

**THE**  
**HATTON NATIONAL BANK**  
**BANK**  
**ANNUAL**  
**REPORT**  
**2010**

**SRI LANKA IS GROWING; AND HNB IS AT THE FOREFRONT OF THIS DRIVE, DELIVERING A SPECTRUM OF SOLUTIONS THAT HELP DEVELOP A NATION, ECONOMY AND ITS PEOPLE ON THE RISE.**

**OUR NATIONAL COMMITMENT HAS ALWAYS BEEN TO CONVERT WORLD-CLASS FINANCIAL SOLUTIONS TO PEOPLE FRIENDLY BANKING PRODUCTS THAT HELP INDIVIDUALS AND BUSINESS REALIZE THEIR PROMISE. OUR UNDERSTANDING AND OUR RESPONSE TO NATIONAL FINANCIAL NEEDS HAS BEEN LONGSTANDING.**

**THIS IS WHAT TRULY MAKES US A NATIONAL BANK. AND WE KNOW THERE IS NO BETTER TIME THAN NOW, TO SHARE THE NATIONAL FOCUS AND GIVE SRI LANKANS THE IMPETUS TO SURGE AHEAD.**



# 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 & 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**

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# FINANCIAL GOALS AND PERFORMANCE

**GROSS  
NPA RATIO  
4.5%**

**DEPOSITS  
Rs 234 Bn  
+11.2%**

**MARKET  
CAPITALISATION  
Rs 76.5 Bn  
+137%**

**PBT  
Rs 6.7 Bn  
+13.8%**

**ADVANCES  
Rs 210 Bn  
+18.5%**

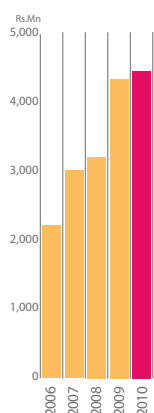
|   | 2006  | 2007  | 2008  | 2009  | 2010  | Medium Term Goals |
|---|-------|-------|-------|-------|-------|-------------------|
| <b>Results For the Year</b>                                       |       |       |       |       |       |                   |
| Return on Average Assets (%)                                      | 1.2   | 1.4   | 1.3   | 1.6   | 1.5   | Over 1.5          |
| Return on Average Shareholders' Funds (%)                         | 18.4  | 19.3  | 16.5  | 19.6  | 17.5  | Over 20.0         |
| Cost / Net Income Ratio (Excl. Financial VAT) (%) *               | 57.8  | 56.2  | 54.2  | 54.3  | 56.5  | Below 50.0        |
| Dividend per Share (Rs)   | 5.00  | 3.50  | 4.00  | 6.50  | 7.00  | Over 4.00         |
| <b>Capital Adequacy</b>   |       |       |       |       |       |                   |
| Tier 1 Capital Ratio (%) (Statutory Minimum Ratio Required is 5%) | 10.23 | 10.32 | 9.25  | 11.10 | 10.99 | 9.00              |
| Total Capital Ratio (%) (Statutory Minimum Ratio Required is 10%) | 11.32 | 12.08 | 11.40 | 13.16 | 12.64 | 12.50             |

\* Operating expenses consist of personnel expenses, premises equipment and establishment expenses, fee and commission expenses and other expenses.  
Net income consists of net interest income, foreign exchange profit, Fee and commission income, dividend income and other income.

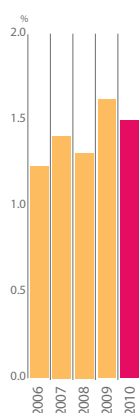
# FINANCIAL HIGHLIGHTS

| Results For the Year   | Bank           |                |             | Group          |                |             |
|--|----------------|----------------|-------------|----------------|----------------|-------------|
|  | 2010<br>Rs. Mn | 2009<br>Rs. Mn | %<br>Change | 2010<br>Rs. Mn | 2009<br>Rs. Mn | %<br>Change |
| Income   | 35,582         | 39,358         | - 9.6       | 38,105         | 41,301         | - 7.7       |
| Net profit before income tax   | 6,731          | 5,918          | + 13.7      | 7,252          | 6,167          | + 17.6      |
| Income tax on profits  | 2,267          | 1,566          | + 44.8      | 2,365          | 1,613          | + 46.6      |
| Net profit after taxation  | 4,464          | 4,352          | + 2.6       | 4,887          | 4,553          | + 7.3       |
| Gross Dividends  | 1,648          | 1,533          | + 7.5       | 1,678          | 1,556          | + 7.9       |
| Profit available after appropriation   | 2,816          | 2,819          | - 0.1       | 3,209          | 2,998          | + 7.0       |
| <b>At the Year End</b>   |                |                |             |                |                |             |
| Shareholders' funds (Capital and Reserves)   | 27,274         | 23,900         | + 14.1      | 29,978         | 26,374         | + 13.7      |
| Deposits from customers  | 234,071        | 210,507        | + 11.2      | 233,881        | 210,363        | + 11.2      |
| Advances to customers including Leasing,<br>Bills of Exchange & Commercial paper (Gross) | 210,068        | 177,229        | + 18.5      | 208,070        | 174,476        | + 19.3      |
| Total Assets   | 313,913        | 280,289        | + 12.0      | 323,258        | 287,208        | + 12.6      |
| <b>Information per ordinary share</b>  |                |                |             |                |                |             |
| Earnings (Rs.)   | 18.84          | 18.47          | + 2.0       | 20.20          | 19.03          | + 6.1       |
| Dividends (Rs.)  | 7.00           | 6.50           | + 7.7       |                |                |             |
| Dividend Yield (%)   | 1.75           | 3.82           | - 54.2      |                |                |             |
| Net asset value (Rs.)  | 114.61         | 101.37         | + 13.1      | 125.97         | 110.83         | + 13.7      |
| Market value (Rs.) - Voting  | 399.90         | 170.25         | + 134.9     |                |                |             |
| Market value (Rs.) - Non voting  | 214.60         | 104.75         | + 104.9     |                |                |             |
| <b>Ratios</b>  |                |                |             |                |                |             |
| Return on average shareholders' funds (%)  | 17.45          | 19.57          | - 10.8      | 16.99          | 18.19          | - 6.6       |
| Price earning (Times)  | 21.23          | 9.22           | + 130.3     | 19.80          | 8.95           | + 121.3     |
| Dividend cover (Times)   | 2.71           | 2.84           | - 4.6       | 2.91           | 2.93           | - 0.5       |
| <b>Capital Adequacy Ratios</b>   |                |                |             |                |                |             |
| Tier 1 (%) (Statutory minimum ratio required is 5%)                                      | 10.99          | 11.10          | - 1.0       | 10.96          | 10.85          | + 1.0       |
| Tier 1 & 2 (%) (Statutory minimum ratio required is 10%)                                 | 12.64          | 13.16          | - 4.0       | 12.73          | 12.92          | - 1.5       |

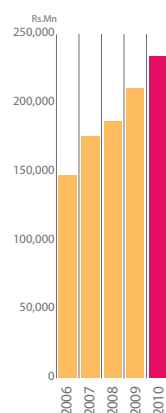
Net Profit After Taxation



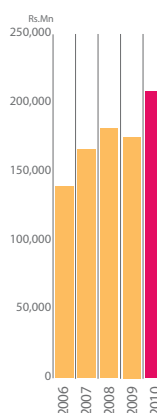
Return on Average Assets



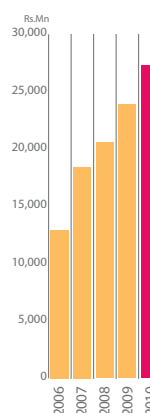
Total Deposits



Total Advances



Shareholders' Funds



# CHAIRMAN'S MESSAGE



**In the year 2010, our nation witnessed an encouraging economic rebound. It is without doubt that Sri Lanka is on the throes of economic resurgence, with surety of economic boom evidenced through positive indications prevalent in the year 2010.**

It gives me great pleasure to welcome all of you, our valued shareholders, to the forty second Annual General Meeting of Hatton National Bank PLC and to present to you the audited Financial Statements and Annual Report for the year 2010. For Hatton National Bank, the year 2010 has been yet another formidable year. As a financial institution that has a long history and reputation as a corporate that works in the national interest, your Bank has once again substantiated its status as an integral element in the

**nation's engine of growth. Our legacy by far establishes us not only as a pioneer but also a revolutionary force in shaping the future of Sri Lanka's economic and commercial intent.**

### **Sri Lanka's economy rebounds post-conflict**

In the year 2010, our nation witnessed an encouraging economic rebound. It is without doubt that Sri Lanka is on the throes of economic resurgence, with surety of economic boom evidenced through positive indications prevalent in the year 2010. The national economy grew by an estimated 8%, over and above the growth expectations for the year 2010, with inflation at 6.9% and unemployment down to 4.9%. Most encouragingly, the all island poverty rate declined to 7.6% in 2010 from 15.2% in 2006. It is indeed heartening to note that the Government is pursuing economic growth in a manner that is inclusive of the rural economy. Indeed, as Hatton National Bank has demonstrated over the decades, growth can only be sustained through wealth creation that is far reaching and equitable.

### **Fundamentals for a robust growth trajectory**

Most importantly, the future outlook for the nation is brightened by the strategic approach to national development adopted by the Government of Sri Lanka, an approach that was amply demonstrated by the government's budgetary proposals for the year 2010 / 2011. Pragmatism and a concerted strategic approach are indeed the tools with which our nation can once again rise above and overcome the drudgery of economic underachievement that was imposed on us through three decades of conflict. In the year 2010, the Government of Sri Lanka demonstrated its will to put into action its vision for the nation, through broad budgetary and economic proposals that call for reform and reconstruction. Moreover, the Government has perceptively understood and accepted that progressive and sustainable national development can only be achieved through private-public sector partnership. This I concur, is a robust and sustainable foundation for the future, and is a call that must be heeded by the nation's business community to collaborate as integral partners of national development. The national outlook in the medium and long term, I believe, will be the outcome of remedial steps undertaken through such a partnership. Indeed,

the private sector has the experience and far more success stories as implementers of strategy. Thus, it is critical going forward that we transfer this available expertise to realise more potent outcomes through the collaboration of private initiatives with public resources.

The late Sir Arthur C. Clarke shared with me this nugget of wisdom once, "the private sector must not only do well but also do good". This statement truly resonates my sentiments on the need for private-sector leadership for our nation's future development and prosperity. Of course, for national progress to be realised, we as a nation must also accept that transparency and governance in every institution – be it private or public – must be upped to that of global standards. Bureaucracy has to be curbed, with the public sector machinery becoming more efficient and agile. The private sector needs to embrace positivity and be corporates that truly demonstrate entrepreneurial spirit and leadership.

Allocation of resources, of the State as well as the private sector, to rural communities is imperative for equitable wealth creation, wherein perceptible evidence of growth in rural Sri Lanka should be the fulcrum of the drive for development. Whilst the Government of Sri Lanka must be recognised and given due credit for taking the appropriate measures towards controlling inflation, stabilising the exchange rate and curbing domestic interest rates, we need to accept that these measures will be conducive for short and medium term progress. For long-term economic stability, the creation of incremental wealth therefore, is imperative. There is undoubtedly room for growth. The nation's critical sectors – tourism, construction, agriculture, health, education, infrastructure and industry – are all presently under capacity. As a nation we have enormous scope for capacity building in a foray of sectors including those mentioned above. Going forward, the Government and the private sector need to come together as partners to identify and hone sector specific growth strategies, demarcating the most feasible opportunities from a growth perspective and therein invest decisively with the intention of reaping long-term returns. Our forward march as an economy too should be one that imbues solidarity and friendship with nations across the globe.



# CHAIRMAN'S MESSAGE

## Consistency in regulation as a pivot for strong economic growth

We have witnessed over the past few years tighter regulation of the financial services industry. With the adoption of global standard Basel II by the financial services sector, industry players have progressed towards meeting risk and capital management requirements to ensure adequate protection from overexposure to lending, investment practices and challenges of the operating environment. In addition, rigorous regulation and supervision by the Central Bank of Sri Lanka have brought greater stability and transparency to the sector. However, it is equally important that the same ethical standards and levels of governance are applied to Public Sector Financial Institutions (PSFIs), especially since PSFIs enjoy a significant share of the financial services sector and all of us are part of the same playing field.

## Global trends indicate the need to self-assess values

Consumerism as a precept has given rise to overspending as opposed to savings. Thus, the nations that were looked upon as the leaders of the global economy are in fact nations that are steeped in the concept of consumerism. As the past few years have demonstrated, those economies that are fuelled by consumerism have experienced a financial fall-out that has been marked as grave as the Great Depression. The global economic crisis, though salvaged and reversed before reaching its climax, was protracted and pervaded every nation designated as a western economic icon due to inherent weaknesses in the systems and processes that characterise these economies. In retrospect, nations that are steeped in the value of savings, desisted the domino effect of the global financial crisis. Thus, I strongly believe that as a nation we need to self-assess our value systems and be true to those values that have been our strength in the past.

## The role of your Bank

Hatton National Bank has always been a leader and proponent of national priorities. In much the same way, it will continue to play a catalyst role in achieving the economic objectives of this new Sri Lanka. Through the conceptualisation of new products and services that target growth sectors and which will contribute towards the achievement of national priorities, the Bank will continue to align its business strategy with the achievement and implementation of national goals and strategies. It will continue

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to accelerate its efforts towards socially mobilising rural Sri Lanka with special focus on the people of the Northern and Eastern provinces who need to be empowered towards the achievement of self-sustenance. At Hatton National Bank we are confident of what our nation can achieve and committed towards playing a vital role in achieving economic success.

## Appreciations

I would like to take this opportunity to thank my fellow Directors who have at all times extended their fullest support and shared their valued expertise towards the betterment of the Bank. My deep appreciation is extended to the Management and Staff for their unstinted cooperation and for their tireless pursuit of the Bank's strategic expectations.

Our customers, who have stood by us for many decades have truly demonstrated the meaning of loyalty. We are proud and privileged to serve you. Thank you for placing your trust in us.

I would like to take this opportunity to thank His Excellency the President and Minister of Finance Mahinda Rajapakse and officials at his Ministry, the Governor of the Central Bank of Sri Lanka, Mr Ajith Nivard Cabraal and his officials for their guidance and continued support during the year.

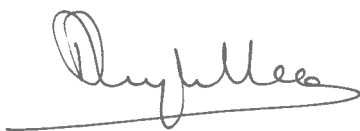


Our shareholders have been the very pillars of strength upon which we have built this Bank. I would like to thank you all for your investment into this Bank, your belief in its potential is a reflection of our passion to achieve.

We stay committed to serve all our stakeholders. On behalf of the Board of Directors, I pledge that we will continue to add shareholder value through the execution of prudent business strategies whilst ensuring that we contribute towards the achievement of national priorities.

Ladies and Gentlemen, having served HNB for a period of 34 years of which the last 24 years was as your MD / CEO for 17 years and 7 years as the Chairman, I will be stepping down from the Chairmanship as well as from the Board on the 31st March 2011.

I have watched with much satisfaction the great value addition that has occurred to our organisation over this long period. This has been mainly due to the prudent management, efficiency and transparency displayed by your Board of Directors in enthusiastically formulating and directing policy for the organisation. As I bid goodbye to the Bank, I am quite pleased to leave behind lasting memories of my long stay with an abundance of hope and faith on the excellent prospects that HNB has for further growth and rapid progress in the future.



Rienzie T. Wijetilleke  
*Chairman*

Colombo, Sri Lanka  
18th February 2011

**THE**  
**HATTON**  
**NATIONAL BANK**  
**BANK**

# CHIEF EXECUTIVE OFFICER'S REVIEW



**Hatton National Bank, as a stalwart of national banking heritage continued its progression as a Bank that operates in the interests of the nation. During the year, the Bank continued to map its 3-year corporate strategy with the national vision, in the process seeking, identifying and strategising operational pillars which reflect the Bank's core competencies and yield competitive advantages.**

## **Economic resurgence transcends challenges**

The financial year 2010 was essentially a year where challenges were juxtaposed with optimism for the future. The nation's economy buoyed by confidence resurged commendably during the year. The cessation of hostilities in 2009, and sound progress towards reconstruction of lives and livelihoods in the primarily affected Northern and Eastern provinces of Sri Lanka catalysed economic activity in an area which for over 3 decades had stood

still in time. The progressive actions taken by the Government of Sri Lanka to set in motion greater economic activity, drawing in communities and individuals to contribute towards economic development was the fundamental crux of the economic gain in 2010. The optimism displayed in 2009 for Sri Lanka's future in a post conflict era continued to be a constant in the future sentiments for the nation.

### **National vision mirrored in corporate strategy**

Hatton National Bank, as a stalwart of national banking heritage continued its progression as a Bank that operates in the interests of the nation. During the year, the Bank continued to map its 3-year corporate strategy with the national vision, in the process seeking, identifying and strategising operational pillars which reflect the Bank's core competencies and yield competitive advantages. Hatton National Bank followed a concerted drive in contributing towards the national vision in tandem with the realisation of specific corporate objectives.

### **Financial and Operational performance**

At Hatton National Bank, challenges have never been an impediment to our growth. In 2010, as in the past, by strategising proactively, setting the tone at the top, by integrating business focus with needs of stakeholders and by being consistently transparent through continuous disclosures, the Bank was able to augment its operation to one of enhanced wealth creation.

Thus, agility and acceleration of strategy implementation paved the way for greater growth in 2010. Despite the adversities, our financial performance proved to be robust with the Bank posting a pre tax profit of 6.73 Bn and post tax profit of 4.46 Bn. The Group posted an after tax profit of Rs 4.89 Bn.

Solid contribution from core banking activities contributed towards the expansion of financial performance during the year. Group performance was enhanced considerably during the year with a majority of the subsidiaries posting commendable returns. The Insurance subsidiary – HNB Assurance PLC - posted robust growth in

business and profitability. Likewise, Sithma Development (Pvt) Ltd (Sithma), performed exceptionally, posting a commendable Rs 170.7 Mn after tax profit in 2010. It was a milestone year for Sithma which recouped its entire accumulated losses. Overseas investments performed with promise; Majan Exchange (Oman) performed well and is expected to break-even in the first half of the upcoming financial year. Delma Exchange (UAE) continued to garner a greater share of business through enhanced accessibility and distribution. Delma Exchange (Canada) however proved to be an operational challenge, largely due to the market context where the presence of a large grey market for remittances limited the scope for continuity. As a result, commercial operations of the subsidiary were ceased in October 2010. Acuity Partners (Pvt) Ltd., which was newly formed in 2008, as a Joint Venture with DFCC Bank incorporating the businesses of stock brokering, fixed income securities, corporate finance and venture capital, posted excellent returns with a consolidated after tax profit of Rs 301 Mn. After the acquisition by Acuity Partner (Pvt) Ltd, Lanka Venture PLC was repositioned during 2010, with the venture capital company's main operational lines focused towards healthcare and renewable energy; an initiative that is directly in line with meeting national developmental priorities. The Lanka Ventures Group posted commendable returns of Rs 102.6 Mn (after tax) during the nine months to December 2010.

In last quarter of 2009, the Government of Sri Lanka instituted a reduction in domestic interest rates amongst the State banks with a view to precipitate post conflict development. In the first quarter of 2010, the financial services industry witnessed a pervasive reduction of domestic interest rates as the Government looked to bolster and accelerate the rate of investment. However, as consequence financial institutions grappled with the dilemma of balancing re-pricing of assets whilst liabilities partly remained contracted to pre-agreed rates. Whilst liability re-pricing was a key concern for the Bank over the first half of the year, concentration on asset re-pricing was a key area of focus over the remaining quarters.

As a direct outcome of the interest rate decline, the first half of the financial year was characterised by declining asset and liability books, due largely to sluggish domestic credit growth, thus precipitating a dip in the net interest income and affecting the top line targets for the year. However, in the second half of 2010 domestic credit growth witnessed a commendable recovery, placing



# CHIEF EXECUTIVE OFFICER'S REVIEW

the Bank's performance for the year in better light. In particular, the expectations for 2011 remain high should the credit growth trend continue with the same momentum witnessed during the last quarter of 2010. From a macro perspective, the financial services industry as a whole was negatively affected with credit growth at a marginal 3.8% during the first quarter of the year. Credit growth did however, recover aggressively to end the year with a 22.6% growth.

A stable exchange rate scenario in 2010 saw the Sri Lankan Rupee strengthen against the greenback. Despite the lack of a scenario of exchange fluctuations that normally sets the stage for exceptional exchange income, the Bank remained one of the few in the industry to achieve commendable foreign exchange income which reflected 12.5% growth over the previous year.

On a macro level, the year was defined by commendable achievements. Despite the challenges posed during the year and the somewhat discouraging credit growth scenario during the first half of 2010, the Bank continued to execute its strategies for future growth with urgency and priority with the intention to build capacity in readiness for future growth. As such, the Bank's plans to increase accessibility were well executed with the opening of 19 customer centres and the commissioning of 40 additional Automated Teller Machines (ATM), sustaining an equitable rural, semi urban reach of the Bank's services. The enhanced distribution network is undoubtedly a platform for greater mobilisation of services going forward and is a strategic initiative that is well aligned with the national vision for rural empowerment.

As in previous years credit quality remained an area of critical focus. The Bank worked tirelessly towards the achievement of a significantly reduced Non Performing Advances portfolio (NPA). Its strategies towards this end enabled the Bank to successfully constrain NPAs to achieve a gross NPA below 5 percent for the year, the lowest achieved in over a decade. The excellence in NPA management placed the Bank well above the industry norm of 5.3% for NPA. The Bank's diligent and relentless pursuit of portfolio quality continued to pay dividends in 2010 as in the previous financial year.

However, in 2010 the cost to income ratio increased marginally to 56.5%, and remained below expectations. Cost to income remains a critical area of concern, with the need to break through the 50% psychological barrier imperative in the medium term.

During the year asset growth was managed through internal sources, with primary dependence on the plough back of internally

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generated profits. However, going forward, the Bank may objectively consider external financing options to add impetus to growth in the medium term.

Risk management and governance took centre stage during the financial year, with the Bank placing due emphasis on the full integration of BASEL II whilst being mindful of the recent announcements on the requirements of the BASEL III road map. In addition, the Bank is steadfastly pursuing preparations for the adoption of Sri Lanka Accounting Standards 44 – "Financial Instruments: Presentation" and Sri Lanka Accounting Standards 45 – "Financial Instruments: Recognition and Measurement". The Bank remains on target to adopt the Standards by January 2012.

## **Recognition of Excellence**

In 2010, the Bank received numerous accolades as recognition for its outstanding performance and service excellence. In this review, I wish to make mention only of a few of these accolades as these alone vividly portray the successes of the Bank in diverse areas of operational and performance excellence

Hatton National Bank was the winner for the "Best Retail Bank in Sri Lanka 2009" presented by "The Asian Banker" in The Asian Banker Excellence in Retail Financial Services Awards 2010 for the third consecutive year. Likewise, Euromoney Finance Magazine recognised the Bank as the "Best Bank in Sri Lanka" at the Euromoney Awards for Excellence 2010 for second consecutive year. The Bank swept the prestigious Institute of Chartered Accountants of Sri Lanka (ICASL) Annual Report Awards 2009 Competition organised by the Institute of Chartered Accountants of Sri Lanka winning four Gold Awards including the Cyril Gardiner Memorial

Trophy for Overall Excellence and Edmond J Cooray Memorial Trophy for Banking Sector Excellence for the second consecutive year. It was the first time in the history of ICASL Annual Report Awards, that a participating institution won 4 gold awards in one particular year and is indeed a feat that demonstrates the Bank's commitment to the highest levels of transparency and accuracy. During the year, the Bank garnered further recognition by being ranked First in Asia in terms of "Total Shareholder Return" in the last five years (2005-2009) under the category of 'Small Cap Banks' according to the Investor Audit Services of The Asian Banker.

These awards and accolades recognise the Bank for an array of achievements – financial performance, sustainability, business model and strategy, and reporting initiatives - and therefore are a sound representation of the Bank's all round focus on achieving excellence.

### **Future outlook**

The Government's budget proposals for 2011 placed the financial services sector on a strong footing for robust growth. The Government proposed to abolish the bank debit tax so that withdrawals from banks will not be liable for any tax, to reduce VAT on financial services to 12% from 20% and to implement a reduced income tax structure on profits (with cap of 35% reducing to 28% ) of banking and financial institutions applicable uniformly to all off-shore and domestic banks as well as to finance companies, leasing, insurance and other specialised banking and financial services. The Bank intends to reciprocate the Government's gesture of goodwill by ably leveraging its balance sheet towards the national development agenda in particular, by taking longer term tenor risk on project and development banking lending activity.

In moving forward, the Bank will continue to expand the distribution network to benefit from the opportunities in post conflict Sri Lanka whilst continually strengthening the Bank's capital base.

In 2010 an industry-consolidated framework became reality and going forward, it is hoped that the framework will be consistently strengthened. It is the Bank's intention to be involved from a leadership standpoint in the future development of this initiative by actively pursuing opportunities for growth through mergers and acquisitions.

### **Appreciations**

I would like to extend my sincere appreciation to the Governor of the Central Bank of Sri Lanka and his able staff for their tremendous support throughout this financial year. My deepest gratitude to the Chairman and my fellow Board of Directors for their continuous and consistent support, encouragement, wisdom, input and guidance. A special appreciation to my Chairman Mr Rienzie T. Wijetilleke for his invaluable wisdom and advice which will be missed as he does not intend seeking re- election to the Board of Directors at the forthcoming Annual General Meeting. To the HNB team, thank you for your persistent perseverance and passion, you have been the engine of our Bank's success. We have many more great things to achieve for the future, and I am confident that we will leave Hatton National Bank's indelible mark on Sri Lanka's future prosperity.



**Rajendra Theagarajah**  
*Managing Director / CEO*

Colombo, Sri Lanka  
18th February 2011



**THE**  
**HATTON NATIONAL BANK**  
**BANK**

**MANAGEMENT INFORMATION**  
**EMPOWERING DELIVERY**

|                             |           |
|-----------------------------|-----------|
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# BOARD OF DIRECTORS



**Mr Rienzie T. Wijetilleke**  
Chairman



**Mr Rajendra Theagarajah**  
Managing Director / Chief Executive Officer



**Mr D H S Jayawardena**  
Director



**Mr M V Theagarajah**  
Director



**Mr R K Obeyesekere**  
Director



**Ms Pamela C. Cooray**  
Director



**Mr Ranjeevan Seevaratnam**  
Director



**Mr N G Wickremeratne**  
Director



**Ms M A R C Cooray**  
Director



**Ms Indrani Goonesekera**  
Board Secretary



## Chairman

### Mr Rienzie T. Wijetilleke

*F.C.I.B. (London), F.I.B. (Sri Lanka)*

Managing Director & Chief Executive Officer from July 1988 to December 2004. He counts over fifty years as a practicing Banker, including overseas assignments. Appointed Chairman in March 2004. He is also the Chairman of HNB Assurance PLC, Sithma Development (Private) Ltd and Sunshine Holdings PLC and a Director of Nawaloka Hospitals PLC, Ceylon Biscuits Ltd and Mahaweli Reach Hotels PLC. He was Chairman of HNB Stockbrokers (Pvt) Ltd (up to 3rd November 2008) and HNB Securities Ltd (up to 4th November 2008). He was former Chairman of the Colombo Stock Exchange.

## Managing Director/ Chief Executive Officer

### Mr Rajendra Theagarajah

*F.C.M.A. (U.K.), F.C.A (Sri Lanka), M.B.A. (Cranfield), F.I.B. (Hon) Sri Lanka*

Appointed Director/General Manager/Chief Executive Officer in December 2004. He was appointed Managing Director in December 2005. Member of the Corporate Management of HNB since 1997. He counts over 26 years in Banking including overseas assignments. He is a Director of HNB Assurance PLC, Acuity Partners (Private) Ltd, Sithma Development (Pvt) Ltd. He is the Chairman of Acuity Securities Ltd, Acuity Stockbrokers (Pvt) Ltd and Lanka Financial Services Bureau Ltd. He was a past Chairman of Sri Lanka Banks' Association (Guarantee) Ltd and Financial Ombudsman Sri Lanka (Guarantee) Ltd and Chairman of the Asian Bankers Association. Member of the Sri Lanka Accounting & Auditing Standards Monitoring Board, Ceylon Chamber of Commerce and Chartered Institute of Management Accountants Governing Board Sri Lanka. Council Member of the Institute of Directors of Sri Lanka.

## Director

### Mr D H S Jayawardena

Director since 1988. He is the Chairman of Stassen Group of Companies, Aitken Spence Group of Companies, Lanka Bell (Pvt) Ltd, Periceyl (Pvt) Ltd, the Chairman and Chief Executive Officer of Distilleries Company of Sri Lanka PLC, Lanka Milk Foods (CWE) PLC, Balangoda Plantations PLC, Madulsima Plantations PLC and Browns Beach Hotels PLC

and the Chairman of the Ceylon Petroleum Corporation. He is also the Consul-General for Denmark in Sri Lanka. He was awarded the Knight Cross of Dannebrog by Her Majesty the Queen of Denmark.

## Director

### Mr M V Theagarajah

*F.C.M.A. (U.K.), F.C.I.A.A., F.I. Mgt. (London)*

Associated with the Bank since its inception and a Director since 1979. He retired as Chairman of the Browns Group of Companies on 30th June 2006. He has over 45 years experience in commerce, finance, industry and management.

## Director

### Mr R K Obeyesekere

Director since 1998. He was former Deputy Chairman - Sri Lanka Insurance Corporation. He is a Director of Stassen Group of Companies, Lanka Milk Foods (CWE) PLC, Distilleries Company of Sri Lanka PLC, Madulsima Plantations PLC and Lanka Dairies (Pvt) Ltd.

## Director

### Ms Pamela C. Cooray

*LL.B.*

Appointed Director in April 2004. She was a past Director of the Board of Investment of Sri Lanka and Associated Battery Manufacturers (Ceylon) Ltd.

## Director

### Mr Ranjeevan Seevaratnam

*B.Sc (London), F.C.A. (England & Wales), F.C.A. (Sri Lanka)*

Appointed Director in March 2007. Former Partner of KPMG Ford Rhodes Thornton & Co – Chartered Accountants. He is a Director of Haycarb PLC, Dipped Products PLC, Diesel & Motor Engineering PLC, Acme Printing & Packaging PLC, Acme Packaging Solutions (Pvt) Limited, Metecno Lanka (Pvt) Limited, Classic Teas (Pvt) Limited, Tea Small Holders Factories Limited, Green Farms Limited, Hayleys MGT PLC, Tokyo Cement PLC, Nestle Lanka PLC, Shaw Wallace & Hedges PLC, Shaw Wallace Marketing Ltd, Lanka Aluminium Industries PLC, Kelani Valley Plantations PLC, Colombo Fort Land & Building Co PLC.

## Director

### Mr N G Wickremeratne

*B.Sc University of Ceylon, Peradeniya, Sri Lanka*

Appointed Director in July 2009. Former Chairman of Hayleys PLC. and Chief Executive of Dipped Products PLC from its inception to 2007. He is a Director of Finlays Colombo PLC.

He had chaired the Sri Lanka Association of Manufacturers and Exporters of Rubber Products, served as a Committee Member of the Ceylon Chamber of Commerce and had been its representative on the National Labour Advisory Council. He is past President of the Sri Lanka-France Business Council.

## Director

### Ms M A R C Cooray

*B.A. (Hons.) University of Ceylon, Peradeniya, Sri Lanka  
Msc. Strathclyde University, U.K.*

Appointed Director in February 2010. She is a retired Deputy Governor of the Central Bank of Sri Lanka after a period of service of over 35 years. She is a Director of Ceylon Guardian Investment Trust PLC and Ceylon Investment PLC .

On release from the Central Bank, she had served the Ministry of Finance in the capacity of Director General Fiscal Policy and Economic Affairs Department for nearly 6 years, represented the Government on the Boards of DFCC Bank, Sri Lanka Institute of Information Technology, Sri Lanka Telecom, Ceylon Electricity Board, De La Rue Currency and Security Print (Pvt) Ltd., Export Development Board, National Housing and Development Authority, and represented the Monetary Board on West Coast Power (Pvt) Ltd.

She has served as the Vice Chairperson of the Institute of Bankers of Sri Lanka for 5 years.

## Board Secretary

### Ms Indrani Goonesekera

*Attorney-At-Law*

Appointed Board Secretary in April 2001. She is the Deputy General Manager (Legal) of the Hatton National Bank PLC and is a member of the Corporate Management of the Bank for over 14 years. She is also the Board Secretary of HNB Assurance PLC, Sithma Development (Pvt) Ltd and was the Board Secretary of Acuity Securities Limited (formerly HNB Securities Limited) up to 31st December 2010).

# CORPORATE MANAGEMENT



**Rajendra Theagarajah**  
*M.B.A. (Cranfield), F.C.M.A.(UK), F.C.A. (Sri Lanka)*  
Managing Director / Chief Executive Officer



**A J Alles**  
*M.B.A. - Finance (Stirling), A.I.B. (Sri Lanka)*  
Chief Operating Officer



**J M J Perera**  
*F.C.I.B. (London)*  
Senior Deputy General Manager - Business  
Development & International Relations



**J D N Kekulawala**  
*M.B.A. (Manchester), F.C.I.B.(London),  
F.C.A.(England & Wales)*  
Senior Deputy General Manager  
- Strategy & Compliance



**C P Abeywickrema**  
*B.Com. (Special) Sri Lanka*  
Deputy General Manager  
- Marketing & Retail Banking



**Ms I Goonesekera**  
*Attorney-at-Law & Notary Public*  
Deputy General Manager (Legal) /  
Board Secretary



**Ms D C Cooke**  
*F.C.A.(Sri Lanka)*  
Deputy General Manager  
- Operations & Systems



**Ms I R D Thenabadu**  
*F.C.I.B. (London), F.C.M.A.(UK)*  
Deputy General Manager  
- Corporate Banking



**J R P M Paiva**  
*B.A. (Hons) Ceylon*  
Deputy General Manager  
- Human Resources & Administration



**Ms L L C C Thambiah**  
Deputy General Manager  
- Network Management



**P D Hennayake**  
*M.B.A. (A.I.T) Thailand, PG. Dip (Eng.), B.Sc. Eng. (Hons) Moratuwa, C.Eng., M.I.E. (Sri Lanka)*  
Deputy General Manager - Services



**D P N Rodrigo**  
*M.B.A. (Cranfield), F.C.M.A.(UK), F.C.C.A.*  
Deputy General Manager - Risk



**P Sridharan**  
Assistant General Manager  
- Personal Financial Services



**R H Abayasekara**  
Assistant General Manager - Correspondent  
Banking & International Operations



**A Ratnasabapathy**  
*F.P.M.A.*  
Assistant General Manager  
- Corporate Banking



**M Asokan**  
*F.C.A. (Sri Lanka), A.C.M.A. (UK), C.I.S.A. (USA), C.I.A (USA)*  
Head of Internal Audit



**A P L Fernando**  
*M.B.A. (Colombo), F.I.B. (SL), Dip. in Bank Mgmt. (IBSL)*  
Assistant General Manager - Recoveries  
& Credit Quality Management



**D A de Vas Gunasekara**  
*A.C.A, F.C.M.A. (Sri Lanka)*  
Chief Financial Officer





**D St E Fernando**  
Assistant General Manager - Operations



**N U Jumat**  
*F.I.B. (Sri Lanka)*  
Assistant General Manager - Trade Services



**R J Thambirajah**  
Assistant General Manager  
- Network Management



**R M P Dayawansa**  
*M.B.A. (Sri J.), F.I.B. (SL), F.C.I.M. (UK), F.S.L.I.M.*  
Assistant General Manager  
- Specialised Financial Services



**Ms S Gnanapragasam**  
*BSc. (Hons), F.C.M.A.(UK)*  
Assistant General Manager  
- Treasury & Markets



**Ms L C Cooray**  
*Dip. in HR (IPMSL), I.P.M.A. - CP (USA)*  
Assistant General Manager  
- Human Resources



**Ms K A L T Ranaweera**  
*Attorney at Law, LL.M. (Cambridge),  
Dip. in Int'l. Affairs (BCIS)*  
Assistant General Manager  
- Legal



**S N Wijeratne**  
*M.B.A. (Sri J.), B.Sc. (IT) - UK*  
Assistant General Manager  
- Information Technology

# SENIOR MANAGEMENT

- 1 **K L Wijesooriya**  
*LL.B (Sri Lanka)*  
Chief Manager - Remittances
- 2 **V Vijayakumar**  
*M.Sc. (I.T.) UK, A.I.B. (SL), M.I.M.I.S. (Lond.),  
A.M.I.A.P. (Lond.), M.A.A.T. (SL), M.B.C.S.*  
Chief Manager - IT Operations
- 3 **B K Wijeratne**  
*B.Sc. (Physical Science) Colombo*  
Chief Manager - Leasing
- 4 **P G Wilson**  
*B.Sc. (Kelaniya), Dip. in IT (N.I.B.M), M.C.S.E. - Security*  
Chief Manager - Network Infrastructure
- 5 **S Sivalingam**  
*A.C.I.B. (London)*  
Chief Manager - Procurement & Logistics
- 6 **A Goonesekere**  
*M.B.A. (Sri J), F.C.A. (Sri Lanka), F.C.M.A. (Sri Lanka)*  
Chief Accountant
- 7 **R B Warnakulasuriya**  
*M.B.A. (Sri J), B.Com. (Special) Kelaniya, M.A.A.T, A.I.C.M.*  
Chief Manager - Greater Colombo Region
- 8 **V Ratnasabapathy**  
*A.C.I.B. (London)*  
Chief Manager - Credit Risk
- 9 **U N I Elapata**  
*B.A. (Hons) - Uni. of Texas (Austin)*  
Chief Manager - Card Centre
- 10 **Ms R Prabhakaran**  
*A.I.B. (Sri Lanka)*  
Chief Manager - Treasury / International Operations
- 11 **Ms N M C P Wettasinha**  
*Attorney-at-Law & Notary Public*  
Senior Manager - Legal
- 12 **S Udayakumar**  
*D.B.A. (UK), B.Sc. (AM), M.C.M.I. (Lond), M.S.L.I.M, Dip. in Busi. Mgmt & Admin  
(UK), M.C.P.M.(SL), Dip. in Sales Mgmt & Marketing (UK), A.I.T.D. (SL)*  
Deputy Regional Head - Greater Colombo Region
- 13 **J T M Weeresinghe**  
Senior Manager - Credit Risk
- 14 **Ms M K Rambukwella**  
*M.B.A. (Sri J), M. Sc. (Pera.), B.A. (Hons)- (Pera.)  
A.C.I.M. (UK), M.S.L.I.M., A.M.I.T.D.(SL)*  
Senior Manager - Training & Development
- 15 **A G Gomez**  
Senior Manager - Treasury
- 16 **Ms K Balasubramaniam**  
*LL.B (Sri Lanka)*  
Senior Manager - Human Resource Management
- 17 **H J A Ferdinando**  
Senior Manager - Centralized Operations
- 18 **L S C L R Fernando**  
*A.I.B. (Sri Lanka)*  
Senior Manager - Central Region
- 19 **N M Kulatunga**  
*M.B.A. (Sri J), A.I.B. (Sri Lanka)*  
Senior Manager - Credit Administration
- 20 **W J T Fernando**  
*M.B.A. (Sri J), A.I.B. (Sri Lanka)*  
Senior Manager - North Western Region
- 21 **D S L Ferdinando**  
Senior Manager - Corporate Account Relationship
- 22 **A R Uduwela**  
*M.B.A. (Sri J), B.Sc. Special (Pera.)*  
Senior Manager - City Office
- 23 **P H K S C Ranasinghe**  
*B.Sc. (Eng.) Moratuwa, A.C.M.A. (UK)*  
Senior Manager - IT Strategy & Solutioning
- 24 **W M C O Panditharatne**  
Senior Manager - Employee Remuneration & Benefits
- 25 **L S Sameera**  
*C.Eng., M.B.C.S., C.I.T.P., M.C.S. (SL), C.M.A. (Australia)*  
Senior Manager - IT Software Development
- 26 **R L Maheswaran**  
Senior Manager - Pettah
- 27 **Ms G Arjuna**  
*F.C.M.A. (UK)*  
Senior Manager - Personal Financial Services
- 28 **N Y Liyanage**  
*N.D.T. (Civil Eng.) - Moratuwa, P.G. Dip. in Project Mgmt. (Moratuwa),  
A.M.I.E (Sri Lanka), M.S.S.E.(Sri Lanka)*  
Senior Manager - Premises & Engineering
- 29 **P Paranathan**  
*P.G. Exe. Dip. in Bank Mgmt. (IBSL)*  
Senior Manager - Pawning
- 30 **A V Abeygunasekara**  
*M.B.A. (Colombo), B.Sc. (Hons.) (Colombo), A.C.M.A. (UK)*  
Senior Manager - Treasury
- 31 **B K Achan**  
*M.Sc. (Bombay) B.Sc. (Hons) (Calcutta), C.A.I.I.B.(India)*  
Chief Representative Officer - Chennai
- 32 **Kausar Ali**  
*B.Com.*  
Chief Representative Officer - Karachi

# MANAGEMENT DISCUSSION DELIVERING STRATEGIES

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**Focus:  
Fundamental bases  
strengthened to  
overcome industry  
slack**

**CORPORATE  
BANKING**



As the year 2010 progressed, Sri Lanka's economy geared itself for a revival on the back of sound economic policy and governmental stimuli steering the nation towards greater prosperity. The high interest rate scenario which has by large been attributed for the lack of economic inertia in the past, was reversed with interest rates reduced to a six year low in the fourth quarter of 2010. However, despite the aura of future economic confidence and expectations for accelerated investment, the corporate banking sector as an industry demonstrated slow growth in the 1st half of the year. This trend is of course expected to reverse in 2011 with the full impact of interest rate cuts and other governmental policy stimuli accelerating the rate of investment, as was witnessed in the fourth quarter of 2010, where precipitated growth pushed overall performance upwards.

