IN SHARE CAPITAL

Year	Issue	Basis	No of Shares
	Prior to public issue		50,000
1971	Public issue		220,000
1977	Rights issue [@ Rs 10/-]	42:50	230,000
1980	Rights issue [@ Rs 10/-]	1:1	500,000
1982	Bonus	1:1	1,000,000
1988	Bonus	1:1	2,000,000
1990	Bonus	1:2	2,000,000
1993	Bonus	1:1	6,000,000
1996	Bonus	2:3	8,000,000
1998	Bonus	1:2	10,000,000
1999	Bonus	2:3	20,000,000
1999	Rights (non voting @ Rs 70/-)	3:10	15,000,000
2002	Bonus	1:10	6,500,000
2004	Rights (voting @ Rs 55.00 and non voting @ Rs 33.00)	2:5	28,600,000
2005	Issue of underlying shares for GDR	-	17,664,700
2007	Bonus	1:1	117,764,700
2009	Shares issued under ESOP		240,747
2010	Shares issued under ESOP		2,198,875
2011	Sub division of shares	1:2	119,179,782
2011	Rights (voting @ Rs 219.50 and non voting @ Rs 119.50)	1:10	21,858,851
2011	Private placement of unsubscribed rights		8,975,700
2011	Shares issued under ESOP		613,488
2012	Scrip Dividend		7,890,528
2012	Shares issued under ESOP		759,078
2013	Shares issued under ESOP		2,308,752
2014	Shares issued under ESOP		3,042,455
2015	Shares issued under ESOP		3,223,714
2016	Shares issued under ESOP		1,314,043
2016	Scrip Dividend		6,680,061
2017	Shares issued under ESOP		1,201,044
2017	Scrip Dividend		5,830,259
2017	Rights issue (voting @ Rs 220.00 and non voting @ Rs 190.00)	1:6	67,706,913
Total			488,553,690



9. MAJOR SHAREHOLDERS (VOTING) OF THE BANK AS AT 31ST DECEMBER 2017

	Name	% on total capital	% on total voting capital	No. of Shares	No. of Shares
				2017	2016
1.	Employees Provident Fund	7.83	9.75	38,259,574	32,352,748
2.	Sri Lanka Insurance Corporation - Life Fund	6.64	8.27	32,451,260	32,014,697
3.	Milford Exports (Ceylon) Limited	6.35	**7.91	31,039,075	26,247,009
4.	Stassen Exports Ltd	5.51	**6.86	26,903,640	22,750,036
5.	Mr.Sohli Edelji Captain	5.23	6.51	25,555,023	24,089,530
6.	HSBC Int'l Nominees Ltd-JPMLU-Franklin Templeton Investment	4.39	5.46	21,428,848	11,084,554
7.	Sonetto Holdings Limited	3.95	4.92	19,292,233	14,936,204
8.	Sri Lanka Insurance Corporation - General Fund	3.40	4.24	16,616,599	16,393,058
9.	Distilleries Company of Sri Lanka PLC	2.46	**3.07	12,037,030	10,178,656
10.	National Savings Bank	2.31	2.87	11,262,707	9,523,878
11.	Standard Chartered Bank Singapore S/A HL Bank Singapore	1.51	1.88	7,367,358	6,270,219
12.	The Bank of New York Mellon SA/NV-CF Ruffer Total return Fund	1.26	1.57	6,174,926	5,221,591
13.	Ms.Leesha Anne Captain	1.19	1.48	5,796,589	2,916,548
14.	RBC Investor Services Bank - COELI SICAV I - Frontier Market	1.03	1.28	5,034,689	3,068,364
15.	CitiBank Newyork S/A Norges Bank Account 2	0.91	1.14	4,461,303	3,558,424
16.	BNYM SA/NV Re-CF Ruffer Absolute Return Fund	0.85	1.06	4,144,792	3,504,886
17.	HSBC Int'l Nom Ltd-JPMLU-T Rowe Price Funds Sicav	0.81	1.01	3,952,285	165,690
18.	Mrs. Cheryl Susan De Fonseka	0.72	0.89	3,510,132	2,763,993
19.	HSBC Int'l Nom Ltd-JPMCB-Templeton Global Investment Trust	0.69	0.86	3,372,511	2,818,429
20.	BNYM SA/NV Re-Magna Umbrella Fund Plc	0.68	0.85	3,318,658	1,184,451
	Sub total	57.72	71.88	281,979,232	231,042,965
	* Unregistered Shares	3.94	4.91	19,245,985	18,987,071
	Balance held by 4,487 voting shareholders (Total voting shareholders- 4,507)	18.64	23.22	91,079,341	80,726,746
	Total voting shares	80.30	100.00	392,304,558	330,756,782
	Shares held by 10,368 Non-voting shareholders	19.70		96,249,132	83,058,692
	Total No. of Ordinary shares	100.00		488,553,690	413,815,474

* 19,245,985 shares remain unregistered arising from a direction given by the CBSL dated 26th August 2010 in terms of Sec. 12(IC)(c) of the Banking Act.

** Pursuant to the provisions of the Banking Act Directions No. 1 of 2007, the total collective voting rights in the Bank, of Milford Exports (Ceylon) Limited, Stassen Exports Limited and Distilleries Company of Sri Lanka (who collectively hold 17.84% of the voting shares of the Bank) are limited to 10% of the total voting rights of the Bank with effect from 15th March 2012 as the voting rights in excess of such percentage is deemed invalid from that date.

Investor Relations

10. MAJOR SHAREHOLDERS (NON-VOTING) OF THE BANK AS AT 31ST DECEMBER 2017

	Name	% on total capital	% on total non-voting capital	No. of Shares	No. of Shares
				2017	2016
1.	CITI Bank Newyork S/A Norges Bank Account 2	1.80	9.16	8,812,130	6,125,146
2.	HSBC Int'l Nom Ltd-UBS AG Zurich	1.75	8.87	8,535,961	7,203,090
3.	HSBC Intl nominees Ltd-JPMLU-Franklin Templeton Invest	1.42	7.22	6,945,406	5,778,350
4.	BNYM SA/NV-Frontaura Global Frontier Fund LLC	0.90	4.58	4,408,152	4,339,801
5.	BNYM SA/NV-Neon Liberty Lorikeet Master Fund LP	0.69	3.52	3,387,027	2,576,898
6.	BNYM SA/NV-CF Ruffer Total Return Fund	0.63	3.20	3,083,010	2,601,605
7.	Akbar Brothers Pvt Ltd A/c No. 01	0.63	3.18	3,060,155	2,478,154
8.	BNYM SA/NV-CF Ruffer Absolute Return Fund	0.42	2.13	2,053,685	1,733,008
9.	CB Europe Plc LUX S/A Dunross & Co. AB	0.41	2.08	2,000,000	281,820
10.	Union Assurance PLC No. 1 A/c	0.31	1.56	1,501,851	1,131,457
11.	Mr. Sohli Edelji Captain	0.31	1.55	1,491,069	1,467,949
12.	Rubber Investment Trust Limited A/c # 01	0.29	1.46	1,403,493	1,184,341
13.	BNY-CF Ruffer Investment Funds:CF Ruffer Pacific Fund	0.25	1.27	1,219,065	1,028,711
14.	Mr. Jayampathi Divale Bandaranayake	0.23	1.17	1,129,168	1,002,077
15.	Deutsche Bank AG as Trustee for JB Vantage Value Equity Fund	0.21	1.06	1,024,312	749,353
16.	Union Assurance PLC A/c No. 5 (Unit-linked life insurance fund-equity fund)	0.20	1.01	967,683	542,493
17.	Employees Trust Fund Board	0.18	0.94	900,766	909,800
18.	The Ceylon Guardian Investment Trust PLC A/c #02	0.18	0.92	889,795	750,857
19.	The Ceylon Investment PLC A/c No. 2	0.15	0.76	727,884	614,227
20.	Hatton National Bank PLC A/c No. 2	0.14	0.72	692,934	584,735
	Sub total	11.10	56.35	54,233,546	43,083,872
	Balance held by 10,348 Non-voting shareholders (Total Non-voting shareholders-10,368)	8.60	43.65	42,015,586	39,974,820
	Total Non-voting shares	19.70	100.00	96,249,132	83,058,692
	Shares held by 4,507 voting shareholders	76.36		373,058,553	311,769,711
	* Unregistered voting Shares	3.94		19,245,985	18,987,071
	Total voting shares	80.30		392,304,538	330,756,782
	Total No. of Ordinary shares	100.00		488,553,670	413,815,474

* 19,245,985 arregrate of shares remain unregistered arising from a direction given by the CBSL dated 26th August 2010 in terms of Sec. 12(IC)(c) of the Banking Act.