Whilst in the previous year the Bank has opportunely utilised the year to revisit and reinforce business processes, in 2010 the focus lay on strengthening customer relations. Extensive customer portfolio evaluations, market and sector based analysis and strategic development of key growth drivers were

emphasised upon as fundamental bases in readiness for the future.

**Corporate Banking**

Despite the low appetite for corporate funding in the first half of 2010, the portfolio was maintained and grown with aggressive recovery strategies contributing to the maintenance of a healthy portfolio. The depressed demand for capital despite an increased interest in specific core sectors such as tourism, hospitality and infrastructure contributed towards high market liquidity. The lack of conversion of interest to action remained a key concern during the year, although expectation of these conversions to investment in 2011 remains probable, especially in light of the accelerated growth witnessed in the final quarter of the year under review. The Bank continued to spearhead the entry of private sector financing into large-scale infrastructure development projects such as utilities and road development.

The Division actively facilitated capital for share trading as interest in the share market grew exponentially during the year whilst vehicle finance also remained a key area of interest especially with respect to financing of vehicles that are in the high-end price tier.

**Project Finance**

Project Financing continued to be focused on renewable energy and power generation projects during the year under review, as has been the norm in the previous financial year. Continued interest in the sector has been precipitated by the growing global, socio-economic debate on the need for green energy, and the Bank's emphasis on garnering a greater level of involvement in the energy sector, specifically as it has been recognised as a strategic value driver, going forward.

In the latter half of the year 2010, as the tourism industry gained momentum, a spike in tourism sector related financing opportunities arose and have been undertaken for facilitation in 2011, consequent to appraisal. The healthcare sector remained bullish during the year with the Bank financing healthcare and hospital projects in the Northern province, including the construction of a full service hospital in Jaffna.

New market development was judiciously explored during the year with planned entry into Bangladesh as a new market for project financing, subsequent to successful project implementation in the Maldives and the African continent in previous years.

Astute yet innovative strategies, a focus on quality, enhanced monitoring, controls and continuous prudent evaluations were the hallmark for Corporate and Project Finance operations during the year under review.

**Small and Medium Industries (SMI)**

Financing for the Small and Medium Industries category gathered further momentum in 2010 with renewed accessibility to enterprises in the Northern and Eastern provinces as well. The Bank has viewed this geographic area as a viable growth market for decades, and consistent and sustained emphasis in the development of this market through financial accessibility has led to the establishment of strong relations with Small and Medium Industries (SMIs).

SMIs such as Agriculture including Tea and Fisheries, Construction and Tourism demonstrated capacity for growth and have been key areas where Hatton National Bank actively facilitated capital investment in view of the strategic importance of these sectors to the national economy.

**Future Outlook**

In the short term, the Bank will look towards capitalising on the growing interest of customers on the Colombo Stock Exchange as a viable investment tool. Thus, in 2011 the launch of margin trading as a new product is under consideration. The product will be fully developed with formalised processes and will be offered as a cohesive corporate banking service.

In the medium term, focus will remain on the growth of international markets as a key pillar for future sustainability of the business. Thus, new markets such as Bangladesh will continue to be explored. On the domestic front, focus on the above sectors as catalysts to economic recovery will no doubt necessitate adequate financial support. The Bank plans to facilitate and meet these needs especially in national priority sectors such as Dairy, Agriculture, Tourism, Port & Aviation and Hospitality.



**Focus:  
Activating economic  
development  
through pro-active  
partnerships**

**SMALL AND  
MEDIUM  
ENTERPRISES**



From the inception of the Bank over a century ago, Hatton National Bank's focus on Small and Medium Enterprises (SME) has been one driven by the desire to grow and develop the small scale entrepreneur. In 2010, the Bank took this focus a step further, in full alignment with the national vision to develop the SME sector to be core contributors to national wealth creation.

During the year, in recognition of the importance of small and medium scale entrepreneurs to the growth of Sri Lanka's national economy, the Bank proactively positioned itself as the Small and Medium Enterprise Development Partner through the development of a financial solution that meets the full range of financial needs of SMEs. This sectoral product is expected to be launched in the first quarter of the upcoming financial year.

Through the utilization of the product the Bank is expected to, accelerate its reach to SMEs in the rural pockets of Sri Lanka. Through the offer of a full range of financial solutions to the SME sector, the Bank expects to engage the sector effectively in capacity building,

thereby ensuring not only its long-term sustainability but also the sustainability of its contribution to the national economy. The Bank views its strong brand equity, branch network and retail banking expertise as core competencies for the future success of the product.

Garnering experience and strength from its operations in the sector, the Bank continued to pursue a strategy of qualitative portfolio management comprising mainly of improved credit evaluation techniques and the utilisation of a variety of risk management tools, including credit scoring, to identify viable ventures. Over the past five years, the Bank's lending strategy has shifted primarily to working capital finance and cash flow management moving away from the traditional security oriented lending. In line with this move, the Bank advises customers to undertake business planning in a systematic manner, thereby assisting them in viable business management.

### **Future Outlook**

In the short term, the launch of the new SME product in 2011 will energise the Bank's operations in the sector, sharpening the focus and increasing the scope and scale of SME services. It is expected that in the medium term, SME will contribute significantly to the Bank's overall business performance whilst acting as a catalyst in the economic performance of the nation.

**Focus:  
Providing access to  
finance to stimulate  
national wealth  
creation**

**PERSONAL  
FINANCIAL  
SERVICES**



Hatton National Bank from its inception has been a Bank driven by the needs of its retail customer base. The Bank's retail banking service and product portfolio is composed of a wide spectrum of personal financial services that endeavour to meet every financial need of a retail customer. In 2010, the Bank persisted with its two-fold strategy of retail banking service penetration whilst preserving the quality of the lending portfolio.

National well-being has been at the pinnacle of Hatton National Bank's concerns throughout its operational history. Whilst in the past, the Bank strived to cater to the people of Sri Lanka – across every stratum of demography and geography – through financial solutions that embraced people who had previously been excluded as non-bankable, in 2010, the Bank made headway in assisting the realisation of the national strategy for reconstruction of the Northern and Eastern provinces. Accelerated penetration into the region with financial solutions and financial literacy programmes has enabled Hatton National Bank to truly justify its market position as a leader and a “partner in progress”.

The Bank's national-focused strategy drew international accolades in the year under review. Hatton National Bank was recognised for the third consecutive year as Sri Lanka's Best Retail Bank - winning the award for the year 2009 in the ninth Asian Banker Excellence in Retail Financial Services Awards Programme. The Bank received the award at The Asian Banker Excellence in Retail Financial Services Awards 2010 ceremony, held in conjunction with the region's foremost retail banking event, the Excellence in Retail Financial Services Convention. The international Euromoney Finance Magazine also recognised the Bank as the “Best Bank in Sri Lanka” for the second consecutive year at the Euromoney Awards for Excellence 2010. The Bank's role in acting as the foundation of the banking industry through pervasive personal financial services within the periphery of sustainable business practice continued to be the bed-rock of its success in the year under review.

**Providing accessibility to every customer across the nation**

In the year 2010, the Bank accelerated its network expansion to cater even to the most remote villages across the nation. At the end of the financial year, 205 customer centres were open for business, enabling people across the nation to have access to affordable finance and financial services. During the year, in support of the national strategy for re-integration of the Northern and Eastern provinces and with a view to catalyse economic activity in the Region, the Bank focused its network expansion efforts on the North-East whilst penetration into the less accessible regions of the Southern and North Western Provinces was also focussed on.

In line with the overall business strategy, the Bank initiated a drive to upgrade the network with customer centres enhanced to meet the standard requirements of a Branch while extension offices were upgraded to operate as separate business units, responsible for their profitability. The network upgrade has been implemented during the year with a view to enhance the customer service at every point of customer access. With greater responsibility meted out to extension offices, the Bank believes that the customers will be better

served with access to a larger portfolio of services even in the most remote of locations.

In the medium term, Hatton National Bank will execute an enhanced network strategy with the intention of operating extended-hour banking across all regions. This will entail the operation of seven day banking branches, Sunday banking centres, and the commencement of specialist centres that focus on a limited number of financial services for the retail customer.

**One of the widest Automated Teller Machine (ATM) penetrations in the country**

The Bank, during the year under review furthered its strategy of greater accessibility through the aggressive expansion of electronic delivery channels, specifically through enhanced penetration of the ATM network. With the commissioning of the 350th ATM in 2010, Hatton National Bank is widely regarded as having one of the widest ATM penetrations in Sri Lanka. The network caters not only to the Bank's own debit and credit card holders but also provides accessibility to holders of Visa and MasterCard credit and debit cards, Maestro debit cards and Cirrus ATM cards.

The Bank currently maintains 287 on-site (at customer centre premises), and 63 off-site ATMs spread across the island. This number also includes two “drive-thru” ATMs located at the Bank's Head Office, “HNB Towers”, and at its Priority Banking Centre. In the ATM expansion process during the year, priority consideration was given to the establishment of stand-alone ATMs in a bid to enhance the accessibility and service at strategic locations across the country. During the year 2010, 40 new ATMs were commissioned in total, out of which 27 locations are out of Colombo, at key public places.

The ATM network was further upgraded during the year with a view to providing a stable backbone required to facilitate the aggressive ATM expansion drive. An advanced ATM monitoring system with the highest levels of on-site security affords customers the reassurance of secure transactions. A 24-hour customer help desk has also greatly improved service levels by reducing response time. The

introduction of several value additions to the ATM services enabled the expansion of the service offering via electronic channels.

### **E-Banking as an alternate channel for service delivery**

Hatton National Bank recognises the need to look beyond traditional delivery channels in an era where consumers are gaining sophistication in the manner in which they transact and interact with service providers. Whilst the Bank's traditional brick and mortar service delivery – the branch network, micro banking infrastructure etc – reaches out to the majority of the Bank's customer base, a growing demand for alternate delivery channels has driven the growth of Bank's E-banking solutions. With the growth of Internet and mobile telephony penetration in Sri Lanka, this trend is expected to grow.

The Bank's Internet Banking Service, "Virtual Branch" was revamped during the year with the introduction of a new User Interface to facilitate a more user-friendly online experience for customers. The migration of the Internet Banking solution to "Finacle" – the Bank's core banking platform was completed on schedule during the year, and has enabled the Bank to offer a wider range of services via its Virtual Branch. The migration has also enhanced the service through lowered transactions costs, greater flexibility and greater security in transactions.

The Virtual Branch continued to garner increased traffic and transactions with over 154,000 financial transactions exceeding Rs 2.7 Bn completed during the year. The usage of SMS and Mobile Banking evidenced a growth of 32% during the year with over 1,500 transactions carried out monthly on average at a total transaction value of Rs 3.2 Bn over the year.

### **Deposit Mobilisation**

The year 2010 was a commendable year from the perspective of Rupee deposit mobilisation. The Bank witnessed sound growth spurred primarily by savings, lifestyle and products targeting minors. In 2010 the Bank's rupee deposit mobilisation drive garnered a deposit base of approximately

Rs 25 Bn. Thus, Year on Year (YOY) deposit growth was a commendable 15% from that of 2009, a growth trend that is indicative of the success of the Bank's deposit mobilisation strategy for the year.

Driven by Hatton National Bank's flagship deposit mobilisation tool – HNB Pathum Vimana- that has been the key stimulus for savings mobilisation over the past 17 years, the Bank's savings base grew exceptionally in the year under review. Pathum Vimana has been an effective means to rally low interest cost savings accounts from across the nation. It has effectively enabled the Bank to expand the savings deposits as a result of the successful appeal of the Draw, and in the year 2010 Pathum Vimana stimulated a 23% growth. Savings products – Singithi Kirikatiyo and Singithi Lama – aimed at inculcating the habit of thrift amongst children effectively drew in substantial deposits during the year.

The interest rate decline in the latter half of the year, led to contracted returns from term deposits which in the previous year had already been experiencing stifled growth due to intense market competition. In 2010, Term deposits contracted by 3%. However, the impact of the contraction in Term Deposits was considerably offset by the Bank's ability to strategically utilise the Pathum Vimana Draw to convert existing Term Deposits to Savings upon maturity, thus retaining the deposits within the Bank.

Capital Savings performed commendably to post a 64% growth. Capital Savings has been a beneficial tool in attracting savings from the more urban market and is a critical tool in penetrating the Socio-Economic Class A and B demographics even though the product is less profitable to the Bank due to the relative high cost of capital.

Foreign Currency deposits witnessed a marginal decline in growth due to declining interest rates. NRFC and RFC deposits were marketed aggressively through the relaunch of HNB Pathum Udanaya Draw as HNB World, with greater brand appeal and reach to a greater global audience.

### **Pawning**

Pawning as a product has seen tremendous growth in terms of its contribution to the Bank's bottom-line and has emerged as a pivotal product in the retail-banking sector from an industry perspective. In 2010, Hatton National Bank retained its leadership position as one of the top 3 in the Banking sector. Deploying a strategy aimed at growing the scale of the business through initiatives to enhance the awareness of the product, extended banking hours as well as improved customer service in tandem with revisions to the scale of advances to customers, the Bank completed the financial year with a commendable performance contribution from Pawning.

During 2010 the pawning portfolio witnessed a significant increase aiding in the growth of approximately Rs 6.05 Bn in business for the year equivalent to 28% YOY growth from 2009. The rising prices of gold in the global market continued to aid the growth of the business in 2010.

In recognition of the strategic importance of the product in the immediate and medium term, the Bank carried out a series of strategic evaluations comprising of a comprehensive competitor and industry analysis, and undertook primary research to effectively understand the needs of the customer in relation to pawning. Drawing from these insights to determine a concerted strategic direction, the Bank aims to grow the pawning business in the upcoming financial year.

The Bank's pawning portfolio retained its high level of quality despite the aggressive marketing of the product. The Bank's strict compliance and stance towards responsible lending have ensured that the Bank persists in strict quality evaluations prior to lending. Due to keen focus on the quality of the portfolio, the Bank continued to enjoy a Non Performing Advances (NPA) ratio below 1%, and has maintained minimal capital losses during the year.

### Leasing

Leasing as a product rebounded in the year 2010, stimulated by the Government's relaxation of duty on vehicle imports. The market opportunity for the product grew exponentially with the growth in the market for new and reconditioned vehicles. As a result in 2010, the Bank's leasing products performed commendably and recovered from lackluster performance in the previous financial year. Witnessing a 49% overall portfolio growth, the Bank experienced a significant growth in new business as well. Improved economic conditions realised an increase in recoveries and overdue payments, thereby improving the overall cash flows during the year.

The Bank focused its marketing of the leasing products mainly in the rural and outstation areas across Sri Lanka with particular emphasis on the Northern and Eastern Provinces. Joint promotions with automotive dealers and leasing fairs in key locations constituted the crux of the marketing drive whilst one on one campaigns with vehicle importers were also carried out. With the support of the Bank's extensive distribution network, Hatton National Bank retained its leadership position amongst the commercial banks. However, specialised leasing and finance companies continued to dominate the market and increased their competitiveness in the marketplace. Going forward, the Bank looks to implement key strategies to maintain the momentum of growth in the upcoming financial year.

### Housing Loans

The housing loan portfolio witnessed a remarkable growth in the second half of the year on the back of domestic interest rate reductions and reversed the stagnation that was evident in the first half of the year. As a result, by the end of the financial year 2010, the Bank disbursed Rs 5.1 Bn worth of housing loans, which is a commendable 81% growth over the previous year. The push was possible through the twin effects of the interest rate reductions – which benefited the industry as a whole – and the positive outcome of a concerted promotional drive, which effectively enhanced the appeal of the

Bank's housing loan product "Shanthi". The NPA improved dramatically in the face of measures undertaken in 2009 to contain the growth of NPAs as a result of which the portfolio quality improved during the year.

### Personal Loans

The personal loan portfolio demonstrated a remarkable growth with loan disbursements increasing by 158% during the year propelled by the introduction of two new products targeted at Executives and Medical Specialists. The decline in interest rates further stimulated the growth of the portfolio. NPA in the personal loan portfolio was reduced during the year in both volume and value, thereby increasing overall health of the portfolio during 2010.

## Focus: Support to national development programmes further the Bank's involvement in rural wealth creation

### DEVELOPMENT BANKING



In living up to its stance as the private sector commercial bank with the national outlook, Hatton National Bank has for over four decades focused on Development Banking as a tool to catalyse the rural economy. In its role as the “national” Bank, the Hatton National Bank has made a significant impact on the micro and SME sectors of Sri Lanka, assisting small-scale enterprises to rise and sustain themselves over time and remains the only private commercial bank that has customised operations to meet the needs of the micro / agriculture finance market.

#### Rural/Agri Lending and Micro Finance

In the year 2010, the Bank furthered its own strategy for development banking by catering to agriculture / agro based SMEs and micro financing sectors.

The Bank continued to promote a number of rural sector refinance and non-refinance credit lines and provides a comprehensive package of financial services for the development of the rural economy through its linkages as a ‘Participating Credit Institution’ for almost all credit lines funded by

the Asian Development Bank, World Bank, International Fund for Agricultural Development and Japan Bank for International Cooperation apart from the concessionary credit lines introduced by the Government of Sri Lanka.

The focus of the Bank’s own micro financing programmes lay in the growth of national wealth across all provinces of the country, although the emphasis on the Western province was even less than in previous years. Rebuilding and resettlement of the communities in the Northern and Eastern provinces was a key priority during the year, with Development Banking taking the lead in spurring economic recovery. The Bank accelerated the provision of Micro / Agri finance to the two provinces in turn accelerating economic activity to commence commercial recovery. Focus on providing financial assistance by promoting credit and building financial literacy and technical know-how among the micro entrepreneurs and farming community via the Bank’s strong developmental banking resources - branch managers, agricultural officers and micro finance officers serving in the areas – in 2010 is expected to complement economic progression in the provinces.

In view of the national priority to uplift the rural economy, the Bank continued to follow a strategy to achieve micro entrepreneurial capacity building, with the objective of elevating the rural community from poverty twinned with youth empowerment. To this end staff development programmes were undertaken during the year to build capacities with a view to better meet the needs of customers from focal industries and sectors.

Moreover, in the previous financial year the Bank pioneered a concept for long-term surety of farmer produce through corporate collaboration. By establishing linkages and partnerships that allow for the optimisation of farmer produce, the Bank networked with corporates to assure long-term market viability for rural farmers. In 2010, the Bank furthered this concept of gearing its micro entrepreneurs / farmers for “to-market” readiness by continuing to collaborate with

major corporate partners who are established household names among rural communities. The corporate partner collaborations strengthened the payback of the Bank’s micro customers with surety for their produce through buy-back agreements. Capacity building and the Bank’s “to market” strategy for micro enterprises is expected to generate employment opportunities in the agricultural sector and related fields, create awareness for entrepreneurs to move towards new technology, techniques and market opportunities and provide opportunities to entrepreneurs to move from grass root level to commercial level, thus graduating the micro entrepreneur to the next level of commercial enterprise.

In the year under review, the rural agri lending and micro financing portfolio grew by 33% to Rs 8.5 Bn with disbursement of loans amounting to Rs 4.2 Bn during the year to a total of 16,000 rural entrepreneurs. Portfolio quality remained a key consideration in loan disbursement in 2010.

The Bank is effectively drawing into the national economy the productive labour of thousands of individuals, who otherwise would not have contributed to economic growth. With over 130 dedicated micro / agri finance experts on the field, Hatton National Bank has taken banking to the doorstep of the rural community.

#### Financial Literacy as a means to financial inclusiveness

During the year under review, the Bank’s financial literacy programme “Divi Saviya” which comes under the purview of the Development Banking Division furthered financial education and awareness amongst the rural masses. The main features of this programme are Financial Literacy, Technology Transfer, Personal Development and Health Education. In 2010, over 28 projects were conducted under the programme covering all four key areas of the programme with the intention of inculcating responsibility and accountability amongst customers and potential customers. The Programme’s main intention is to grow each customer from his current life situation to a better economic and emotional state. During the year, the project

## **MANAGEMENT DISCUSSION**

has facilitated over 39,000 micro-entrepreneurs across the island.

### **Housing for underserved sectors**

During the year 2010, the Bank partnered with Lanka Financial Services for Underserved Settlements (LFSUS) to provide housing for low income families. In total 88 families from Hambantota and Nuwera Eliya were provided houses in an effort to elevate their livelihoods. LFSUS and the Bank collaborated to play a pivotal role in contributing towards the development of rural low income societies in Sri Lanka. The primary aim of the Bank and LFSUS initiatives is assisting people in rural areas of the country in order to generate new prospects through housing finance, leading to the development of the rural economy and creation of new employment in the area.

### **Micro Insurance**

The Bank's Micro Insurance product launched in association with HNB Assurance PLC posted a significant growth during the year with an increase of 66% in policy holders from that of 2009. Volume wise the product garnered 2,141 policies as against 1,286 policies in 2009. The growth momentum of the product during the year indicates a strong market potential for the product in the year ahead.

### **Future Outlook**

In the medium term, the Bank envisages opportunity to further strengthen the Development Finance sector in the Northern and Eastern provinces. It foresees its role as a catalyst in infusing sustainable business practices to the communities of these provinces thereby precipitating development of the socio-capital and the livelihoods of the people. The Bank will also continue to work in close partnership with the Central Bank of Sri Lanka with the objective of achieving national priorities. In view of this in the year ahead, the Bank plans to further strengthen its field force with the addition of approximately 20 field officers of whom majority will be graduates in agricultural

studies, and therefore better equipped to assist customers through greater technical expertise in finance and sector specific know-how.



## Focus: Strengthened remittance network adds momentum to meet future national goals

### INTERNATIONAL OPERATIONS



#### Remittances Demonstrate Healthy Growth

The volume and velocity of inward remittances to Sri Lanka continues to be crucial to support economic activity in the year 2011.

Foreign remittances which is one of the main foreign exchange earning channels reached USD 3.3 Bn in 2009 and is expected to be around USD 4 Bn in 2010 with expatriate worker remittances from the Middle East region being the highest contributor.

In 2010 HNB augmented its present remittance partnerships network through the appointment of two more commercial banks in Korea and remittance houses in Jordan and Italy.

Remittance inflow in 2010 surpassed the figure for 2009 by recording a 16% growth to reach an absolute value of USD 679 Mn during the year 2010 as opposed to USD 573 Mn the previous year.

The Bank's existing operations in Oman and UAE continue to act as key catalysts in

propelling growth in inward remittances from these corridors.

The online remittance system HNB Cash Xpress which is proprietary to the Bank greatly supported the delivery of remittances during the year and remains the critical value addition to customer service. Overall initiatives toward strengthening the distribution channels through strategic alliances with a portfolio of Exchange Houses / Money Transfer agencies within key "Send Countries" are expected to fortify HNB's position as a remittance handler.

#### MoneyGram

HNB has operated as a Super Agent for MoneyGram since 2008 and this relationship has enabled many Sri Lankans overseas to use this channel to send remittances from over 207,000 agent locations in 190 countries and territories.

During the year under review the Bank teamed up with MoneyGram to create awareness amongst the Sri Lankan Expatriate community in Cyprus resulting in an encouraging growth in remittances from Cyprus to Sri Lanka via MoneyGram.

In recognition of HNB's commitment to MoneyGram and excellent delivery of remittances, the Bank was presented the award "Excellence in Customer Care -2009" during the conference held in April 2010 in Cochin, India for MoneyGram Agents from South Asia and Middle East. During the year the Bank appointed another sub-representative for MoneyGram in the capacity of Super Agent for MoneyGram bringing the number of sub-agents to two.

#### Infrastructure Development continues to drive International Operations portfolio

As in the previous years, particularly the services for Letters of Guarantee relating to infrastructure development projects in the country were sought after and contributed significantly recording an increase of 15% on fee based income in 2010 under this segment. Increased focus on infrastructure development particularly in the areas of water

management, sewerage and power generation across the nation has been the key driver of this component of business.

#### Future Outlook

With the Sri Lankan Government disclosing its intentions to continue to focus on inward remittances and encouraging international participation in domestic infrastructure development, the Bank views these two areas as critically important and will continue to formulate strategies to match national objectives, while ensuring a substantial growth in volumes. In the medium term the Bank will follow a strategy of expansion with focus on growing strategic alliances and partnerships to harness inward remittances. The Bank is evaluating new markets for inward remittances and these include Israel and Australia. On the short term the focus will continue to be on ensuring that the Exchange Houses in which the Bank has invested and has management control reach breakeven within predetermined timelines.

#### Trade Services

International trade operations in 2010 witnessed a marked turn-around from the decline evident in the previous financial year. The market situation improved on the back of import duty reductions on consumer electronics and motor vehicles. The resulting surge in imports was propelled further by the positive economic outlook and government impetus, particularly in infrastructure development and reconstruction efforts in the Northern and Eastern provinces. This placed trade as a buoyant component of the national economy during the year. Consequently, demand for import financing as a product increased with a marginal increase in demand for export financing.

This resulted in non fund income from trade business increasing by about 40%. Nevertheless, low interest rates prevalent throughout the final three quarters of the year led to a scenario of lower returns on fund income in value terms.

The Bank's Trade Services operation was re-certified as compliant with ISO 9001:2008 in 2010, whilst the Division underwent

restructuring initiatives to allow for future growth through enhanced operational efficiency.

In 2010, the Division organised a well-attended international trade seminar intended to create awareness and to educate the Bank's customer base with the participation of 120 trade customers. The seminar opened for discussion a range of pertinent topics from the economy; regulations; to shipping and customs; with four authoritative guest speakers, two of whom were from overseas, outlining the key issues for each topic.

### **Future Outlook**

In the short and medium term, the scope for International Trade operations is encouraging especially in light of positive economic growth expectations. As Sri Lanka takes full advantage of the prevalent economic revival and increases the momentum of economic growth through agriculture, infrastructure development and commercial activity, by and large trade is forecasted to continue its growth trajectory. Full exploitation of the Free Trade Agreements between India and Pakistan will further the opportunities for the Bank's International Trade operations.

From an operational perspective, the Division looks to continue its focus on employee quality with emphasis on Certified Documentary Credit Specialist (CDCS) qualifications. Meanwhile, customer education through seminars and workshops will remain a key strategy for business development, especially in the regions.



**Focus:  
Rising above market  
uncertainty to  
overcome  
challenges**

**TREASURY  
OPERATIONS**



By the end of the financial year 2009, confidence in the global economic recovery waned with the re-emergence of recessionary pressures jeopardising economies particularly in Europe. In early 2010, fears of a sovereign debt crisis, termed the “2010 Euro Crisis” emerged concerning European Union members Portugal, Ireland, Greece and Spain. Despite expectations for the United States economy to rebound in early 2010, growth momentum there too remained shrouded by rising unemployment, and further quantitative easing.

However, against the backdrop of global uncertainty, the Sri Lankan economy in 2010 performed commendably, riding on a wave of optimism arising from the many opportunities for the post-conflict economy. However, the scope for proprietary Treasury Operations remained somewhat limited due to a scenario of thin interbank volumes, the steady exchange rate and low volatility that prevailed during the year. Market interest

rates and inflation declined gradually during the year until the final quarter when both stabilised.

During the year under review, focus remained on Forex trading whilst continuous improvements to service remained a key priority especially in consideration of the need to strengthen client relationships as a strategy for future growth. In 2010 the Bank enhanced its focus on its corporate client portfolio as a measure to sustain business in a stable market context and thus grew foreign exchange income by 12.5% over the previous year. Closer ties and improved communications with the customer were further augmented by the provision of advisory services to international trade participants. As a result, the cumulative outcome of prudent and proactive risk management policies, focus on fundamentals, and continuous customer service improvements enabled the Bank to maintain its position as a significant player in Forex and Money Markets. Ongoing attention to funds and balance sheet management as well as yield enhancement initiatives also paid dividends.

**Future Outlook:**

The Bank views relationships as the key to future business sustainability especially in the arena of Treasury Operations. It looks to utilise the synergies and linkages from the Bank’s other operational sectors for business development and will direct its energies towards rigorous management of assets and liabilities, trading in fixed income and Forex as well as the introduction of new products going forward.

**Focus:  
Leveraging IT  
beyond transaction  
processing for  
strategic business  
optimization**

**INFORMATION  
TECHNOLOGY**



Information Technology and its strategic implementation across the financial services industry have widely changed the function of banking, leading to greater fluidity and agility in an industry that has traditionally been looked upon as conservative. In the last two decades, IT has propelled the speed of delivery of financial services not only in Sri Lanka but the world over. Now considered a dynamic industry, the use of technology in varying avenues by banks have led to greater communication and connectivity whilst on the other hand it has redefined the very foundations of the banking industry through streamlining and process reengineering. Technological innovations have allowed the banking industry to achieve sophisticated product development, to open up efficient delivery channels, implement reliable techniques for control of risks while aiding financial intermediaries to reach geographically distant and diversified markets in a cost efficient manner.

It is widely acknowledged that IT has helped the banking industry in Sri Lanka to deal with the challenges of the new economy – globalisation, prolific competition, greater

regulatory demands and internationalisation of business. At Hatton National Bank, over the past decade technology has been a change agent. It has changed the contours of three major functions performed by the Bank; access to liquidity, transformation of assets and monitoring of risks.

In the year under review, the focus of the IT strategy was in essence to graduate the use beyond mere transaction processing to exploit strategic business use. In this respect, the Bank determined strategies to establish and stabilise the core operating platform with a view to implement a series of system improvements and process optimisations that will radically improve the Bank's business orientation. Going forward, Hatton National Bank is confident that through some of these initiatives, the Bank will garner several competitive advantages through its leadership in technology implementation.

**Future Outlook**

In 2011, the Bank will effectively plan to leverage on the existing foundation to determine a strategic IT plan that supports the Bank's overall "go to market" strategy with focus on implementing initiatives that will take the Bank beyond the realm of transaction processing to utilise IT for analytics, business intelligence and optimisation.

In essence, the foundation will be laid for the addition of:

- business intelligence and data warehousing modules to the existing information repository, so that the Bank will be in a position to better assimilate customer insights whilst also having the ability to maintain data quality.
- anti-money laundering (Know Your Customer) systems and processes that are primarily driven by regulatory needs. This process will address concerns raised by regulatory bodies on the need for pre-emptive systems and processes to curtail fraud. The processes that will be implemented in 2011 will include fraud and crime management, risk management through management of

operational, and financial risk, as well as compliance requirements for BASEL II.

- streamlined systems where there are coherent synergies arising from integration, such as optimised back-office operations. These simplified and streamlined systems are expected to lower cost of operations and gear up the scale to provide greater accessibility to customers through enhanced customer touch-points and delivery channels.

In the upcoming year, the full realisation of the system implementations outlined above will give greater agility to the Bank's operations. In the medium term IT enhancements will lend the Bank a competitive edge whilst in the long term the full implementation of the IT strategy will see greater utilisation of business intelligence and product specific enhancements which will allow Hatton National Bank to optimise its business not only operationally but also performance-wise, with perceptible positive impacts on the bottom-line.

## Focus: Communicate and re-affirm the Bank's role as partner in national progress

### MARKETING



Hatton National Bank's extensive involvement in national development has been a conscious and intrinsic component of the Bank's own corporate strategy. The Bank's role as a stimulant of the national economy has been at the core of the Bank's operations. This symbiotic relationship has over the years benefited both the Hatton National Bank as well as the national economy.

As such in 2010, stemming from the corporate strategy, the marketing and marketing communications strategies evolved from this need to further the developmental platform. The marketing strategy objectively focused on retaining the Bank's identity as a propagator of national wealth creation. Marketing initiatives during the year aimed at creating a more pervasive distribution of wealth across the nation, objectively reaching out further to low access areas whilst offering a range of financial solutions to suit every geo-demographic stratum through strategic profiling of the customer.

Strategic marketing and marketing communications together proved to be key

contributors to the performance of the Bank in the financial year 2010. The thrust of the communications strategy during the year under review, therefore, was to communicate and reaffirm the Bank's role as a partner in national progress. This was a continuation of the communication strategy employed in 2009, wherein the Bank's heritage and its association with national development was communicated through the campaign idea "through every change, we changed for you", reinforcing the role of the Bank as a constant in the developmental journey of every individual and the nation as a whole.

With the utilisation of a mixed bag of above the line and below the line communication tools, the communications strategy for the year was effectively implemented through an integrated communications plan. In the arena of sponsorships, the Bank partnered with a number of institutions that have a greater developmental value as national wealth creators. As such the Bank offered its services as the "Main Banker" to the Construct Sri Lanka Conference and Exhibition organised by the National Construction Association of Sri Lanka and the foremost educational exhibition Adyapana 2010 organised by the Lanka Exhibition and Conference Services and was the Platinum Sponsor of the Annual HRM Conference organised by Association of HR Professionals.

Aligning the Bank's strategic interest in Microfinance as a long-term driver of both corporate and national priorities, the Bank was the local host of the Asia Micro Finance Forum which was convened by the Banking With The Poor Network (BWTP) and organised by the Foundation for Development Cooperation. The Asia Micro Finance Forum is held every two years and is considered to be one of the largest gatherings of all stakeholders involved in microfinance activities in Asia including practitioners, investors, policymakers as well as other capacity builders. The rationale for the Bank's partnership with the conference was largely in view of the benefits arising from the event to the national economy, particularly through the image enhancement of Sri Lanka as an emerging nation post-conflict, and the opportunities for micro level development.

The Conference also served as an ideal forum to showcase Hatton National Bank's leadership position in microfinance and to re-affirm its position as the only commercial bank in the country to develop a sustainable microfinance strategy that has over the last two decades contributed towards bringing to life over 100,000 micro finance entrepreneurs, successfully mobilising over Rs 4 Bn in micro level savings, whilst financing over Rs 7 Bn to the sector. The Bank's association with the Conference emphatically elevated its standing as a national leader in microfinance development.

### Integrated Marketing converts interest to action

As in previous years the Bank unveiled a series of integrated marketing efforts to activate specific sub-brands. Whilst many of the promotions are ones that have been a constant in previous years, others were conceptualised to stimulate consumer interest during the year under review.

#### **HNB Pathum Vimana**

The HNB Pathum Vimana draw was held for the seventeenth consecutive year in 2010. The promotional tool holds the distinction of being the biggest deposit draw in the financial services and banking industry in Sri Lanka, and incentivises customers to save on a regular basis to build substantial savings accounts. The scheme, which is multi-pronged, provides customers with multiple chances to win. In 2010, the draw was immensely successful in growing the savings base, whilst also acting as a stimulus to convert term deposits to savings thus enabling the Bank to grow its deposit base. In 2010 a large number of winners collected in excess of Rs 100 Mn in prizes.

#### **HNB World**

Pathum Udanaya, the Bank's NRFC and RFC promotional tool was re-launched in 2010 as HNB World with the prime objective of creating greater awareness amongst the Sri Lankan diaspora on the numerous opportunities of HNB World. The Bank's prize draw was promoted extensively in key cities across the world and with the relaunch has

witnessed a greater affinity amongst Sri Lanka expatriates due to the new brand identity.

### **HNB Singithi Lama and Singithi Kirikatiyo**

The Bank's minor savings scheme was successfully marketed by way of two product offerings namely Singithi Lama and Singithi Kirikatiyo. As a cohesive product offering the Singithi product progressively caters to stages across the childhood of a minor from newborn to toddler to child.

In 2010, the Bank organised and sponsored for the third consecutive year "Lowa Dinana Singitho" an island wide inter school competition which saw an impressive participation of over 300,000 children competing in different aspects of the competition from regional to national level.

### **HNB Shanthi**

The Bank's housing finance brand Shanthi saw enormous returns from a promotional draw conducted during the year. The draw further propelled the popularity of Shanthi housing loans effectively providing customers with an added reason to opt for the product despite intense competition and conducive interest terms being prevalent across the industry.

### **HNB Privilege**

The Bank unveiled a new "Privilege Current Account" as the latest addition to its strong product portfolio. HNB Privilege is a current account that provides its target audience of executives of blue chip companies in Sri Lanka with an array of benefits, and noticeably spans the highest definition of "service" in a current account. A direct and integrated communications campaign launched the product into the market place during the year to create awareness amongst the target audience.

### **ATM penetration**

With the integration of the Bank's ATM network to the Finacle platform, an integrated cohesive communications campaign was conducted to communicate the core

functionality of the ATM network and the added benefits ranging from utility bill payments to fund transfers, etc. Further the campaign positioned the HNB ATM distribution as one of the most wide spread networks in Sri Lanka whilst enhancing the image of the product as technologically superior.

### **HNB Leasing**

The Bank conducted a number of Joint Promotions with leading automotive dealers and importers with a view to promote the Bank's leasing product. As such the Bank partnered with leading motor vehicle importers such as Diesel & Motor Engineering PLC (DIMO) to promote the TATA Commercial Vehicles, Indra Traders to promote FOTON trucks, United Motors Lanka PLC to promote Mitsubishi commercial vehicles amongst many others. Top of mind recall for HNB Leasing as a leader in leasing among banks, was maintained through regular advertising and branch level activations such as road shows.

### **HNB Pawning**

The HNB Pawning brand was active throughout the year with a promotional drive to maintain high brand visibility, familiarity and brand re-call. The aggressive marketing initiatives saw us maintaining a position within the top 3 among banks.

### **HNB Credit cards**

The Bank's card operations during the year included launching a co-branded credit and loyalty card in collaboration with fashion retail inspiration ODEL with a view to reward the customer base. During the year a number of merchant driven and seasonal promotions were carried out with the aim of driving card usage up and building loyalty.

### **Customer network expansion**

The Bank's network expansion efforts were duly communicated under the theme of "HNB team" giving recognition to the teams at each customer centre whilst also creating an aura of service excellence for the customer.

### **Future Outlook**

Increasing competition and fragmentation of the marketplace will call for greater focus on marketing in the years ahead. Whilst maintenance of loyalty and consolidation of existing customer bases will remain critical for the Bank, consumer relevant advertising incorporating the Bank's ethical beliefs and shaping of promotional activity will lead the approach towards customer retention. To this end, the Bank will continue to gear itself for precision in marketing whilst continuing to do what it has done best in the years past; that is building and retaining relationships with the critical masses of Sri Lanka and the future generation of customers, through financial inclusion of the rural and youth segments of Sri Lanka.

## Focus: Strategy of innovation and market penetration leads to consistent growth

### SUBSIDIARY OPERATIONS HNB Assurance PLC



HNB Assurance demonstrated commendable growth in the year 2010, persisting with excellence in financial performance through the execution of strategic plans as a cumulative outcome of prudent business practices in risk management and governance. During the year, the Company achieved a turnover growth of 15% and a profit growth of 20% recording a pre-tax profit of Rs 269.5 Mn and a post tax profit of Rs 241.7 Mn for the year ended 31st December 2010. The Company's stability and overall performance excellence was evident in 2010 with HNB Assurance surpassing a market capitalisation of Rs 3 Bn during the year, posting considerable growth from the Rs 2 Bn mark reached in 2009.

The Company's market penetration strategy led the growth momentum in the year under review. With a network of 51 branches – of which 4 new branches were opened in 2010 in Balangoda, Thambuthegama, Nelliady and Manipay – HNB Assurance effectively reached out to rural communities as viable target markets. Rebranding in the Northern and Eastern provinces was effectively followed through with a concerted marketing drive in

the region with a specific focus on push strategies for Life and Home insurance products. In addition, 98 centres across the country actively promoted Bancassurance through the Hatton National Bank branch network with the aid of dedicated staff members stationed at HNB branches. The aggressive push of the channel precipitated a 135% growth in GWP contribution from Bancassurance during the year. The channel continued to witness exceptional growth rates and is expected to demonstrate further acceleration in growth in 2011.

From a business continuity perspective, HNB Assurance persisted with the implementation of an IT system upgrade embarked on in 2009. The Life Insurance business was fully converted to the new system during the year, whilst a considerable part of the General Insurance system implementation has also been completed. In the upcoming financial year, the Company expects to reap optimal efficiencies arising from full system implementation, including increased management transparency through the availability of greater information across the organisation's decision makers.

During the year HNB Assurance retained the Fitch National Long-term Rating 'A (lka) with a stable outlook whilst also retaining the National Insurer Financial Strength (IFS) rating at 'A' (lka). In 2010, HNB Assurance won the bronze award for its innovative product "My Life" -which was launched in the previous financial year- in the category "Best new entrant" at the SLIM Brand Excellence Award 2010. It was also awarded the second place in Corporate Governance Disclosures at the SAFA Best Presented Accounts Award 2010 held in Katmandu, Nepal and the first runner-up position in the Insurance Category at the Annual Reports Awards 2010 held by the Institute of Chartered Accountants of Sri Lanka.

#### Review of operations: General Insurance

The Company posted a Gross Premium growth of 19% for General Insurance, achieving the targets set for the year whilst superseding the industry growth rate. From a profitability perspective, the combined ratio

was improved despite a contraction in contribution to premiums from terrorism cover, which witnessed a sharp decline in the scenario of post-conflict recovery. This is perceived as an on-going challenge to the overall profitability in the medium term. The interest rate decline witnessed throughout the year of 2010 also exerted pressure on profitability, but the Company overcame these challenges to post a 20% growth in profits from General Insurance.

#### Review of operations: Life Insurance

Life Insurance posted an overall growth of 10%, though the GWP growth rate from endowment policies and mortgage reducing policies recorded 27% and 55% respectively in 2010. However, GWP from investment policies witnessed a contraction as a direct outcome of the interest rate decline experienced in the financial year. Premium persistency grew consistently to over 80% by the year-end. However, the gross premium growth in Life Insurance was comparatively low during the year and yet remained on course to achieve predetermined expectations for 2010. The overall performance of Life from an industry perspective remained marginally below industry standard for the year.

#### Future Outlook

In the medium term HNB Assurance will employ a concerted strategy of market penetration with the intention of improving the quality and profitability of the business. As such the Company will pursue strategies to garner a greater proportion of micro and SME customers with a focus towards regional business development. The selective expansion of corporate business will also be targeted benefitting, in particular, from HNB's focus on large scale infrastructure financing. Aggressive growth is expected from the Life business through the deployment of a series of strategic initiatives to catalyse greater returns, particularly through product and market development strategies in the short and medium term.

**Focus:  
Profitability through  
prudent operational  
strategies**

**SUBSIDIARY OPERATIONS**

**SITHMA  
DEVELOPMENT  
(PVT) LIMITED**



**Performance Review**

Sithma Development in 2010 demonstrated robust returns with profitability up by 151% from that of the previous year to stand at Rs 170.7 Mn by the end of the financial year. Containment of operational costs combined with a favourable interest rate scenario culminated in a commendable profitability outlook for 2010. The deployment of prudent operational strategies furthered the viability of the business in the medium term.

HNB Towers, Sithma's flagship project continued to be an icon of modern construction for Colombo. During the year, initiatives were taken to optimise space utilisation at the Towers by the Bank, with the prime objective of revenue enhancement. Sithma thereby objectively leased the remaining floor space to leading local and international commercial enterprises. As such in 2010, the HNB Towers reached over 95% occupancy.

Spathodea Residencies, Sithma's condominium development project has been completed and sale and purchase agreements have been signed for over 55 per

cent of the apartments by December 2010. Spathodea Residencies is considered a prestigious and high quality construction in Colombo.

**Future Outlook**

Looking at the immediate future, Sithma Development will concentrate its efforts on maximising its return from Spathodea Residencies whilst seeking and evaluating attractive new real estate development opportunities. In the medium term, the Company will continue to utilise its experience and acumen in the construction of energy efficient buildings.



## Focus: Market expansion to propel growth

### EXCHANGE HOUSES



#### **Majan Exchange LLC, Oman**

Majan Exchange completed its second operational year in 2010 and is on target to breakeven in early 2011. During the year a fresh infusion of capital to Majan Exchange amounting to OMR 40,000 was made, in keeping with regulations in Oman pursuing its second outlet in Ghala scheduled for the first quarter of 2011. Plans are in motion to open two more branches during the course of the year 2011.

Majan Exchange, while focusing on remittances to Sri Lanka also caters to corridors such as India, Nepal, Bangladesh, Pakistan and Philippines. As a send agent for MoneyGram, Xpress Money, EzRemit, Majan possesses the capability to serve many other corridors.

In the medium term Majan Exchange is expected to contribute to the Bank, consequent to breaking even and building on its viability.

#### **Delma Exchange United Arab Emirates**

Commenced commercial operation in April 2009, at Abu Dhabi, UAE. Opened its first branch in April 2010 in an industrial zone locality in Al Quoz followed by a branch in Musaffah City in July 2010. The fourth outlet was opened in December 2010 in Karama and the fifth outlet is to be opened in Hamdan Street during the first quarter of 2011.

Delma Exchange also focuses on remittances to Sri Lanka while catering to the expatriate communities of Indians, Nepalese and Filipinos. As a send agent for Western Union, Delma Exchange caters to remitters to a variety of other destinations.

In the medium term four additional outlets have been planned to commence operations in 2011. Focus is concentrated on improving efficiency and margins to accelerate returns and breakeven before the end of 2011.

#### **Delma Exchange Canada**

From an operational standpoint the market though indicative of promise due to the high concentration of the Sri Lankan community proved to be too sensitive to penetrate as a regulated establishment. Due to the non viable status of operations, Delma Exchange, Canada reluctantly ceased its commercial operations at the end of October 2010.

**Focus:  
Sustain growth  
momentum to  
continue exceptional  
performance**

**ACUITY  
PARTNERS  
(PVT) LTD**



The financial year 2010 was a defining year in the short history of Acuity Partners. Operational since February 2009, Acuity in the year under review validated beyond doubt the viability of its operations. Moreover, the success of the Company and its ability to garner a high ROI through exceptional performance, despite the short time frame, places Hatton National Bank and DFCC Bank as visionary corporates for their foresight in conceptualising and moulding Acuity at a time when the investment climate was low. Acuity was formed during the height of the conflict, yet as business proponents, Hatton National Bank and DFCC Bank, looked beyond the market and the economic turbulence to

the opportunities and the promise of a post conflict era. This far-sighted approach to business has today enlarged the shareholder value of the investors.

In 2010, the Sri Lankan economy rebounded strongly reaping the peace dividend. The momentum of growth that commenced immediately post conflict in mid 2009, accelerated precipitously during the year and was most strongly evident in the stock market performance. The Colombo Stock Exchange (CSE) continued to perform exceptionally during 2010 to record a return of 90.6% YTD. As an outcome of the vibrancy of the stock market, Acuity's brokering operations were greatly enhanced and recorded an exceptional performance during the year. The Group posted a pre-tax profit of Rs 450 Mn and post tax profit of Rs 301 Mn, indicating a growth of 229% and 257% respectively over the previous financial year. On 18th January 2010, Acuity acquired investment and venture capitalist Lanka Ventures PLC for a purchase consideration of Rs 719 Mn and currently holds a 79.6% stake of the company. The CSE performed at an almost daily record-breaking trend in 2010, however, in the financial year ahead, the market is expected to strengthen, recovering from minor overheating experienced during the year. The securities aspect of business continued to show progress during 2010 despite rate stability.

The Corporate Finance services during the year enabled Acuity to be at the forefront of the financial services industry, leading and managing a number of core projects including a series of high-profile Initial Public Offerings in a range of sectors; from tea and financial services to banking and diversified holdings. The mandate for Corporate Finance

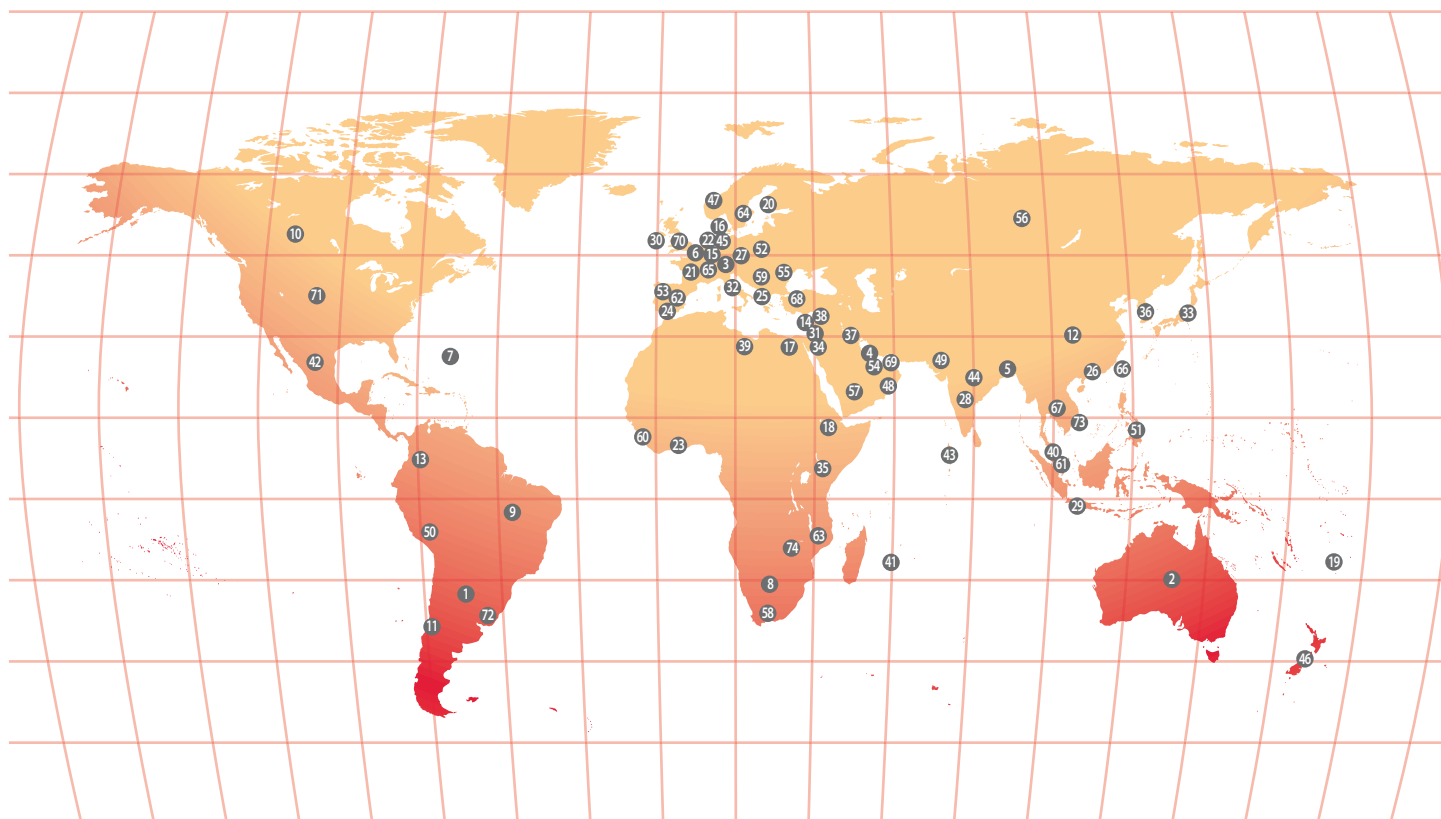
Services for the year outlined key focus areas of engagement, all of which were successfully achieved during the year 2010. By signing an agreement with Millennium Capital Management of Maldives, Acuity in the year under review laid the foundation for the enlargement of its operations in the future. As a result of this association with Millennium Capital, Acuity has already been mandated to secure loan syndications for two leading hotel chains based in the Maldives.

**Future Outlook**

The conducive post conflict scenario will only further the opportunities for Acuity in the medium term. As the CSE strengthens and as Sri Lanka's business community gathers further confidence in the economy, a multiplier investment effect is expected. Economic development will precipitate and catalyse foreign direct investment, placing Sri Lanka as the centre of international attention in the long term. Going forward, Acuity is geared to grasp these opportunities to add further value to its stakeholders through the introduction of new business lines such as Margin Trading and Asset management to add to the existing products and services portfolio, whereby Acuity furthers its capacity to become Sri Lanka's premier 'one stop' Investment banking firm.

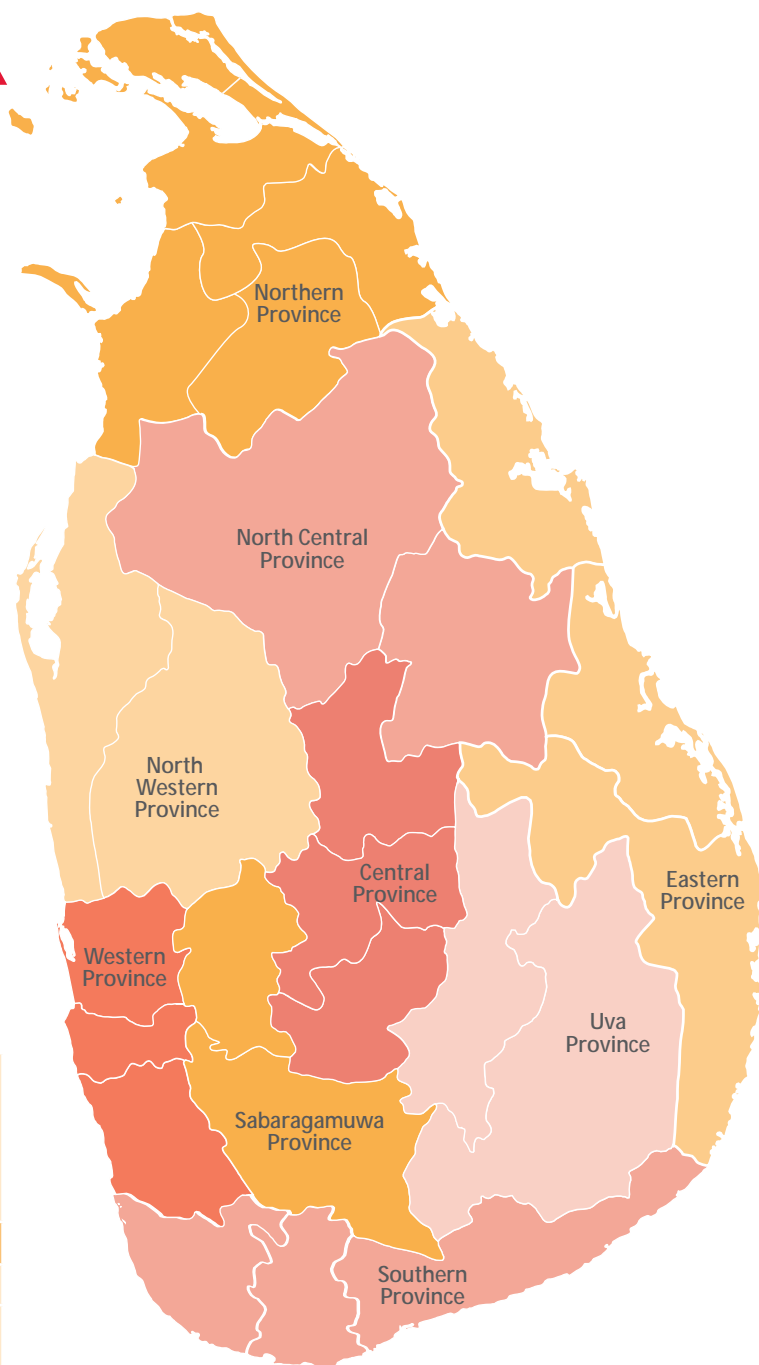


# MAIN CORRESPONDENTS WORLDWIDE



- |    |                |    |                |    |                          |
|----|----------------|----|----------------|----|--------------------------|
| 1  | Argentina      | 26 | Hong Kong      | 51 | Philippines              |
| 2  | Australia      | 27 | Hungary        | 52 | Poland                   |
| 3  | Austria        | 28 | India          | 53 | Portugal                 |
| 4  | Bahrain        | 29 | Indonesia      | 54 | Qatar                    |
| 5  | Bangladesh     | 30 | Ireland        | 55 | Romania                  |
| 6  | Belgium        | 31 | Israel         | 56 | Russian Federation       |
| 7  | Bermuda        | 32 | Italy          | 57 | Saudi Arabia             |
| 8  | Botswana       | 33 | Japan          | 58 | South Africa             |
| 9  | Brazil         | 34 | Jordan         | 59 | Serbia & Montenegro      |
| 10 | Canada         | 35 | Kenya          | 60 | Sierra Leone             |
| 11 | Chile          | 36 | Korea          | 61 | Singapore                |
| 12 | China          | 37 | Kuwait         | 62 | Spain                    |
| 13 | Colombia       | 38 | Lebanon        | 63 | Swaziland                |
| 14 | Cyprus         | 39 | Libya          | 64 | Sweden                   |
| 15 | Czech Republic | 40 | Malaysia       | 65 | Switzerland              |
| 16 | Denmark        | 41 | Mauritius      | 66 | Taiwan                   |
| 17 | Egypt          | 42 | Mexico         | 67 | Thailand                 |
| 18 | Ethiopia       | 43 | Maldiv Islands | 68 | Turkey                   |
| 19 | Fiji Islands   | 44 | Nepal          | 69 | United Arab Emirates     |
| 20 | Finland        | 45 | Netherlands    | 70 | United Kingdom           |
| 21 | France         | 46 | New Zealand    | 71 | United States of America |
| 22 | Germany        | 47 | Norway         | 72 | Uruguay                  |
| 23 | Ghana          | 48 | Oman           | 73 | Vietnam                  |
| 24 | Gibraltar      | 49 | Pakistan       | 74 | Zambia                   |
| 25 | Greece         |    |                |    |                          |

# CUSTOMER CENTRE NETWORK



HNB Customer Centres to be opened during the 1st quarter of the year  
Kinniya  
Udappuwa  
Siyambalanduwa

|                                   | 2009   | 2010   |
|-----------------------------------|--|--|
| Customer Centres                  | 186  | 205  |
| HNB Student Banking Centres       | 153  | 159  |
| HNB Gami Pubuduwa Banking Centres | 111  | 117  |
| Village Based Units               | 18   | 8  |
| Branch Based Units                | 92   | 108  |
| Micro Banking Units               | 1  | 1  |
| HNB Mobile Banking Service Units  | Kandalama<br>Heritage Hotel<br>Amaya<br>Lake Hotel<br>(Dambulla) | Kandalama<br>Heritage Hotel<br>Amaya<br>Lake Hotel<br>(Dambulla) |
| Overseas Representative Offices:  | Chennai<br>– India<br>Karachi<br>– Pakistan                      | Chennai<br>– India<br>Karachi<br>– Pakistan                      |

Customer Centre Network - As at 31/12/2010

| Province      | Customer Centres | ATMs       |
|---------------|------------------|------------|
| Central       | 21               | 32         |
| Eastern       | 16               | 25         |
| North Central | 7                | 10         |
| North Western | 16               | 23         |
| Northern      | 13               | 19         |
| Sabaragamuwa  | 10               | 15         |
| Southern      | 17               | 21         |
| Uva           | 10               | 15         |
| Western       | 95               | 190        |
| <b>Total</b>  | <b>205</b>       | <b>350</b> |

## Western Province – 95

|   |   |   |   |   |   |
|---|---|---|---|---|---|
| <ul style="list-style-type: none"> <li>• Airport Office</li> <li>• Aluthgama</li> <li>• Aluthkade</li> <li>• Athurugiriya</li> <li>• Avissawella</li> <li>• Bambalapitiya</li> <li>• Beruwela</li> <li>• Biyagama</li> <li>• Boralesgamuwa</li> <li>• Borella</li> <li>• Cinnamon Gardens</li> <li>• City Office</li> <li>• Dehiwela</li> <li>• Delgoda</li> <li>• Dematagoda</li> <li>• Divulapitiya</li> <li>• Ekala</li> </ul> | <ul style="list-style-type: none"> <li>• Gampaha</li> <li>• Ganemulla</li> <li>• Grandpass</li> <li>• Green Path</li> <li>• Gunasinghepura</li> <li>• Hanwella</li> <li>• Head Office Branch</li> <li>• Hendala</li> <li>• Homagama</li> <li>• Horana</li> <li>• Hulftsdorp</li> <li>• IWMI – Pelawatta</li> <li>• Ja-ela</li> <li>• Jampettah Street</li> <li>• Kadawatha</li> <li>• Kaduwela</li> <li>• Kalutara</li> </ul> | <ul style="list-style-type: none"> <li>• Kandana</li> <li>• Katunayake</li> <li>• Kelaniya</li> <li>• Kiribathgoda</li> <li>• Kirindiwela</li> <li>• Kirullapone</li> <li>• Kochchikade</li> <li>• Kohuwala</li> <li>• Kollupitiya</li> <li>• Kotahena</li> <li>• Kottawa</li> <li>• Kotte</li> <li>• Lanka Hospitals</li> <li>• Maharagama</li> <li>• Malabe</li> <li>• Maligawatte</li> <li>• Maradana</li> </ul> | <ul style="list-style-type: none"> <li>• Marandaghamula</li> <li>• Mathugama</li> <li>• Minuwangoda</li> <li>• Mirigama</li> <li>• Mirihana</li> <li>• Moratumulla</li> <li>• Moratuwa</li> <li>• Mt. Lavinia</li> <li>• Mutwal</li> <li>• Narahenpita</li> <li>• Nawala</li> <li>• Nawaloka Hospital</li> <li>• Nawam Mawatha</li> <li>• Negombo</li> <li>• Negombo Extension Office</li> <li>• Negombo Metro</li> </ul> | <ul style="list-style-type: none"> <li>• Nittambuwa</li> <li>• Nugegoda</li> <li>• Overseas School of Colombo</li> <li>• Padukka</li> <li>• Panadura</li> <li>• Panchikawatte</li> <li>• Pettah</li> <li>• Pettah – 2nd Office</li> <li>• Piliyandala</li> <li>• Ports Authority</li> <li>• Pugoda</li> <li>• Ragama</li> <li>• Ratmalana</li> <li>• Sea Street</li> <li>• Seeduwa</li> </ul> | <ul style="list-style-type: none"> <li>• Sri Jayawardenapura Hospital</li> <li>• Sri Lankan Airlines Admin Complex</li> <li>• Talangama</li> <li>• Thalawathugoda</li> <li>• The Cental Hospital</li> <li>• Thimbirigasyaya</li> <li>• Wattala</li> <li>• Weliveriya</li> <li>• Wellawatte</li> <li>• Wellawatte Extension Office</li> <li>• Wijerama</li> <li>• World Trade Centre</li> <li>• Yakkala</li> </ul> |
|---|---|---|---|---|---|

## North Western Province – 16

|   |  |   |  |  |  |
|---|--|---|--|--|--|
| <ul style="list-style-type: none"> <li>• Alawwa</li> <li>• Chilaw</li> <li>• Dankotuwa</li> </ul> | <ul style="list-style-type: none"> <li>• Galgamuwa</li> <li>• Giriulla</li> <li>• Hettipola</li> </ul> | <ul style="list-style-type: none"> <li>• Kuliyaipitiya</li> <li>• Kurunegala</li> <li>• Marawila</li> </ul> | <ul style="list-style-type: none"> <li>• Madampe</li> <li>• Nikaweratiya</li> <li>• Norochchole</li> </ul> | <ul style="list-style-type: none"> <li>• Nawinne - Kurunegala</li> <li>• Puttalam</li> <li>• Wennappuwa</li> </ul> | <ul style="list-style-type: none"> <li>• Wariyapola</li> </ul> |
|---|--|---|--|--|--|

## Northern Province – 13

|  |  |   |   |   |  |
|--|--|---|---|---|--|
| <ul style="list-style-type: none"> <li>• Chankanai</li> <li>• Chavakachcheri</li> <li>• Chunnakam</li> </ul> | <ul style="list-style-type: none"> <li>• Jaffna</li> <li>• Jaffna – 2nd Office</li> <li>• Kilinochchi</li> </ul> | <ul style="list-style-type: none"> <li>• Mannar</li> <li>• Manipay</li> <li>• Nelliady</li> </ul> | <ul style="list-style-type: none"> <li>• Point Pedro</li> <li>• Thirunelvely</li> <li>• Vavuniya</li> </ul> | <ul style="list-style-type: none"> <li>• Velanai</li> </ul> |  |
|--|--|---|---|---|--|

## North Central Province – 7

|  |   |  |   |  |  |
|--|---|--|---|--|--|
| <ul style="list-style-type: none"> <li>• Anuradhapura</li> <li>• Anuradhapura Ext. Office</li> </ul> | <ul style="list-style-type: none"> <li>• Kekirawa</li> <li>• Madawachchiya</li> </ul> | <ul style="list-style-type: none"> <li>• Nochchiyagama</li> <li>• Polonnaruwa</li> </ul> | <ul style="list-style-type: none"> <li>• Thambuttegama</li> </ul> |  |  |
|--|---|--|---|--|--|

## Eastern Province – 16

|  |  |   |   |   |  |
|--|--|---|---|---|--|
| <ul style="list-style-type: none"> <li>• Akkaraipattu</li> <li>• Ampara</li> <li>• Batticaloa</li> </ul> | <ul style="list-style-type: none"> <li>• Chenkaladi</li> <li>• Kaluwanchikudy</li> <li>• Kalmunai</li> </ul> | <ul style="list-style-type: none"> <li>• Kantalai</li> <li>• Kattankudy</li> <li>• Ninthavur</li> </ul> | <ul style="list-style-type: none"> <li>• Pottuvil</li> <li>• Sammanthurai</li> <li>• Thandavenveli</li> </ul> | <ul style="list-style-type: none"> <li>• Trincomalee</li> <li>• Trincomalee – Courts Road</li> <li>• Thirukkivil</li> </ul> | <ul style="list-style-type: none"> <li>• Valachchenai</li> </ul> |
|--|--|---|---|---|--|

## Central Province – 21

|  |   |  |  |   |  |
|--|---|--|--|---|--|
| <ul style="list-style-type: none"> <li>• Akurana</li> <li>• Bogawantalawa</li> <li>• Dambulla</li> <li>• Digana</li> </ul> | <ul style="list-style-type: none"> <li>• Gampola</li> <li>• Galewela</li> <li>• Geli Oya</li> <li>• Hatton</li> </ul> | <ul style="list-style-type: none"> <li>• Kandy</li> <li>• Kandy City Centre</li> <li>• Katugastota</li> <li>• Maskeliya</li> </ul> | <ul style="list-style-type: none"> <li>• Matala</li> <li>• Nawalapitiya</li> <li>• Nuwara Eliya</li> <li>• Peradeniya</li> </ul> | <ul style="list-style-type: none"> <li>• Pilimathalawa</li> <li>• Pussellawa</li> <li>• Ragala</li> <li>• Rikillagaskada</li> </ul> | <ul style="list-style-type: none"> <li>• Thalawakelle</li> </ul> |
|--|---|--|--|---|--|

## Sabaragamuwa Province – 10

|   |   |  |   |   |  |
|---|---|--|---|---|--|
| <ul style="list-style-type: none"> <li>• Balangoda</li> <li>• Embilipitiya</li> </ul> | <ul style="list-style-type: none"> <li>• Godakawela</li> <li>• Kahawatte</li> </ul> | <ul style="list-style-type: none"> <li>• Kegalle</li> <li>• Mawanella</li> </ul> | <ul style="list-style-type: none"> <li>• Pelmadulla</li> <li>• Pinnawela</li> </ul> | <ul style="list-style-type: none"> <li>• Ratnapura</li> <li>• Warakapola</li> </ul> |  |
|---|---|--|---|---|--|

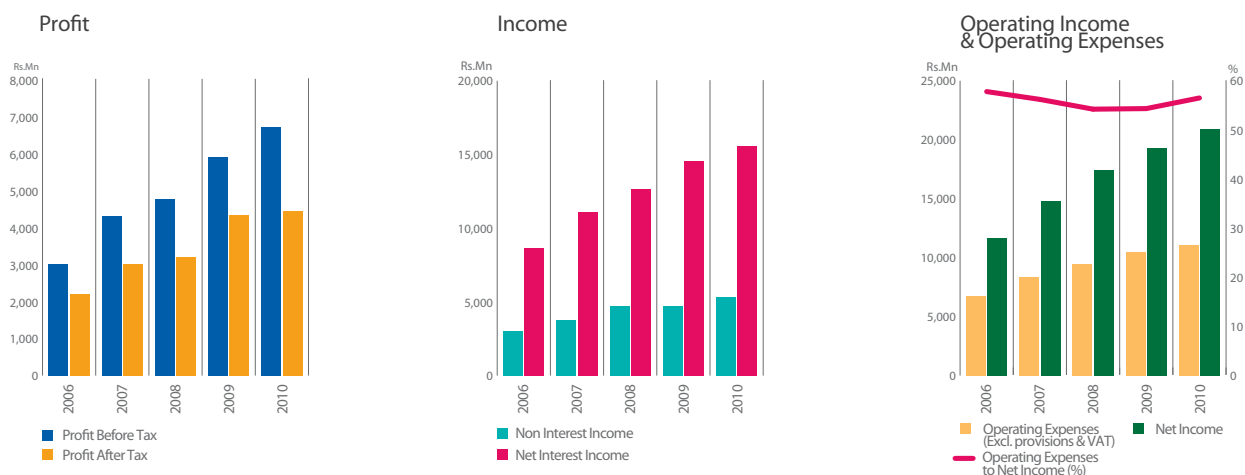
## Southern Province – 17

|   |   |   |   |   |   |
|---|---|---|---|---|---|
| <ul style="list-style-type: none"> <li>• Agunakolapelassa</li> <li>• Akuressa</li> <li>• Ambalangoda</li> </ul> | <ul style="list-style-type: none"> <li>• Ambalantota</li> <li>• Deniyaya</li> <li>• Elpitiya</li> </ul> | <ul style="list-style-type: none"> <li>• Galle</li> <li>• Karapitiya</li> <li>• Kataragama</li> </ul> | <ul style="list-style-type: none"> <li>• Hambantota</li> <li>• Koggala</li> <li>• Matara</li> </ul> | <ul style="list-style-type: none"> <li>• Middeniya</li> <li>• Pitigala</li> <li>• Suriyawewa</li> </ul> | <ul style="list-style-type: none"> <li>• Tangalle</li> <li>• Tissamaharama</li> </ul> |
|---|---|---|---|---|---|

## Uva Province – 10

|  |   |   |   |   |  |
|--|---|---|---|---|--|
| <ul style="list-style-type: none"> <li>• Badulla</li> <li>• Bandarawela</li> </ul> | <ul style="list-style-type: none"> <li>• Bibile</li> <li>• Buttala</li> </ul> | <ul style="list-style-type: none"> <li>• Haputale</li> <li>• Mahiyangana</li> </ul> | <ul style="list-style-type: none"> <li>• Moneragala</li> <li>• Passara</li> </ul> | <ul style="list-style-type: none"> <li>• Welimada</li> <li>• Wellawaya</li> </ul> |  |
|--|---|---|---|---|--|

# FINANCIAL REVIEW



## Industry overview

The financial year 2010 was a year that presented a mix of challenges and opportunities for the financial services industry. As a consequence of the slowdown in economic activity in 2009, credit growth remained sluggish during the major part of 2010. In fact, the negative credit growth witnessed by the industry in 2009 continued in to the early part of 2010. However, the prospects for the industry remained promising with interest rates declining to single digits during the year. Moreover the return to economic activity and contribution from approximately one third of the country's land mass after three decades of unrest, augurs well for the future.

The Sri Lankan economy recovered commendably in 2010 despite the persisting negative effects of the global financial crisis witnessed during 2009. The robust inflow of foreign funds improved foreign reserves, assisting towards the strengthening of the Sri Lankan Rupee against hard currencies, in particular the US Dollar.

## Financial Performance

### Income

The decline in interest rates coupled with the sluggish loan growth witnessed during the first half of the year contributed towards a drop in the Bank's top line where interest income declined by 12.6% to Rs 30.2 Bn from Rs 34.6 Bn in 2009. The drop in interest rates also enabled the Bank to contain its interest cost. The Bank's prudent asset and liability management strategies enabled it to convert a significant portion of its fixed deposits into comparatively low cost deposits which helped improve the deposit mix where current and savings accounts (CASA) balances represented 53% of total deposit base compared to 46% in

2009. This too contributed towards the further reduction of interest cost thereby achieving a 6.6% growth in net interest income despite the drop in the top line.