11. DEBENTURE INFORMATION

HNB Subordinated Debentures 2006

i) Market Value

12 months ended 31st December 2017

These debentures have not traded during the year ended 31st December 2017

ii) Interest Rate

12 months ended 31st December

	2017				2016			
	Amount Rs 000	Coupon Rate %	Annual Effective Rate %	Interest Rate of comparable Govt. Security %	Amount Rs 000	Coupon Rate %	Annual Effective Rate %	Interest Rate of comparable Govt. Security %
15 year Fixed Rate [11.00% p.a.] [Zero Coupon]	366,598	-	11.00	10.78	330,287	-	11.00	13.37
18 year Fixed Rate [11.25% p.a.] [Zero Coupon]	700,268	-	11.25	11.15	629,495	-	11.25	13.76

HNB Subordinated Debentures 2007

i) Market Value

12 months ended 31st December 2017

These debentures have not traded during the year ended 31st December 2017

ii) Interest Rate

12 months ended 31st December

	2017				2016			
	Amount Rs 000	Coupon Rate %	Annual Effective Rate %	Interest Rate of comparable Govt. Security %	Amount Rs 000	Coupon Rate %	Annual Effective Rate %	Interest Rate of comparable Govt. Security %
15 year Fixed Rate [16.75% p.a.]	758,625	16.75	16.75	11.02	758,625	16.75	16.75	13.64

HNB Subordinated Debentures 2011

i) Market Value

12 months ended 31st December 2017

These debentures have not traded during the year ended 31st December 2017

ii) Interest Rate

12 months ended 31st December

	2017				2016			
	Amount Rs 000	Coupon Rate %	Annual Effective Rate %	Interest Rate of comparable Govt. Security %	Amount Rs 000	Coupon Rate %	Annual Effective Rate %	Interest Rate of comparable Govt. Security %
10 year Fixed Rate [11.50% p.a.]	2,115,945	11.50	11.83	10.78	2,115,628	11.50	11.83	13.46

Investor Relations

HNB Subordinated Debentures 2013

i) Market Value

12 months ended 31st December 2017

	Market Value			Traded Yield		
	Highest Rs	Lowest Rs	Last Traded Rs	Highest %	Lowest %	Last Traded %
05 year Fixed Rate [14.00% p.a.]	101.70	101.60	101.70	13.78	13.77	13.77

ii) Interest Rate

12 months ended 31st December

	2017				2016			
	Amount Rs 000	Coupon Rate %	Annual Effective Rate %	Interest Rate of comparable Govt. Security %	Amount Rs 000	Coupon Rate %	Annual Effective Rate %	Interest Rate of comparable Govt. Security %
5 year Fixed Rate [14.00% p.a.]	4,309,918	14.00	14.00	8.51	4,309,918	14.00	14.00	11.17

HNB Senior Debentures 2013

i) Market Value

12 months ended 31st December 2017

These debentures have not traded during the year ended 31st December 2017

ii) Interest Rate

12 months ended 31st December

	2017				2016			
	Amount Rs 000	Coupon Rate %	Annual Effective Rate %	Interest Rate of comparable Govt. Security %	Amount Rs 000	Coupon Rate %	Annual Effective Rate %	Interest Rate of comparable Govt. Security %
10 year Fixed Rate [14.25% p.a.]	1,587,729	8.00	14.25	10.03	1,536,302	8.00	14.25	12.35

HNB Senior Debentures 2014

i) Market Value

12 months ended 31st December 2017

	Market Value			Traded Yield		
	Highest Rs	Lowest Rs	Last Traded Rs	Highest %	Lowest %	Last Traded %
05 year Fixed Rate [7.75% p.a.]	85.00	85.00	85.00	9.12	9.12	9.12

ii) Interest Rate

12 months ended 31st December

	2017				2016			
	Amount Rs 000	Coupon Rate %	Annual Effective Rate %	Interest Rate of comparable Govt. Security %	Amount Rs 000	Coupon Rate %	Annual Effective Rate %	Interest Rate of comparable Govt. Security %
05 year Fixed Rate [7.75% p.a.]	2,864,961	7.75	7.90	9.26	2,864,961	7.75	7.90	11.85
10 year Fixed Rate [8.33% p.a.]	87,569	8.33	8.50	10.04	87,569	8.33	8.50	12.49

HNB Subordinated Debentures 2016 - March

i) Market Value

12 months ended 31st December 2017

	Market Value			Traded Yield		
	Highest Rs	Lowest Rs	Last Traded Rs	Highest %	Lowest %	Last Traded %
5 year Fixed Rate [11.25% p.a.]	95.00	85.50	88.00	13.16	11.84	12.78

ii) Interest Rate

12 months ended 31st December

	2017				2016			
	Amount Rs 000	Coupon Rate %	Annual Effective Rate %	Interest Rate of comparable Govt. Security %	Amount Rs 000	Coupon Rate %	Annual Effective Rate %	Interest Rate of comparable Govt. Security %
5 year Fixed Rate [11.25% p.a.]	7,599,795	11.25	11.25	9.71	7,599,795	11.25	11.25	12.04

HNB Subordinated Debentures 2016 - November

i) Market Value

12 months ended 31st December 2017

	Market Value			Traded Yield		
	Highest Rs	Lowest Rs	Last Traded Rs	Highest %	Lowest %	Last Traded %
7 year Fixed Rate [13.00% p.a.]	101.00	99.85	100.00	13.02	12.87	13.00

ii) Interest Rate

12 months ended 31st December

	2017				2016			
	Amount Rs 000	Coupon Rate %	Annual Effective Rate %	Interest Rate of comparable Govt. Security %	Amount Rs 000	Coupon Rate %	Annual Effective Rate %	Interest Rate of comparable Govt. Security %
5 year Fixed Rate [11.75% p.a.]	2,039,274	11.75	11.75	9.75	2,039,274	11.75	11.75	12.15
7 year Fixed Rate [13.00% p.a.]	4,086,904	13.00	13.00	10.03	4,086,904	13.00	13.00	12.51

Note: HNB Senior Debenture information is listed under Debt Securities issued, Note 46 of the Financial Position.

Note: HNB Debenture information is listed under Subordinated Term Debts, Note 47 of the Financial Position.

Ratios	2017	2016
Debt to Equity Ratio [%] *	90.84	119.84
Interest Cover [Times] **	4.46	5.06
Liquidity Asset Ratio [LAR] [%]	24.06	23.50

* Debt includes Borrowings and Debentures

** Includes interest paid on Borrowings and Debentures

Independent Assurance Statement



Scope and Approach

DNV GL represented by DNV GL Business Assurance Lanka (Private) Limited has been commissioned by the management of Hatton National Bank PLC ('HNB' or 'the Bank') to carry out an independent assurance engagement [Type 2, Moderate level] for the non-financial - qualitative and quantitative information [sustainability performance] reported in HNB PLC Annual Integrated Report 2017 ('the Report') in its printed format for the financial year ending 31st December 2017.

The sustainability disclosures in this Report is prepared by the Bank, based on International <IR> Framework of the International Integrated Reporting Council (IIRC). Report also contains references to the Global Reporting Initiative (GRI) Sustainability Reporting Standards 2016, to bring out non-financial performance related to identified material topics.

We performed our work using AccountAbility's AA1000 Assurance Standard 2008 (AA1000 AS) and DNV GL's assurance methodology VeriSustain™, which is based on our professional experience, international assurance best practice including International Standard on Assurance Engagements 3000 (ISAE 3000) Revised* and the Global Reporting Initiative (GRI) Sustainability Reporting Guidelines. Our assurance engagement was planned and carried out in February 2018.

The intended user of this assurance statement is the management of Bank ('the Management'). The reporting aspect boundary of sustainability performance is based on internal and external materiality assessment covering HNB's operations and key internal and external stakeholders, as set out in the Report.

We planned and performed our work to obtain the evidence we considered necessary to provide a basis for our assurance opinion and the process did not involve engagement with external stakeholders.

Responsibilities of the Management of HNB and of the Assurance Providers

The management of HNB have sole responsibility for the preparation of the Report as well as the processes for collecting, analysing and reporting the information presented in the Report and our responsibility is limited to the management of HNB; however, our statement represents our independent opinion and is intended to inform the outcome of our assurance to the stakeholders of HNB. DNV GL was not involved in the preparation of any statement or data included in the Report except for this Assurance Statement.

DNV GL did not provide any other services to HNB, which would have constituted a conflict of interest with this assurance engagement.

DNV GL's assurance engagements are based on the assumption that the data and information provided by the client to us as part of our review have been provided in good faith and free from material misstatements. We were not involved in the preparation of any statements or data included in the Report except for this Assurance Statement. DNV GL expressly disclaims any liability or co-responsibility for any decision a person or an entity may make, whether investment or otherwise, based on this Assurance Statement.