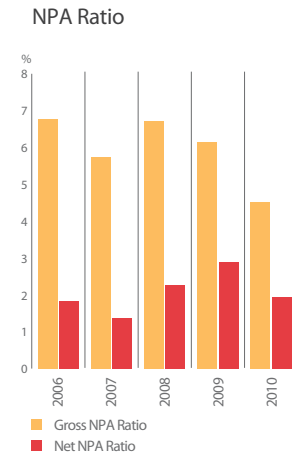
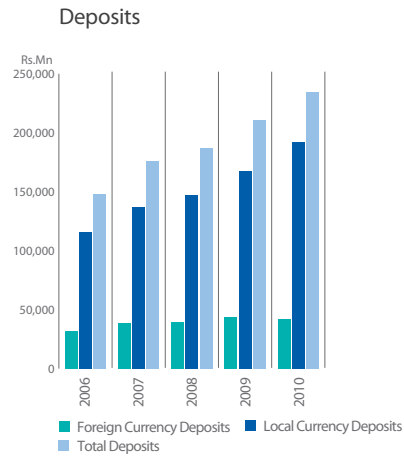
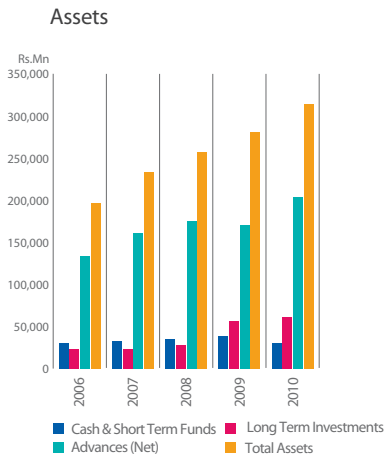
The Bank continued to focus on improving non-interest income which in total grew by 12.6% compared to 2009. The foreign exchange income grew by 12.5% which is a commendable performance considering the relatively stable foreign exchange rates witnessed during the year.

Commission income too witnessed a notable growth with trade related income taking centre stage as international trade started to pickup after a dismal year in 2009.

During the year under review the Bank disposed its non-strategic investments in Commercial Bank of Ceylon PLC and Distilleries Company of Sri Lanka PLC while the direct holdings in Lanka Ventures PLC and Acuity Securities (Pvt) Ltd were brought under the Acuity umbrella as part of the long term strategy. The divestments resulted in an increase in the investment income during the year.

Other income witnessed a drop in 2010 despite the recovery of Rs 421.4 Mn from non performing loans, largely due to 2009 having been an exceptional year for recoveries. In the preceding year the Bank effectively recovered a substantial amount from its largest non performing account at the time, namely Kabool Lanka. The lack of such a scenario in 2010, therefore, accounted for the decline in the volume of recoveries during the year. The persistence towards effective recoveries, however, remained high.

Overall the net income of the Bank grew by 8.1% in 2010 compared to the previous year, while improving the non interest income to net income ratio from 24.5% to 25.5% in 2010.



## Operating expenses

Realizing the need to improve productivity to maintain profitability in a competitive environment, the Bank continued its aggressive cost management strategies both at head office as well as in branches. The salary bill of the Bank grew by 12.3% while general expenses increased by a mere 5.4% during 2010. The Bank continued to manage costs, curtailing the increase in cost to a minimum despite rolling out an aggressive growth strategy culminating in the commissioning of 19 new customer centers and 40 new ATMs during the year. Majority of the new customer centers opened during the year were geographically located in the rural pockets of Sri Lanka, especially in the under-developed and previously war ravaged Northern and Eastern provinces.

Primarily due to the aggressive expansion drive, the cost to income ratio increased marginally to 56.5% in 2010. The Bank has laid down strategies towards managing costs and is focused on driving the cost to income ratio below 50% in the medium term.

The Bank remained extremely aggressive in its recovery efforts during 2010 resulting in its gross non performing ratio declining to 4.51%, while the net non performing ratio declined to 1.95%. To maintain this ratio below 5% the Bank persisted with the implementation of a three pronged strategy - aggressive recoveries, post credit monitoring and integrated risk management techniques - for credit evaluation. The provision cover as at end of 2010 improved to 56.8%.

The Bank managed to grow its pre-tax profits by a healthy 13.8% to Rs 6.7 Bn compared to the previous year, while the Group posted a pre-tax profit of Rs 7.2 Bn recording a growth of 17.6%.

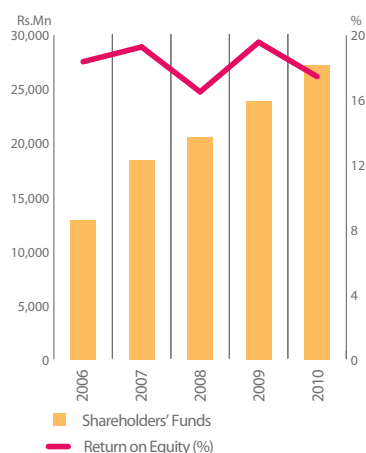
## Group Companies

Majority of the Group companies contributed positively during 2010 with HNB Assurance PLC leading the way. The 60% owned insurance subsidiary demonstrated a profit growth of 20% with its gross written premium improving by 15%. Though a relatively new player in the highly competitive insurance industry, HNB Assurance remains one of the fastest growing insurance companies in the Country.

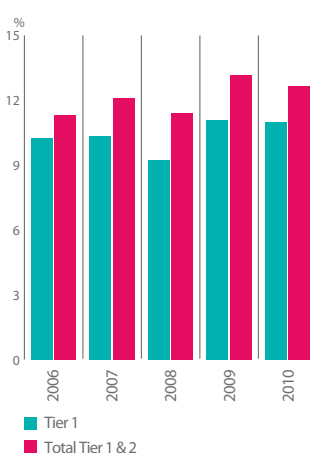
The Bank's timely investment in a joint venture investment bank paid off during 2010 as capital markets started performing exceptionally well during the year. The joint venture Investment Banking Group, Acuity Partners (Pvt) Ltd demonstrated a commendable profit growth of 257% during 2010 with positive contributions from all its business activities, which include corporate finance, stock broking and dealing in fixed income securities. Both the Bank and DFCC together further strengthened the Acuity Group during the year by bringing in Lanka Ventures PLC under the Acuity umbrella. The Bank will continue to invest in this space as it has identified capital markets as one of the key beneficiaries in Sri Lanka's post conflict economy.

The property management subsidiary of the Bank which owns the state of the art HNB Towers, also managed to positively contribute towards the Group's bottom line. However, the two exchange houses namely Majan and Delma are yet to break-even, mostly as they are new investments. Both Majan and Delma have demonstrated great potential and have been avenues through which the Bank has increased its penetration in to the Middle East.

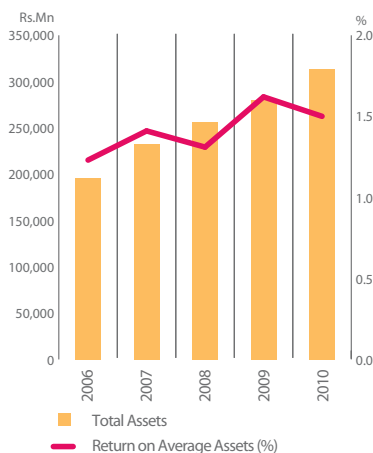
### Shareholders' Funds



### Capital Adequacy Ratio



### Return on Average Assets



## Taxation

The corporate tax charge for the Bank increased by a substantial 44.8% to Rs 2.3 Bn in 2010 compared to the previous year. The main reason for this was the exceptionally low tax charge witnessed in 2009 resulting from the Bank utilising carried forward tax losses and write-back of over provided taxes during early years. Accordingly, the effective corporate tax rate increased to 33.7% in 2010 compared to a low 26.5% in 2009.

The net profit after tax stood at Rs 4.46 Bn recording a modest growth of 2.6% in 2010 compared to the previous year despite a reasonable growth in the pre tax profit mainly due to the Bank enjoying a low effective tax rate in 2009 as explained above. The Group net profit for 2010 amounted to Rs 4.89 Bn which represents a 7.3% growth YoY.

## Balance sheet

The Hatton National Bank balance sheet is reflective of the Bank's position as a robust and sustainable business, and is a demonstration of the strategic foresight and prudent decision making that have been the hallmarks of the way the bank is managed.

## Asset growth

The Bank managed to grow its asset base by 12% during the year to Rs 313.9 Bn. The loan book of the Bank remained flat during the major part of this year due to low demand for credit. However the last 2 quarters witnessed rejuvenation in credit demand as the Bank ended the year with a YoY loan growth of 19.6% with total net loans and advances reaching Rs 203 Bn from Rs 169.8 Bn in 2009 which is quite exceptional in the context that the Bank's loan book contracted by 1% in the first quarter of 2010. The growth in credit was driven primarily by leisure, infrastructure, health sectors as well by leasing and retail credit.

## Liability growth

The Bank recorded a 11.2% growth in the total deposit base during 2010 with total rupee and foreign currency deposits standing at Rs 234.1 Bn compared to Rs 210.5 Bn in 2009. It is important to note that during 2010 the Bank managed to change its rupee deposit mix as mentioned earlier by increasing its low-cost deposits of savings and current accounts by 27.1% and 60.5% respectively. During the year the foreign currency deposits of the Bank marginally declined by 2.8% to Rs 42.1 Bn.

## Shareholders' funds

Shareholders' funds grew by 14% in the financial year, from Rs 23.9 Bn to Rs 27.3 Bn. An interim dividend of Rs 1.50 per share was declared for 2010 amounting to Rs 338.6 Mn. The Bank proposes a final dividend of Rs 5.50 per share on profits for the year under review which will amount to a total dividend payout of Rs 1,648 Mn.

## Capital adequacy

During 2010 the Bank did not infuse fresh capital and the growth in the asset book was supported purely by retained earnings. The Bank's capital adequacy ratios remained healthy with tier 1 and total ratios at 10.99% and 12.64% respectively as at December 2010.

## Return on Average Assets

The Bank's return on average assets stood at 1.5% and return on average equity at 17.4% in 2010.



## **Future Outlook**

Hatton National Bank has aligned its corporate strategy in line with the government's national developmental strategy for Sri Lanka. The Bank's core business pillars are reflective of areas that are deemed as priority in the national agenda. The North and East continue to be among the bank's priorities – as one of the main private commercial banks that consistently maintained a significant presence in the region over the past forty years, even during the height of the conflict, the bank has built meaningful relationships with the people of the region. As such, HNB is determined to play a significant role in the ongoing reconstruction and development efforts in the two battered provinces. Furthermore, the Bank will continue to promote and facilitate the financial inclusion of grassroot communities at the heart of the nation.

In 2011, the financial outlook for the Bank will, to a considerable degree be shaped and defined by its role in supporting infrastructure development, agriculture and fisheries sectors through SME empowerment, microfinance to generate economic activity, remittance based services to support the migrant workers and their families as well the revival of post war areas.

As always, the Bank will follow its prudent strategies and continue to demonstrate financial acumen in steering itself towards sustainable growth.

# **RISK & GOVERNANCE** **ENABLING RELIABILITY**

|                                      |           |
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# RISK MANAGEMENT

## Vision and Strategy for Risk Management

Risk management is a fundamental part of HNB's business activities. To keep risk management at the centre of the executive agenda, it is embedded in the everyday management of the business.

The vision for Risk Management is to proactively assist the business in delivering superior shareholder value by ensuring an optimal trade-off between risk and return. HNB's Risk Management Strategy is based on a clear understanding of various risks, disciplined assessment, measurement and continuous monitoring of such risks in the context of a predetermined risk appetite approved by the Board. The implementation of the Integrated Risk Management Strategy is a function of four pillars, namely a conducive organization structure, periodically updated policies reflecting ongoing assessment of key risks, regulatory and internal standards, an objective oriented meeting schedule and relevant and timely Analytics to assess performance improvements. Following a diagnostic review in 2007 with the assistance of external consultants a 5 year roadmap was developed to implement best practices in Risk Management and we are on track in the implementation efforts.

HNB's Integrated Risk Management Division, reports to Board Integrated Risk Management Committee (BIRMC) and Chief Executive Officer and comprises six units; whilst retaining its independence effectively integrates with business functions to ensure Risk Management is seamlessly ingrained in HNB's culture.

The Integrated Risk Management Division provides the BIRMC the assurance that the performance of the overall risk management framework and Risk Management Initiatives meet the requirements of the Risk Charter, which is reviewed annually for balanced coverage.

## Organisational Control and Board Governance

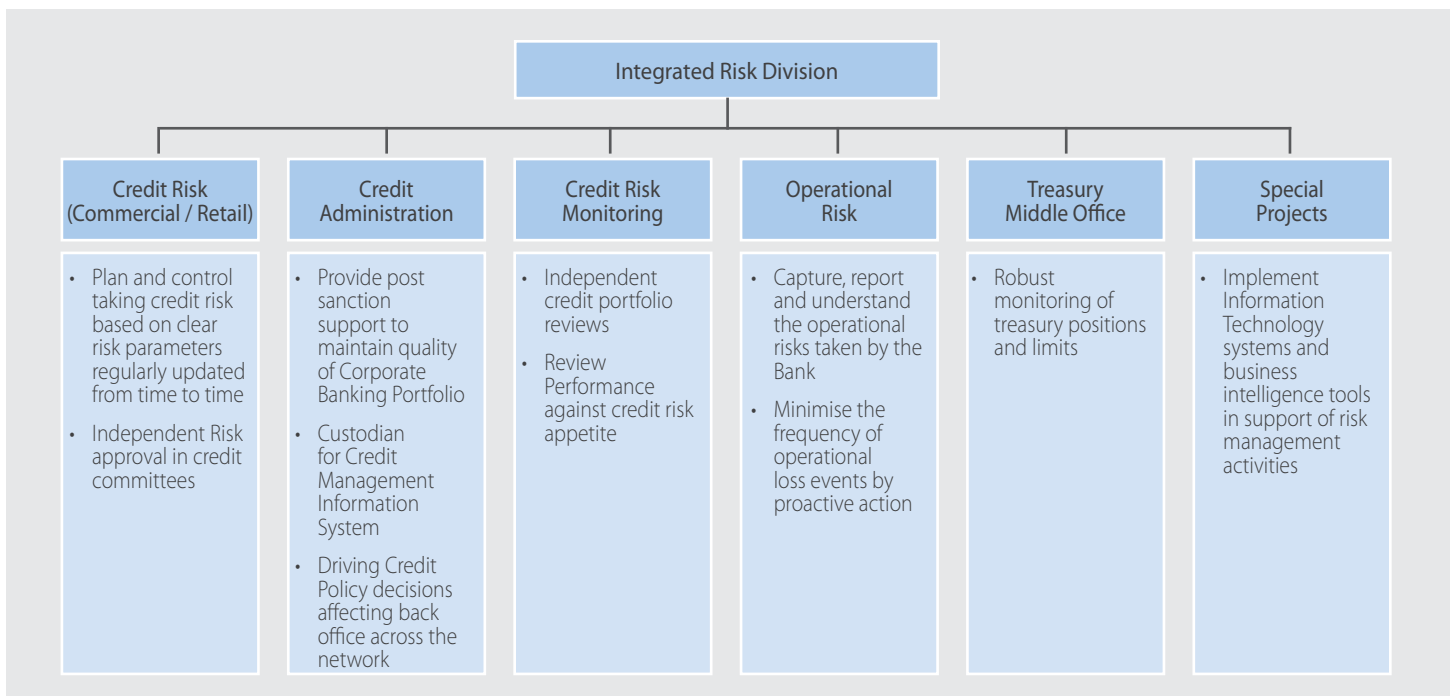
HNB's Board has ultimate responsibility for risk management. In discharging its governance responsibility for overall risk management and control, the Board has established two key Committees, the BIRMC and the Audit Committee.

The Audit Committee assists the Board in overseeing internal audit and the appropriateness of HNB's accounting policies and financial reporting.

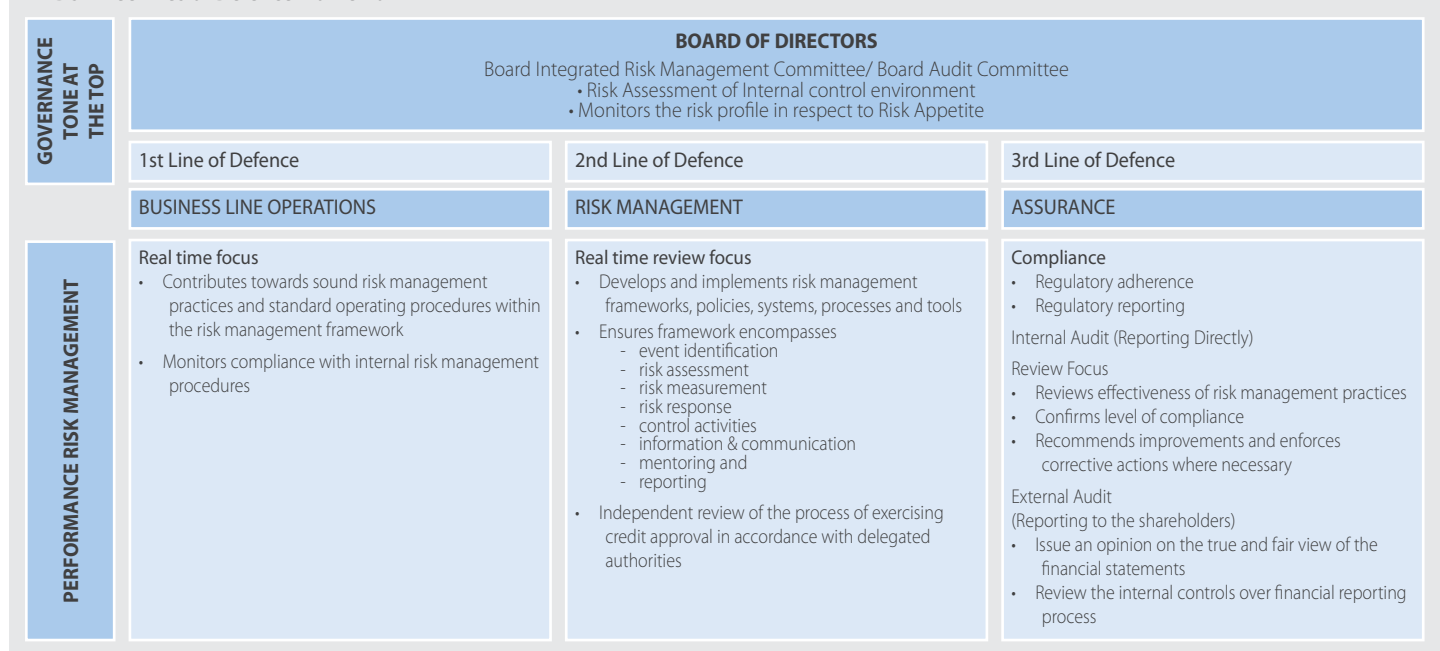
The BIRMC assists the Board in fulfilling its responsibilities relating to the oversight of HNB's risk management strategies, policies and processes that have the potential to impact significantly on earnings performance, reputation and capital protection. BIRMC also assists the Board to assess and to approve significant credit transactions and other matters beyond the discretion of executive management.

The following Executive Management Subcommittees, each with specialized focus, support the BIRMC and are responsible for the co-ordination of risk matters for each of the areas of risk management:

- Executive Risk Management Committee
- Asset and Liability Committee (ALCO)
- Credit Policy Committee
- Operational Risk Committee (business unit level)
- Investment Committee
- IT Steering Committee
- Corporate Social Responsibility Trust



## HNB's Three lines of Defence Framework



## HNB's approach to managing key risks

### Credit Risk

Credit risk relates to a borrower unable to meet its financial obligations to the lender. HNB has a well diversified credit portfolio in terms of concentration, business segments and industry representing a major source of income and over 2/3rd of its Asset base, consequently safeguarding portfolio quality is of paramount importance. The credit risk that the Bank faces arises mainly from corporate banking and retail loans and advances, while exposure to credit risk from trading activities is low in relative terms.

In managing credit risk, the Bank adopts a four pronged focus. Specific Objectives include:

1. Establishing an appropriate credit risk philosophy  
The credit approval structure broadly sets out HNB's Credit Strategy and discretionary lending limits. This document is reviewed at least annually and approved by the Board. A monthly Credit Policy Meeting chaired by the Chief Executive Officer, drives policy decisions and implementation.
2. Operating a sound credit granting process  
We adopt a committee based approval structure, where all approval signatories carry equal responsibility for credit risk. Individual credit facilities beyond a threshold, requires an independent risk signatory with no revenue targets in respective committees. The structure ensures business development and credit administration functions are clearly separated.

Our Credit Risk Monitoring unit periodically reviews conformity with internal risk parameters based on credit portfolio reviews. At corporate level an Executive Risk Committee is in place with balanced representation of business managers and risk managers to review performance against a predefined risk charter.

3. Maintaining an appropriate credit administration, measurement and monitoring process

Centralized Credit Administration Division provides efficient and effective post sanction support to corporate banking in order to maintain requisite quality of bank's credit portfolio. It also ensures adequate segregation of duties from business origination.

An internally developed online MIS (known as '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.

Early warning systems, age analysis of temporary unsecured facilities and new additions to delinquent portfolio are key focus areas in the review process.

At Corporate Level, a Credit Risk Dashboard indicates performance against the risk appetite for necessary action by business heads.

4. Controls over credit risk

We measure, monitor and manage credit risk for each borrower and also at the portfolio level. We have standardised credit approval processes, which include a well-established procedure of comprehensive credit appraisal and rating. We have implemented

# RISK MANAGEMENT

internal credit rating methodologies for Large Corporate, Middle Market and Small and Medium Enterprises (“SME”) customers. The rating factors include quantitative and qualitative issues and credit enhancement features specific to the borrower. The rating for each borrower is an input to the approval process and reviewed at least annually. Industry knowledge is constantly updated through field visits and interactions with clients, regulatory bodies and industry experts. Significant strides have been made to internalize the concept of Credit ratings with a view to giving due prominence to lending based on cashflow repayment ability as distinct from availability of collateral. However, comfort can be derived from the fact that the credit portfolio is largely secured by tangible collateral and bank guarantees with adequate internally defined margins in our favour. (see page 252)

A post disbursement review process is in place to assess performance by approval committee to ensure necessary learning and strengthen controls where appropriate.

## Liquidity and Interest Rate Risk

At a portfolio level the Bank’s loan book is comfortably financed by retail deposits, therefore reliance on wholesale deposits and interbank market is minimal. The non existence of long term borrowing instruments at affordable cost results in some maturity mismatch in the asset book (borrow short and lend long) however, this is considerably mitigated by a large stable and growing low cost deposit base. In these circumstances Bank remains highly liquid comfortably exceeding minimum statutory liquid asset ratios.

Conceptually the Bank is exposed to interest rate risk arising from a predominantly fixed rate liability book where repricing is significantly slower than the largely fixed rate lending portfolio in a reducing interest rate scenario. However empirical results indicate ability to protect its Net Interest Margins despite an almost 7% reduction in interest rates for the year ended August 2010.

HNB is committed to strengthen its risk management capabilities in this area with the implementation of an Asset Liability Management System and Fund Transfer Pricing System in 2011.

## Operational Risk

Operational risk is the risk of direct or indirect losses resulting from human factors, external events, and inadequate or failed internal processes and systems. Operational risks in the Bank are managed through a comprehensive internal control framework.

An Operational Risk Policy is in place comprising risk identification, implementation of controls for measurement, monitoring and mitigation of Operational risks. The Operational Risk Unit facilitates its implementation through internally defined Operational Risk Guidelines and Operational Risk Meetings conducted across the network.

HNB has a comprehensive Loss tracking database analysed by business function and loss incident as per BASEL requirements. A high level

Operational Risk Dashboard is circulated to keep BIRMC and Senior Management apprised of key operational losses on a monthly basis. Furthermore, an effective feedback loop is in place to ensure that learning from loss incidents, is regularly disseminated across the network to prevent / minimise recurrence.

Insurance continues to be the key risk mitigant for Operational Risks and adequacy and effectiveness of insurance is independently evaluated by Operational Risk, at least annually.

## Market Risk

Market risk is the possibility of loss in ‘on and off-balance sheet’ positions arising from changes in the value of financial instruments due to movements in market variables such as interest rates, exchange rates, equity and commodity prices.

A comprehensive Board approved Treasury Policy is in place and is regularly updated to reflect regulatory and market developments.

The Treasury Middle Office monitors the asset-liability position under the supervision of the ALCO. It also independently reviews activities of the Treasury Front Office and adherence to regulatory / internal policy guidelines.

Following the strengthening of the Treasury Front Office to take more aggressive positions within stipulated regulatory limits, the Bank is committed to augment its Market Risk Infrastructure in terms of skills, systems and controls to support Treasury’s expansion plans. (Presently exposure to Trading Book is only 2% of the Banking Book which is indicative of the regulatory climate and minimal opportunities in FX market.) Initiatives taken during the year include developing country limits, duration based limits and Value At Risk (VAR) based limits for currencies and bond portfolios. A Market Risk Dashboard was developed to indicate performance against risk appetite and continues to be refined in line with best practice.

## Compliance Risk

The Board expects HNB’s business to be conducted in accordance with the Bank’s Code of conduct, laws, and regulations and has zero tolerance for failure to identify and escalate breaches of these obligations.

In the wake of the global financial crisis, the local regulator has predictably strengthened regulations particularly in the areas of Treasury, Governance and Risk, Microfinance and Mobile payments among others. HNB continues to assess the impact of these developments on business and takes steps to ensure conformity.

HNB bi-furcated Compliance function from Risk Management during the year to ensure greater focus and independence. Compliance ensures regulatory conformance including Anti Money Laundering (AML) / Know Your Customer (KYC) and its responsibilities are set out in HNB’s Compliance Policy.



## Conformity to New Regulations introduced during the year (Table 1)

| Mandatory Regulations   |  |
|---|--|
| Obtaining KYC Data from customers (August 2008 update)<br>- New Customers<br>- Existing                                   | Already Compliant<br>Data collection in process, progress monitored monthly  |
| Contribute to a Deposit Insurance Fund – allocation of 0.25% of Deposit Base each year commencing 2010                    | Compliant  |
| Reduce General Provision on Advances to 0.5%<br>Directions on Risk Management relating to Forex Business (September 2009) | Compliant<br>Significantly Compliant, Treasury Policy amended to reflect where necessary and internal timelines developed to ensure compliant per Regulatory deadlines |
| Direction on Outsourcing (October 2010)   | Significantly Compliant, Gaps identified for resolution by March 2011  |
| Adoption of SLAS 44 and 45 by January 2012  | Hired external consultancy firm to assist in implementation efforts, on track for parallel reporting by mid 2011 and full compliance by regulatory deadline.           |
| Mandatory Lending to Agricultural Sector – achievement of 10% of Total Advances annually w.e.f December 2009              | Compliant  |
| Guidelines  |  |
| AML Risk Profiling of all Customers (May 2007)<br>(AML – Anti Money Laundering)   | AML system implementation will be a pre-requisite, expected to commence post implementation, prior to end 2011.  |
| Draft Guidelines on Integrated Risk Management Systems in Banks (September 2009)  | An Internal Gap Analysis is in place with plans to bridge the identified gaps. This analysis is part of HNB's BASEL Advanced Risk Management Implementation Roadmap    |
| Credit Card operational Guidelines  | An internal gap analysis is in place with plans to bridge the identified gaps. Simultaneously, clarifications from regulator being sought where necessary.             |
| Draft Mobile Payment Guidelines   |  |
| Guidelines on Microfinance  |  |

### Our roadmap towards implementing best practices in Risk Management

Despite the overhang of the global economic crisis and the contagion impacts in Europe, local business activity picked up significantly particularly in the second half of the year buoyed by growth in transport, construction and leisure sectors. Risk Management focus this year was to further consolidate initiatives taken last year to quantify risk appetite for principal risk areas – credit, operational and market in the form of dashboards and galvanize action across the network to address these risks.

### Capacity Building for the future

HNB views BASEL 2 Risk Management Practices as an opportunity to embrace best in class Risk Management Practices in our continuing quest of Learning, applying, Growing and developing Winning Strategies to achieve Sustainable Profits.

As a systemically important bank in Sri Lanka, HNB has made significant strides to put in place Basel 2 Internal Risk Based (IRB) infrastructure ahead of the regulatory deadline and is largely on track on the roadmap developed for its implementation. The key focus areas for 2011 will be on further refining the structure and analytics to support decentralization efforts in credit, inculcating best practices in liquidity and interest rate risk management and improving the risk infrastructure in Treasury to support significant position taking.

Global regulatory developments are moving in the direction where banks will be expected to maintain even higher levels of liquidity and capital with the advent of Basel 3 guidelines. HNB will continue to follow developments in this sphere to ensure necessary strategic alignment.

## Stress Testing

A fundamental role of risk management is to ensure organisations do not neglect to prepare for the worst event as they plan for success. Stress testing helps HNB to understand how its portfolios would react if business conditions became significantly more challenging.

The following stress tests have been computed based on the Central Bank of Sri Lanka Risk Management guidelines issued in September 2009.

| Base Data (All figures in Rs Mn) |         |                                    |        |
|----------------------------------|---------|------------------------------------|--------|
| Capital Adequacy Ratio (CAR)     | 12.64%  | Net Open Position                  | (929)  |
| Capital as at December 2010      | 26,060  | Equity Market Value                | 9,029  |
| Risk Weighted Assets             | 206,184 | Liquid Assets / Liquid Liabilities | 23.55% |
| Total NPA                        | 11,087  |                                    |        |

| Stress Tests   | Exposure<br>Rs Mn | Original Position<br>31st December 2010<br>CAR% | Magnitude of Shock |        |        |
|--|-------------------|---|--------------------|--------|--------|
|  |                   |   | 5%                 | 10%    | 15%    |
|  |                   |   | Revised CAR %      |        |        |
| A. Credit Risk<br>Non Performing Advances                  | 11,087            | 12.64%  | 12.40%             | 12.17% | 11.93% |
| B. Equity Price Risk<br>Fall in stock market prices        | 9,029             | 12.64%  | 12.45%             | 12.25% | 12.06% |
| C. Exchange Rate Risk<br>Adverse movement in exchange rate | (929)             | 12.64%  | 12.62%             | 12.60% | 12.58% |
| D. Commodity Price Risk<br>Adverse movement in Gold Prices | 27,970            | 12.64%  | 12.52%             | 12.40% | 12.16% |

Note 1: A reduction in gold prices of 5%, 10% and 15% over the year assumes an incremental NPA on Pawning Portfolio of 2%, 4% and 8% respectively.

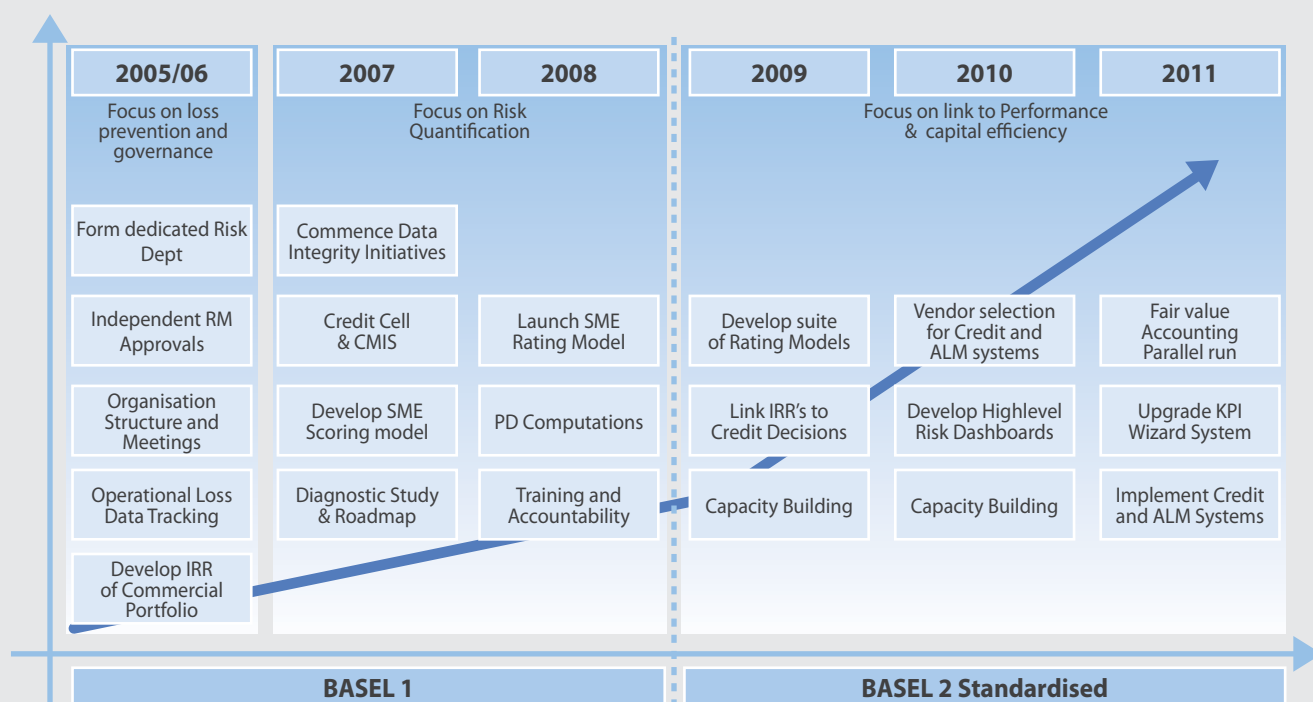
| Stress Tests<br>Liquidity Risk | Exposure<br>Rs Mn | Original Position<br>31st December 2010<br>LAR% | Magnitude of Shock           |        |        |
|--------------------------------|-------------------|---|------------------------------|--------|--------|
|                                |                   |   | 5%                           | 10%    | 15%    |
|                                |                   |   | Revised Liquid Asset Ratio % |        |        |
| A. Fall in liquid liabilities  | 257,771           | 23.55%  | 19.53%                       | 15.06% | 10.06% |

| Stress Tests<br>Credit Risk                                    | Exposure<br>Rs Mn | Original Position<br>31st December 2010<br>CAR% | Magnitude of Shock |        |        |
|--|-------------------|---|--------------------|--------|--------|
|  |                   |   | 50%                | 80%    | 100%   |
|  |                   |   | Revised CAR %      |        |        |
| A. Negative shift in NPL categories<br>Weighted NPA's (Note 2) | 7,218             | 12.64%  | 12.37%             | 12.20% | 12.09% |

Note 2: Composition of NPA categories Special Mention, Substandard, Doubtful and Loss are 21%, 13%, 7% and 59% respectively.

| Key Risk Management Initiatives implemented during 2010                 |  |
|---|--|
| Development of Risk Dashboards for Credit, Operational and Market Risks | Risk Dashboards incorporating performance against Board Approved risk appetite are tabled for review on a periodic basis. These dashboards serve as a business intelligence tool to communicate risk performance indicators, adherence to regulatory limits / internal targets and assess impact of stress testing on key variables.   |
| Vendor selection for Credit and ALM Systems                             | The Bank was able to identify a strategic solution provider to<br>a) Overhaul existing credit system – loan origination, rating system with requisite Basel 2 infrastructure which will enable the Bank to accommodate multiple internal risk ratings for its customer base, risk based pricing and carry out necessary statistical computations required<br>b) Implement a new Asset and Liability / Fund Transfer Pricing system – with a view to developing the necessary infrastructure to manage liquidity risk and interest rate risk more effectively                     |
| Capacity Building – Talent and Systems                                  | A comprehensive program on Risk Management was conducted for Risk Management Staff in two phases in December 2009 and Jan 2010 by a team of foreign trainers.<br><br>Successfully completed Credit Risk Modular training for third batch of Corporate Banking Relationship Managers and Branch Managers / Credit Officers. Accordingly 55 associates have successfully completed Omega Credit Skills program and possess a globally accepted credit qualification.<br><br>Developed full day Risk Management Program for Branch Managers which was rolled out across the network |
| Priorities for 2011   |  |
| Implement new Credit and ALM Systems                                    | Implementation of these two essential capacity building initiatives will take place driven by cross functional steering committees supported by training and necessary changes to structure, systems and accountabilities to accommodate the new systems.  |
| Business Intelligence and Analytics tool                                | The internally developed KPI Wizard system which enables business performance to be assessed at branch, regional and Bank level will be further upgraded to a business intelligence and analytics tool with greater depth and drill down capabilities.   |
| Adoption of SLAS 44 and 45 for adoption by June 2011                    | HNB has engaged the assistance of an external consultancy firm to assist in implementation efforts ahead of the regulatory deadline.   |

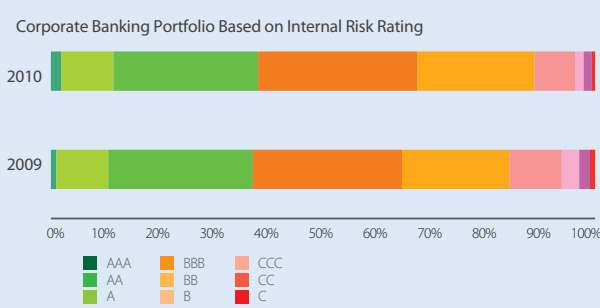
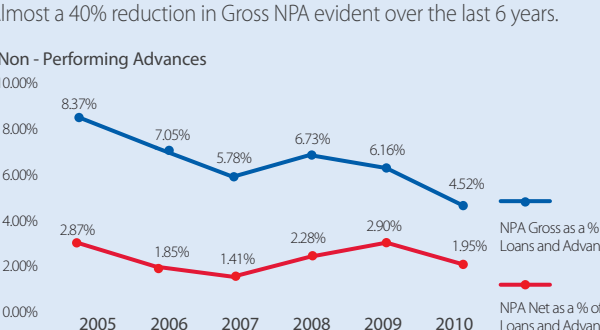
## Our Roadmap Towards BASEL II



KPI : Key Performance Indicator  
EL : Expected Loss  
SME : Small and Medium Enterprises  
CMIS : Credit Management Information System

ALM : Asset and Liability Management System  
PD : Probability of Default  
IRR : Internal Risk Ratings  
RM : Risk Management

## Risk Console

| Risk Category   | Risk Rating              | Mitigating Actions Implemented in 2010  |   |
|---|--------------------------|---|---|
|   |                          | Risk Assessment   | Risk Mitigating Strategies  |
| <b>Credit Risk</b><br><b>Risk of borrower default</b>   | This Year<br>(Last Year) |   |   |
| Effectiveness of Credit Policy<br>Risk arises where Credit Policy amendments do not keep pace with changes in local and global environment          | Low<br>(Moderate)        | Adequacy and Effectiveness of Credit Policies evaluated in Monthly Meetings<br><br>Regular review of Credit Approval Structure based on feedback from Regional Management / Network<br><br>Miscellaneous Reports developed for policy amendments as necessary. e.g. Impact of Basel 3, Industry Risk Reviews, Impact of Sri Lanka external rating upgrade, Recommendations to improve Capital Adequacy Ratio etc. | Credit Policy and Discretionary Lending Limits regularly updated.<br><br>Risk Evaluation of new products prior to launch.<br><br>Performance against internally defined risk appetite reviewed monthly in Credit Risk Dashboards.<br><br>Reports circulated among relevant business segments, Credit Policy Members and Board as necessary. |
| Adequacy of Portfolio monitoring<br>Risk arises where systems and controls are not in place to regularly assess the health of the credit portfolio. | Low<br>(Low)             | Internalised KPI Wizard, a standardized MIS is used to track Risk Performance across business units. This will assist in improving overall management of Credit Risk through greater focus on Key Risk Ratios, improved sharing of best practices through performance benchmarking and improved accountability at all levels.   | Risk Managers independently review Branch / Regional Performance and provide monthly feedback highlighting areas for improvement to line management   |
|   |                          | Independent Regional Credit Reviews to assess effectiveness of monitoring and adherence to internal policies. 1155 client facilities were reviewed as a part of this exercise. In addition 65 corporates were reviewed as part of the Concentration Risk Analysis, below.   | Responses to our observations from business units obtained and followed through to implementation. General control weaknesses were shared across the network.   |
|   |                          | Credit Quality Based on Internal Risk Ratings<br><br>Corporate Banking Portfolio Based on Internal Risk Rating<br><br>  | Focusing on High Risk Accounts (Internally Risk Rated B and below) reviews by Risk Managers<br><br>Quarterly Review of Watch listed accounts to ensure adequate assessment of quality across the network and timely identification of account strategies.   |
|   |                          | Almost a 40% reduction in Gross NPA evident over the last 6 years.<br><br>Non - Performing Advances<br>   | Quarterly review of new additions to Non Performing Advances ("NPA") by action category (i.e. housekeeping issues, legal action, negotiation etc.) for follow up<br><br>Quarterly review of Commodity Price Trends for circulation to network with recommendations  |

| Risk Category  | Risk Rating         | Mitigating Actions Implemented in 2010   |  |
|--|---------------------|--|--|
|  |                     | Risk Assessment  | Risk Mitigating Strategies   |
| <b>Credit Concentration Risk</b><br>Risk arises where Credit Portfolio is not sufficiently diversified | Low (Low)           | <b>Industry Concentration</b><br>Industrywise Exposure<br><p>2010: Agriculture &amp; Fishing (16%), Traders (16%), Manufacturing (12%), Tourism (12%), Transport (6%), Construction (6%), Infrastructure (3%), Other Services (3%), New Economy (3%), Financial and Business Services (1%), Pawning (1%), Credit card (1%), Other (1%).</p> <p>2009: Agriculture &amp; Fishing (18%), Traders (12%), Manufacturing (14%), Tourism (7%), Transport (3%), Construction (3%), Infrastructure (2%), Other Services (2%), New Economy (2%), Financial and Business Services (2%), Pawning (2%), Credit card (2%), Other (2%).</p> | Industry Limits developed / updated for key industries with a view to communicating risk appetite and monitoring actual exposure on a periodic basis.<br><br>Strategies developed to gradually improve penetration of low risk industries and conversely reduce exposure to high risk industries.  |
|  | High (High)         | <b>Geographical Concentration</b><br>Geographical Distribution<br><p>2010: Western (60%), Southern (5%), Uva (4%), North Central (4%), North Western (9%), Eastern (5%), Northern (2%), Sabaragamuwa (5%), Central (3%), Overseas (3%).</p> <p>2009: Western (72%), Southern (4%), Uva (2%), North Central (2%), North Western (4%), Eastern (2%), Northern (2%), Sabaragamuwa (2%), Central (5%), Overseas (4%).</p>  | Largely inevitable, given development efforts have been historically focused in Western Province. With the improvement in infrastructure and recent development efforts in Northeast and South HNB is ideally placed with its extensive, ever expanding branch network to leverage on emerging opportunities thereby reduce the level of concentration in any one geographical area over time. |
|  | Low (Low)           | <b>Exposure by Counterparties</b><br>Exposure by Counterparties<br><p>2010: Corporates &gt; 1 Bn (29%), Corporates 100 Mn - 1 Bn (22%), Corporates 35 Mn - 100 Mn (8%), SME 35 Mn - 10 Mn (9%), Micro finance (4%), Leasing (7%), Housing (9%), Personal Loans (12%), Other (7%).</p> <p>2009: Corporates &gt; 1 Bn (31%), Corporates 100 Mn - 1 Bn (24%), Corporates 35 Mn - 100 Mn (8%), SME 35 Mn - 10 Mn (10%), Micro finance (4%), Leasing (5%), Housing (10%), Personal Loans (10%), Other (10%).</p>  | HNB has a well diversified portfolio comprising Corporate, SME, Retail and Microfinance segments.  |
|  | Moderate (Moderate) | <b>Material Exposures</b><br>Top 20 Exposure as a % of Total Exposure (On Balance Sheet only)<br><p>2010: Top 20 (21%)</p> <p>2009: Top 20 (19%)</p>   | An increase in exposure to Top 20 customers is evident.<br><br>It is relevant to mention that<br>a) Aggregate of 'Material Exposures' (Lending Exposures above 15% of capital base) is well below the regulatory guideline of 500% of Tier 2 capital<br>b) Exposure to Related Parties represents only 20% of Top 20 Exposures and below 5% of the total portfolio                             |

| Risk Category  | Risk Rating         | Mitigating Actions Implemented in 2010  |  |
|--|---------------------|---|--|
|  |                     | Risk Assessment   | Risk Mitigating Strategies   |
| <b>Operational Risk</b><br>Risk of Losses arising from faulty control systems, human negligence, internal and external fraud and acts of god                     |                     |   |  |
| Effectiveness of Operational Risk Policy   | Low (Low)           | Adequacy and effectiveness of Operational Risk Policies regularly assessed at Risk Committee Meetings.  | Updated operational risk policy in line with regulatory developments   |
| Risks arising from a poor Control Environment  | Low (Low)           | A comprehensive Operational Loss database is in place to track losses by incident type and business line per BASEL 2 Guidelines.<br>Total Gross Operational Losses Reported for the Year was Rs 82.18 Mn (Against Rs 222 Mn last year) represents 0.39% of Net Income, and analyzed as follows. | Material Losses regularly analysed by cause and actions taken to improve systems and controls to prevent recurrence in the future.<br>Regular meetings with Regional Management and Support Functions to ensure effectiveness of Operational Risk Meetings across the network and adequate follow up of issues identified for implementation |
|  |                     | <p>Note : No losses were recorded under events 3 &amp; 4.</p>   |  |
| Technology Risk arising from New Core Banking System implementation and consequent risks arising from system breakdowns and disruptions following implementation | Moderate (Moderate) | Access Control reviews and effectiveness of interest and other computations through specialized audit software was conducted by internal audit during the year.   | An automated Performance Monitoring system in place.   |
| Technology Risk of not keeping abreast of latest technology and delivery channels in banking   | Moderate (Moderate) | The emergence of cost efficient alternative delivery channels (ie. Internet, mobile banking) threatens the traditional brick and mortar banking model   | The bank is committed to aggressively penetrate market share in alternative delivery channels and are making the necessary investments in people, structure and systems to ensure competitive advantage.   |
| <b>High Impact Unforeseen Events</b><br>Risk arising from lack of preparedness to Natural Disasters and Terrorism  |                     | Risk Assessment and Contingency Plans are in place across the organization, including. <ul style="list-style-type: none"> <li>- Branch Network</li> <li>- Payments and Settlements</li> <li>- Treasury</li> <li>- Systems</li> </ul>  | These documents were tabled at Board Risk Committee and subject to ongoing review  |



| Risk Category  | Risk Rating         | Mitigating Actions Implemented in 2010   |   |
|--|---------------------|--|---|
|  |                     | Risk Assessment  | Risk Mitigating Strategies  |
| <b>Risk arising from inadequate risk mitigation strategies</b>   | Moderate (Moderate) | Insurance is identified as the key mitigant for operational risk and consequently, a strong interaction between the two departments is in place to ensure adequacy and effectiveness of insurance cover in key areas. Analysis of last 5 years operational losses indicate over 40% are recovered through insurance or other means.  | A culture where Operational risk reviews / challenges effectiveness of Insurance in place.  |
| <b>People Risk</b><br>Risk arising from inability to attract and retain skilled staff at middle to senior management levels          | Moderate (Moderate) | The twin impact of the end of the Northeast conflict and the contagion effects of the Global economic crisis, expected to reflect in a reversal in the brain drain which was a considerable issue in the financial services sector.  | Talent development, Retention of Top performers and Succession Planning for all departments are key focus areas.<br>Performance Related Share Options in place for Management grade Staff and upwards<br>Preference given to Bank staff for overseas job placements within bank |
| <b>Market Risk</b><br>Risks arising from fluctuations in interest rates, foreign exchange positions and prices of equity investments |                     |  |   |
| General appetite for Market Risk based on Treasury activity  | Low (Low)           | Treasury Management Focus is on covering Corporate Banking Positions with minimal trading on own account under the guidance of ALCO and Treasury Committee. Trading Book accounts for just 2% of Banking Book.   | Treasury Policy amended to reflect regulatory developments.   |
| <b>Foreign Exchange Risk</b><br>Risk arising from unhedged foreign exchange positions and poor treasury controls.                    | Low (Low)           | Very little exposure to unhedged positions given internal policy and strengthened supervision by the regulators on minimizing open foreign currency positions  | New Treasury Trading System with new functionalities have been rolled out with new Core Banking System implementation.<br>Monthly tabling of Market Risk Dashboard at ALCO.   |
| <b>Liquidity Risk</b><br>Risk arising from inability to meet maturing deposit liabilities as they fall due.                          | Moderate (Moderate) | Regular review of Asset and Liability Yield Analysis by product monitored at ALCO to ensure optimal Net Interest Margins.<br>Bank maintains a Loans to Deposit ratio of well over 90% and is a net lender in the call money market.<br>As a key remittance player in the country, foreign currency deposits of HNB exceed foreign currency lending by over 100%. Therefore, the reliance on interbank borrowing is low, which is a considerable strength.<br>The absence of a long term yield curve, results in having to borrow short to lend long for both rupee and dollar exposures. | Specific Strategies developed to retain and grow Local and Foreign currency (low cost) deposit base<br>Marketing of longer term Deposit products with a view to bridging the maturity mismatch gap.   |
| Interest Rate Risk arising from Maturity Mismatch  | Moderate (Moderate) | Contractual Maturity Mismatch of Rupee and FCY Earning Assets and Liabilities reviewed and implications identified. The absence of a long term yield curve, results in having to borrow short to lend long for both rupee and dollar exposures.  | Ensuring long-term lending on floating rate basis whilst ensuring regular re-pricing of fixed priced loans<br>The investment in an ALM System as described under Priorities for 2011 above.   |
| <b>Regulatory Risk</b><br>Risks arising from not conforming to statutory and regulatory requirements                                 | Low (Low)           | In a continually changing regulatory environment, the Compliance unit centrally monitors adherence.  | Quarterly checklist confirming adherence to regulatory requirements submitted to Board Audit Committee.<br>A Compliance Policy is in place.   |

| Risk Category  | Risk Rating         | Mitigating Actions Implemented in 2010   |   |          |          |                                       |     |     |                                  |    |     |                               |     |    |                        |     |     |                           |    |     |  |
|--|---------------------|--|---|----------|----------|---------------------------------------|-----|-----|----------------------------------|----|-----|-------------------------------|-----|----|------------------------|-----|-----|---------------------------|----|-----|--|
|  |                     | Risk Assessment  | Risk Mitigating Strategies  |          |          |                                       |     |     |                                  |    |     |                               |     |    |                        |     |     |                           |    |     |  |
| Risk arising from non Compliance with Anti Money Laundering legislation  | Low (Low)           | In today's environment AML Risks are an integral element of bank risks and HNB has played a critical role in spearheading industry efforts in this area. Bank continues to maintain sound relationships with regulators and law enforcement agencies   | The bank has a dedicated AML unit which submits reports to FIU per regulations. The bank's intranet hosts an E-Learning module on AML which has been completed by all branch staff involved in customer centres across the network<br><br>An AML System will be implemented before end 2011, which will significantly improve monitoring and reporting efforts in this area |          |          |                                       |     |     |                                  |    |     |                               |     |    |                        |     |     |                           |    |     |  |
| <b>Legal Risk</b><br>Risk arising from litigation against the bank or faulty legal documentation   | Low (Low)           | HNB runs a full fledged legal department. Specialist legal advice is obtained from external consultants on a need basis.   | No significant court cases awarded against HNB during the year.<br><br>Legal Charter developed supported by an executive committee.   |          |          |                                       |     |     |                                  |    |     |                               |     |    |                        |     |     |                           |    |     |  |
| <b>Reputation Risk</b><br>Risk arising from an event or behaviour that could adversely impact market 'perception' thereby affecting its going concern. |                     |  |   |          |          |                                       |     |     |                                  |    |     |                               |     |    |                        |     |     |                           |    |     |  |
| Risk arising from poor external and internal surveillance to identify strategic risks in a timely manner   | Moderate (Moderate) | Corporate Management meets at least annually at 'offsite' strategy meetings, to develop / review medium term goals and strategic priorities in the context of the environment.   | Specific action plans with accountabilities and timelines developed to address each Strategic goal / Risk area identified.  |          |          |                                       |     |     |                                  |    |     |                               |     |    |                        |     |     |                           |    |     |  |
| Risk to Brand / Reputation arising from lack of / inadequate Corporate Social Responsibility practices   | Low (Low)           | An active Corporate Social Responsibility ("CSR") Committee is in place with cross- functional representation to oversee implementation of CSR Projects<br><br><div style="text-align: center;"> <p>CSR Allocation</p> <table border="1"> <caption>CSR Allocation Data</caption> <thead> <tr> <th>Category</th> <th>2010 (%)</th> <th>2009 (%)</th> </tr> </thead> <tbody> <tr> <td>School Libraries and Computer Centres</td> <td>36%</td> <td>47%</td> </tr> <tr> <td>Safe Drinking Water &amp; Sanitation</td> <td>8%</td> <td>20%</td> </tr> <tr> <td>Assistance to Cancer Patients</td> <td>25%</td> <td>5%</td> </tr> <tr> <td>Climate Change Project</td> <td>23%</td> <td>17%</td> </tr> <tr> <td>Health related assistance</td> <td>8%</td> <td>11%</td> </tr> </tbody> </table> </div> | Category  | 2010 (%) | 2009 (%) | School Libraries and Computer Centres | 36% | 47% | Safe Drinking Water & Sanitation | 8% | 20% | Assistance to Cancer Patients | 25% | 5% | Climate Change Project | 23% | 17% | Health related assistance | 8% | 11% | Key Performance Indicators have been developed to conceptualise goals and assess progress on CSR initiatives |
| Category   | 2010 (%)            | 2009 (%)   |   |          |          |                                       |     |     |                                  |    |     |                               |     |    |                        |     |     |                           |    |     |  |
| School Libraries and Computer Centres  | 36%                 | 47%  |   |          |          |                                       |     |     |                                  |    |     |                               |     |    |                        |     |     |                           |    |     |  |
| Safe Drinking Water & Sanitation   | 8%                  | 20%  |   |          |          |                                       |     |     |                                  |    |     |                               |     |    |                        |     |     |                           |    |     |  |
| Assistance to Cancer Patients  | 25%                 | 5%   |   |          |          |                                       |     |     |                                  |    |     |                               |     |    |                        |     |     |                           |    |     |  |
| Climate Change Project   | 23%                 | 17%  |   |          |          |                                       |     |     |                                  |    |     |                               |     |    |                        |     |     |                           |    |     |  |
| Health related assistance  | 8%                  | 11%  |   |          |          |                                       |     |     |                                  |    |     |                               |     |    |                        |     |     |                           |    |     |  |

# CORPORATE GOVERNANCE

## YOUR BOARD ROOM LEADERSHIP REPORT...

### Chairman's Statement

After recovering from the shellshock of 2008/09, the banking industry started to rebuild the stakeholder trust it had lost in 2010, globally and locally. Your Board of Directors would like to reiterate its appreciation for the support received from you during these difficult times. Certainly the New Year will see more progress being made in this domain, driven by the different regulatory measures that are being initiated. Changes are being proposed and implemented in both domains of Risk and Governance, Financial Reporting and Disclosures and many other topics.

Of late, our counterparts in the United Kingdom have taken many Governance initiatives based on Sir David Walker's Review on the Corporate Governance of Banks and Other Financial Institutions. This prompted the Financial Reporting Council to revise the Combined Code and issue the UK Corporate Governance Code in June 2010. As we go along we will embrace the best practices prescribed in these two pronouncements as part of our framework.

As Chairman, a key part of my role is to ensure that the composition of the Board is appropriate. To this end, the Bank has strengthened the independence on issues of strategy, performance, risks and resources by inclusion of another Independent Non Executive Director, this year as well bringing the total number of Independent Non Executive Directors to five.

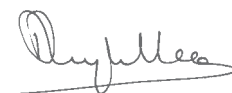
Our goal is to retain an undisputed position as the most respected bank in the country. As part of that effort, we want to set the standard for

Corporate Governance amongst our peers. We are guided by commitment to leadership, corporate responsibility and our dedication to serve and cater to the best interests of our stakeholders.

We report below on how we have embraced and complied in 2010 with the Code of Best Practice on Corporate Governance issued jointly by the Securities and Exchange Commission of Sri Lanka and the Institute of Chartered Accountants of Sri Lanka in 2008 and the Banking Act Direction No 11 of 2007 and subsequent amendments thereto on Corporate Governance for Licensed Commercial Banks in Sri Lanka issued by the Central Bank of Sri Lanka in 2008 effective from 1st January 2008, and requiring full compliance by Licensed Commercial banks by 1st January 2009, except where extended compliance dates have been specifically provided for by the Central Bank of Sri Lanka. As required by the above Code I confirm that, I am not aware of any material violations of any of the provisions of the Code of Business Conduct and Ethics of the Bank.

I hope that this report will assist you to gain a better understanding on how Corporate Governance works at HNB. For Corporate Governance structures to work effectively, shareholders must be active and prudent in the use of their rights. As in the last year I urge you to exercise your rights and provide constructive feedback on our Governance initiatives.

Sincerely Yours,

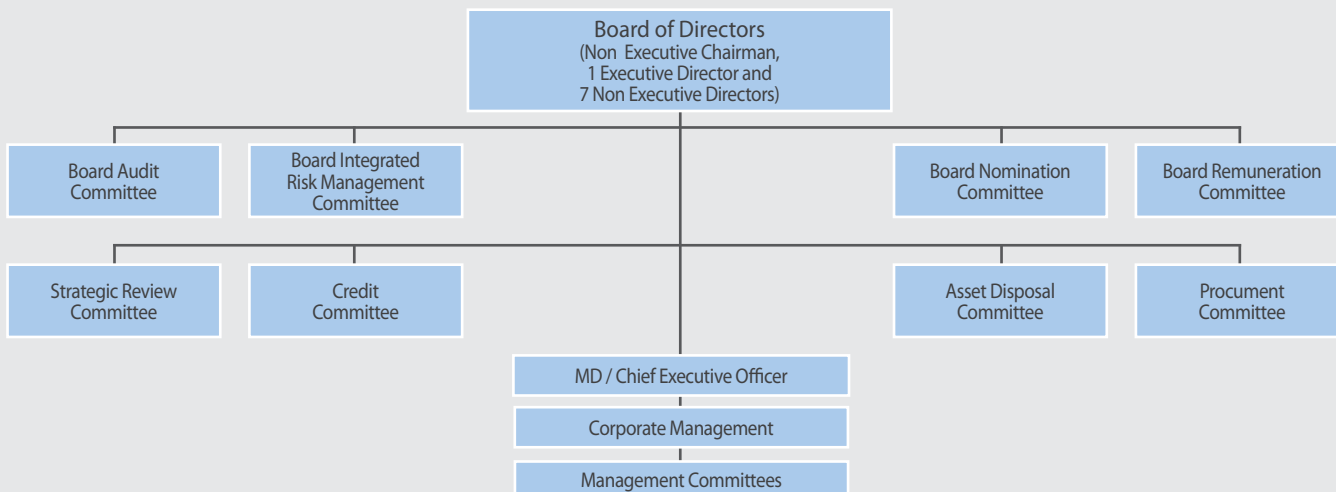


**Rienzie T. Wijetilleke**  
Chairman

Colombo, Sri Lanka  
18th February 2011

### CORPORATE GOVERNANCE FRAMEWORK

Good Corporate Governance practices are not just a matter for the Board but are at the heart of everything that we do within the Bank. The Bank operates within a comprehensive Governance framework, which is outlined in the diagram below and set out in the report that follows



## CORPORATE GOVERNANCE

Corporate Governance is the system of internal controls and procedures by which HNB is managed. It provides a framework that defines the rights, roles and responsibilities of different groups within the Bank, namely - Board, Management and Staff within the Bank, so as to promote the credibility and soundness of the Bank, which will lead to the overall stability of the banking sector in Sri Lanka. The Board is responsible and accountable for the management of the affairs of the Bank, conduct of business and maintenance of prudent risk management and soundness of HNB.

The Board ensures that all shareholders have the same right to participate in the Governance of the Bank and receive fair treatment from the Board and Management, and all rights of shareholders and others are clearly delineated and communicated. The Board's role is to provide entrepreneurial leadership to the Bank within the framework of prudent and effective controls which enables risks to be identified and managed. The Board sets the Bank's strategic aims, ensuring that the necessary financial, human and physical resources are in place for the Bank to meet its objectives. The Board defines the Bank's values and standards and ensures that its obligations to its stakeholders are clearly understood and met. The Board is also responsible for ensuring that management maintains an effective system of internal controls that provides assurance on efficient operations and compliance with applicable laws and regulations. In carrying out this responsibility, the Board gives regard to what is appropriate for HNB's business and reputation, the materiality of financial and other risks inherent in the business and the relative costs and benefits of implementing specific controls. The Board is also the policy-making body for all matters that are of strategic importance to HNB.

**“The Board ensures that all shareholders have the same right to participate in the Governance of the Bank and receive fair treatment from the Board and Management....”**

Corporate Governance is a fundamental part of the culture and business practices of HNB. Our report this year comprises of two sections. This year's report does not include a section on compliance with CSE listing rule on Corporate Governance, as Listed Banks are exempted from complying with the said rule from this year onwards as the Bank is governed by the Corporate Governance Direction of the Monetary Board of the Central Bank of Sri Lanka and makes the required disclosures of the said Direction.

**SECTION ONE** covers Bank's level of adoption of the Code of Best Practice on Corporate Governance issued jointly by the Securities and Exchange Commission of Sri Lanka and the Institute of Chartered Accountants of Sri Lanka.

**SECTION TWO** covers HNB's level of compliance with the Banking Act Direction No 11 of 2007 and subsequent amendments thereto on Corporate Governance for Licensed Commercial Banks in Sri Lanka issued by the Central Bank of Sri Lanka.

## CORPORATE GOVERNANCE - HOW IT WORKED IN 2010

- FEBRUARY** - Further strengthened the Board with the appointment of another Independent Non Executive Director.
- MARCH** - Re-composition of the Board Integrated Risk Management Committee, for more independence.
- MAY** - Revision of the Audit Committee Charter.
- OCTOBER** - Appointed a dedicated three member Board Committee on Strategic Review, majority of who are Independent Non Executive Directors.
- NOVEMBER** - Improvement to the framework of Internal Controls over Financial Reporting.
- DECEMBER** - Appointed a Senior Independent Non Executive Director as recommended in the Banking Act Direction No 11 of 2007.

## SECTION ONE

CODE OF BEST PRACTICE ON CORPORATE GOVERNANCE ISSUED BY THE SECURITIES AND EXCHANGE COMMISSION OF SRI LANKA & THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

### Statement of Compliance

The disclosures below reflect HNB's level of conformance to the above Code which comprises of six fundamental principles. These are namely:

- A. Directors
- B. Directors' Remuneration
- C. Relations with Shareholders
- D. Accountability and Audit
- E. Institutional Investors and
- F. Other Investors

The structures in place and the conformance to the requirement and expectations are tabulated below under the said six fundamental principles.

| Corporate Governance Principles  | SEC & ICASL Code Reference | Adoption Status | HNB's Extent of Adoption in 2010  |
|--|----------------------------|-----------------|---|
| <b>A. DIRECTORS</b>  |                            |                 |   |
| <b>A.1. The Board</b>  |                            |                 |   |
| The Code requires that the company should be headed by a Board, which should direct, lead and control the company. HNB's Board consists of professionals in Banking, Accounting, Management, Law, Economics and Business Leaders. They possess the skills and experience and knowledge to set the directions and oversee the operations of the Bank. The Board reflects sound balance of independence and anchor shareholder commitment. |                            |                 |   |
| 1. Meetings  | A. 1.1                     | Adopted         | The Board met 14 times during the year, at approximately monthly intervals. Strategy is reviewed regularly at these meetings with updates at each meeting on execution of the agreed strategy. Scheduled Board and Committee meetings are arranged well in advance and all Directors are expected to attend each meeting. Any instances of non-attendance at Board meetings are generally related to prior business or personal commitments or illness. The attendance at Board meetings held in 2010 is set out on page 74.  |
| 2. Board responsibilities  | A. 1.2                     | Adopted         | The Board is responsible to the shareholders for creating and delivering sustainable shareholder value through the management of business. The Directors act in a way that promotes the long term success of the Bank for the benefit of the shareholders. The Board is also responsible for determining the nature and extent of the significant risks it is willing to take in achieving its strategic objectives. The Board is collectively responsible for the success of the Bank. The MD / CEO is directly responsible for business operations and supported by the Corporate Management of the Bank. The Non Executive Directors are responsible for bringing independent judgment and scrutiny to decisions taken by the Board. The Non Executive Directors must satisfy themselves on the integrity of financial information and that financial controls and systems of risk management are robust. Through the above process the Board ensures that the integrity of financial information, financial controls and systems of risk management are robust and the Bank complies with all applicable laws, regulations and ethical standards. |
| 3. Compliance with laws and access to independent professional advice  | A. 1.3                     | Adopted         | The Directors are mindful of their duties as set out in the laws and regulations affecting the Bank. The procedure for Directors to seek independent professional advice, in furtherance of their duties, at HNB's expense, is coordinated through the Board Secretary, as and when it's necessary.   |
| 4. Board Secretary   | A.1.4                      | Adopted         | All Directors have access to the Board Secretary, who is an Attorney-at-Law by profession. Her services are available to all Directors, particularly the Non Executive Directors who may need additional support to ensure they receive timely and accurate information to fulfill their duties. Directors may also take independent professional advice on request at the Bank's expense.  |
| 5. Independent judgment  | A. 1.5                     | Adopted         | Non Executive Directors are responsible for bringing independent judgment and scrutinising the decisions taken by the Board on issues of strategy, performance, resources and business conduct. The Board promotes an environment whereby challenging contribution from the Non Executive Directors is welcomed and encouraged, combined with full support for and empowerment of the MD / CEO in implementing decisions.   |

| Corporate Governance Principles   | SEC & ICASL Code Reference | Adoption Status | HNB's Extent of Adoption in 2010   |
|---|----------------------------|-----------------|--|
| 6. Dedication of adequate time and effort by the Board and Board Committees   | A. 1.6                     | Adopted         | <p>The Chairman and members of the Board dedicate adequate time for the fulfillment of their duties as Directors of the Bank. In addition to attending Board meetings, they attend Sub-committee meetings and also make decisions via circular resolution.</p> <p>The Board Sub-committees include:</p> <ul style="list-style-type: none"> <li>- Audit Committee</li> <li>- Integrated Risk Management Committee</li> <li>- Human Resources / Remuneration Committee</li> <li>- Nomination Committee</li> <li>- Credit Committee</li> <li>- Procurement Committee</li> <li>- Asset Disposal Committee</li> <li>- Strategic Review Committee</li> </ul>   |
| 7. Training for new Directors   | A. 1.7                     | Adopted         | <p>Directors recognize the need for continuous training and expansion of knowledge and undertake such professional development as they consider necessary in assisting them to carry out their duties as Directors. Presentations are made to the Board by the Corporate Management of HNB from time to time on industry related matters. Ms M A R C Cooray, the new Director appointed was provided with training on the general Director's responsibilities and specific banking related concerns.</p> <p>The entire Board attended the Annual Bank Directors' Symposium conducted by CBSL in December 2010.</p>   |
| <b>A.2. Chairman and Chief Executive Officer</b>  |                            |                 |  |
| <p>The Code requires a clear division of responsibilities between the Chairman and Chief Executive to ensure a balance of power and authority, in such a way that any individual has no unfettered powers of decisions. The roles of the Chairman and Chief Executive Officer are functioning separately at HNB. The Chairman's main responsibility is to lead and manage the work of the Board to ensure that it operates effectively and fully discharges its legal and regulatory responsibilities. MD / CEO is responsible for the day-to-day operations of the Bank.</p> |                            |                 |  |
| 8. Division of responsibilities of the Chairman and MD / CEO  | A. 2.1                     | Adopted         | <p>The roles of the Chairman and Chief Executive are separate. The role of the Chief Executive is to manage the day-to-day running of the Bank. The Board has delegated this responsibility to the Chief Executive and he then leads the Corporate Management team in making and executing operational decisions. The Chief Executive is also responsible for recommending strategy to the Board.</p>  |
| <b>A.3. Chairman's Role</b>   |                            |                 |  |
| <p>The Code requires the Chairman to lead and manage the Board, ensuring that it discharges its legal and regulatory responsibilities effectively and fully and preserves order and facilitates the effective discharge of the Board function.</p>  |                            |                 |  |
| 9. Role of the Chairman   | A. 3.1                     | Adopted         | <p>The Chairman is responsible for leadership of the Board and ensuring its effectiveness of all aspects of its role. The Chairman of HNB is a Non Executive Director, elected by the Board. The Chairman's role encompasses:</p> <ul style="list-style-type: none"> <li>- Ensuring that Board members undertake appropriate induction, covering terms of appointment, duties and responsibilities.</li> <li>- Facilitates and encourages discussions amongst all Directors where decisions are needed on matters of risk and strategy.</li> <li>- Representing the views of the Board to the public.</li> <li>- Ensuring regular meetings, the minutes of which are accurately recorded and where appropriate included the individual and collective views of the Directors.</li> <li>- Encouraging effective participation of all Directors in the decision making process to optimize contribution.</li> <li>- Approving the agenda prepared by the Board Secretary; and conducting Board meetings.</li> <li>- Initiates the process for self assessment of the Board from its members and uses the meaningful feedback to further improve the effectiveness of the Board.</li> </ul> |



| Corporate Governance Principles   | SEC & ICASL Code Reference | Adoption Status | HNB's Extent of Adoption in 2010   |
|---|----------------------------|-----------------|--|
| <b>A.4. Financial Acumen</b>  |                            |                 |  |
| The Code requires the Board to ensure the availability within it of sufficient financial acumen and knowledge to offer guidance on matters of finance. The Board is equipped with sufficient financial acumen as three out of nine of the Board members have appropriate financial background and hold fellow membership of their respective professional accountancy bodies. |                            |                 |  |
| 10. Availability of sufficient financial acumen and knowledge   | A. 4                       | Adopted         | The MD / CEO is a fellow member of the Institute of Chartered Accountants of Sri Lanka, a fellow member of the Chartered Institute of Management Accountants – UK and is an appointed member of the Sri Lanka Accounting and Auditing Standards Monitoring Board. In addition, the Board includes a fellow member of the Chartered Institute of Management Accountants – UK, and a Director who is a fellow member of the Institute of Chartered Accountants of Sri Lanka & also a fellow member of the Institute of Chartered Accountants in England and Wales. These members of the Board have the ability to offer guidance on matters of finance to the Board. |
| <b>A.5 Board Balance</b>  |                            |                 |  |
| The Code recommends having a balance of Executive and Non Executive Directors so that no individual or small group of individuals can dominate the Board's decision-making.   |                            |                 |  |
| 11. Presence of Non Executive Directors   | A. 5.1                     | Adopted         | Eight of the nine Directors of the Board are Non Executives. The MD / CEO is the sole Executive Director.  |
| 12. Independent Directors   | A. 5.2                     | Adopted         | Four out of the eight Non Executive Directors are independent as defined by the Code.  |
| 13. Independence Evaluation Review  | A. 5.3                     | Adopted         | The Board considers Non Executive Director's independence on an annual basis, as part of each Director's performance evaluation. The Board reviewed the independence of each Non Executive Director in 2010 and concluded that each of them continues to demonstrate these essential behaviors.  |
| 14. Signed declaration of independence By the Non Executive Directors   | A. 5.4                     | Adopted         | All Non Executive Directors of the Bank have made written submissions as to their independence against the specified criteria set out by the Bank, which is in line with the requirements of Schedule H of this Code.  |
| 15. Determination of independence of the Directors by the Board   | A. 5.5                     | Adopted         | The Board has determined that the submission of declaration by the Non Executive Directors, as to the independence of them, as a fair representation and will continue to evaluate their submission annually. Circumstances have not arisen for the determination of independence by the Board, beyond the criteria set out in the Code. The following Directors are deemed to be Independent Directors;<br>Ms Pamela C. Cooray<br>Mr Ranjeevan Seevaratnam<br>Mr N G Wickremeratne<br>Ms M A R C. Cooray  |
| 16. Senior Independent Director   | A. 5.6                     | N/A             | The requirement to appoint a Senior Independent Director does not arise as the roles of Chairman and CEO are separated.  |
| 17. Confidential discussion with the Senior Independent Director  | A. 5.7                     | N/A             | Please refer above comment.  |
| 18. Meeting of Non Executive Directors  | A. 5.8                     | Adopted         | Chairman meets with the Non Executive Directors without the presence of MD / CEO, on a need basis.   |
| 19. Recording of concerns in Board Minutes  | A. 5.9                     | N/A             | There were no concerns raised by the Directors during the year, which needed to be recorded in the Board Meeting Minutes.  |
| <b>A.6. Supply of Information</b>   |                            |                 |  |
| Management is required to provide time bound information in a form and of quality appropriate to enable the Board to discharge its duties. Financial and non financial information are analyzed and presented in a form for the Board to make informed and accurate decisions.  |                            |                 |  |
| 20. Information to the Board by the Management  | A. 6.1                     | Adopted         | The Board was provided with timely and appropriate information by the management by way of Board papers and proposals. The Board sought additional information as and when necessary. Members of the Corporate Management made presentation on issues of importance. The Chairman ensured that all Directors were briefed on issues arising at Board meetings.   |

| Corporate Governance Principles  | SEC & ICASL Code Reference | Adoption Status | HNB's Extent of Adoption in 2010  |
|--|----------------------------|-----------------|---|
| 21. Adequate time for effective Board meetings   | A. 6.2                     | Adopted         | The Board papers were sent to the Directors at least a week before the respective Board meetings, giving adequate time for Directors to study the related papers and prepare for a meaningful discussion at the meeting.  |
| <b>A.7. Appointments to the Board</b>  |                            |                 |   |
| The Board is required by the Code to adopt a formal and transparent procedure for the appointment of new Directors to the Board. During the year an additional Independent Non Executive Director was appointed to the Board.                        |                            |                 |   |
| 22. Nomination Committee   | A. 7.1                     | Adopted         | The Nomination Committee makes recommendations to the Board on all new appointments. The terms of reference for the members of the Nomination Committee are similar to the one set out in Schedule A to this code. Nomination Committee of HNB is comprised of the following four Directors. MD / CEO attends these meetings by invitation.<br>Mr Rienzie T. Wijetilleke – Non Executive Chairman<br>Mr D H S Jayawardena – Non Executive Director<br>Mr M V Theagarajah – Non Executive Director<br>Mr R K Obeyesekere – Non Executive Director  |
| 23. Assessment of Board Composition by the Nomination Committee  | A. 7.2                     | Adopted         | The Nomination Committee carried out continuous review of the composition of the Board, which includes identifying, evaluating and recommending candidates for suitable positions to ensure succession planning within HNB for the approval of the Board. More than 1/3rd of the existing Board comprises of Independent, Non Executive members. New appointments are made to strengthened the Board composition to respond to the challenges and take advantage of the opportunities in the Banking sector.  |
| 24. Disclosure of details of new Directors to shareholders   | A. 7.3                     | Adopted         | Details of new Directors are disclosed to the shareholders on their appointment by way of public announcements as well as in the Annual report. Prior notice on appointment of new Directors is given to the Director of Bank Supervision of CBSL as well as to the Colombo Stock Exchange. All new appointments as well as continuing Directorships are reviewed by the Nomination Committee. The Directors are required to report any substantial change in their professional responsibilities and business associations to the Nomination Committee, which will examine the facts and circumstances and make recommendations to the Board.  |
| <b>A.8. Re- election</b>   |                            |                 |   |
| The Code requires all Directors to submit themselves for re-election at regular intervals and at least once in every three years. It also requires that all Non Executive Directors to be appointed for a specific terms and subject to re-election. |                            |                 |   |
| 25. Appointment of Non Executive Directors   | A. 8.1                     | Adopted         | Articles of Association of the Bank requires, each Director other than the MD / CEO and any nominee Director, to retire by rotation once in every three years and is required to stand for re-election by the shareholders at the Annual General Meeting. The proposed re-election of Directors is subject to prior review by the full Board.<br><br>Mr R K Obeyesekere, Ms Pamela C. Cooray and Mr Ranjeevan Seevaratnam retire by rotation at the AGM under the Articles of Association of the Bank. Mr R K Obeyesekere and Ms Pamela C. Cooray offer themselves for re-election, with the unanimous support of the Board. Mr Ranjeevan Seevaratnam has informed the Board that he would not offer himself for re-election.<br><br>Mr Rienzie T. Wijetilleke and Mr M V Theagarajah – Directors having attained the age of 70 years retire at the AGM under the provision of the Companies Act. The Directors have declared that they would not be offering themselves for re-appointment at the AGM. |
| 26. Election of Directors by the shareholders  | A. 8.2                     | Adopted         | Please refer comments above.  |
| <b>A.9. Appraisal of Board Performance</b>   |                            |                 |   |
| The Board is required by the Code to periodically appraise its own performance against the pre set targets in order to ensure that the Board responsibilities are satisfactorily discharged.   |                            |                 |   |
| 27. Appraisal of Board performance   | A. 9.1                     | Adopted         | The performance of the Board is evaluated by the Chairman. The Sub committees, except for the Audit Committee, carry out a self assessment process annually, in accordance with the preset criteria, to ensure they function effectively and efficiently with the objective of facilitating continuous improvement in conformance and performance related areas. The Audit Committee evaluation is conducted by the Non Executive Chairman, with the assessments from the Committee members, CEO, SDGM - Strategy and Compliance, CFO, the Head of Internal Audit and the External Auditor in accordance with International best practices.   |