Basis of our opinion

A multi-disciplinary team of sustainability and assurance specialists performed work at HNB's Corporate/ Head Office, and as part of assurance we visited sample banking operations in Colombo, Sri Lanka. We undertook the following activities:

- Review of HNB's approach to application of Reporting Principles i.e. stakeholder engagement and materiality determination process and the outcome as reported in this Report. We did not have any direct engagement with external stakeholders;
- Interviews with selected senior managers responsible for management of sustainability issues and review of selected evidence to support issues discussed. We were free to choose interviewees and interviewed those with overall responsibility to deliver the Company's sustainability objectives;
- Site visits to HNB City Office and five Retail Customer Centres: Wattala, Kalutara, Panadura, Mt. Lavenia, and in Negombo to review processes and systems for preparing site level sustainability data and implementation of sustainability strategy. We were free to choose sites we visited;
- Review of the processes for gathering and consolidating the specified performance data and, for a sample, checking the data consolidation. The reported data on economic performance and other financial data are based on audited financial statements issued by the Company's statutory auditors;

During the assurance process, we did not come across limitations to the scope of the agreed assurance engagement.

⁽¹⁾The VeriSustain protocol is available on www.dnvgl.com

Opinion and Observations

On the basis of the verification undertaken, nothing came to our attention to suggest that the Report does not describe following HNB's non-financial performance related to identified material topics and performance Indicators verified by us as part of our assurance engagement:

- GRI 201: economic performance-2016-201-1, 201-2, 201-3;
- GRI 203: indirect economic-impacts-2016-203-2;
- GRI 206: anti-competitive-behavior-2016-206-1;
- GRI 302: energy 2016-302-1, 302-3, 302-4;
- GRI 401: employment-2016-401-1;
- GRI 403: occupational health and safety-2016-403-1;
- GRI 404: training and education-2016-404-3;
- GRI 417: marketing and labeling-2016-417-2, 417-3;
- GRI 418: customer privacy-2016-418-1.

Without affecting our above assurance opinion, we also provide the following observations:

AA1000AS Principles

Inclusivity

The participation of stakeholders in developing and achieving an accountable and strategic response to Sustainability.

The stakeholder engagement process is an ongoing and continuous process and involves engagement with key stakeholders including employees, investors, customers, business partners, regulators and community to identify and respond to significant sustainability concerns of stakeholder groups.

Materiality

The process of determining the issues that is most relevant to an organization and its stakeholders.

The HNB has established a process of materiality determination and report discloses the outcome of the materiality assessment exercise, the process considered inputs from diverse sources such as needs and concerns of external and internal stakeholders, media reports and impacts of material issues on its key stakeholders.

Responsiveness

The extent to which an organization responds to stakeholder issues.

The report brings out strategic responses to identified key stakeholder concerns. We consider the response to key stakeholder concerns are well disclosed within the Report i.e. disclosures include business model, policies, management systems and governance mechanisms etc. The report is structured and brings out strategic sustainability priorities including initiatives implemented in 2017 and planned for 2018.

Reliability

The accuracy and comparability of information presented in the report, as well as the quality of underlying data management systems.

The robustness of the data management and aggregation systems was evaluated, and the sample data and information verified as part of assurance was found to be reliable. Nothing has come to our attention to suggest that reported data has not been properly collated from information reported at operational level, nor that the assumptions used were inappropriate. Some of the data inaccuracies identified during the verification process were found to be attributable to transcription, interpretation and aggregation errors and the errors have been communicated for correction.

Specific Evaluation of the Information on Sustainability Performance

We consider the methodology and process for gathering information developed by Bank for its sustainability performance reporting to be appropriate, and the qualitative and quantitative data included in the Report was found to be identifiable and traceable; the personnel responsible were able to demonstrate the origin and interpretation of the data and its reliability. We observed that the Report presents a faithful description of the reported sustainability activities for the reporting period.

Additional principles as per DNV GL VeriSustain

Completeness

How much of all the information that has been identified as material to the organisation and its stakeholders is reported?

The Report has fairly reported the disclosure requirements related to Integrated Reporting Framework and selected GRI standards to report its non-financial performance for identified material topics within its identified reporting boundary.

Independent Assurance Statement



Neutrality

The extent to which a report provides a balanced account of an organization's performance, delivered in a neutral tone.

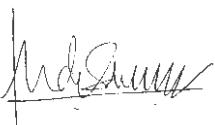
The disclosures related to sustainability issues, challenges and performances are reported in a neutral tone, in terms of content and presentation.

Opportunities for Improvement

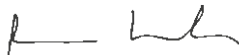
The following is an excerpt from the observations and opportunities for improvement reported to the management of the Bank and are not considered for drawing our conclusions on the Report; however, they are generally consistent with the management's objectives:

- Establish medium and long term sustainability goals and targets for identified material Aspects and disclose the same in its future reports;
- A systematic process of internal audit of data management systems will further strengthen the reliability of reported disclosures;
- It would be worthwhile if the Report benchmarks its key sustainability performance against peer practices within the sector and provides performance trend for at least three years for the identified material topics.

For DNV GL



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Glossary of Financial / Banking Terms

A

ACCEPTANCES

The signature on a Bill of Exchange indicates that the person on whom it is drawn accepts the conditions of the Bill. In other words a Bill of Exchange that has been accepted.

ACCOUNTING POLICIES

The specific principles, bases, conventions, rules and practices adopted by an entity in preparing and presenting financial statements.

ACCRUAL BASIS

Recognising the effects of transactions and other events when they occur without waiting for receipt or payment of cash or cash equivalent.

ACTUARIAL GAIN/LOSS

Gain or loss arising from the difference between estimates and actual experience in a company's pension plan.

AMORTISATION

The systematic allocation of the depreciable amount of an intangible asset over its useful life.

AMORTISED COST

Amount at which the financial asset or financial liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount and minus any reduction for impairment or uncollectability.

ASSOCIATE

An associate is an entity, including an unincorporated entity such as a partnership, over which the investor has significant influence and that is neither a subsidiary nor an interest in a joint venture.

AVAILABLE FOR SALE FINANCIAL ASSETS

Available for sale financial assets are those non derivative financial assets that are designated as available for sale or are not classified as loans and receivables, held to maturity investments or financial assets at fair value through profit or loss.

B

BILLS SENT FOR COLLECTION

A Bill of Exchange drawn by an exporter usually at a term, on an importer overseas and brought by the exporter to his Bank with a request to collect the proceeds.

BONUS ISSUE

The issue of new shares to existing shareholders in proportion to their shareholdings. It is a process for converting a company's reserves (in whole or part) in to issued capital and hence does not involve an infusion of cash.

C

CAPITAL ADEQUACY RATIO

The percentage of risk-adjusted assets supported by capital as defined under the framework of risk-based capital standards developed by the Bank for International Settlements (BIS) and as modified to suit local requirements by the Central Bank of Sri Lanka.

CAPITAL RESERVE

Capital reserves consist of revaluation reserves arising from revaluation of properties owned by the Bank.

CASH EQUIVALENTS

Cash equivalents are short-term highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

CASH GENERATING UNIT (CGU)

The smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or group of assets.

CEDED INSURANCE ARRANGEMENTS

An arrangement where an insurance company passes the part or all of its risks from its insurance policy portfolio to a reinsurance firm.

COLLECTIVELY ASSESSED LOAN IMPAIRMENT PROVISIONS

Also known as portfolio impairment provisions. Impairment assessment on a collective basis for homogeneous groups of loans that are not considered individually significant and to cover losses that has been incurred but has not yet been identified at the reporting date. Typically

assets within the consumer banking business are assessed on a portfolio basis.

COMMERCIAL PAPER

An unsecured, short-term debt instrument issued by a corporation, typically for the financing of accounts receivable, inventories and meeting short-term liabilities. The debt is usually issued at a discount, reflecting prevailing market interest rates.

COMMITMENT TO EXTEND CREDIT

Credit facilities available to clients either in the form of loans, bankers' acceptances and other on-balance sheet financing or through off-balance sheet products such as guarantees and letters of credit.

COMPREHENSIVE INCOME

The change in equity of a business enterprise during a period from non-owner sources. This includes all changes in equity during a period except those resulting from investments by owners and distributions to the owners. Comprehensive income equals net income plus other comprehensive income.

CONTINGENCIES

Conditions or situations at the reporting date, the financial effect of which are to be determined by the future events which may or may not occur.

CONTRACTUAL MATURITY

Contractual maturity refers to the final payment date of a loan or other financial instrument, at which point all the remaining outstanding principal will be repaid and interest is due to be paid.

CORPORATE GOVERNANCE

The system of internal controls and procedures by which corporate entities are governed. It is concerned with the way in which power is exercised over the management and direction of entity, the supervision of executive actions and accountability to owners and others.