| Corporate Governance Principles  | SEC & ICASL Code Reference | Adoption Status    | HNB's Extent of Adoption in 2010   |
|--|----------------------------|--------------------|--|
| 28. Annual self evaluation of the Board and its Committees   | A 9.2                      | Adopted            | Refer comments given for Section A. 9.1 on page 64.  |
| 29. Disclosure of the Appraisal of Board and Board Sub Committee performance   | A 9.3                      | Adopted            | Refer comments given for Section A. 9.1 on page 64.  |
| <b>A.10. Disclosure of Information in respect of Directors.</b>  |                            |                    |  |
| The Code requires that the details in respect of each Director to be disclosed in the annual report for the benefit of the shareholders.   |                            |                    |  |
| 30. Details in respect of Directors  | A. 10.1                    | Adopted            | Details of the Directors are given on pages 14 and 15 Directors attendance of Board and Board Sub Committee meetings are given on pages 74 and 75.   |
| <b>A.11. Appraisal of the CEO</b>  |                            |                    |  |
| The Board of Directors is required, to evaluate annually to, assess the performance of the Chief Executive Officer.  |                            |                    |  |
| 31. Targets for MD / CEO   | A.11.1                     | Adopted            | MD / CEO's performance scheme is aligned with business sustainability of the Bank. The performance targets for the MD / CEO are set at the commencement of every year by the full Board which are in line with the short, medium and long term objectives of the Bank.   |
| 32. Evaluation of the performance of the MD / CEO  | A.11.2                     | Adopted            | There is an ongoing process to evaluate the performance of MD / CEO against the financial and non financial targets set as described above, which is followed by a formal annual review by the Board at the end of each financial year.  |
| <b>B. DIRECTORS' REMUNERATION</b>  |                            |                    |  |
| <b>B.1. Remuneration Procedures</b>  |                            |                    |  |
| The Code requires companies to have a formal and transparent procedure for developing policy on executive remuneration and fixing the remuneration packages of individual Directors and also recommends that no Director should be involved in deciding his / her remuneration in order to avoid the self review threat. |                            |                    |  |
| 33. Remuneration / Human Resources Committee   | B. 1.1                     | Adopted            | The Remuneration Committee is responsible for assisting the Board with regard to the remuneration policy for the Executive Director and the Corporate Management, and for making all relevant disclosures.<br><br>The Committee determines and agrees with the Board, the broad policy framework for the remuneration of the MD / CEO. The MD / CEO participates in meetings by invitation in deciding the remuneration of the Corporate Management in order to recruit, retain and motivate the Corporate Management team.  |
| 34. Composition of the Remuneration Committee  | B. 1.2<br>B. 1.3           | Adopted<br>Adopted | The Remuneration Committee comprises of the following four Non Executive Directors<br>Ms Pamela C. Cooray – Independent Non Executive Chairperson<br>Mr Rienzie T. Wijetilleke – Non Executive Director<br>Mr R K Obeyesekere - Non Executive Director<br>Mr N G Wickremeratne- Independent Non Executive Director   |
| 35. Remuneration of the Non Executive Directors  | B. 1.4                     | Adopted            | The Board as a whole decides the remuneration of the Non Executive Directors.<br><br>The Non Executive Directors receive a fee for being a Director of the Board and additional fee for either chairing or being a member of a Committee, working on special Committees and / or serving on Subsidiary Boards. They do not receive any performance related / incentive payments.   |
| 36. Consultation of the Chairman and access to professional advice   | B. 1.5                     | Adopted            | Input of the Chairman is obtained by his involvement as a member of the said Sub committee. External professional advice is sought by the Remuneration Committee, on a need basis through the Board Secretary.   |
| <b>B.2. Level and make up of Remuneration</b>  |                            |                    |  |
| The Code recommends that the level of remunerations of both Executive and Non Executive Directors to be sufficient to attract and retain the Directors needed to run the company successfully.   |                            |                    |  |
| 37. Level and makeup of the remuneration of MD / CEO   | B. 2.1                     | Adopted            | The Board is mindful of the fact that the remuneration of Executive and the Non Executive Directors should reflect the expectation of the Bank and sufficient enough to attract and retain the quality of Directors needed to run the Bank. The remuneration package of the MD / CEO is structured to link rewards to corporate and individual performance.<br><br>The Bank's remuneration framework for CEO is designed to create and enhance value for all HNB's stakeholders and to ensure there is strong alignment between the short term and long term interest of the Bank. |

| Corporate Governance Principles                                  | SEC & ICASL Code Reference | Adoption Status | HNB's Extent of Adoption in 2010   |
|--|----------------------------|-----------------|--|
| 38. Comparison of remuneration with other companies              | B. 2.2                     | Adopted         | The Remuneration Committee in deciding the remuneration of the Directors (including the compensation package of the MD / CEO) takes into consideration the level of remuneration paid by the other comparable companies, performance and risk factors.             |
| 39. Comparison of Remuneration with other companies in the Group | B. 2.3                     | N/A             | The size and scale of the Bank is not comparable with any other Group companies.   |
| 40. Performance related payment to MD / CEO                      | B. 2.4                     | Adopted         | Please refer section B. 1.5 on page 65.  |
| 41. Executive share options                                      | B. 2.5                     | Adopted         | Share options offered to the Executive Director is not on a discounted basis. The details of which are given in Note 48 of the financial statements on pages 224 and 225.  |
| 42. Deciding the Executive Directors remuneration                | B. 2.6                     | Adopted         | In deciding the remuneration of the MD / CEO the Bank took note of the provisions set out in Schedule D.   |
| 43. Early termination of Directors                               | B. 2.7                     | N/A             | Not applicable to the Board except for the MD / CEO who is an employee of the Bank, and his terms of employment is governed by the contract of service.  |
| 44. Early termination not included in the initial contract       | B. 2.8                     | N/A             | Refer comments above.  |
| 45. Remuneration of the Non executive Directors                  | B. 2.9                     | Adopted         | Non Executive Directors receive a nominal fee in line with the market practices as disclosed in this Annual Report. Non Executive Directors do not participate in the current share option plans of the Bank and / or other performance related incentive schemes. |

### B.3. Disclosure of Remuneration

The Code requires every company to disclose the remuneration policy and the details of remuneration of the Board as a whole.

|                                |        |         |  |
|--------------------------------|--------|---------|--|
| 46. Disclosure of remuneration | B. 3.1 | Adopted | Please refer section B 1.2 on page 65 for the details of the Committee. Remuneration Committee's report setting out the policy of the Committee is given on page 150.<br>The Compensation paid to the Board of Directors is disclosed in aggregate in note no 15 to the Financial Statements on page 180 of the Annual Report. |
|--------------------------------|--------|---------|--|

## C. RELATIONS WITH SHAREHOLDERS

### C.1 Constructive use of the Annual General Meeting and Conduct of General Meetings.

The Code requires the Board to use the Annual General Meetings to communicate with shareholders and encourage their active participation.

|  |        |         |  |
|--|--------|---------|--|
| 47. Use of proxy votes                               | C. 1.1 | Adopted | The Bank has a mechanism to record all proxy votes and proxy votes lodged on each resolution.  |
| 48. Separate resolution for all separate issues      | C. 1.2 | Adopted | The Board, remains mindful of being accountable to the shareholders and the need for transparency at all levels, striving to maintain it's value framework in all shareholder dealings and communications.<br>HNB proposes a separate resolution for each item of business, giving shareholders the opportunity to vote on each such issue, separately.  |
| 49. Availability of all Board Sub Committee Chairmen | C. 1.3 | Adopted | The Board, which includes the Chairmen of the Audit, Remuneration, Nomination and Integrated Risk Management Committees, is present at the AGM to answer any questions.  |
| 50. Adequate notice of the AGM                       | C. 1.4 | Adopted | The primary modes of communication between HNB and the shareholders are the Annual Report and AGM. Information is provided to the shareholders prior to the AGM to give them an opportunity to exercise the prerogative to raise any issues relating to the business of HNB, either verbally or in writing prior to the AGM.<br>All shareholders irrespective of their voting status are encouraged to attend the AGM.<br>The Annual Report including financial statements and the notice of the meeting are sent to shareholders at least 15 working days prior to the date of the AGM. |
| 51. Procedures of voting at General Meetings         | C. 1.5 | Adopted | Voting procedures at General Meetings are circulated to the shareholders.  |

| Corporate Governance Principles   | SEC & ICASL Code Reference | Adoption Status | HNB's Extent of Adoption in 2010   |
|---|----------------------------|-----------------|--|
| <b>C.2. Major transactions</b>  |                            |                 |  |
| Directors are required to disclose to shareholders all proposed material transactions which would materially alter the net asset position of the Bank, if entered into. |                            |                 |  |
| 52. Major transactions  | C. 2.1                     | Adopted         | During 2010 there were no major transactions as defined by Section 185 of the Companies Act No 07 of 2007 which materially affected HNB's net asset base.<br>Transactions, if any, which materially affect the net assets base of HNB, will be disclosed in the quarterly / annual financial statements.   |
| <b>D. ACCOUNTABILITY AND AUDIT</b>  |                            |                 |  |
| <b>D.1. Financial Reporting</b>   |                            |                 |  |
| The Board is required to present a balanced and understandable assessment of the Bank's financial position, performance and prospects.                                  |                            |                 |  |
| 53. Statutory and Regulatory reporting  | D 1.1                      | Adopted         | HNB has reported a true and fair view of its position and performance for the year ended 31st December and at the end of each quarter of 2010.<br>In the preparation of quarterly and annual financial statements, HNB had strictly complied with the requirements of the Companies Act No 07 of 2007, the Banking Act No. 30 of 1988 and amendments thereto, and are prepared and presented in conformity with Sri Lanka Accounting Standards. HNB has complied with the reporting requirements prescribed by the regulatory authorities such as the Central Bank of Sri Lanka and Colombo Stock Exchange.<br>As HNB's Global Depository Receipts (GDRs) are listed in the Luxemburg Stock Exchange, HNB has also complied with all the reporting requirements of the Luxemburg Stock Exchange. |
| 54. Directors' report in the Annual Report  | D 1.2                      | Adopted         | The Directors' report given on pages 140 to 145 of the annual report covers all areas of this section.   |
| 55. Statement of Directors' and Auditor's responsibility for the Financial Statements   | D 1.3                      | Adopted         | The statement of Directors' responsibility for financial reporting is given on page 156 of the Annual Report.<br>Auditor's reporting responsibility is given in their report on the Financial Statements given on page 157.  |
| 56. Management Discussions and Analysis   | D 1.4                      | Adopted         | The Management Discussion and Analysis is given on pages 22 to 45 of the Annual Report.  |
| 57. Declaration by the Board that the business as a going concern   | D 1.5                      | Adopted         | This is given in the Directors' report on pages 140 to 145 of the Annual Report.   |
| 58. Summoning an EGM to notify serious loss of capital  | D 1.6                      | Adopted         | Likelihood of such occurrence is remote. However, should the situation arise, an EGM will be called for and shareholders will be notified.   |
| <b>D.2. Internal Control</b>  |                            |                 |  |
| The Code requires the Board to have a sound system of internal controls to safeguard shareholders' investments and the company's assets.                                |                            |                 |  |
| 59. Annual evaluation of the internal controls system   | D 2.1                      | Adopted         | The Board is responsible for establishing a sound framework of internal controls and monitoring its effectiveness on a continuous basis. Through such an effective framework, HNB manages business risks and ensures that the financial information on which business decisions are made and published is reliable.<br>The system of internal controls is evaluated by the Audit Committee. In the year 2010, the Board of Directors was satisfied with the effectiveness of the system of internal controls, which is evidenced through the report by the Board of Directors on the Internal Control over Financial Reporting given on page 76 .  |
| 60. Need for internal audit function  | D 2.2                      | Adopted         | The Bank's internal audit function is managed by capacity which has been developed in house.   |

| Corporate Governance Principles  | SEC & ICASL Code Reference | Adoption Status | HNB's Extent of Adoption in 2010  |
|--|----------------------------|-----------------|---|
| <b>D.3. Audit Committee</b>  |                            |                 |   |
| The Code requires the Board to have a formal and transparent arrangements in selecting and applying the accounting policies, financial reporting and internal control principles and maintaining an appropriate relationship with the Bank's External Auditor. |                            |                 |   |
| 61. Composition and terms and conditions of the Audit Committee  | D. 3.1                     | Adopted         | The Audit Committee of HNB is comprised of four Non Executive Directors, three of them are independent including the Chairman of the Committee. The said committee met 5 times during the year. The Board Secretary functions as the Secretary to the Audit Committee. The CEO, SDGM-Strategy & Compliance, DGM Risk, Head of Internal Audit, CFO and External Auditor attend meetings on invitation.   |
| 62. Duties of the Audit Committee  | D. 3.2                     | Adopted         | The Audit Committee monitors and reviews the External Auditor's independence, objectivity and the effectiveness of the audit process taking into account relevant professional and regulatory requirements. The Committee also sets out the policy for the engagement of the External Auditor to provide non-audit services, taking into account relevant regulations with regard to the provision of non-audit services and the guidelines issued by the Central Bank of Sri Lanka on "Prohibited Services". The Audit Committee has the primary responsibility for making recommendations on the appointment, re-appointment or removal of the External Auditor in-line with professional standards and regulatory requirements.  |
| 63. Terms of reference of the Audit Committee  | D. 3.3                     | Adopted         | The Audit Committee is guided by the Committee Charter which sets out authority and responsibility of the said Committee. The Charter was reviewed in the current year, as part of the continuing evaluation of the terms of reference of the Audit Committee. The Audit Committee monitors and reviews the effectiveness of HNB's Internal Audit function. The Head of Internal Audit reports to the Audit Committee. The Audit Committee reviews and approves the Internal Audit plan and resource requirements. It ensures that the Internal Audit plan adequately covers the significant risks of the Bank, reviews the important Internal Audit findings and follow-up procedures.<br>Duties of the committee also encompasses:<br>- Assisting the Board in the preparation and presentation of Financial Statements<br>- Bank's compliance with applicable regulations<br>- Assess the processes to ensure internal controls are adequate, specially in relation to financial reporting<br>- Assess the Bank's ability to continue as a going concern<br>The Board also considered the Code of Best Practice on Audit Committees of the ICASL in defining the terms of reference for the Audit Committee. |
| 64. Disclosures of the Audit Committee   | D. 3.4                     | Adopted         | The names of the members of the Audit Committee are given on the Audit Committee Report on page 153.<br>The Committee ensures that the rotation of External Audit Engagement Partner, once in every 5 years, is met.<br>The External Auditor has provided an Independence confirmation in compliance with the "Guidelines for Appointment of Auditors of Listed Companies" issued by SEC.   |
| <b>D.4. Code of business conduct &amp; ethics</b>  |                            |                 |   |
| The Code requires the Bank to develop a code of business conduct & ethics for Directors and members of the Corporate Management team.  |                            |                 |   |
| 65. Code of business conduct and ethics  | D. 4.1                     | Adopted         | The Bank has developed a code of business conduct and ethics for all employees, which addresses conflict of interest, corporate opportunities, confidentiality of information, fair dealing, protecting and proper use of the Bank's assets, compliance with applicable laws and regulations and encouraging the reporting of any illegal or unethical behavior etc.  |
| 66. Affirmation of the code of conduct & ethics  | D. 4.2                     | Adopted         | Please refer the Chairman's Statement on page 59 for details.   |
| <b>D. 5. Corporate Governance Disclosures</b>  |                            |                 |   |
| The Code requires the Bank to disclose the extent of adoption of best practice in Corporate Governance.  |                            |                 |   |
| 67. Disclosure of Corporate Governance   | D. 5.1                     | Adopted         | This report addresses this requirement.   |

| Corporate Governance Principles  | SEC & ICASL Code Reference | Adoption Status | HNB's Extent of Adoption in 2010   |
|--|----------------------------|-----------------|--|
| <b>E. INSTITUTIONAL INVESTORS</b>  |                            |                 |  |
| <b>E.1. Shareholders voting</b>  |                            |                 |  |
| Institutional shareholders are required to make considered use of their votes and encouraged to ensure their voting intentions are translated into practice. |                            |                 |  |
| 68. Institutional shareholders   | E. 1.1                     | Adopted         | Annual General Meeting is used to have an effective dialogue with the shareholders on matters which are relevant and concern to the general membership. The Investor Relations team headed by the MD/CEO has regular discussions with key institutional shareholders to share highlights of the Bank's performance and also with the view of obtaining constructive feed back. |
| <b>E.2. Evaluation of Corporate Governance initiatives</b>   |                            |                 |  |
| Institutional investors are encouraged to give due weight to all relevant factors in Board structure and composition.  |                            |                 |  |
| <b>F. OTHER INVESTORS</b>  |                            |                 |  |
| <b>F.1. Investing / Divesting decision</b>   |                            |                 |  |
| 69. Individual Shareholders  | F. 1                       | Adopted         | Individual shareholders are encouraged to carry out adequate analysis or seek independent advice on investing, holding or divesting decisions.   |
| <b>F.2 Shareholder Voting</b>  |                            |                 |  |
| 70. Individual shareholders voting   | F. 2                       | Adopted         | Individual shareholders are encouraged to participate in General Meetings and exercise their voting rights.  |



## SECTION TWO

### Statement of Compliance

Central Bank of Sri Lanka issued the Direction on Corporate Governance (Banking Act Direction No 11 of 2007 and subsequent amendments thereto), in order to improve and sustain the Corporate Governance processes and practices of the Licensed Commercial Banks in Sri Lanka. The disclosures below reflect HNB's level of conformance to the above Direction which comprises of eight fundamental principles, namely:

- 1 The responsibilities of the Board
- 2 The Board's composition
- 3 Criteria to assess the fitness and propriety of Directors
- 4 Management functions delegated by the Board
- 5 The Chairman and Chief Executive Officer
- 6 Board appointed Committees
- 7 Related Party Transactions and
- 8 Disclosures

The structures in place and the conformance to the requirement and expectations are tabulated below under the said eight fundamental principles.

| Corporate Governance Principles                          | CBSL Rule Reference               | Compliance status      | Level of Compliance in 2010   |
|--|-----------------------------------|------------------------|---|
| <b>3 (1) The responsibilities of the Board</b>           |                                   |                        |   |
| 1. Strengthening the safety and soundness of the Bank    | Rule 3(1)(i)                      | Compliant              | The Board is responsible for formulating strategy, ensuring the adequacy of the risk management processes, review of the internal control system and defining the responsibility of the Corporate Management. Please refer section A.1.2 of the SEC & ICASL Code table on page 61 for further details.<br>The Board is in the process of finalizing the formal documentation of the Board Charter which is to be approved by the Board in 2011.   |
| 2. Chairman and CEO                                      | Rule 3 (1)(ii)                    | Compliant              | The Board has appointed the Chairman and the Chief Executive and the roles of the Chairman and the Chief Executive are separate. Please refer Rule 3(5) on page 71 for the respective responsibilities of the Chairman and Chief Executive.   |
| 3. Board Meetings  | Rule 3 (1)(iii)                   | Compliant              | Please refer section A.1.1 of the SEC & ICASL Code table on page 61 for further details.  |
| 4. Inclusion of proposals by all Directors in the agenda | Rule 3 (1)(iv)                    | Compliant              | Proposals from all Directors on promotion of business and management of risk and other areas relevant to the progress of the Bank are included in the agenda for regular meetings   |
| 5. Notice of Meetings                                    | Rule 3 (1)(v)                     | Compliant              | Directors are given adequate time and at least 7 days of notice for regular Board meetings. For all other meetings a reasonable notice period is given.   |
| 6. Non attendance of Directors                           | Rule 3 (1)(vi)                    | N/A                    | This situation has not arisen.  |
| 7. Board Secretary                                       | Rule 3(1)(vii)<br>Rule 3(1)(viii) | Compliant<br>Compliant | Please refer section A.1.4 of the SEC & ICASL Code table on page 61 for details.  |
| 8. Minutes of the Meetings                               | Rule 3 (1)(ix)<br>Rule 3 (1)(x)   | Compliant<br>Compliant | Minutes of the Board meetings are maintained in sufficient detail by the Board Secretary.   |
| 9. Independent professional advice                       | Rule 3 (1)(xi)                    | Compliant              | Please refer section A.1.3 of the SEC & ICASL Code table on page 61 for details.  |
| 10. Conflict of Interests                                | Rule 3 (1)(xii)                   | Compliant              | The Board is conscious of its obligations to ensure that Directors avoid conflicts of interest (both real and apparent) between their duty to HNB and their other interests. The Board has taken steps to ensure that conflicts and potential conflicts of interest of Directors are disclosed to the Board. Any Director with a material personal interest in a matter being considered by the Board declares his / her interest and unless the Board resolves otherwise, he / she does not participate in discussions or vote on that specific matter. Independent Directors do participate in such meetings.<br>The above process will be further strengthened through formal documentation. |
| 11. Formal schedule of matters                           | Rule 3(1)(xiii)                   | Compliant              | The Board distinguishes the matters reserved for it from the matters reserved for the Corporate Management team.<br>The Board is in the process of finalizing the formal documentation of the terms of reference of the Corporate Management, which will be approved in 2011.   |

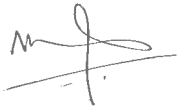
| Corporate Governance Principles  | CBSL Rule Reference | Compliance status | Level of Compliance in 2010   |
|--|---------------------|-------------------|---|
| 12. Situation of Insolvency  | Rule 3(1)(xiv)      | N/A               | This situation has not arisen during the year.  |
| 13. Capital adequacy   | Rule 3 (1)(xv)      | Compliant         | The Bank is fully compliant with the capital adequacy requirements of the Monetary Board.   |
| 14. Corporate Governance Report  | Rule 3 (1)(xvi)     | Compliant         | This report addresses this requirement.   |
| 15. Annual self assessment by the Directors                            | Rule 3 (1)(xvii)    | Compliant         | The Directors provide an annual self assessment to the Board to assess the fit and propriety to hold office as Directors of the Bank. Please refer section A.9.1 of the SEC & ICASL Code table on page 64 for details of the evaluation of the Board and the Sub-committees.<br>The process is being continuously improved. |
| <b>3 (2) The Board's Composition</b>                                   |                     |                   |   |
| 16. Number of Directors  | Rule 3 (2)(i)       | Compliant         | The Board comprises of nine Directors.  |
| 17. Period of service of a Director                                    | Rule 3 (2)(ii)      | N/A               | This section of the Rule is not applicable for the year under review and will become effective from 01st January 2012.  |
| 18. Appointment of an employee as a Director                           | Rule 3 (2)(iii)     | N/A               | This situation has not arisen except in the case of the MD / CEO.   |
| 19. Independent Non Executive Director                                 | Rule 3 (2)(iv)      | Compliant         | The Board includes five Independent Non Executive Directors as per the definition of this Direction, which is more than one third of the Board. The Board considers Non Executive Director's independence on an annual basis, based on the self declaration and as part of each Director's performance evaluation.          |
| 20. Alternative Director   | Rule 3 (2)(v)       | Compliant         | This situation has not arisen.  |
| 21. Credibility, skills and experience of Non Executive Directors      | Rule 3 (2)(vi)      | Compliant         | Please refer pages 14 and 15 for the profiles of the Non Executive Directors.   |
| 22. Presence of Non Executive Directors in Board Meetings              | Rule 3 (2)(vii)     | Compliant         | No meetings of the Board were constituted without the presence of one half of the Non Executive Directors.  |
| 23. Details of Directors   | Rule 3 (2)(viii)    | Compliant         | Please refer page 74 for the details of the Directors and their categories.   |
| 24. Appointment of new Directors                                       | Rule 3 (2)(ix)      | Compliant         | Please refer section A.7.1, A.7.2 and A.7.3 of the SEC & ICASL Code table on page 64 for details  |
| 25. Appointment to fill a casual vacancy                               | Rule 3 (2)(x)       | N/A               | This situation has not arisen.  |
| 26. Resignation / removal of a Director                                | Rule 3 (2)(xi)      | N/A               | This situation has not arisen.  |
| 27. Appointments to other Banks  | Rule 3 (2)(xii)     | Compliant         | None of the Directors nor employees are Directors of another Bank.  |
| <b>3 (3) Criteria to assess the fitness and propriety of Directors</b> |                     |                   |   |
| 28. Directors over 70 Years of age                                     | Rule 3 (3)(i)       | N/A               | This section of the Rule is not applicable for the year under review and will become effective from 1st January 2012.   |
| 29. Holding of office in more than 20 companies                        | Rule 3 (3)(ii)      | N/A               | This section of the Rule is not applicable for the year under review and will become effective from 1st January 2012.   |
| <b>3(4) Management function delegated by the Board</b>                 |                     |                   |   |
| 30. Delegation of work to the management                               | Rule 3 (4)(i)       | Compliant         | The Board annually evaluates the delegated authority process to ensure that the delegation of work does not materially affect the ability of the Board as a whole in discharging its functions.<br>The process is being continuously improved.  |
| 31. Extent of Delegation   | Rule 3 (4)(ii)      | Compliant         | Please refer comments above.  |
| 32. Evaluation of the delegated process                                | Rule 3 (4)(iii)     | Compliant         | Please refer comments on rule 3(4)(i) above.  |
| <b>3(5) The Chairman and Chief Executive Officer</b>                   |                     |                   |   |
| 33. Division of Responsibilities of the Chairman and MD / CEO          | Rule 3 (5)(i)       | Compliant         | The roles of Chairman and Chief Executive Officer are separate Please refer section A.2 and A.3 of the SEC & ICASL Code table on page 62 for further details.   |

| Corporate Governance Principles   | CBSL Rule Reference                                | Compliance status | Level of Compliance in 2010  |
|---|--|-------------------|--|
| 34. Chairman preferably be an Independent Director and if not designate a Senior Director | Rule 3 (5)(ii)                                     | Compliant         | The Chairman of HNB is not considered as independent as per the definition set out in the Direction on Corporate Governance for Licensed Commercial Banks issued by the CBSL. The Board has recognized this area and appointed Ms Pamela C. Cooray as Senior Director as required by the said Rule.  |
| 35. Relationship between Chairman and CEO and other Directors                             | Rule 3 (5)(iii)                                    | Compliant         | There are no material relationship between the Chairman / CEO and / or other members of the Board which will impair their respective roles.  |
| 36. Role of the Chairman  | Rule 3 (5)(iv) to Rule 3 (5)(xi)                   | Compliant         | Please refer section A.3 of the SEC & ICASL Code table on page 62 for detailed information of the role of the Non Executive Chairman.  |
| <b>3(6) Board appointed Committees</b>  |  |                   |  |
| 37. Board appointed four Sub committees   | Rule 3 (6)(i)                                      | Compliant         | There are eight Board appointed Sub-committees including the four Committees prescribed by the CBSL Direction. Please refer section A.1.6 of the SEC & ICASL Code table on page 62. above for the names of the Board Sub-committees.   |
| 38. Audit Committee   | Rule 3 (6)(ii)                                     | Compliant         | Please refer section D.3 of the SEC & ICASL Code table on page 68 for details of the Audit Committee.  |
| 39. Human resources / Remuneration Committee  | Rule 3 (6)(iii)                                    | Compliant         | Please refer section B.1.1 of the SEC & ICASL Code table on page 65 for details.   |
| 40. Nomination Committee  | Rule 3 (6)(iv)                                     | Non-Compliant     | Please refer section A.7.1 and A.7.2 of the SEC & ICASL Code table on page 64 for details for the composition of the Committee. The committee considers and recommends the re-election of the Directors. The committee also set criteria of the succession of the CEO and other key management personnel.<br><br>As the Chairman of the committee is not independent, the Bank is non compliant with this Rule to that extent. The Bank is in the process of rectifying this aspect of non compliance.   |
| 41. Integrated Risk Management Committee  | Rule 3 (6)(v)                                      | Compliant         | Board Integrated Risk Management Committee comprises of the following personnel<br>Mr M V Theagarajah - Independent / Non Executive Director (Chairman)<br>Mr Rienzie T. Wijetilleke- Non Executive Director<br>Mr R Theagarajah – Managing Director / CEO<br>Ms M R A C Cooray – Independent / Non Executive Director<br>Mr J D N Kekulawala – SDGM - Strategy and Compliance<br>Mr D P N Rodrigo – DGM - Risk<br><br>The Committee assesses, reviews and takes action to mitigate the effects of the specific identified risks in credit, market, liquidity, strategic and operational areas. The Committee also oversees the compliance function. The designated compliance officer also reports to the Committee.<br><br>The process is being continuously improved. |
| <b>3 (7) Related Party Transactions</b>   |  |                   |  |
| 42. Avoiding conflict of interest in related party transaction and favorable treatment    | Rule 3 (7)(i)<br>Rule 3 (7)(ii)<br>Rule 3 (7)(iii) | Compliant         | Steps have been taken by the Board to avoid any conflict of interests, that may arise, in transacting with related parties as per the definition of this Direction and Sri Lanka Accounting Standard- 30 on "Related party Transactions". Further, the Board ensures that the no related party benefits from favorable treatment. The pricing applicable to such transactions is based on the assessment of risk and pricing model of the Bank and is comparable with that what is applied to transactions between the Bank and its unrelated customers.<br><br>The process to identify the related parties and collate all relevant details of transactions with related parties is currently being further strengthened.   |
| 43. Accommodations to Directors and / or their close relatives                            | Rule 3 (7)(iv)                                     | Compliant         | All accommodations to Directors and / or their close relatives are approved by all Directors who are available in the Country at the time the said accommodation is considered, other than the Director concerned.   |
| 44. Appointment of Director subsequent to approval of facilities to him / her             | Rule 3 (7)(v)                                      | N/A               | This situation has not arisen.   |

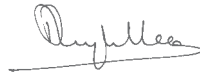
| Corporate Governance Principles   | CBSL Rule Reference               | Compliance status      | Level of Compliance in 2010  |  |             |   |   |      |      |                      |      |      |  |          |      |   |       |      |                            |       |      |   |          |       |
|---|-----------------------------------|------------------------|--|--|-------------|---|---|------|------|----------------------|------|------|--|----------|------|---|-------|------|----------------------------|-------|------|---|----------|-------|
| 45. Accommodation to employees  | Rule 3 (7)(vi)<br>Rule 3 (7)(vii) | Compliant<br>Compliant | Accommodation has not been given to employees on a favorable basis other than the general schemes applicable to all employees of the Bank.   |  |             |   |   |      |      |                      |      |      |  |          |      |   |       |      |                            |       |      |   |          |       |
| <b>3(8) Disclosures</b>   |                                   |                        |  |  |             |   |   |      |      |                      |      |      |  |          |      |   |       |      |                            |       |      |   |          |       |
| 46. Financial reporting, statutory and regulatory reporting   | Rule 3 (8) (i)                    | Compliant              | The Financial Statements for the year ended 31st December 2010 are in conformity with all rules and regulatory requirements and for the quarters then ended have been published in all three languages.  |  |             |   |   |      |      |                      |      |      |  |          |      |   |       |      |                            |       |      |   |          |       |
| 47. Minimum disclosure in the Annual Report   | Rule 3 (8) (ii)                   | Compliant              | <p>(a) Compliance with applicable accounting standards and regulatory requirements has been reported in the Directors' Responsibility Statement for Financial Reporting on page 156 and CEO and CFO's responsibility statement for financial statements on page 155.</p> <p>(b) Directors' report on the effectiveness of the internal control system over financial reporting, "Statement of Internal Control" is given on pages 76 and 77.</p> <p>(c) The Bank has obtained an Assurance Report on the internal controls over financial reporting based on the auditing framework issued by ICASL for this engagement. The recommendations made by the Auditors where relevant, will be dealt with in 2011.</p> <p>(d) Details of the Directors are given on pages 14 and 15 Directors transactions with the Bank and their remunerations have been disclosed in note 48 to the Financial Statements on pages 228 to 240.</p> <p>(e) Accommodation granted to the related parties is given in note 48 to the Financial Statements on pages 228 to 240. The net accommodation granted to each category of related parties is given below as a percentage of the Bank's regulatory capital.</p> <table border="1"> <thead> <tr> <th>CATEGORY OF RELATED PARTY TRANSACTIONS</th> <th>Amount (Mn)</th> <th>%</th> </tr> </thead> <tbody> <tr> <td>- Credit Card balances outstanding from KMP's</td> <td>3.85</td> <td>0.01</td> </tr> <tr> <td>- Facilities to KMPs</td> <td>7.50</td> <td>0.03</td> </tr> <tr> <td>- Loans and advances outstanding from subsidiaries</td> <td>2,184.52</td> <td>7.98</td> </tr> <tr> <td>- Advances and guarantees to subsidiaries</td> <td>33.00</td> <td>0.12</td> </tr> <tr> <td>- Guarantees to Associates</td> <td>79.00</td> <td>0.29</td> </tr> <tr> <td>- Transactions with concerns in which a Director of the Bank or material shareholder has a substantial interest</td> <td>3,145.00</td> <td>11.48</td> </tr> </tbody> </table> <p>(f) Please refer (d) and (e) above.</p> <p>(g) The Bank has obtained the a Factual Findings Report from the Auditors on annual Corporate Governance Report, based on the auditing framework issued by ICASL for this engagement, The recommendations made by the Auditors where relevant will be dealt with in 2011.</p> <p>(h) There were no material non compliance to prudential requirements, regulations, laws and internal controls affecting the Bank.</p> <p>(i) There were no supervisory concerns on lapses in the Bank's risk management system or non compliance with this direction that have been pointed out by the Director of the Bank Supervision Department of the CBSL and requiring disclose to the public.</p> <p>* During the year the Director of the Bank Supervision Department of the CBSL identified two shareholding entities of the Bank as being related to another shareholding group, and directed;</p> <ul style="list-style-type: none"> <li>- the Bank to remove the said two entities from the register of members</li> <li>- the Bank to aggregate any accommodation extended to the said two entities with that of the other shareholding group</li> <li>- the said two entities to divest their respective shareholdings in the Bank within a period of six months from the said direction.</li> </ul> <p>The Bank has complied with the first two aspects of the said direction as at balance sheet date and formally communicated the third aspect of the said direction to the said two entities for their attention.</p> | CATEGORY OF RELATED PARTY TRANSACTIONS | Amount (Mn) | % | - Credit Card balances outstanding from KMP's | 3.85 | 0.01 | - Facilities to KMPs | 7.50 | 0.03 | - Loans and advances outstanding from subsidiaries | 2,184.52 | 7.98 | - Advances and guarantees to subsidiaries | 33.00 | 0.12 | - Guarantees to Associates | 79.00 | 0.29 | - Transactions with concerns in which a Director of the Bank or material shareholder has a substantial interest | 3,145.00 | 11.48 |
| CATEGORY OF RELATED PARTY TRANSACTIONS  | Amount (Mn)                       | %                      |  |  |             |   |   |      |      |                      |      |      |  |          |      |   |       |      |                            |       |      |   |          |       |
| - Credit Card balances outstanding from KMP's   | 3.85                              | 0.01                   |  |  |             |   |   |      |      |                      |      |      |  |          |      |   |       |      |                            |       |      |   |          |       |
| - Facilities to KMPs  | 7.50                              | 0.03                   |  |  |             |   |   |      |      |                      |      |      |  |          |      |   |       |      |                            |       |      |   |          |       |
| - Loans and advances outstanding from subsidiaries  | 2,184.52                          | 7.98                   |  |  |             |   |   |      |      |                      |      |      |  |          |      |   |       |      |                            |       |      |   |          |       |
| - Advances and guarantees to subsidiaries   | 33.00                             | 0.12                   |  |  |             |   |   |      |      |                      |      |      |  |          |      |   |       |      |                            |       |      |   |          |       |
| - Guarantees to Associates  | 79.00                             | 0.29                   |  |  |             |   |   |      |      |                      |      |      |  |          |      |   |       |      |                            |       |      |   |          |       |
| - Transactions with concerns in which a Director of the Bank or material shareholder has a substantial interest | 3,145.00                          | 11.48                  |  |  |             |   |   |      |      |                      |      |      |  |          |      |   |       |      |                            |       |      |   |          |       |
| 48. Transitional and other general provisions   | Rule 3 (9)                        | Compliant              | The Bank has complied with the transitional provisions.  |  |             |   |   |      |      |                      |      |      |  |          |      |   |       |      |                            |       |      |   |          |       |

## REPORT FROM EXTERNAL AUDITORS

The external auditors have performed procedures set out in Sri Lanka Related Services Practice Statement 4750 issued by the Institute of Chartered Accountants of Sri Lanka (SLRSPS 4750), to meet the compliance requirement of the Corporate Governance directive. Their findings were not materially different to the matters disclosed above and did not identify any significant inconsistencies to those reported above by the Board.