CORRESPONDENT BANK

A Bank in a foreign country that offers banking facilities to the customers of a Bank in another country.

COST INCOME RATIO

Operating expenses excluding loan loss provision as a percentage of total operating income.

COST METHOD

Cost method is a method of accounting for an investment whereby the investment is recognised at cost. The investor recognises income from the investment only to the extent that the investor receives distributions from accumulated profits of the investee arising after the date of acquisition. Distributions received in excess of such profits are regarded as a recovery of investment and are recognised as a reduction of the cost of the investment.

COST-PUSH INFLATION

A continuous increase in average price levels due to an increase in production costs.

CREDIT RATINGS

An evaluation of a corporate's ability to repay its obligations or likelihood of not defaulting, carried out by an independent rating agency.

CREDIT RISK

Credit risk is the risk of financial loss to the Bank if a customer or counter party to a financial instrument fails to meet its contractual obligations, and arises principally from the loans and advances to customers and other banks and investment in debt/ equity securities.

CURRENCY RISK

The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

CURRENCY SWAPS

The simultaneous purchase of an amount of a currency for spot settlement and the sale of the same amount of same currency for forward settlement.

D

DEBT RESTRUCTURING / RESCHEDULING

This is when the terms and provisions of outstanding debt agreements are changed. This is often done in order to improve cash flow and the ability of the borrower to repay the debt. It can involve altering the repayment schedule as well as debt or interest charge reduction.

DEFERRED TAX

Sum set aside in the financial statements for taxation that may become payable in a financial year other than the current financial year.

DELINQUENCY

A debt or other financial obligation is considered to be in a state of delinquency when payments are overdue. Loans and advances are considered to be delinquent when consecutive payments are missed.

DERECOGNITION

Removal of a previously recognised financial asset or financial liability from an entity's statement of financial position.

DERIVATIVES

A derivative is a financial instrument or other contract, the value of which changes in response to some underlying variable (eg. an interest rate), that has an initial net investment smaller than would be required for other instruments that have a similar response to the variable, and that will be settled at a future date.

DEPRECIATION

The process of systematically allocating the cost of long - lived (tangible) assets to the periods during which the assets are expected to provide economic benefits.

DILUTED EARNINGS PER SHARE

The earnings per share that would result if all dilutive securities were converted into common shares.

DIVIDEND COVER

Profit after tax divided by gross dividends. This ratio measures the number of times dividend is covered by the current year's distributable profits.

DIVIDEND YIELD

Dividend earned per share as a percentage of its market value.

DIVIDEND PAYOUT RATIO

It is the percentage of earnings paid to shareholders in dividends.

DOCUMENTARY LETTERS OF CREDIT (L/Cs)

Written undertakings by a Bank on behalf of its customers, authorising a third party to draw on the Bank up to a stipulated amount under specific terms and conditions. Such undertakings are established for the purpose of facilitating international trade.

E

EARNINGS PER SHARE (EPS)

Profit attributable to ordinary shareholders, divided by the number of ordinary shares in issue.

ECONOMIC VALUE ADDED (EVA)

A measure of productivity which takes into consideration cost of total invested equity.

EFFECTIVE INTEREST RATE

Rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instruments or when appropriate a shorter period to the net carrying amount of the financial asset or financial liability.

EFFECTIVE TAX RATE

Income tax expense for the year divided by the profit before tax.

EQUITY INSTRUMENT

Equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.

EQUITY METHOD

The equity method is a method of accounting whereby the investment is initially recognised at cost and adjusted thereafter for the post-acquisition changes in the investor's share of net assets of the investee. The profit or loss of the investor includes the investor's share of the profit or loss of the investee.

EMBEDDED DERIVATIVES

An embedded derivative is a component of a hybrid (combined) instrument that also includes a non-derivative host contract with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative.

ESOP (EMPLOYEE SHARE OPTION PLAN)

A method of giving employees shares in the business for which they work.

EX-DIVIDEND DATE

The first date that a share trades without the (i.e. "ex") dividend

EXERCISE PRICE

The fixed price at which an option holder can buy or sell the underlying.

F

FAIR VALUE

The amount at which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transactions. It is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants.

FINANCE LEASE

A lease in which the lessee acquires all the financial benefits and risks attaching to ownership of the asset under lease.

FINANCIAL ASSET OR FINANCIAL LIABILITY AT FAIR VALUE THROUGH PROFIT OR LOSS

Financial asset or financial liability that is held for trading or upon initial recognition designated by the entity as 'at fair value through profit or loss'.

FINANCIAL INSTRUMENT

Financial Instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

FINANCIAL RISK

The risk of a possible future change in one or more of a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates or credit rating or credit index.

FOREIGN EXCHANGE INCOME

The gain recorded when assets or liabilities denominated in foreign currencies are translated into Sri Lankan Rupees on the reporting date at prevailing rates which differ from those rates in force at inception or on the previous reporting date. Foreign exchange income also arises from trading in foreign currencies.

FORWARD EXCHANGE CONTRACT

Agreement between two parties to exchange one currency for another at a future date at a rate agreed upon today.

G

GOODWILL

An intangible asset that represents the excess of the purchase price of an acquired company over the value of the net assets acquired.

GROSS DIVIDENDS

The portion of profit inclusive of tax withheld distributed to shareholders.

GROUP

A group is a parent and all its subsidiaries.

GUARANTEES

Primarily represent irrevocable assurances that a bank will make payments in the event that its customer cannot meet his / her financial obligations to third parties. Certain other guarantees represent non-financial undertakings such as bid and performance bonds.

H

HEDGING

A strategy under which transactions are effected with the aim of providing cover against the risk of unfavourable price movements (interest rate, foreign exchange rate, commodity prices, etc.). A hypothetical combination of the derivative and its underlying that eliminates risk.

HELD TO MATURITY INVESTMENTS

Non derivative financial assets with fixed or determinable payments and fixed maturity that an entity has the positive intention and ability to hold to maturity.

I

IMPAIRED LOANS

Loans where the Group does not expect to collect all the contractual cash flows or expects to collect them later than they are contractually due.

IMPAIRMENT

This occurs when recoverable amount of an asset is less than its carrying amount.

IMPAIRMENT ALLOWANCES

Impairment allowances are provisions held on the statement of financial position as a result of the raising of a charge against profit for the incurred loss. An impairment allowance may either be identified or unidentified and individual (specific) or collective (portfolio) respectively.

INCREMENTAL COST

Costs that would not have been incurred if the entity had not acquired, issued or disposed of the financial instrument.

INCURRED BUT NOT ENOUGH REPORTED (IBNER)

The reserves for claims that become due with the occurrence of the events covered under the insurance policy, but have not been reported yet.

INCURRED BUT NOT REPORTED (IBNR)

An estimate of the liability for claim-generating events that have taken place but have not yet been reported to the insurer or self-insurer.

INDIVIDUALLY SIGNIFICANT LOANS

Exposures which are above a certain threshold decided by the Bank's management which should be assessed for objective evidence, measurement, and recognition of impairment on an individual basis.

INDIVIDUALLY SIGNIFICANT LOAN IMPAIRMENT PROVISIONS

Also known as specific impairment provisions. Impairment is measured individually for assets that are individually significant to the Group. Typically assets within the corporate banking business of the Group are assessed individually.

IRREVOCABLE COMMITMENT

A loan amount that may be drawn down, or is due to be contractually funded in the future.

INTANGIBLE ASSET

An identifiable non-monetary asset without physical substance held for use in the production / supply of goods / services or for rental to others or for administrative purposes.

INTEREST MARGIN

Net interest income as a percentage of average interest earning assets.

INTEREST RATE SWAP

An agreement between two parties (known as counterparties) where one stream of future interest payments is exchanged for another based on a specified principal amount.

INTEREST RATE RISK

The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

INTEREST SPREAD

This represents the difference between the average interest rate earned and the average interest rate paid on funds.

INSURANCE RISK

Risk, other than financial risk, transferred from the holder of a contract to the issuer.

INVESTMENT PROPERTIES

Investment property is property (land or a building - or part of a building - or both) held (by the owner or by the lessee under a finance lease) to earn rentals or for capital appreciation or both, rather than for use or sale.

INTEREST COVER

A ratio showing the number of times interest charges is covered by earnings before interest and tax.

J

JOINT CONTROL

Joint control is the contractually agreed sharing of the control over an economic activity and exists only when the strategic financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control.

JOINT VENTURE

A joint venture is a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control.

K

KEY MANAGEMENT PERSONNEL

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly.

L

LETTER OF CREDIT [L/C]

Written undertakings by a Bank on behalf of its customer (typically an importer), authorising a third party (e.g. an exporter) to draw drafts on the Bank up to a stipulated amount under specific terms and conditions. Such undertakings are established for the purpose of facilitating international trade.