**J D N Kekulawala**  
Senior DGM - Strategy & Compliance



**Rienzie T. Wijetilleke**  
Chairman

Colombo, Sri Lanka  
18th February 2011

## BOARD AND THE COMMITTEE ATTENDANCE

The number of meetings of the Board, Board appointed Sub committees and individual attendance by members is shown below.

| Names                          | Directorship Status                             | Board | Audit Committee  | Nomination Committee | Remuneration / HRM Committee | Integrated Risk Management Committee | Strategic Review Committee |
|--------------------------------|---|-------|------------------|----------------------|------------------------------|--------------------------------------|----------------------------|
| <b>Total No. of Meetings</b>   |   | 14    | 5                | 1                    | 7                            | 4                                    | 2                          |
| Mr Rienzie T. Wijetilleke      | Non Executive Chairman                          | 14/14 | -                | 1/1                  | 6/7                          | 3/4                                  | -                          |
| Mr Rajendra Theagarajah        | Managing Director / CEO                         | 14/14 | 4/5 <sup>a</sup> | 1/1 <sup>a</sup>     | 5/7 <sup>a</sup>             | 2/4                                  | 2/2 <sup>a</sup>           |
| Mr D H S Jayawardena           | Non Executive Director                          | 13/14 | 5/5              | 1/1                  | -                            | -                                    | 0/2                        |
| Mr M V Theagarajah             | Independent Non Executive Director <sup>b</sup> | 14/14 | -                | 1/1                  | -                            | 4/4                                  | -                          |
| Mr R K Obeyesekere             | Non Executive Director                          | 12/14 | -                | 1/1                  | 4/7                          | 1/1 <sup>c</sup>                     | -                          |
| Ms Pamela C. Cooray            | Senior / Independent Non Executive, Director    | 13/14 | 5/5              | -                    | 7/7                          | -                                    | -                          |
| Mr Ranjeevan Seevaratnam       | Independent Non Executive Director              | 12/14 | 4/5              | -                    | -                            | -                                    | -                          |
| Mr N G Wickremeratne           | Independent Non Executive Director              | 13/14 | 5/5              | -                    | 7/7                          | -                                    | 2/2                        |
| Ms M A R C Cooray <sup>d</sup> | Independent Non Executive Director              | 12/12 | -                | -                    | -                            | 3/3                                  | 2/2                        |

The papers relating to Credit, Asset Disposal and Procurement are circulated to the members of the respective Board appointed Sub-committees set out below. If a Director has an interest in the relevant subject matter under consideration, he / she declares his / her interest to the respective committee and withdraws from the approval process.

| Names                                       | Credit     | Asset Disposal | Procurement    |
|---|------------|----------------|----------------|
| <b>Total No. of papers approved in 2010</b> | <b>397</b> | <b>5</b>       | <b>20</b>      |
| Mr Rienzie T. Wijetilleke                   | 349        | 5              | 20             |
| Mr Rajendra Theagarajah                     | 389        | 5              | 20             |
| Mr D H S Jayawardena                        | 160        | -              | -              |
| Mr M V Theagarajah                          | 233        | -              | 20             |
| Mr R K Obeyesekere                          | 197        | 3              | 1 <sup>e</sup> |
| Ms Pamela C. Cooray                         | 263        | 5              | -              |
| Mr Ranjeevan Seevaratnam                    | 188        | -              | -              |
| Mr N G Wickremeratne                        | 195        | 5              | 18             |
| Ms M A R C Cooray                           | 214        | -              | -              |

### Key

- <sup>a</sup> Mr Rajendra Theagarajah attended 4 Audit Committee, 1 Nomination Committee, 5 Remuneration / HRM Committee and 2 Strategic Review Committee meetings by invitation.
- <sup>b</sup> The above table gives Directorship Status as per the CBSL Direction on Corporate Governance, Mr M V Theagarajah is considered as an Independent Director under this. As per the ICASL & SEC Code Mr M V Theagarajah is not considered as an Independent Director.
- <sup>c</sup> The Director resigned from the Integrated Risk Management Committee on 31st March 2010. There was only one meeting up to that date.
- <sup>d</sup> Ms M A R C Cooray was appointed to the Board on 15th February 2010. There were 12 meetings after her appointment, she has attended all 12 meetings. The Director was appointed to the Integrated Risk Management Committee on 31st March 2010. There were 3 meetings after her appointment, she has attended all 3 meetings.
- <sup>e</sup> Mr R K Obeyesekere was co-opted to approve a paper in the absence of a regular committee member.

 - Chairman / Chairperson of the respective committee.

# STATEMENT OF INTERNAL CONTROL

## RESPONSIBILITY

The Board of Directors ("Board") is responsible for the adequacy and effectiveness of the Hatton National Bank PLC ("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 eliminate the risk of failure to achieve the policies and business objectives of the Bank. Accordingly, the system of internal controls can only provide reasonable but not absolute assurance against material misstatement of management and financial information and records or against financial losses or fraud.

The Board has established an ongoing 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 and accords with the guidance for directors of Banks on the Directors' Statement of Internal Control issued by the Institute of Chartered Accountants of Sri Lanka. 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 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 reasonable assurance regarding the reliability of financial reporting, and that the preparation of financial statements for external purposes and 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 by the Board to assist the Board in ensuring the effectiveness of the Bank's daily operations and that the Bank's operations are in accordance with the corporate objectives, strategies and the annual budget as well as the policies and business directions that have been approved.
- 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 all

units and branches, the frequency of which is determined by the level of risk assessed, 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 Audit Committee and the findings of the audits are submitted to the Audit Committee for review at their periodic meetings.

- The Audit Committee of the Bank 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 Audit Committee meetings are tabled for the information of the Board on a periodic basis. Further details of the activities undertaken by the Audit Committee of the Bank are set out in the Audit Committee Report on page 153.
- The Board Integrated Risk Management Committee (BIRMC) is established by the Board to assist the Board to oversee the overall management of principal areas of risk of the Bank. The Management Risk Committee which includes representation from all key business and operating units of the Bank, assists the Board with the implementation of policies advocated at the 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 Committee, the Credit Committee, the Investment Management Committee, and the Information Technology Steering Committee.

In assessing the internal control system, 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 division for suitability of design and effectiveness on an ongoing basis. Due to time constraints, areas with respect to the processes that provided disclosures to the financial statements such as related party transactions, contingencies and commitments were not fully completed.

The assessment covered only the process applied by the Bank and did not include the processes carried out by its subsidiaries.

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



## CONFIRMATION

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

## REVIEW OF THE STATEMENT BY EXTERNAL AUDITORS

The external auditors have reviewed the above Directors Statement on Internal Control for the year ended 31 December 2010 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.

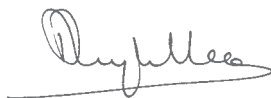
By order of the Board



**Ranjeewan Seevaratnam**  
*Chairman - Audit Committee*



**Rajendra Theagarajah**  
*Managing Director /  
Chief Executive Officer*



**Rienzie T. Wijetilleke**  
*Chairman*

Colombo, Sri Lanka  
18th February 2011

# **SUSTAINABILITY REPORT**

# **CARING PARTNER**

|   |            |
|---|------------|
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# CHIEF EXECUTIVE OFFICER'S STATEMENT



**Social responsibility is at the very core of the Bank's corporate DNA and is an element that transcends from mere philanthropy to a holistic and cohesive component of the long-term corporate strategy, which in turn is reflective of strategic national priorities.**

## **Social Responsibility as an enabler of national development**

At Hatton National Bank we firmly believe that strategic social responsibility is a catalyst to long-term development of the nation. Our sustainability ethos is one that is deeply embedded in the overall business strategy and therefore intrinsic to the way in which the Bank conducts its business. Sustainability at Hatton National Bank has long been a way of life but what is critical is the fact that we view sustainability as an enabler of national development, an avenue for wealth creation and as a means of inclusion. Therefore, social responsibility is at the very core of the Bank's corporate DNA and is an element that transcends mere philanthropy to become a holistic and cohesive component of the long-term corporate strategy, which in turn is reflective of strategic national priorities.

The year under review was a significant year for the nation with Sri Lanka embarking on post conflict reconstruction and development. Our role, in this path of economic and social development of Sri Lanka, is one that is etched firmly in the Bank's own corporate strategy. We firmly believe that sustainable economic and social development is dependant on the contribution of Corporate Sri Lanka as partners in national progress. We continue to demonstrate our support to the national economy through Hatton National Bank's unique approach to social inclusion, through which we have actively drawn thousands from less privileged financial circumstances to be contributors to the national economy. Post-conflict Sri Lanka has witnessed the re-integration of the northern and eastern provinces with the rest of the economy. This will open approximately two thirds of the nation's maritime and coastal resources and one third of untapped fertile land for productive use, thus enabling approximately fifteen percent of the country's population to fully participate in rejuvenated economic activity. Hence we are confident that our model for financial and social inclusion will have far and wide-reaching possibilities.

As a leader in the financial services sector, we have constantly sought to inspire and motivate our peers in the industry to take the initiative to

migrate boldly from defensive banking – where inclusive banking is considered a negative impact on the bottom-line - to sustainable banking. Having moulded our strategy for financial inclusion for over two decades, we are confident that our peers will take our offer of support in goodwill and journey towards strategic, sustainable banking to precipitate the national economic agenda.

## **Commitment towards Sustainability Reporting**

Sustainability reporting projects our commitment towards sustainability; it underlies our responsiveness to those who want to know us better, our customers and suppliers, shareholders and the community, and our present and future employees. Our greatest pride in undertaking sustainability reporting stems from the fact that as a corporate that has a rich tradition of engaging in sustainability, we are now able to through the integration of strategic Corporate Social Responsibility (CSR) with the Bank's business strategy, catering to the nation and its societal needs in a reportable and quantifiable manner. Moreover, it also provides us the opportunity to express the Bank's commitment to a range of wider goals, in particular the United Nations Millennium Development Goals. To further validate the authenticity and the transparency of our sustainability reporting efforts, you will find that this sustainability report has been submitted this year to the Global Reporting Initiative (GRI) for formal checking as a show of commitment towards the sustainability reporting process.

This year as part of our commitment to the Environment, we have endeavoured to make this Annual Report a carbon neutral publication and have obtained certification from the Carbon Consulting Company a Carbon Footprint Expert certified company that operates under the aegis of the Carbon Neutral Company, UK. This is a significant step in our efforts to live the HNB Green Pledge.

## **Our sustainability focus in 2010**

In the year under review, our sustainability focus was honed on four strategic pillars in support of the United Nations Millennium



Development Goals, which are, education; healthcare; environmental protection; financial inclusion and entrepreneurship. The Sustainability Foundation established in 2009 institutionalised our sustainability efforts instilling transparency and governance practices to every aspect of the sustainability process. The Foundation has broadened the interaction of the Board of Directors in strategic CSR, invigourating a top-down approach to sustainable practices and thereby furthering the relationship between corporate and sustainability strategies.

Most importantly, the Sustainability Foundation has been pivotal in garnering partners and collaborators to further strengthen the thrust of our sustainability strategy and tactics, thus enlarging the scope and impact of each sustainability initiative. The Bank views collaboration as a favourable and viable means to transcend barriers in precipitating sustainability efforts through enhanced linkages, capital and human resources.

### Recognition and Rewards

The most gratifying reward for our sustainability efforts lies in the knowledge that our present actions will create a future that is better endowed through natural preservation and social mobilisation. Yet, recognition for our sustainability reporting process serves to inspire us to report better in line with international best practices, improving every financial year to instill greater transparency and governance to the reporting process. In 2010, the Bank received several accolades for its sustainability reporting and corporate responsibility efforts for the previous financial year:

- Emerged as winner in the Large Scale Category at the ACCA Sustainability Reporting Awards 2009 organised by the Association of Chartered Certified Accountants, Sri Lanka.
- Recognised among the Top 10 Best Corporate Citizens of Sri Lanka, identified by the Ceylon Chamber of Commerce at the Best Corporate Citizen Awards, winning 1st Runner Up – Best Corporate Citizen, Winner – Employee Relations Category

### Future Outlook

Going forward, we recognise that the main challenge for our nation is economic empowerment of less privileged communities. We believe entrepreneurial development through financial inclusion and opportune development of linkages enabling small and medium entrepreneurs better access to markets will accelerate national economic activity. With a significant percentage of the national economy comprising of small and medium entrepreneurs, it is necessary to nurture these enterprises to become larger and more gainful businesses, thus augmenting the wealth creation and enhancing better distribution of wealth amongst every tier of society. As such our own corporate and sustainability strategies will contribute towards the realisation of equitable wealth creation across Sri Lanka. We will of course continue to focus on embracing green practices, financing of “green” investments, motivating the adoption of sustainable business practice amongst our customers and suppliers and energising our employees to inspire others to propagate our vision for a sustainable future.

I would also like to take the opportunity to invite our shareholders and stakeholders to actively engage with us. Your response to the feedback form attached to this report will greatly assist us towards enhancing our sustainability approach in the years ahead.

**Rajendra Theagarajah**  
*Managing Director / CEO*

Colombo, Sri Lanka  
18th February 2011

# REPORT PARAMETERS

Sustainability Reporting serves as a window into the performance of the Bank across economic, social and environmental dimensions, primarily as the Bank's sustainability strategy is in full alignment with its core business strategy. As such, this Sustainability Report has been developed within the context of the Bank's overall business strategy, with due consideration of sustainability-related risks and opportunities.

## Sustainability Reporting Frameworks

### Reporting Principles and Reporting Guidelines: GRI

The Bank's Sustainability Report has been developed based on the Sustainability Reporting Framework proposed by Global Reporting Initiative (GRI). Through the adoption of this universally recognised framework for disclosure of information, the Bank in its Sustainability Report strives to comply with specific 'Reporting Principles' and 'Reporting Guidance' as laid down by the G3 guidelines and indicator protocols for economic, environment, human rights, labour, product responsibility and societal performance.

The following have been utilised to develop this Report:

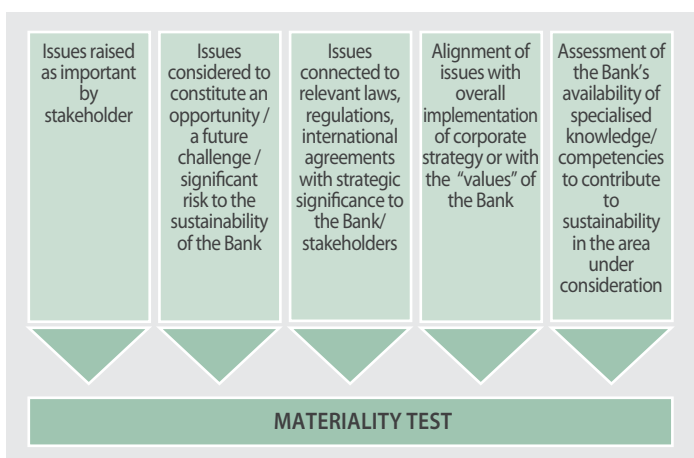
- Indicator Protocols for each of the Performance Indicators contained in the G3 Guidelines;
- Financial Sector Supplement which includes financial sector specific performance indicators;
- Technical Protocols to set the report boundary.

This report has been submitted for a compliance check to the GRI and has been confirmed that it fulfills the requirements of Application Level B+ (refer page 128).

## Defining the Report Content:

### (A) Issue of Materiality

In the preparation and compilation of this Sustainability Report, materiality proved to be a challenge. To develop an approach that provides relevant data and information expected by a cross-section of



stakeholders coupled with the need to identify and understand the sustainability related aspects and issues that define the success of the Sustainability Report proved to be a dilemma.

However, in the year under review the Bank followed a systemised approach to determine the materiality of issues to be reported in the sustainability report, thus largely overcoming the dilemma. The diagram below outlines the criteria that are used by the Bank as a guide in the deliberation process to determine materiality.

By assessing each of the Bank's actions during the year against the five broad criteria shown, key actions and initiatives that fall as material to each of the stakeholder groups have been reported on in this Sustainability Report. Based on the answers to these strategies, actions by the Bank have been evaluated for materiality in the context of each stakeholder. Further, as outlined in the GRI guidelines, the Bank recognises and accepts the importance of materiality. Thus, in this light, our Report covers topics and indicators that reflect the Bank's significant economic, environmental and social impacts or that would substantively influence the assessment and decisions of its stakeholders.

### (B) Stakeholder Inclusiveness and Engagement

Sustainability Reporting affords the Bank a means to communicate and engage with its stakeholders. Given the disparate nature (and interests) of various stakeholders, the Bank is compelled to strategically define its key stakeholder audience to ensure materiality in engagement and reporting. Thus, the Bank defines its key stakeholders as investors, customers, employees, suppliers, communities and the environment. Through stakeholder inclusiveness and engagement, the Bank objectively aims to achieve a conclusive, positive outcome for each of the identified stakeholders.

| Stakeholder Group | Objective   |
|-------------------|---|
| Investors         | Create sustainable wealth for shareholders, whilst setting benchmarks for the industry and contributing towards the achievement of national macro economic objectives |
| Customers         | Ensure that service excellence remains a fundamental in the delivery of superlative products and services   |
| Employees         | Create two way relationships that inculcate team spirit within the Hatna Family concept, whilst consciously enhancing the tangible and intangible worth of employees  |
| Suppliers         | Focus on long lasting partnerships on qualitative platforms   |
| Community         | Create sustainable communities through Education, Entrepreneurial assistance and Health   |
| Environment       | Ensure a sustainable planet through conservation and preservation of the environment by introducing best practices  |

The selection of key stakeholders for engagement is driven by the Bank's desire to exemplify its role as a "Partner in Progress", by exploring circumstances that require judgement relating to business transactions.

- Investors** – The Bank needs to meet the confidence of its investors and maintain balance between profits and the ability to sustain a long-term, stable stream of earnings. It is the Bank's responsibility to judge whether a business decision will generate superior profits without compromising on integrity.
- Customers** – For the business to be sustained it is the responsibility of the Bank as the "lender" to judge whether a customer's aspiration to borrow is affordable and meets with the Bank's assessment of risk and pricing model. Further extending the lending to the lesser affluent with the view of improving quality of life and assisting small businesses to grow without encouraging over indebtedness which could impact both the customer and the Bank.
- Employees** – For sustenance of the business it is imperative that the Bank fosters a talent pool that delivers superior efficiency and performance. It is the Bank's responsibility to judge and ensure that such efficiency is not achieved at the expense of work-life balance or corporate values.
- Suppliers** – Businesses are today required to meet ever-increasing standards of sustainable behaviour. It is important that the Bank balances cost considerations and sustainable procurement practices.
- Community** – With the wide spread branch network it has been possible for the Bank to engage with the community at every level. The responsibility of the Bank is to ensure that its internal policies are maintained, as no amount of philanthropy will substitute for failure to combat financial crime or poor lending.
- Environment** – It is the responsibility of every individual and organisation to ensure the sustainability of our planet. The Bank has taken steps to implement environment friendly policies within the Bank as well as by customers and suppliers as well as encourage such initiatives by lending to specific environmental friendly projects.

### (C) Sustainability Content

This Report presents the Bank's performance in the wider context of sustainability, providing an insight into the Bank's contribution towards the enhancement of economic, environmental and social conditions within which it operates.

## Defining the Report Quality

### (A) Balance, Accuracy and Clarity

This Report endeavours to present an unbiased presentation of the Bank's performance by reflecting positive and negative aspects of the Bank's performance to enable a reasonable assessment of overall performance.

As far as possible, the Report provides accurate information in a manner that is understandable and accessible to its readers.

### (B) Defining the Report Boundary

This Report covers only the sustainable performance of the Bank and has not been extended to cover its subsidiaries, joint ventures or associates.

## Standard Disclosures in the Report

### (A) Strategy and Profile

In this section we provide a high level strategic view of the Bank's relationship to sustainability in order to provide context for understanding the Bank's performance such as its strategy, profile and governance.

### (B) Management Approach & Performance Indicators

The Performance Indicators are organised by Economic, Environmental and Social categories as set out in the GRI Table.

## Independent Assurance

Independent Assurance is a widely accepted norm within the process of Sustainability Reporting. The Bank recognises that independent assurance enhances the transparency and credibility of its Sustainability Reporting process through the delivery of superior value to the Bank, users of the Report and broader stakeholder groups and individuals.

M/s KPMG Ford Rhodes Thornton & Company has provided an Independent Assurance Report on Hatton National Bank's Sustainability Report. The Auditors review engagement was carried out in accordance with the Sri Lanka Standard on Assurance Engagements 3000 "Assurance Engagements Other Than Audits or Reviews of Historical Financial Information" (International Standard on Assurance Engagements (ISAE 3000)).

## Stakeholder Feedback

The Bank considers stakeholder feedback as a critical criterion for future enhancement of its Sustainability Reporting initiatives. As such an Investor/Stakeholder Feedback Form is attached to this Report and serves as a formal feedback mechanism in addition to the continuous stakeholder engagement process.



# STRATEGIC SUSTAINABILITY REVIEW

## The Approach

Hatton National Bank has consistently adopted a strategic approach to sustainability where business and sustainability strategies are intrinsically aligned. The Bank ensures that sustainable development is featured at a strategic level, supported by leadership and envisioning, whilst also integrated into all parts of its operational plan.

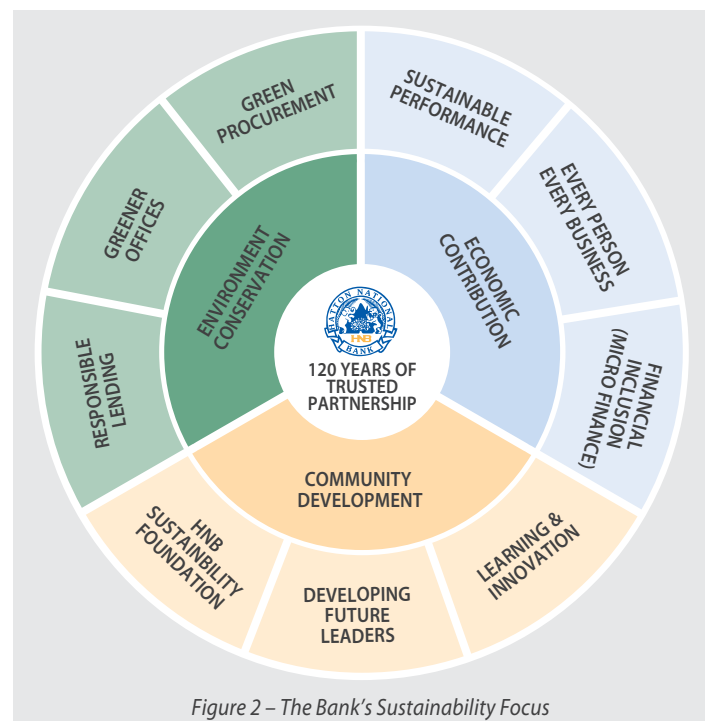
Hatton National Bank's business strategy has and continues to pivot on the end achievement of national priorities. The Bank strives to contribute towards the national agenda and meet national objectives through the effective implementation of its own business strategy. Thus, it fully appreciates that to achieve the greatest long-term benefit the Bank must consistently devise its own unique approach and business case for sustainability. This is fully demonstrated by how the Bank has aligned its business goals in tandem with national goals and in turn with sustainability development.

The Bank is committed to serve all strata of society and through careful customer segmentation provides financial access and services across the continuum of socio-demographic groups. Having served the micro and Small & Medium Entrepreneurs (SME) for over four decades, Hatton National Bank is considered a pioneer in the introduction of financial services to persons considered as "non-bankable" through its Gami Pubuduwa (Village Re-awakening) programme. The entrepreneurial poor remains an important customer base for the Bank with financial inclusion for these segments an area of strategic priority from the perspective of commercial enterprise.

Hatton National Bank recognises the criticality of SMEs to the national economy. As engines of growth, the SMEs drive economic growth. Aligned to the national vision to energise the SME sector, the Bank remains committed to the sustainable development of this sector and recognises it as a revenue optimiser from a business strategy viewpoint.

Sustainability is at the very core of the Bank's corporate strategy. By integrating CSR into core business processes and stakeholder management, the Bank recognises its ability to achieve the ultimate goal of creating both social value and corporate value. However, the adaptation of CSR and sustainability goes beyond face value and the Bank views sustainability as a strategic avenue for growth in the long-term. As opposed to ad-hoc philanthropy, strategic sustainability streams are embedded into the overall business approach and filters to the fundamental business model. Thus, the Bank perceives sustainability beyond the scope of stepped-up environmental performance, but as a comprehensive way of doing business, one that delivers tremendous economic value and opens up a vast array of new opportunities.

As Figure 2 illustrates, the Bank's sustainability strategy aims to impact 3 core areas; economic contribution, environmental conservation and community development. This framework has been developed on the premise that customers, suppliers, employees, shareholders and communities are directly entwined as contributors and beneficiaries of the sustainability strategy.



## Sustainability Stewardship & Structure

Sustainability takes a top-down approach at Hatton National Bank, with direct leadership from the Managing Director/Chief Executive Officer to the Sustainability Committee which in turn gives leadership and direction to the Customer Service & Investor Group, Employee Liaison Group, and Environment & Community Advisory Group Sub Committees.

The Sustainability Committee comprises of key functional heads - Chief Financial Officer, Deputy General Manager (Human Resources & Administration), Deputy General Manager (Marketing & Retail Banking), Deputy General Manager (Corporate Banking) and representatives of the Risk Committee. It is endowed with the tasks of:

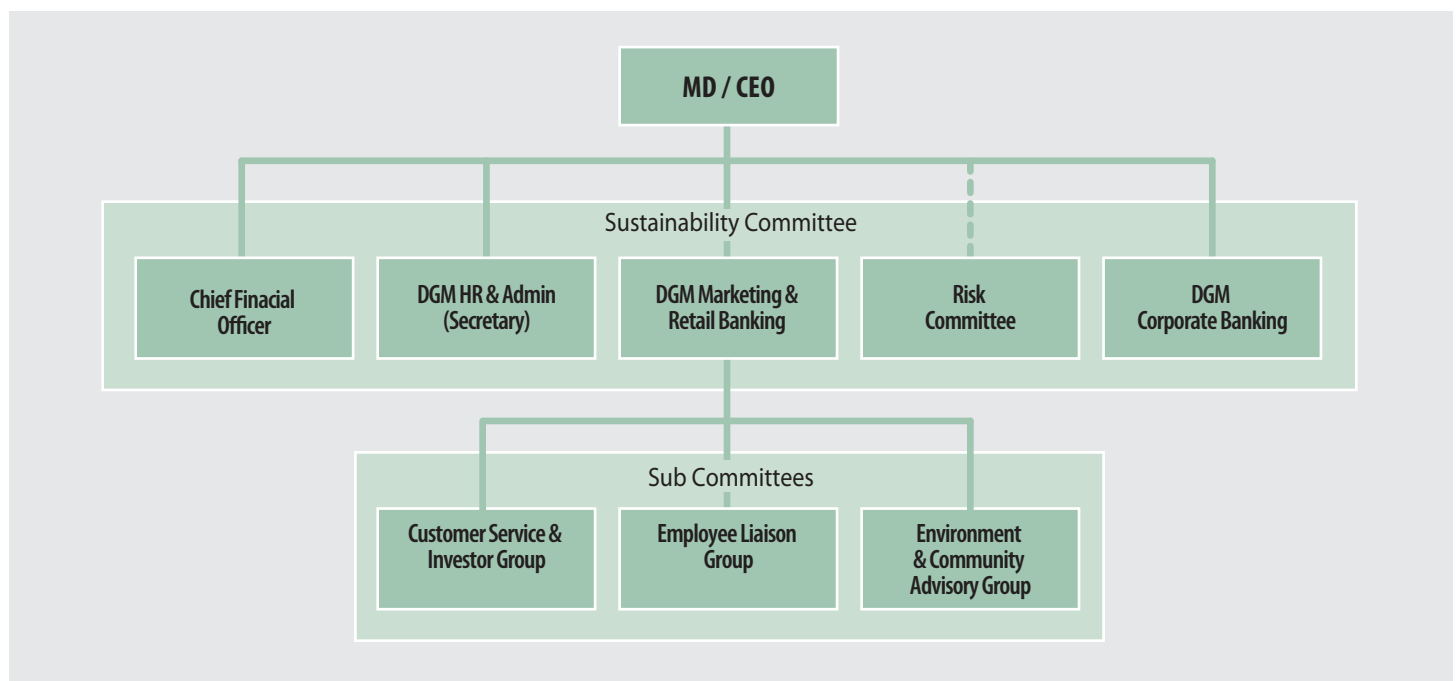
- Overseeing progress across our key stakeholders
- Acting as the think tank in developing the sustainability agenda
- Ensuring conformance with all sustainability guidelines
- Proactively evaluating decisions that impact on the reputation, ethics, and values of the Bank
- Identifying and managing areas of non-compliance with the sustainability principles

The Bank's Risk Committee oversees the CSR activities carried out by the Bank.

## Sustainability Foundation

Founded in 2009, the Sustainability Foundation further propels the CSR strategy and sets in place processes to carry out greater screening of initiatives to fuse with the strategic intent of the Bank. The Foundation independently drives the CSR strategy and acts as the base for sustainability initiatives. The Foundation formulates policy and strategy with implementation encompassing the Bank's employees. The presence of three Board Directors facilitates representation of Board engagement.

The Foundation's Trustees comprise of 3 members of the Board of Directors and 7 members of the Bank's Management team.



## KEY IMPACTS, RISKS AND OPPORTUNITIES

| Area of Impact       | Potential Impact   | Risks vs. Opportunities  | Engagement approach  | Process undertaken   |
|----------------------|--|--|--|--|
| <b>Social</b>        | <ul style="list-style-type: none"> <li>• Social development</li> </ul>   | <ul style="list-style-type: none"> <li>• <b>Risk:</b> Under developed human capital</li> <li>• <b>Opportunity:</b> Empowered human capital through skills development</li> <li>• <b>Risk:</b> Social alienation</li> <li>• <b>Opportunity:</b> Social engagement for wealth creation</li> </ul>  | <ul style="list-style-type: none"> <li>• Training and development for skill enhancement</li> <li>• Social inclusiveness through the Bank's product and service offering as well as sustainability initiatives</li> <li>• Access to finance through rural penetration with a strong presence across the nation</li> </ul>   | <ul style="list-style-type: none"> <li>• Youth empowerment and women empowerment through vocational training</li> <li>• Financial inclusion through Gami Pubuduwa to even the lowest social tier drawing them into self-sufficiency, converting the non-bankable to bankable.</li> <li>• Micro and SME products that are specialised for these sectors</li> <li>• Focus on health and well-being through access to clean drinking water, and sanitation</li> <li>• Imparting the precepts of savings and thrift to school children</li> <li>• Nurture creativity and skills amongst children</li> <li>• Over 205 branches and customer centres and 350 ATMs reaching out to rural populations</li> </ul> |
| <b>Environmental</b> | <ul style="list-style-type: none"> <li>• Global warming</li> <li>• Bio-diversity and eco-systems</li> <li>• Environmental degradation</li> </ul>   | <ul style="list-style-type: none"> <li>• <b>Risk:</b> Change in weather patterns, threatens the livelihoods of Sri Lankans and commercial activity</li> <li>• <b>Risk:</b> Depletion in bio-diversity and loss of eco systems pose danger to national and global welfare</li> <li>• <b>Opportunity:</b> The growing need for "green" investments</li> <li>• <b>Opportunity:</b> Lowered carbon footprint to become a "green financial institution" thus enhancing the Bank's corporate citizen image</li> <li>• <b>Opportunity:</b> Through green practices lower long-term energy and overhead costs</li> </ul>   | <ul style="list-style-type: none"> <li>• Alternative energy usage</li> <li>• Protection of bio-diversity in partnership with wildlife and national heritage conservationists</li> <li>• Construction of "green buildings" to minimise impact of Bank's operations to environment</li> <li>• Green procurement policy</li> <li>• Emphasis of corporate banking on financing of renewable energy and environmental friendly investments</li> </ul>   | <ul style="list-style-type: none"> <li>• Implementation of Green policy processes across the Bank</li> <li>• Implementation of 5S across the Bank to minimise waste and for good housekeeping</li> <li>• Adoption of a policy of Recycle and Re-use</li> <li>• Green buildings operational and in construction</li> <li>• Collaboration with National Wildlife Authority and National Trust of Sri Lanka</li> <li>• Suppliers educated and motivated to adopt green practices</li> <li>• Focus on lending for green investments</li> <li>• Alternative energy use in preliminary testing stage</li> </ul>  |
| <b>Economic</b>      | <ul style="list-style-type: none"> <li>• Community empowerment</li> <li>• National wealth creation</li> <li>• More equitable wealth creation</li> <li>• Changing behaviours and instilling values</li> </ul> | <ul style="list-style-type: none"> <li>• <b>Risk:</b> City-centric employment</li> <li>• <b>Opportunity:</b> Integration of rural economy through employment</li> <li>• <b>Risk:</b> Inward looking business model</li> <li>• <b>Opportunity:</b> Outward looking, nation-aligned business model</li> <li>• <b>Opportunity:</b> Customer development</li> <li>• <b>Opportunity:</b> Act as a catalyst in changing values and behaviours</li> <li>• <b>Opportunity:</b> Grow micro and SME customer capacities as future focus</li> <li>• <b>Opportunity:</b> Mobilise the nation into economic activity</li> </ul> | <ul style="list-style-type: none"> <li>• A policy of employment from every point of the Bank's presence thus developing the skill base for the preservation and development of the industry</li> <li>• Business strategy that has the bandwidth to evolve with national development</li> <li>• Specific customer development programmes around the year, aimed at building capacity and market linkages</li> <li>• Product development – new and existing</li> <li>• Programmes aimed at instilling values vital for economic momentum in the long-term</li> </ul> | <ul style="list-style-type: none"> <li>• Nation-wide recruitment</li> <li>• Elementary Course in Banking &amp; Finance for youth from Jaffna, an initiative to drive employability of youth from the northern province and to enrich the industry</li> <li>• Products and services that meet the national priorities</li> <li>• Customer development with a "to market" approach, thus sustaining their businesses</li> <li>• SME focused product development</li> <li>• Student banking units, rural empowerment</li> </ul>   |

# MANAGEMENT APPROACH



## Corporate Governance and Risk Management

Corporate Governance is a fundamental component of the culture and business practices of the Bank. It is the management framework that facilitates the conduct of the Bank's business in a responsible and accountable manner so as to promote its credibility and soundness, which will in turn lead to the overall stability of the banking sector in Sri Lanka. The Bank's Board of Directors is responsible and accountable for the management of the affairs of the Bank, its conduct of business, the design and implementation of a prudent risk management framework and its overall soundness.

The Board's role is therefore to provide entrepreneurial leadership to the Bank within the framework of prudent and effective controls that enable key risks to be managed. The Board sets the Bank's strategic aims, ensuring that the necessary financial, human and physical resources are in place for the Bank to meet its objectives. The Board sets the Bank's values and standards and ensures that its obligations to its stakeholders are clearly understood and met.

Risk is an integral aspect of the banking business and Hatton National Bank consistently aims to deliver superior shareholder value by achieving an appropriate trade-off between risk and returns. The Bank's Risk Management strategy is based on a clear understanding of the various risks, disciplined assessment, measurement and continuous monitoring leading to the mitigation of such risks. The policies and procedures established for this purpose are continuously reviewed in the Bank's quest to benefit from a blend of local and international best practices.

## Sustainability Precepts

### 1. Commitment to Sustainability

To fully integrate the consideration of ecological limits, social equity and environmental justice into corporate strategies and core business areas, to put sustainability objectives on an equal footing to shareholder maximisation and client satisfaction, and to actively strive to finance transactions that promote sustainability.

### 2. Commitment to 'Do No Harm'

Commit to do no harm by preventing and minimising the environmentally and/or socially detrimental impacts of the Bank's portfolios and operations by creating policies, procedures and standards based on the Precautionary Principle to minimise environmental and social harm, improve social and environmental conditions where the Bank operates, and avoid involvement in transactions that undermine sustainability.

### 3. Commitment to Responsibility.

The Bank bears full responsibility for the environmental and social impacts of its transactions including financial risks, as well as social and environmental costs that are borne by communities.

### 4. Commitment to Accountability

The Bank is accountable to its stakeholders. Accountability means that stakeholders have an influential voice in financial decisions that affect the quality of their environments and their lives - both through ensuring that stakeholders rights are protected by law, and through practices and procedures adopted by the Bank itself.

### 5. Commitment to Transparency

The Bank is at all times transparent to its stakeholders, not only through robust, regular and standardised disclosures, but also by being responsive to stakeholder needs for specialised information on the Bank's policies, procedures and transactions.

### 6. Commitment to Sustainable Markets and Governance

The Bank ensures that markets are more capable of fostering sustainability by actively supporting public policy, regulatory and/or market mechanisms that facilitate sustainability.

## MANAGEMENT APPROACH



### Information Security

Information security and Online data protection for the Bank's customers was a key area of focus in 2010. The Bank's implemented a new IT system designed to curtail fraud and manage online crime through management of operational, and financial risk, as well as by meeting the compliance requirements for BASEL 2. Data security was enhanced through vigilant monitoring and review of security measures in use.

The security systems of the Bank's ATM network were upgraded to meet the latest international standards with the implementation of state of the art monitoring and fraud preventive technology. ATM and branch security measures are the subject of continuous review and risk assessment. The Bank invested to protect the physical security of branches and cash machine networks. This included the deployment of anti-skimming devices to ATMs across the country. CCTV technologies have been further enhanced for additional security to deter security breaches at branches and customer centres.

### Product Stewardship for Fair Banking

The business case for sustainable banking is strongest when a bank can focus on a business line where it can take advantage of scale, become a first mover, or find a niche market. Hatton National Bank has demonstrated its ability to focus on key business lines that have been fully explored through the infusion of innovation across time.

The Bank's size and scale entails freedom of operations from the smallest to the largest financial need. As a partner in large-scale infrastructure development, the Bank has demonstrated its ability to service the financial needs across the chain of sub-contractors. From a business strategy perspective this has enabled the Bank to capture cash flows, thus enhancing its resource-base, whilst providing services across the product and service continuum of the Bank, thereby facilitating small time operators to participate on an equal footing to that of large and medium scale operators through financial inclusion.

Similarly, the Bank's role in serving the migrant workers of Sri Lanka has been a mainstay of the business strategy for many decades. Through its inward remittance services, the Bank provides a cost effective, secure and speedy service to Sri Lankan migrant labour placed across the globe. Moreover, the Bank has played a vital role in minimising the unnecessary consumption of foreign exchange by inculcating a savings habit amongst its client base. In turn, the Bank has effectively cross-sold a range of financial instruments and services such as agricultural loans whilst retaining foreign exchange savings. Thus, capacity building through savings and recycling and capture of capital has enabled the Bank to effectively sustain the livelihoods of its client base whilst also meeting national objectives towards the augmentation of foreign exchange reserves.

The balancing of business strategy with sustainable development of the nation, thus, has consistently delivered win-win solutions to both the Bank as well as to its clients and the nation at large.