LIABILITY ADEQUACY TEST [LAT]

Assessment on each reporting date whether the recognized insurance liabilities are adequate, using current estimates of future cash flows under the insurance contract.

LIQUID ASSETS

Assets that are held in cash or in a form that can be converted to cash readily, such as deposits with other Banks, Bills of Exchange and Treasury Bills.

LIQUIDITY RISK

The risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities.

LOANS AND RECEIVABLES

Non derivative financial assets with fixed or determinable payments that are not quoted in an active market other than those intended to sell immediately or in the near term and designated as fair value through profit or loss or available for sale on initial recognition.

LOSS GIVEN DEFAULT [LGD]

LGD is the percentage of an exposure that a lender expects to lose in the event of obligor default.

M

MARKET CAPITALISATION

Number of ordinary shares in issue multiplied by the market value of each share at the year end.

MARKET RISK

This refers to the possibility of loss arising from changes in the value of a financial instrument as a result of changes in market variables such as interest rates, exchange rates, credit spreads and other asset prices.

MATERIALITY

The relative significance of a transaction or an event, the omission or misstatement of which could influence the decisions of users of financial statements.

N

NET ASSET VALUE PER SHARE

Shareholders' funds divided by the number of ordinary shares in issue.

NET-INTEREST INCOME

The difference between what a Bank earns on assets such as loans and securities and what it pays on liabilities such as deposits, refinance funds and inter-bank borrowings.

NON CONTROLLING INTEREST

Equity in a subsidiary not attributable, directly or indirectly to a parent.

NET PREMIUM METHOD

A Net Premium Valuation is an actuarial calculation, used to place a value on the liabilities of a life insurer.

O

OFF BALANCE SHEET TRANSACTIONS

Transactions that are not recognised as assets or liabilities in the statement of financial position, but which give rise to contingencies and commitments.

ONEROUS CONTRACT

A type of contract where the costs involved with fulfilling the terms and conditions of the contract are higher than the amount of economic benefits received.

OPERATIONAL RISK

This refers to the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events.

P

PARENT

A parent is an entity that has one or more subsidiaries.

PAST DUE

A financial asset is past due when a counterparty has failed to make a payment when contractually due.

PRICE EARNINGS RATIO [P/E RATIO]

Market price of an ordinary share divided by earnings per share [EPS].

PROBABILITY OF DEFAULT [PD]

PD is an internal estimate for each borrower grade of the likelihood that an obligor will default on an obligation.

PRUDENCE

Inclusion of a degree of caution in the exercise of judgement needed in making the estimates required under conditions of uncertainty, such that assets or income are not overstated and liabilities or expenses are not understated.

R

REGULAR WAY TRADES

A type of trade that is settled through the regular settlement cycle required for the particular investment being traded. The settlement cycle is the time that the regulations of the securities market allows for the buyer to complete payment and for the seller to deliver the goods being purchased.

REPURCHASE AGREEMENT

This is a contract to sell and subsequently repurchase government securities at a given price on a specified future date.

RETURN ON AVERAGE ASSETS (ROAA)

A profitability ratio calculated as profit after tax expressed as a percentage of average total assets, used along with ROE, as a measure of profitability and as a basis of intra-industry performance comparison.

RETURN ON AVERAGE EQUITY (ROAE)

Profit after tax less preferred share dividends if any, expressed as a percentage of average ordinary shareholders' equity.

REVENUE RESERVE

Reserves set aside for future distribution and investment.

REVERSE REPURCHASE AGREEMENT

Transaction involving the purchase of government securities by a Bank or dealer and resale back to the seller at a given price on a specific future date.

RIGHTS ISSUE

Issue of shares to the existing shareholders at an agreed price, generally lower than market price.

RISK-WEIGHTED ASSETS

Used in the calculation of risk-based capital ratios. The face amount of lower risk assets is discounted using risk weighting factors in order to reflect a comparable risk per rupee among all types of assets. The risk inherent in off-balance sheet instruments is also recognised, first by adjusting notional values to balance sheet (or credit) equivalents and then by applying appropriate risk weighting factors.

S

SEGMENT REPORTING

Segment reporting indicates the contribution to the revenue derived from business segments such as banking operations, leasing operations, stock broking and securities dealings, property and insurance.

SHAREHOLDERS' FUNDS

Shareholders' funds consist of stated capital, statutory reserves, capital and revenue reserves.

SPECIFIC IMPAIRMENT PROVISIONS

Impairment is measured individually for loans that are individually significant to the Bank.

STATUTORY RESERVE FUND

Reserve created as per the provisions of the Banking Act No. 30 of 1988.

SUBSIDIARY

A subsidiary is an entity, including an unincorporated entity such as a partnership, that is controlled by another entity (known as the parent).

SUBSTANCE OVER FORM

The consideration that the accounting treatment and the presentation in financial statements of transactions and events should be governed by their substance and financial reality and not merely by legal form.

T

TIER I CAPITAL

Consists of the sum total of paid up ordinary shares, non cumulative, non redeemable preference shares, share premium, statutory reserve fund, published retained profits, general and other reserves, less goodwill.

TIER II CAPITAL

Consists of the sum total of revaluation reserves, general provisions, hybrid capital instruments and approved subordinated debentures.

TOTAL CAPITAL

Total capital is the sum of Tier I capital and Tier II capital.

TRANSACTION COSTS

Incremental cost that is directly attributable to the acquisition, issue or disposal of a financial asset or financial liability.

U

UNEARNED PREMIUM RESERVE

The premium corresponding to the time period remaining on an insurance policy.

UNIT TRUST

An undertaking formed to invest in securities under the terms of a trust deed.

V

VALUE ADDED

Value added is the wealth created by providing banking services less the cost of providing such services. The value added is allocated among the employees, the providers of capital, to government by way of taxes and retained for expansion and growth.

Y

YIELD TO MATURITY

Discount rate which the present value of future cash flows would equal the security's current price.

Branch Network

CENTRAL PROVINCE - 25

- | | | |
|--|--|--|
| <p>Kandy - 14</p> <ul style="list-style-type: none"> • Akurana • Digana • Galaha • Gampola • Geliyaya • Kandy • Kandy City Centre [Extension Office] • Katugastota • Kundasale | <ul style="list-style-type: none"> • Kurunduwatte • Nawalapitiya • Peradeniya • Pilimathalawa • Rikillagaskada <p>Matale - 03</p> <ul style="list-style-type: none"> • Dambulla • Galewela • Matale | <p>Nuwara Eliya - 08</p> <ul style="list-style-type: none"> • Bogawanthalawa • Ginigathhena • Hatton • Maskeliya • Nuwara Eliya • Pussellawa • Ragala • Thalawakele |
|--|--|--|

EASTERN PROVINCE - 25

- | | | |
|--|--|---|
| <p>Ampara - 11</p> <ul style="list-style-type: none"> • Akkaraipattu • Ampara • Dehiattakandiya • Kalmunai • Karaitivu • Ninthavur • Pottuvil • Samanthurai • Thandavenvely • Thirukkovil | <ul style="list-style-type: none"> • Uhana <p>Batticaloa - 05</p> <ul style="list-style-type: none"> • Batticaloa • Eravur • Valachchenai • Kaluwanchikudy • Kattankudy <p>Trincomalee - 09</p> <ul style="list-style-type: none"> • Kantale • Kinniya | <ul style="list-style-type: none"> • Marathamunai • Mullipathana • Muttur • Trinco Metro • Serunuwara • Trincomalee • Uppuveli |
|--|--|---|

NORTHERN PROVINCE - 21

- | | | |
|---|---|---|
| <p>Jaffna - 12</p> <ul style="list-style-type: none"> • Atchchuveli • Chankanai • Chavakachcheri • Chunnakam • Jaffna • Jaffna Metro • Kaithady • Kodikamam • Manipay | <ul style="list-style-type: none"> • Nelliady • Point Pedro • Thirunelvely <p>Kilinochchi - 02</p> <ul style="list-style-type: none"> • Kilinochchi North • Kilinochchi South <p>Mannar - 03</p> <ul style="list-style-type: none"> • Mannar • Mallavi | <ul style="list-style-type: none"> • Nanattan <p>Mullaitivu - 02</p> <ul style="list-style-type: none"> • Mullaitivu • Mulliyawalai <p>Vavuniya - 02</p> <ul style="list-style-type: none"> • Kurumankadu • Vavuniya |
|---|---|---|

SOUTHERN PROVINCE - 25

- | | | |
|---|--|--|
| <p>Galle - 09</p> <ul style="list-style-type: none"> • Ambalangoda • Batapola • Elpitiya • Galle • Hikkaduwa • Karapitiya • Koggala • Pitigala • Yakkalamulla | <p>Hambantota - 8</p> <ul style="list-style-type: none"> • Ambalantota • Angunakolapelessa • Hambantota • Middeniya • Sooriyawewa • Tangalle • Tissamaharama • Walasmulla | <p>Matara - 08</p> <ul style="list-style-type: none"> • Akuressa • Deniyaya • Devinuwara • Dickwella • Hakmana • Matara • Urubokka • Weligama |
|---|--|--|

NORTH CENTRAL PROVINCE - 10

- | | |
|--|---|
| <p>Anuradhapura - 07</p> <ul style="list-style-type: none"> • Anuradhapura • Anuradhapura Metro • Kekirawa • Medawachchiya • Nochchiyagama | <ul style="list-style-type: none"> • Padavi • Parakramapura • Thambuttegama <p>Polonnaruwa - 03</p> <ul style="list-style-type: none"> • Aralaganwila • Medirigiriya • Polonnaruwa |
|--|---|

NORTH WESTERN PROVINCE - 18

- | | | |
|---|--|---|
| <p>Kurunegala - 09</p> <ul style="list-style-type: none"> • Alawwa • Galgamuwa • Giriulla • Hettipola • Kuliypitiya • Kurunegala • Kurunegala Metro | <ul style="list-style-type: none"> • Nikaweratiya • Wariyapola <p>Puttalam - 09</p> <ul style="list-style-type: none"> • Anamaduwa • Chilaw • Dankotuwa • Madampe | <ul style="list-style-type: none"> • Marawila • Norochchole • Puttalam • Udappuwa • Wennappuwa |
|---|--|---|

SABARAGAMUWA PROVINCE - 11

- | | | |
|--|---|---|
| <p>Kegalle - 04</p> <ul style="list-style-type: none"> • Mawanella • Kegalle • Pinnawala • Warakapola | <p>Ratnapura - 07</p> <ul style="list-style-type: none"> • Balangoda • Embilipitiya • Godakawela • Kahawatta | <ul style="list-style-type: none"> • Kalawana • Pelmadulla • Ratnapura |
|--|---|---|

UVA PROVINCE - 12

- | | | |
|--|---|--|
| <p>Badulla - 06</p> <ul style="list-style-type: none"> • Badulla • Bandarawela • Haputale • Mahiyanganaya | <ul style="list-style-type: none"> • Passara • Welimada <p>Monaragala - 06</p> <ul style="list-style-type: none"> • Buttala | <ul style="list-style-type: none"> • Bibile • Kataragama • Monaragala • Siyambalandyuwa • Wellawaya |
|--|---|--|

Branch Network**WESTERN PROVINCE - 104****Colombo - 66**

- Aluthkade
- Asiri Surgical Hospital [Pay Office]
- Athurugiriya
- Avissawella
- Bambalapitiya
- Boralesgamuwa
- Borella
- Cinnamon Gardens
- City Office
- Dehiwela
- Dematagoda
- Grandpass
- Greenpath
- Hanwella
- Head Office Branch
- Homagama
- Hulftsdorp
- International Water Management Institute [Pay Office]
- Jampettah
- Sri Jayawardenapura Hospital [Pay Office]
- Kaduwela
- Kelaniya
- Kiribathgoda
- Kirulapone
- Kohuwela
- Kollupitiya
- Kolonnawa
- Kotahena
- Kottawa
- Kotte
- Maharagama
- Pettah Metro
- Malabe
- Maligawatte

- Maradana
- Mirihana
- Moratumulla
- Moratuwa
- Mount Lavinia
- Mutwal
- Narahenpita
- Nawala
- Nawaloka [Pay Office]
- Nawam Mawatha
- Nugegoda
- Overseas School of Colombo [Pay Office]
- Padukka
- Pamankada
- Panchikawatte
- Peliyagoda
- Pettah
- Piliyandala
- Ratmalana
- Sea Street
- SLPA [Pay Office]
- Thalangama
- Thalawathugoda
- Asiri Central Hospital [Pay Office]
- Thimbirigasyaya
- Wellawatte
- Wijerama
- World Trade Centre
- Orian City [Pay Office]
- Pension Department [Pay Office]
- Lotus Road [Pay Office]
- Lanka Hospital PLC [Pay Office]

Gampaha - 29

- Airport Departure Counter [Pay Office]
- Biyagama
- Delgoda
- Divulapitiya

- Ekala
- Gampaha
- Ganemulla
- Hendala
- Ja-Ela
- Kadawatha
- Kandana
- Katunayake
- Kirindiwela
- Kochchikade
- Marandagahamula
- Minuwangoda
- Mirigama
- Negombo
- Negombo Metro
- Nittambuwa
- Pamunugama
- Pugoda
- Ragama
- Seeduwa
- Sri Lankan Airlines [Pay Office]
- Veyangoda
- Wattala
- Weliveriya
- Yakkala

Kalutara - 09

- Aluthgama
- Bandaragama
- Beruwala
- Horana
- Ingiriya
- Kalutara
- Mathugama
- Panadura
- Wadduwa

Corporate Information

NAME OF COMPANY

HATTON NATIONAL BANK PLC

LEGAL FORM

A public limited company incorporated on 5th March 1970 under the Laws of the Republic of Sri Lanka. The Company was re-registered under the Companies Act No 7 of 2007 on 27th September 2007. It is a Licensed Commercial Bank under the Banking Act.

COMPANY REGISTRATION NUMBER

PQ 82 (Previous PBS 613)

ACCOUNTING YEAR END

31st December

STOCK EXCHANGE LISTING

The ordinary shares and the unsecured subordinated redeemable debentures of the Bank are listed on the Colombo Stock Exchange in Sri Lanka.

REGISTERED OFFICE

"HNB Towers"
No. 479, T B Jayah Mawatha (Darley Road),
P O Box 837, Colombo 10, Sri Lanka.

HEAD OFFICE

"HNB Towers",
No. 479, T B Jayah Mawatha (Darley Road),
P O Box 837,
Colombo 10, Sri Lanka.

Cable Address : HATNABANK

Telephone Nos : +94 11 2664664

: +94 112662772

: +94 11 4764764

Fax No : +94 112662832

Swift : Bic Code - HBLILKX

e - mail : moreinfo@hnb.net

Web : www.hnb.net

CREDIT RATINGS

The Bank has been assigned a national long term rating of AA-[Ika] by Fitch Ratings Lanka Limited and a Foreign Currency Issuer rating of B1 by Moody's Investors Service.

BOARD OF DIRECTORS

Mr Rienzie Arseculeratne *[Chairman]*
Mr Jonathan Alles *[Managing Director / CEO]*
Ms M A R C Cooray
Dr L R Karunaratne
Mr Sujeewa Mudalige
Ms D S C Jayawardena
Mr R S Captain
Mr Amal Cabraal
Mr Palitha Pelpola
Mr D Soosaipillai
Mr A N de Silva
Mr Dinesh Weerakkody

BOARD SECRETARY

Ms K A L Thushari Ranaweera
*Attorney-at-Law, LL.M [Cambridge],
Dip in Int'l Affairs [BCIS]*

AUDIT COMMITTEE

Mr Sujeewa Mudalige *[Chairman]*
Dr L R Karunaratne
Mr Amal Cabraal
Mr A N de Silva

NOMINATION COMMITTEE

Mr Rienzie Arseculeratne *[Chairman]*
Ms M A R C Cooray
Mr R S Captain
Mr Palitha Pelpola

HR & REMUNERATION COMMITTEE

Mr Rienzie Arseculeratne *[Chairman]*
Mr Sujeewa Mudalige
Mr Amal Cabraal
Mr Rusi Captain

BOARD INTEGRATED RISK MANAGEMENT COMMITTEE

Ms M A R C Cooray *[Chairperson]*
Ms D S C Jayawardena
Mr D Soosaipillai
Mr Jonathan Alles - *Managing Director/CEO*
Mr Damith Pallewatte - *Chief Risk Officer/
AGM [Risk] / Chief Information Security Officer*
Ms Mohini Seneviratne - *Head of Compliance*

JOINT VENTURE COMPANIES

Acuity Partners (Pvt) Ltd 50%
[Financial Services]

SUBSIDIARY COMPANIES

HNB Assurance PLC 60%
[Insurance Services]
Sithma Development (Pvt) Ltd 100%
[Property Development]
HNB Grameen Finance Limited 51%
[Financial Services]

AUDITORS

Ernst & Young
Chartered Accountants
201, De Saram Place
Colombo 10, Sri Lanka.

INVESTOR INFORMATION

Institutional Investors, Stockbrokers and Security Analysts requiring financial information should contact the Chief Strategy Officer

"HNB Towers", Level 16,
No. 479, T B Jayah Mawatha,
Colombo 10, Sri Lanka.

Telephone : +94 11 2661178

Fax : +94 11 2662815

e-mail : investor.relations@hnb.lk

Notice of Meeting

Notice is hereby given that the Forty Ninth [49th] Annual General Meeting of Hatton National Bank PLC [the "Bank"] is convened on Wednesday, the Twenty Eighth [28th] day of March 2018 at the Auditorium on Level 22 of "HNB Towers" at No. 479, T.B. Jayah Mawatha, Colombo 10, at 10.00 in the forenoon when the following business will be transacted:

- i. To receive and consider the Annual Report of the Board of Directors along with the Financial Statements of the Bank for the year ended 31st December 2017 and the Auditor's Report thereon.
- ii. To declare a final dividend as recommended by the Board of Directors, to consider and if thought fit, to pass the following resolutions:

ORDINARY RESOLUTION - DECLARATION OF DIVIDEND AND APPROVAL OF ITS METHOD OF SATISFACTION

IT IS HEREBY RESOLVED:

- (a) THAT a final dividend of Rupees Two [Rs 2/-] per share constituting a total sum of Rs 977,107,380/- be paid on the issued and fully paid ordinary voting shares and ordinary non-voting shares of the Bank for the financial year ended 31st December 2017 based on the issued ordinary voting shares and ordinary non-voting shares as at February 20th, 2018, subject to any necessary revision being made to such amount to be distributed in order to include and accommodate the dividends pertaining to any new shares to be issued by the Bank to its employees under the Hatton National Bank PLC ESOP scheme;
- (b) THAT such dividend be paid out of exempt dividends received [if any], dividends received on which Withholding Tax has already been paid by the paying companies [if any], and the balance out of the profits of the Bank, which balance would be liable to a Withholding Tax of ten per centum [10%].
- (c) THAT the shareholders entitled to such dividend would be those shareholders [holders of both ordinary voting shares and ordinary non-voting shares], whose names have been duly registered in the Register of Shareholders and those shareholders whose names appear on the Central Depository Systems [Pvt] Ltd ['CDS'] as at end of trading on the date on which the requisite resolution of the Shareholders in regard to the final dividend is passed ['entitled Shareholders'];
- (d) THAT the said final dividend of Rs. 2/- per share be distributed and satisfied by the allotment and issue of new ordinary voting shares and ordinary non-voting shares [the "distribution scheme"] based on the share prices of ordinary voting shares and ordinary non-voting shares as at February 19th, 2018 in the following manner, subject however to any necessary revision being made to the amount of dividends to be distributed and the number of shares to be issued, (i) in order to include and accommodate the dividends pertaining to any new shares that may be issued by the Bank to its employees under the Hatton National Bank PLC ESOP scheme and/or (ii) pursuant to any changes to the applicable law:
 - A. By way of the allotment of and issue of new shares for voting shares:

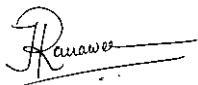
THAT a sum of Rs 784,609,116/- [less any withholding tax] be distributed to the holders of ordinary voting shares in the form of a scrip dividend at the rate of Rupees two [Rs 2/-] per each share, by the issue of a total of 2,924,009 ordinary voting shares computed on the basis of one [1] ordinary voting share for every 134.1666725376 ordinary voting shares currently in issue [which computation is based on a valuation of Rs. 241.50 per each ordinary voting share].
 - B. By way of the allotment of and issue of new shares for non-voting shares
THAT a sum of Rs 192,498,264/- [less any withholding tax] be distributed to the holders of ordinary non-voting shares in the form of a scrip dividend at the rate of Rupees two [Rs 2/-] per each share, by the issue of 907,059 ordinary non-voting shares computed on the basis of one [1] ordinary non-voting share for every 106.1112143752 non-voting shares currently in issue [which computation is based on a valuation of Rs.191.00 per each ordinary non-voting share].
- (e) THAT the shares arising from the aggregation of the residual fractions consequent to the scrip dividend be issued to and disposed of in the market by the trustees to be nominated by the Board of Directors and the proceeds to be distributed to charitable organization[s].
- (f) THAT (a) the new ordinary voting shares to be issued in pursuance of the distribution scheme shall, immediately consequent to the allotment thereof to the entitled Shareholders rank equal and pari passu in all respects with the existing issued and fully paid ordinary voting shares of the Bank and (b) the new ordinary non-voting shares to be issued in pursuance of the distribution scheme shall, immediately consequent to the allotment thereof to the entitled Shareholders rank equal and pari passu in all respects with the existing issued and fully paid ordinary non-voting shares of the Bank, and shall be listed on the Colombo Stock Exchange.
- (g) THAT the new ordinary voting shares and ordinary non-voting shares to be so allotted and issued shall not be eligible for the payment of dividend declared hereby.
- (h) THAT accordingly, the Bank's management be and is hereby authorized to take all necessary steps to give effect to the aforesaid proposed issue of new ordinary voting shares and ordinary non-voting shares of the Bank.

SPECIAL RESOLUTION – APPROVAL OF THE HOLDERS OF VOTING SHARES UNDER SECTION 99 OF THE COMPANIES ACT NO. 7 OF 2007, FOR THE ISSUE OF SHARES BY WAY OF A SCRIP DIVIDEND

IT IS HEREBY RESOLVED THAT the issue by the Bank of [a] 2,924,009 ordinary voting shares to the holders of ordinary voting shares on the basis of one [1] ordinary voting share for every 134.1666725376 ordinary voting shares currently in issue and [b] 907,059 ordinary non-voting shares to the holders of ordinary non-voting shares on the basis of one [1] ordinary non-voting share for every 106.1112143752 ordinary non-voting shares currently in issue, by way of a scrip dividend (subject to any necessary revision being made to the number of shares to be so issued [i] to include and accommodate any dividends pertaining to any new shares to be issued by the Bank to its employees under the Hatton National Bank PLC ESOP scheme and/or [ii] pursuant to any changes to the applicable law) with the shares arising from the aggregation of the residual fractions consequent to the scrip dividend being issued to and disposed of in the market by the trustees to be nominated by the Board of Directors and the proceeds from such disposal being distributed to charitable organization(s), be and is hereby approved.

- iii. To re-elect Mrs Rose Cooray, who retires at the Annual General Meeting, as a Director of the Bank in terms of Article 34 of the Articles of Association of the Bank.
- iv. To re-elect Mr Palitha Pelpola who retires at the Annual General Meeting, as a Director of the Bank in terms of Article 34 of the Articles of Association of the Bank.
- v. To re-elect Mr Duliksha Soosaipillai who retires at the Annual General Meeting, as a Director of the Bank in terms of Article 34 of the Articles of Association of the Bank.
- vi. To re-elect Mr Dinesh Weerakkody, as a Director of the Bank in terms of Article 36 of the Articles of Association of the Bank.
- vii. To re-appoint Messrs Ernst & Young (Chartered Accountants) as the Bank's Auditors for the ensuing year and to authorize the Directors to fix their remuneration.
- viii. To authorize the Directors to determine payments for the year 2018 for charitable and other purposes.

By order of the Board of Hatton National Bank PLC,



K A L Thushari Ranaweera (Mrs)
Deputy General Manager (Legal) /Board Secretary

Colombo, Sri Lanka.
20th February 2018

Notes :

1. A member entitled to attend or attend and vote at the meeting, is entitled to appoint a proxy to attend or attend and vote as the case may be, in his stead.
2. A proxy need not be a member of the Company. The Form of Proxy is enclosed.
3. The completed Form of Proxy should be deposited with the Board Secretary at the Registered Office of the Company at No. 479, T.B. Jayah Mawatha, Colombo 10 [at "HNB Towers", Level 18], not less than 24 hours before the time appointed for holding the meeting.

Notice of Meeting

SUMMARY OF ARTICLE 22 OF THE ARTICLES OF ASSOCIATION OF HATTON NATIONAL BANK PLC

PROCEDURE ON VOTING AND HOW A POLL IS TO BE TAKEN

- » Voting at a meeting of shareholders shall, unless a poll is demanded, be by a show of hands, or voting by voice as may be determined by the Chairman.
- » Subject to any rights or restrictions for the time being attached to any class or classes of shares, on a show of hands or voting by voice as aforesaid every member who is present at the meeting shall have one [01] vote, and on a poll every member who is present in person at the meeting shall be entitled to one [01] vote for each voting share held by him.
- » A declaration by the Chairman of the meeting that a resolution is carried by the requisite majority is conclusive evidence of that fact, unless a poll is demanded.
- » At a meeting of shareholders, a poll may be demanded on a particular question as provided for in the Companies Act No.7 of 2007 by,
 - the Chairman;
 - not less than five [5] shareholders having the right to vote at the meeting; or
 - a shareholder or shareholders representing not less than ten per centum [10%] of the total voting rights of all shareholders having the right to vote at the meeting.
- » A poll may be demanded either before or after the vote is taken on a resolution. A demand for a poll may be withdrawn any time before the poll is taken.
- » If a poll is taken, votes shall be counted according to the votes attached to the shares of each shareholder present and voting.
- » In the case of an equality of votes, whether on a show of hands or on a poll, the Chairman of the meeting shall be entitled to a second or casting vote.
- » A declaration by the Chairman of the meeting that a resolution has been carried, or carried unanimously or by a particular majority, or lost, and an entry made to that effect in the minute book, shall be conclusive evidence of the fact without proof of the number or proportion of the votes recorded for or against such a resolution.

Form of Proxy [Voting]

I/We of being *a member/members of the Hatton National Bank PLC, hereby appoint of or failing him/her, Rienzie Anicetus Fernando Arseculeratne or failing him, Antonio Jonathan Alles or failing him, Mirihana Arachchige Rose Chandralatha Cooray or failing her, Lokuwithanage Rohan Karunaratne or failing him, Don Tiburtius Sujeeva Handapangoda Mudalige or failing him, Don Sanjivani Clarinda Jayawardena or failing her, Rusi Sohli Captain or failing him, Damian Amal Cabraal or failing him, Palitha Srideva Chulakumara Pelpola or failing him, Eugen Duliksha Pratharp Soosaipillai or failing him, Appu Hennadige Don Anthony Nilanth de Silva or failing him, Dinesh Stephen Weerakkody as *my/our proxy, to attend, vote and speak on *my/our behalf represent *me/us at the Forty Ninth (49th) Annual General Meeting of the Bank to be held at the Auditorium on Level 22 of "HNB Towers" at No. 479, T B Jayah Mawatha, Colombo 10, on the Twenty Eighth (28th) day of March, 2018 at 10.00 in the forenoon and at any adjournment thereof.

*I/we the undersigned hereby authorize *my/our proxy to vote on *my/our behalf in accordance with the preference** indicated below:

[i]	To declare the recommended dividend of Rs. 2/- per share as the final dividend for 2017 and	In favour	<input type="checkbox"/>
		Against	<input type="checkbox"/>
[a]	to adopt Ordinary Resolution - Declaration of Dividend and approval of its method of satisfaction	In favour	<input type="checkbox"/>
		Against	<input type="checkbox"/>
[b]	to adopt Special Resolution - Approval of the holders of voting shares under section 99 of the Companies Act No. 7 of 2007, for the issue of shares by way of a scrip dividend	In favour	<input type="checkbox"/>
		Against	<input type="checkbox"/>
[ii]	To re-elect Mrs Rose Cooray as a Director of the Bank	In favour	<input type="checkbox"/>
		Against	<input type="checkbox"/>
[iii]	To re-elect Mr Palitha Pelpola as a Director of the Bank	In favour	<input type="checkbox"/>
		Against	<input type="checkbox"/>
[iv]	To re-elect Mr Duliksha Soosaipillai as a Director of the Bank	In favour	<input type="checkbox"/>
		Against	<input type="checkbox"/>
[v]	To re-elect Mr Dinesh Weerakkody as a Director of the Bank	In favour	<input type="checkbox"/>
		Against	<input type="checkbox"/>
[vi]	To re-appoint Messrs Ernst & Young [Chartered Accountants] as the Bank's Auditors for the ensuing year/ authorize the Directors to fix their remuneration	In favour	<input type="checkbox"/>
		Against	<input type="checkbox"/>
[vii]	To authorize the Directors to determine payments for charitable and other purposes	In favour	<input type="checkbox"/>
		Against	<input type="checkbox"/>

* Delete inappropriate words

** Mark your preference with "✓" or "x"

Signed this day 2018.

Signature/s

Form of Proxy [Voting]

Please provide the following details:

Shareholder's NIC No / Company Registration No. :

Folio No / Number of Shares held :

Proxy holder's NIC No (if not a Director) :

Instructions to complete proxy

1. The full name and the registered address of the shareholder appointing the Proxy should be legibly entered in the Form of Proxy, duly signed and dated.
2. The completed Proxy should be deposited with the Board Secretary, at the Registered Office of the Bank at No. 479, T B Jayah Mawatha, Colombo 10 ["HNB Towers", Level 18], not less than 24 hours before the time appointed for holding the Meeting.
3. The Proxy shall -
 - [a] in the case of an individual, be signed by the shareholder or by his attorney, and if signed by an attorney, a notarially certified copy of the Power of Attorney should be attached to the completed Proxy if it has not already been registered with the Bank.
 - [b] in the case of a company or corporate body, either be under its Common Seal or signed by its attorney or by an officer on behalf of the company or corporate body in accordance with the Articles of Association or the Constitution of that company or corporate body.

The Bank may but shall not be bound to, require evidence of the authority of any such attorney or officer.
 - [c] in the case of joint-holders, the first joint-holder has the power to sign the proxy without the concurrence of the other joint-holder/s.
4. Every alteration or addition to the Proxy must be duly authenticated by the full signature of the shareholder signing the Proxy. Such signature should as far as possible be placed in proximity to the alteration or addition intended to be authenticated.

Form of Proxy [Non-Voting]

I/We of being *a member/members of the Hatton National Bank PLC, hereby appoint of or failing him/her, Rienzie Anicetus Fernando Arseculeratne or failing him, Antonio Jonathan Alles or failing him, Mirihana Arachchige Rose Chandralatha Cooray or failing her, Lokuwithanage Rohan Karunaratne or failing him, Don Tiburtius Sujeewa Handapangoda Mudalige or failing him, Don Sanjivani Clarinda Jayawardena or failing her, Rusi Sohli Captain or failing him, Damian Amal Cabraal or failing him, Palitha Srideva Chulakumara Pelpola or failing him, Eugen Duliksha Pratharp Soosaipillai or failing him, Appu Hennadige Don Anthony Nilanth de Silva or failing him, Dinesh Stephen Weerakkody as *my/our proxy, to represent *me/us at the Forty Ninth [49th] Annual General Meeting of the Bank to be held at the Auditorium on Level 22 of "HNB Towers" at No. 479, T B Jayah Mawatha, Colombo 10, on the Twenty Eighth [28th] day of March, 2018 at 10.00 in the forenoon and at any adjournment thereof.

* Delete inappropriate words

Signed this day 2018.

Signature/s

Please provide the following details:

Shareholder's NIC No / Company Registration No. :

Folio No / Number of Shares held :

Proxy holder's NIC No (if not a Director) :

Note - See reverse hereof for instructions to complete the proxy.

Form of Proxy [Non-Voting]

Instructions to complete proxy

1. The full name and the registered address of the shareholder appointing the Proxy should be legibly entered in the Form of Proxy, duly signed and dated.
2. The completed Proxy should be deposited with the Board Secretary, at the Registered Office of the Bank at No. 479, T B Jayah Mawatha, Colombo 10 ["HNB Towers", Level 18], not less than 24 hours before the time appointed for holding the Meeting.
3. The Proxy shall -
 - [a] in the case of an individual, be signed by the shareholder or by his attorney, and if signed by an attorney, a notarially certified copy of the Power of Attorney should be attached to the completed Proxy if it has not already been registered with the Bank.
 - [b] in the case of a company or corporate body, either be under its Common Seal or signed by its attorney or by an officer on behalf of the company or corporate body in accordance with the Articles of Association or the Constitution of that company or corporate body.

The Bank may but shall not be bound to, require evidence of the authority of any such attorney or officer.
 - [c] in the case of joint-holders, the first joint-holder has the power to sign the proxy without the concurrence of the other joint-holder/s.
4. Every alteration or addition to the Proxy must be duly authenticated by the full signature of the shareholder signing the Proxy. Such signature should as far as possible be placed in proximity to the alteration or addition intended to be authenticated.

Investor Feedback Form

To request information or submit a comment / query to the Company, please complete the following and return this page to -

Chief Strategy Officer,
 Hatton National Bank PLC,
 No. 479, T.B. Jayah Mawatha, Colombo 10.
 Sri Lanka

Email : investor.relations@hnb.lk

Name		
Permanent Mailing Address		
Contact Numbers	[Tel]		
		Country Code	Area Code
	[Fax]		
		Country Code	Area Code
E-mail		
Name of Company [If Applicable]		
Designation [If Applicable]		
Company Address [If Applicable]		

Queries / Comments

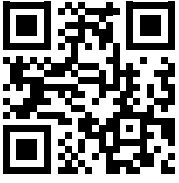
Please tick "✓" the appropriate box

	Yes	No
Would you like to receive soft copies of the HNB annual and interim reports via e-mail?	<input type="checkbox"/>	<input type="checkbox"/>
Would you like to receive news and press releases of HNB via e-mail?	<input type="checkbox"/>	<input type="checkbox"/>
Would you like to receive any information on our products / services?	<input type="checkbox"/>	<input type="checkbox"/>

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