### Financing Green Investments

Sustainable energy finance has increased our Bank's visibility and market differentiation in a highly competitive domestic market. The Bank has actively sought to endorse sustainable energy finance in propagating an awakening amongst Sri Lankan commercial enterprises to propel sustainable energy projects. As a niche market player, the Bank foresees future growth potential from a business strategy perspective, whilst fostering a sound solution to the growing energy needs of the nation. Through its related company Lanka Ventures (Pvt) Ltd., the Bank has indirectly financed a number of renewable energy projects and continues to support those seeking sustainable energy finance. The Bank's corporate banking division continues to support and encourage investments in environmental friendly projects.



The Bank's power sector exposure is quantified as follows:

| Description   | Capacity (MW) | Exposure as at 31 December 2010 | Contribution to the National Grid |
|---|---------------|---------------------------------|-----------------------------------|
| 22 mini hydro power plants in operation with a total capacity of                                | 51.5 MW       | Rs 605.3 Mn                     | 160.5GWh per annum                |
| 4 hydropower plants under implementation with a total capacity of (Total commitment Rs 648. Mn) | 15.6 MW       |                                 |                                   |
| 1 wind power plant with a total capacity of   | 9.6 MW        |                                 |                                   |

Presently, the Bank is evaluating the viability of financing into three wind power projects and seven mini hydro projects in the upcoming financial year.

In addition the Bank has participated in financing environment friendly projects such as hazardous waste reduction, and pollution control measures under the E-Friends Loans Scheme (exposure as at 31 December 2010 - Rs 320.7 Mn)

## Policies that shape our Management Approach



1. The Bank recognises that work-life balance is imperative for the well-being of the employees, and therefore supports and promotes a balance between work and life for all employees. The Bank fully endorses the maintenance of a sound balance in work and life and acknowledges that this enhances the overall productivity of employees, increasing staff retention, reducing absenteeism and raising employee morale. The scope of the work-life balance policy is organisation-wide and is applicable to all the employees. It specifically covers provisions for employee leave, career breaks, financial assistance towards achieving personal objectives, integration of family in sports and social activities, access to health related information and guidance, as well as employees' access to counseling where necessary.

- The Bank is committed to achieving high standards of health and safety (H&S) at the workplace and strives to achieve an incident free occupational environment. The H&S policy is one that is holistic and inclusive, and is a priority consideration for all business operations. By complying to the above standards which supersede the minimum H&S regulations laid out by the relevant authorities, the Bank creates a secure environment for employees, customers and other stakeholders.
- Equity & Diversity is promoted at the Bank through policies in place to eradicate discrimination. The Bank actively strives to ensure that its workforce reflects diverse populations and intends to create a place where employees hold common values about respect for others, and respecting differences between people. The principles of the Equity & Diversity policy ensure that the Bank adopts a non-discriminatory approach to employment, career development, training, and all other recognition and reward.
- The Bank's grievance handling policy ensures that its employees have the opportunity to make presentations to the Management for redress. This is aimed at improving employee-employer relations and thereby instituting sound industrial relations. The grievance handling procedure is a three-step approach that allows the grievance to be escalated to the highest level of authority within the organisation ensuring fairness and transparency of the process.
- The Green Pledge commits every employee to act with environmental consciousness. Every employee at the Bank is committed to the pledge and not only limits his or her behaviour to the precepts of the pledge but also commits to cascade the awareness across his family and peers.
- Human rights are upheld at every aspect of the Bank's operations. The Human Rights policy reflects the Bank's commitment to conduct business in a manner consistent with the principles of the policy. The Bank also strives to protect human rights within the Bank's areas of influence. The Bank does not employ workers under the legal minimum age, prohibits the use of all forms of forced labour, respects employees rights to join, form or not join a labour union, respects the principles of collective bargaining, provides health & safety at work, is non-discriminatory to age, race, religion or sex, prohibits sexual harassment, limits work to standard accepted hours and condemns the use of corporal punishment.
- The Bank's Code of Conduct and Compliance and Integrity Programme is at the heart of its management approach to sustainable business. The Code is applicable to all employees and calls for honest and ethical conduct, outlines conflict of interests, misuse of corporate opportunities specifically information security, defines gifts and entertainment, calls for financial integrity in disclosure to investors and regulators, calls for compliance with laws, regulations and rules, and commits every employee to report concerns where the code has been breached.

# STAKEHOLDER ENGAGEMENT



Connecting with varied stakeholders is a vital aspect of the Bank's operations. As a responsible business, the Bank understands that its actions will affect others and that their actions in turn will reflect back upon the Bank. As a part of the process of managing social and environmental sustainability, the Bank is cognizant of the need to increase engagement with stakeholders, making itself more open and more accountable to a wider range of interested parties.

Thus, effective stakeholder engagement assists the Bank to understand the current emerging challenges faced by its stakeholders and in turn challenges the Bank to develop mutually beneficial solutions.

This process also entails communicating results clearly, openly, and thoroughly, a critical criteria, as the Bank's business depends upon credibility, and on the trust placed in the Bank by its stakeholders.

On the external front, the Bank engages with the wider community. Communicating the Bank's performance in sustainability initiatives and social and environmental management to external stakeholders is a key

component in creating long-term value. Among other things, it enhances the Bank's reputation, builds its brand, and improves its image in the community.

Demonstrating financial gains from sustainable banking enhances shareholder value. Moreover, good public reporting has improved the Bank's access to capital and to international markets. A major part of improving communication is engaging in clearer, more open, and more transparent public reporting on environmental, social, and economic performance. Leadership in reporting has assisted the Bank to develop and differentiate itself in the marketplace and generated positive relationships with external stakeholders.

Another aspect of increasing engagement with stakeholders is promoting corporate governance. The manner in which governance is embraced by the Bank has been described in detail in the Corporate Governance section of this report on page 59 - 75.



## Engagement Processes

| Stakeholder                | Process   |
|----------------------------|---|
| <b>Customers</b>           | <ul style="list-style-type: none"> <li>Bank carries out, on an on-going basis, a series of qualitative and quantitative measures both through in-house as well as through outsourced research houses. The results of these surveys and research processes are used continually to determine how well and to what extent the Bank's service portfolio as well as the service levels require to be augmented.</li> <li>Meetings, events and festivities that bring a cluster of customers face to face with the Bank's Management also allow the Bank to gauge the relationship with each customer and to fortify these relationship going forward.</li> <li>The Bank conducts a series of "secret shopper" styled programmes that aim to allow the Bank's Management to "experience" the service levels afforded to the customer base. These "experience" sessions allow the Management to determine changes to the service levels and to the service code.</li> </ul> |
| <b>Employees</b>           | <ul style="list-style-type: none"> <li>Various internal communication tools and employee feedback tools, open door policies, HatnaMag (the Bank's internal publication) and the Bank's inspiring innovation programme "Spark" all contribute towards the creation of an open and constructive dialogue.</li> <li>The "CSR Champion programme" and "The Green Pledge" undertaken by the Bank's employees further serve as an exercise to strengthen the engagement process across the Bank.</li> </ul>   |
| <b>Financial Investors</b> | <ul style="list-style-type: none"> <li>Annual General Meeting is an effective dialogue process on matters which are relevant and of concern to the general membership.</li> <li>The Investor Relations team headed by the MD/CEO has regular discussions with key institutional shareholders/ Fund Managers to share highlights of the Bank's performance and also with the view of obtaining constructive feed-back .</li> <li>The Bank's website also serves as a tool towards effective engagement.</li> </ul>   |
| <b>Communities</b>         | <ul style="list-style-type: none"> <li>The Bank's branches serve as the main medium for engagement with the community. With a high level of interaction taking place between the staff of branch offices and communities within which they operate, community focused sustainability initiatives have largely been stimulated through stakeholder dialogue.</li> </ul>  |
| <b>Suppliers</b>           | <ul style="list-style-type: none"> <li>The adoption of the "Green Procurement Policy" ensures that sustainability criteria are included in specifications to suppliers and that sustainability criteria are met in the award of contracts by ensuring that suppliers' environmental credentials are considered in the supplier appraisal process.</li> <li>Bank communicates and educates suppliers on the Green policy and the need for the implementation of ethical manufacturing processes for the long term sustainability of their own businesses.</li> </ul>   |
| <b>Environment</b>         | <ul style="list-style-type: none"> <li>The Bank engages with like-minded conservationists and experts in the areas of bio-diversity conservation, "green" design and construction and forged business partnerships along the lines of green finance/renewable energy.</li> <li>The Green Pledge has been a tool to engage with those stakeholders who are external to the Bank, thereby cascading the green message to communities in which the Bank operates.</li> </ul>   |

### Engaging stakeholders through sustainable business practice

The Bank strives to consistently achieve a balance through the infusion of practices towards the realisation of social and environmental considerations in business. To this end, it is aware of the role of and the need for stakeholder inclusiveness as a core driver of sustainable business practice. This is aptly illustrated through the following:

#### A) Policies with specific environmental and social components applied to business lines

- Green Pledge Champion programme: training and awareness for employees, customers and suppliers on decreasing the impact on the environment through adoption of green practices.
- Customised training programmes for branch teams on customer service followed by mystery shopping exercises
- Sustainable procurement policy necessitates that suppliers comply with and adopt sustainability precepts in the functioning

of their own businesses. Education of suppliers towards the needs of the procurement policy as well as on how to integrate green practices to business has been an area of focus over the past two financial years (2009,2010).

- Green Financing has become a key area of focus for the Bank and it has been proactively driving this area of business through lending schemes that afford better terms than the conventional lending tools.
- Enhancing capacities by imparting financial and specialist know-how to customers (Refer Table page 92 for scope and scale of such activities undertaken in 2010). As depicted below, the Bank through a well-defined stakeholder engagement process undertakes customer education with initiatives that enhance the beneficiary's financial literacy as well as general business and sector related skills.

## STAKEHOLDER ENGAGEMENT



| Description  | Locations   | No of programmes | No. of participants |
|--|---|------------------|---------------------|
| Trade finance for corporate customers  | Colombo   | 1                | 120                 |
| Training for SME customers & non customers                                     | Matara  | 1                | 40                  |
| General awareness programmes   | Boralesgamuwa, Chilaw, Gampaha, Mirigama, Nuwara Eliya, Tangalle, Tissamaharama | 7                | 15,615              |
| Entrepreneur development programmes including specialised programmes for youth | Boralesgamuwa, Galle, Giriulla, Nittambuwa, Vavuniya                            | 5                | 1,025               |
| Training for dairy farmers   | Homagama, Horana, Padduka, Wariyapola   | 5                | 850                 |
| Training on new technologies for offshore fishing                              | Chilaw  | 1                | 100                 |
| Awareness programmes for Farmers   | Kottawa, Mannar, Nawalapitiya, Nuwara Eliya, Thambuttegama, Trincomalee         | 6                | 20,950              |
| Climate change & water resource management                                     | Nuwara Eliya  | 2                | 200                 |
| Student Managers conferences (for school children)                             | Colombo, Tissamaharama, Galle, Ratnapura, Kandy, Kurunegala, Jaffna             | 7                | 1,000               |

### B) Procedures for assessing / screening environmental and social implications of business operations with Processes for monitoring clients' implementation / compliance

Performance evaluation and measurement of sustainability criteria within the functions of the Bank are carried out through a range of energy efficiency, waste improvement and environmental performance criteria. The Bank meets and benchmarks against Key Performance Indicators and undertakes initiatives to enhance the environmental credibility of the organisation whilst minimising its carbon footprint.

Hatton National Bank adopts a systematic process to assess the environmental and social risks and opportunities arising from its clients' business activities, manage the bank's exposure to them, and improve operating efficiency and effectiveness.

This sustainability system ensures that sustainability considerations play a part in the Bank's decision-making processes, including credit assessments and portfolio analysis. It enables the Bank to consider

environmental and socio-economic issues comprehensively, and by so doing, move beyond simply complying with regulations to taking advantage of sustainability opportunities.

Score-cards and rating systems are implemented to assess risks especially in lending. Covenants placed in offer letters and agreements are followed by regular monitoring and inspections. As a policy the Bank endeavours to balance financial gain with sustainable practices.

### C) Processes for improving staff competency to implement the environmental and social policies and procedures as applied to business lines

Changing behaviours is deemed critical to the long-term effectiveness of the Bank's sustainability strategy. Towards this end, the Bank continues to initiate programmes that instill the values of social responsibility and which aim towards the achievement of social reform.

By commencing with its own employees, the Bank undertook a Green Pledge coinciding with the World Environment Day in 2009. The Bank

drew inspiration from the United Nations theme for 2009 “Your planet needs you. Unite to combat climate change” to compose the actions stated in the Green Pledge. The pledge was preceded by a comprehensive training for team leaders on waste management and energy efficiency whilst an internal communication strategy supported the initiative increasing awareness amongst the Bank’s employees and customers on an individuals’ desired action towards a greener planet.

The Bank in 2010 carried out comprehensive training programmes directed at its employees with a view to enhance their awareness on green practices including sustainable products. Since the introduction of the “Green Pledge”, a pervasive drive to inculcate green practices at both the workplace and home has been deployed. Numerous internal communication programmes have been carried out and the Bank’s e-learning tool on the intranet carries a module on green practices with specific focus on the key areas highlighted under the “Green Pledge”.

Moreover, the implementation of sustainability KPI tracking systems has enabled the Bank to persistently strive towards reaching greater efficiencies in green practice. To inspire and motivate employees to adopt and strive for excellence in the adoption of green practices, the “Green branch” awards scheme was launched. Every financial year, after assessment of KPIs, the branch that excels on both quantitative (KPI based criteria) and qualitative fronts (softer criteria such as taking the green message to customers and other stakeholders) is declared the best “green branch” for the year.

#### **D) Interactions with clients/investors/business partners regarding environmental and social risks and opportunities**

The Bank also considers the behaviours of all of its stakeholders in championing change towards sustainability awareness and empathy. From a supplier perspective, the Bank adopts a sustainability conscious procurement strategy which gives precedence to suppliers who follow sustainability requirements as laid out in the procurement guidelines. Currently in the first stages of implementation, the Bank expects the sustainability procurement strategy to heavily impact the roles and actions of suppliers in the years to come, necessitating change in the way they do business in the future.

From a national and business perspective, the Bank considers behavioural change to a more conducive social and economic focus, a dire need for the future development of the nation. In addressing these needs, the Bank undertook to build talent and catalyse change in the Northern province due in large to the vast gap in resources for the communities resident therein. After more than three decades of conflict and with considerable brain drain due to it, the Bank recognised the need for a large drive for advocacy in the area. In developing the existing resources in the province, the Bank resolved to train and recruit participants from the Northern province for the Bank’s staff requirements for the area. With several batches of school leavers unemployed, the Bank has undertaken to train and develop the selected participants to better equip them to enter the financial services

industry. Consciously training more than the Bank’s requirement, it is the expectation of the Bank to build capacity by developing the youth of the area from both an intellectual as well as social perspective to obtain employment in other financial service organisations in the area. The programme is expected to continue over the next three years and will be cascaded to the Eastern province in 2011.

Along the same lines, the Bank’s “Divi Saviya” Programme aims to create financial inclusion for rural micro-entrepreneurs. Started over two decades ago the programme has facilitated over 100,000 youth micro-entrepreneurs to date. Working in tandem with the Bank’s Micro-financing programme “Gami-Pubuduwa” or “Village Re-awakening”, the financial literacy efforts are compounded by giving the youth of rural Sri Lanka the opportunity and the accessibility to financial services.

As a part of its innovative initiatives to develop the rural economy in Sri Lanka and in part to further augment the “Divi Saviya” Programme the Bank has collaborated with corporate partners to go beyond the normal engagement of providing financial assistance to customers. Through tripartite agreements – with the Bank, its customers and corporate buyers – the Bank assists customers to find markets for their products. In establishing “to market” linkages, the Bank has conducted trade fairs, utilised information technology to actively promote customer products and linked the producers to online buyers, and assisted towards quality improvements through introduction of quality assurance experts. The Bank’s collaborative programme aims to build and strengthen new linkages within these communities enabling them to meet sustainability opportunities and risks with greater confidence.

#### **Membership Commitments**

- ACCA Sri Lanka Branch
- American Chamber of Commerce (Amcham)
- Asian Bankers Association
- Association of Professional Bankers Sri Lanka
- Banking with the Poor Network, Singapore
- Employers Federation of Ceylon
- International Chamber of Commerce Sri Lanka
- Sri Lanka Forex Association
- The Ceylon Chamber of Commerce
- The Chartered Institute of Management Accountants - Sri Lanka Chapter
- The Institute of Bankers of Sri Lanka
- The Institute of Chartered Accountants of Sri Lanka
- Trade Finance Association of Bankers

# OTHER STAKEHOLDERS' PERSPECTIVE

## CUSTOMER RESPONSIBILITY



Hatton National Bank has been perceptive to customer needs from its very origins over a century ago. Evolving over the years to meet the changing needs of the customer and to match international standards in financial servicing, the Bank has built its core business strategy around customers as one of its primary stakeholder groups.

The Bank recognises that a sustainable customer orientation extends beyond merely providing services sought by its customers. It recognises the need to continually review and redesign its service offer whilst proactively reaching out to create a difference in the way in which the Bank economically empowers its customer base. Accessibility, innovation, use of best practices in product and service offer as well as

financial literacy education form the crux of its strategy towards customer responsibility.

### Exceeding customer expectations

During the year in review, the Bank maintained its efforts towards active participation in determining customer expectations and satisfaction levels by undertaking a number of qualitative and quantitative research projects. The key outcomes of the research conducted during the year have been fully assessed and are being taken into consideration by the Bank's Management in an effort to elevate the levels of customer service as an ongoing and proactive process.

| Project  | Description  | Period of Implementation | Activities undertaken in 2010   |
|--|--|--------------------------|---|
| Market Research survey – Youth                           | Survey of youth with intention to tap insights into their consumer behaviour towards financial services, map perceptions and need patterns with the intention to launch a youth empowerment product with two variants for rural and urban consumers  | 2010 and ongoing         | Sample of 600 respondents aged between 18-25 years from rural and urban geographies in Colombo, Kandy, Galle, Vavuniya, Badulla and Ampara. The survey is being conducted in 3 phases comprising of a familiarisation workshop with facilitators, qualitative research followed by a quantitative research process.<br>Financial assistance towards the project from SEEP Foundation USA                                |
| Market Research Survey – Remittances                     | Survey of senders and receivers of remittances to determine ways in which to improve on the existing remittance processes with the intention to launch a new remittance product. Research carried out in collaboration with International Fund for Agricultural Development (IFAD) and Womens World Bank (WWB) | 2010 and ongoing         | Sample of 150 receivers of remittances from the Southern and Central provinces and 40 senders resident in the Middle East. Focus Groups are the main research method employed.  |
| Continuous product / service Quality improvement schemes | A multitude of initiatives are undertaken to ensure continuous product improvement. These initiatives are ongoing programmes of action that continue irrespective of timelines with the objective of reaching excellence in customer satisfaction  | Ongoing                  | <ul style="list-style-type: none"> <li>Internal reviews – a bottom-up approach to service enhancement with suggestions stemming from branch level.</li> <li>Mystery shopper schemes where service quality is rated periodically across the branch network</li> <li>Meetings, events and festivities that bring a cluster of customers face to face with the Bank's Management for interaction and discussion</li> </ul> |
| Corporate Customer Audit                                 | Quarterly audits carried out to determine levels of satisfaction and to proactively mitigate issues  | Ongoing                  | Audits are carried out periodically   |



Product and service enhancement initiatives took many forms during the year. From a product stewardship perspective, new product development and improvement of existing products through thorough product assessments was a significant aspect of the Bank's product

development process. Similarly, continuous focus on prompt response to customer complaints continued to be critical to the Bank's overall customer centric service approach.

| Project                        | Description  | Period of Implementation | Activities undertaken in 2010  |
|--------------------------------|--|--------------------------|--|
| Product Development Committee  | Meets periodically to assess market needs based on research and customer suggestions   | Ongoing                  | Determined changes to existing products and designed new products and services – refer list of new/ re-launched products on page 96.   |
| Addressing Customer Complaints | Once a customer complaint is made, either verbally or in a written manner, the Branch Manager in his capacity as the Chief Complaint Officer acts to solve or rectify the issue at hand. Where he is unable to do so it is escalated to Head of the Region, the Chief Complaints Officer or the Financial Ombudsman respectively. Circular 2003/25 outlines the process whilst a centralised unit for resolution of complaints under the Deputy General Manager (Marketing and Retail Banking) liaises with the Financial Ombudsman. | Ongoing                  | During the year a total of 102 written complaints were received by the Bank - of which 86 were received by the Bank's Management and all were resolved. The balance 16 was those received by the Financial Ombudsman and referred to the Bank. All these were also resolved. |
| Customer Safety                | Ensure customer safety through better security and compliance, customer privacy and responsible lending to ensure that customers are exposed to levels where repayments will be an issue   | Ongoing                  | Enhanced infrastructure at branch level to offer further levels of privacy, evaluation of customer context to determine saturation of capital and interest repayments as per income, continuous process to ensure strict compliance  |

## Multi-point distribution enhances accessibility to financial services

The Bank employs a multi-point distribution strategy with a view to increase the penetration of its service offer, the strategy being to reach even the most rural of customers. As such the Bank operates fully fledged branches and customer centres, micro branches that cater to the specific needs of micro-enterprises and doorstep branches which offer the most basic of banking services in deep rural pockets where communities have little or no access to financial services.

During the year accessibility was greatly enhanced through the opening of several new branches and customer centres in all nine of the country's provinces. In total 19 branches and customer centres were opened in 2010 of which Negombo Metro serves as a priority-banking centre whilst Kandy City Centre branch operates 365 days of the year. Hatton National Bank truly demonstrates its national outlook through its distribution strategy with 205 customer centres reaching out and serving customers across the nation, empowering them and drawing those who have never used the services of a bank into the arena of financial inclusion.

The Bank's network of customer interaction points facilitates a greater understanding of location specific trade requirements with greater emphasis on areas that lack adequate financial infrastructure. As such in 2010, the focus remained on growing the Bank's infrastructure in the Northern and Eastern provinces that still remain inadequately served. The opening of the 13th customer centre in Jaffna during the year assisted in the creation of greater awareness amongst customers on the

ways and means in which the Bank can support their personal and entrepreneurial endeavours.

In 2010 the Bank's Automated Teller Machine network expanded to 350, placing the Bank at the forefront of ATM penetration in the country (refer table on page 40)

## Product Development to resonate the customer's lifestyle

During the year under review, Hatton National Bank reviewed its product portfolio to ensure that each of the Bank's products and services matched customer expectations and served to uplift their lifestyles. As such during the year 8 products were either re-launched or newly launched into the marketplace.

Prior to making the products or services available to the customer, each product undergoes a rigorous assessment for compliance. Each product is fully tested and evaluated for suitability. Most often products are put forward for compliance testing and where applicable to third parties (such as the Central Bank of Sri Lanka) for authorisation.

## CUSTOMER RESPONSIBILITY



|                 | Product                                   | Description   |
|-----------------|---|---|
| New Product     | HNB Privileged Account                    | Current account product that targets executives within SEC A, B classifications. Product includes a range of diverse value additions.   |
|                 | Special package for Medical Practitioners | Package offered to customers in the medical profession and consists of a range of financial services.   |
|                 | Special credit package for executives     | A personal loan scheme that offers credit for a variety of financing needs.   |
|                 | HNB Pay Link                              | Offered to corporate clients to facilitate SLIPS transactions via the internet  |
| Revised Product | HNB World NRFC & RFC Draw                 | A draw scheme that was formally known as HNB Pathum Udanaya was rebranded as HNB World to reflect a more global appeal. Scheme encompasses NRFC, RFC and Singithi Surakum accounts. |
|                 | Lifeline Account                          | A current account product that includes free life insurance.  |
|                 | Senior Citizens Account                   | A scheme that provides special privileges to senior citizens over 55 years of age.  |
|                 | Dream Drive Vehicle Loans                 | Vehicle loan product  |
|                 | Millennium Shield                         | Insurance cover offered free to NRFC account holders who maintain a pre-specified minimum balance   |



## Customer Engagement

Hatton National Bank actively engages in a robust and consistent process of customer engagement. The objectives of the Bank's customer engagement process are two-fold. Primarily it aims to understand issues, concerns and suggestions from customers for the betterment of the service process such that continuous service development can be achieved. Secondly, it engages with customers with the intention to educate and empower customers with the Bank acting as the catalyst for livelihood and capacity development. The process of engagement is varied for the first objective and comprises of initiatives such as personal interaction at the Bank, at

events held for customer interaction, at meetings at village level and with Gami Pubuduwa Upadeshakas (Micro banking field officers) as well as through written communications with customers, suggestion box inputs, queries on line, email newsletters and via email. For the second objective the engagement process is unique to each engagement project. During the year 2010, the Bank continued to develop upon the core engagement projects that have been in place over the past three to five years whilst adding further projects to enhance the overall customer education, capacity development aspect.

| Project                                   | Description  | Period of Implementation | Activities undertaken in 2010   |
|---|--|--------------------------|---|
| Lowa Dinana Singiththo                    | The Programme is conducted in association with the Ministry of Education and offers a unique opportunity for the young generation to bring out their creativity skills and inbuilt talents in different areas such as Art, Signing, Speech, Drama and Writing. The Bank is confident that through the development of these skills a child will benefit and be better facilitated to meet challenges in the future especially through the development of character and self-assurance and by empowering them to reach out for bigger goals. | 2008-2010                | The programme had a participation of 500,000 children from over 9,800 schools island wide participating to display their talents and creativity in any three of their competent national languages.   |
| Industry specific education for customers | Specific programmes for customers engaged in agriculture, fisheries, and paddy and cash crop cultivation are held periodically with the intention of enhancing customer know-how and to impart best practices. As an institution that has been globally recognised as one that has reached out to the rural population through programmes aimed at financial literacy, the Bank understood the dire need for a programme focused on knowledge based capacity building.   | Ongoing                  | <ul style="list-style-type: none"> <li>Sub-programmes dedicated to agro-techniques with the collaboration of agro-experts to showcase the latest technological aspects of farming, quality improvement methodologies, packaging techniques as well as how to obtain marketing linkages.</li> <li>Sub-programme focused on the latest fishing techniques, the more optimal fishing catchment areas as well the preservation and transportation methods.</li> </ul> |



## CUSTOMER RESPONSIBILITY

| Project   | Description   | Period of Implementation | Activities undertaken in 2010  |
|---|---|--------------------------|--|
| Student Banking: Financial Literacy for the Youth               | <p>The Student Banking Programme was established in 1990 to involve the rural youth, provide them access to resources and to allow them to interact with the rest of the nation.</p> <p>Through the aegis of the Ministry of Education, the Bank progressively approached schools, assisted them in infrastructure development and capacity building. To complement the national curriculum the Bank established Student Banking Units within the premises of these schools. Through this process the Bank undertook to not only inculcate the savings habit but also to impart financial education, responsibility and accountability to the Student Bankers. In the long term, the Bank is confident that its interaction with the students would enable them to procure employability with ease. To this effect the Bank certifies the participation of each Student Banker in the Financial Literacy Programme.</p> | 1990-ongoing             | <p>Over the years the Student Banker programme has successfully trained over 30,000 students.</p> <p>The objective of promoting a savings culture among students has been significantly met with 158 HNB Student Banking Centres administrated by 1,000 Student Bankers. The Programme contributes towards personal growth, imparting of marketing and administrative know-how to students whilst creating a scenario of self-assurance, capability and positivism amongst students from an early age.</p> <p>On a quarterly basis, Branch level training was conducted for the Student Bankers whilst special financial education programmes were conducted at the participating schools focused on educating the majority of the student population.</p> |
| "Divi Saviya": Financial Literacy for Rural Micro-entrepreneurs | <p>The Bank's financial literacy programme aims to create financial inclusion for rural micro-entrepreneurs. Started over two decades ago the programme now popularly known as "Divi Saviya" has facilitated several thousands of youth micro-entrepreneurs to date. Working in tandem with the Banks' Micro-financing programme "Gami-Pubuduwa" or "Village Re-awakening", the financial literacy efforts are compounded by giving the youth of rural Sri Lanka the opportunity and the accessibility to financial services.</p> <p>Refer Case in point: "Broadening the national economy through micro-enterprise development".</p>   | 1990-ongoing             | <p>During the year under review, under the "Divi Saviya" Programme approximately 39,000 individuals were facilitated and encouraged into mainstream commercial entrepreneurship, thereby enabling them to create a scenario of livelihood sustainability as well enlarging the national economy. Of these 20,600 entrepreneurs were from the Northern and Eastern provinces, thus showcasing the Bank's focus on aligning its business and sustainability strategies against the national strategy for economic development.</p>   |
| Financial Management Education                                  | <p>Collaborating with International Finance Corporation (IFC), Hatton National Bank established a programmed aimed at creating a greater understanding of financial management amongst Small and Medium Enterprises in Matara.</p>  | 2010                     | <p>The Programme allowed both the customers of the Bank as well as other SME's to interact with experts in the area of financial management to better understand how practices can be utilised in their own businesses.</p>  |
| Corporate Seminars  | <p>Seminars on specialist areas of Banking and financial management are held by the Bank to allow corporate customers to interact with financial service experts from across the world.</p>   | Ongoing                  | <p>In 2010, an international trade seminar was held with renowned speakers from the Investment Bank JP Morgan. A total of 120 representatives from the corporate banking customer base were present.</p>   |



## Case in point: “Broadening the national economy through micro-enterprise development”

For over two decades Hatton National Bank has been actively broadening the national economy through its Financial Literacy programmes now rebranded as “Divi Saviya” Programme providing Financial Literacy to Rural Micro-entrepreneurs in tandem with the Bank’s micro-banking product “Gami Pubuduwa” or “Village Awakening”. In the late 1980s as Sri Lanka faced one of the worst social debacles of its times – a youth insurgency – Hatton National Bank conceived the two programmes aimed at drawing the nation’s youth into economic productivity in an effort to stem future youth unrest. The Bank’s finest achievement lies off the beaten track in the rural areas of Sri Lanka. Hatton National Bank’s Barefoot Banker named Gami Pubuduwa Upadeshaka (Village Awakening Advisor) steers both the financial literacy and the micro financing programmes and acts as a mentor to budding rural entrepreneurs. Sustainable development and financial security have been the outcomes of this programme: empowered intellectually and financially, the rural youth associated with the Bank’s programme understand and accept that self-sustenance through agriculture and commercial enterprise is a sound proposition for future wealth creation.

Mr W W M Wijekoonbanda’s success as an entrepreneur is a fine example of how “Gami Pubuduwa” and its financial literacy programme have spurred the rural economy. His story is one amongst over 100,000 youth entrepreneurs, all of whom started with almost nothing to achieve economic stability and a hopeful future. “When I approached the Gami Pubuduwa Bankuwe Mahattaya (Gami Pubuduwa Upadeshaka), all I had, was the will to succeed. I lived in Kantale then, in the Eastern Province of Sri Lanka, and when I heard about the “Gami Pubuduwa” and its financial literacy programme I knew that there is a higher power out there, listening to our every prayer”, he recalls.

“The Bankuwe Mahattaya (gentleman from the bank) too shared our enthusiasm. I felt that he too was just like us. He understood what I wanted and he believed in my dream and because of his ability to relate to me he helped me obtain a Rs. 15,000/- cultivation loan. Then I was able to obtain a loan of Rs 150,000/-. For me this was an incomprehensible amount of money, and with it I purchased a stock of paddy. We had it pounded at various mills and then distributed throughout the area of Maharagama. Seeking our fortune in the Western Province was a big step for us. That was in 1999,” he notes. Now Mr W W M Wijekoonbanda is an entrepreneur of firm standing, the Bank assisted him along his journey, not only financially but also through financial literacy, and as he notes “it wasn’t just about getting a series of loans, No, my relationship with the Bank was much wider, they helped me understand how to do business, taught us the basic principles in financial management and was always at our side to help us grow by educating us”.

“Our business has flourished, and Hatton National Bank has been there with us every step of the way as we continue to make progress with our dream. I now have 20 employees working under me. The purchase of paddy and the milling process takes place in Kantale under the supervision of my brother Wijekoonbanda, while sales-related transactions are handled by myself at our warehouse in Mattegoda. The warehouse is currently on rented premises but in 2006 we bought some land close to our current warehouse premises and we have constructed our own new warehouse there with the intention of achieving greater heights in our business. We named it as ‘Siyasa Sahal Sala’ and it was opened in 2008”.

# OTHER STAKEHOLDERS' PERSPECTIVE

## EMPLOYEE RESPONSIBILITY



### Developing people to meet HR needs beyond the organisational context

As Sri Lanka as a nation stands poised for development, garnering opportunities from a post-conflict scenario, Hatton National Bank recognises that it too needs to play a pivotal role in creating a conducive environment that goes beyond the context of offering financial services. In this respect, the Bank has been and will continue to be responsible for HR practices and initiatives that go well beyond the organisational context in terms of benefits accrued.

Whilst from every angle of the sustainability strategy the Bank has endeavoured to instill values and knowledge across its stakeholder groups with the end objective of growing know-how and capacities

towards spurring the national economy, in employee responsibility the Bank has focused on instilling the pursuit of excellence amongst employees and future employees. The Bank truly demonstrates its national stance by engaging in Human Resource practices that not merely develop an individual in the capacity of his / her job function but focus on developing an individual who is an inspired, motivated professional with the depth and capacity to make a significant contribution to the industry and Sri Lanka's new economy. Therefore, the intention is to focus beyond the organisation and build Human Resources that will add value to the nation in terms of building national HR capacities that match or supersede international standards.

| Initiative                      | Description  | Implementation period | Outcomes in 2010  |
|---------------------------------|--|-----------------------|---|
| "Upward Mobility" System : HRIS | HR Information System enables strategic Human Resource intelligence tools to be utilised for planning and decision-making and is expected to improve business performance. The system enables the Bank to cater to personalised HR needs of employees. It acts as a sound base for organisational development. | 2008-ongoing          | Progressively implemented in 2010 and has produced impressive results in terms of enhancements in performance management, communication, training and development, quick decision making and has promoted a concept of paperless functions with respect to HR.  |
| Online Recruitment              | The Bank's recruitment process was overhauled with the implementation of the e-recruitment process. The system covers the main aspects of the recruitment process online. Hatton National Bank is the first organisation in Sri Lanka to introduce an online recruitment system.                               | 2009-ongoing          | During the year the Bank undertook the recruitment process – from application assessment, screening of applications, evaluation tests– online. The new application has decreased the recruitment time frame to 3 weeks in comparison with the 2 months in previous years. Thus the e-recruitment process accelerated the recruitment cycle giving the Bank the capability to recruit with ease. |
| Creating a culture of Learning  | The Bank actively strives towards the creation of a culture of learning, one that is built on a firm foundation of knowledge, skills and attitude. The Bank effectively utilises Training and Development as a tool towards the creation of high levels of functional and emotional aptitude.                  | Ongoing               | The Bank's HR Development Plan mirrors the strategic vision, objectives and the overall strategic intent for the Bank and in broader perspective that of the industry and the nation. <ul style="list-style-type: none"> <li>Overseas Training – over 10 per cent of the Bank's Executive Management attended reputed training programme overseas.</li> </ul>                                   |

| Initiative                                    | Description  | Implementation period | Outcomes in 2010  |
|---|--|-----------------------|---|
|   |  |                       | <ul style="list-style-type: none"> <li>Local training – 551 staff members attended external programmes</li> <li>In-house training – 4,094 employees participated in training programmes organised by the Bank's Training Centre</li> <li>Management Development Programme – 36 Junior executives attended a 3 month, 12 module programme aimed at training Junior Executives to meet future corporate and personal needs.</li> <li>Continuous Professional Development (CPD) – 45 per cent of the Bank's Branch Managers have now participated in a CPD programme at the Post Graduate Institute of Management over the last 3 years, an initiative that stems from a quality enhancement approach to business by building on managerial know-how to equip the Managers to take up challenges and meet current and future requirements.</li> <li>Efforts were made to facilitate better communication with classes conducted to enhance the proficiency in all 3 national languages.</li> <li>Mentoring programme – revisited and accelerated to ensure that the executives of the Bank receive greater attention in terms of developing both soft and hard skills, thus moulding them for future leadership roles.</li> <li>Coaching and Counseling programme conducted by a UK based trainer where Regional Heads were trained to coach and counsel, thereby extending their people skills such that they will be better able to address people related matters arising from their respective regions.</li> <li>E-Learning has awakened the desire for knowledge amongst the Bank's employees. The tool carries courses on every aspect of banking, general management, finance, customer service and a host of other more specialist areas of interest, and gives the user the ability to build competence through online competency tests.</li> </ul> |
| 5S Implementation                             | The Bank has implemented 5S across its entire Branch Network and attributes the adoption of the housekeeping system to its high levels of efficiency   | Ongoing               | In 2010, 34 branches were short listed to compete at the 5S competition organised by the Taiki Akimoto 5S - Japan Sri Lanka Technical & Cultural Association. The Bank was recognised for its excellence in 5S implementation when it won 5 awards.   |
| Recognising & Rewarding Employee volunteerism | Employee safety is given the highest of priority at the Bank with many measures in place to ensure that health and safety issues are proactively managed. Similarly, the Bank's focus on sustainability makes it a priority concern. As employees are the foundation of the organisation, the Bank believes that employees should champion health and social responsibility in order to inculcate ownership to initiatives. As such three volunteer programmes were initiated to stimulate employee-led action with the aim of enhancing each individual's personal value. | 2010                  | The Champion scheme is a points led reward mechanism that seeks to reward and recognise individuals who take ownership and act as stewards of safety and sustainability. During the year employees were nominated as Champions of different causes/issues, for example Fire Safety Champions were expected to provide leadership to fire prevention initiatives including training whilst HIV & AIDS Champions served as the Bank's ambassadors for HIV & AIDS. The Champions were expected to lead initiatives relating to creating awareness about HIV & AIDS and supporting victims. A Green Pledge Champion scheme is also active under the stewardship of employees.   |

## EMPLOYEE RESPONSIBILITY

| Initiative                           | Description   | Implementation period | Outcomes in 2010   |
|--------------------------------------|---|-----------------------|--|
| Investing in HRD for Industry growth | The Certificate Course in Elementary Banking and Finance intends to educate youth who have secondary education in the fundamentals of Finance and Banking. This initiative stemmed from the growth of economic activity in the Northern province and was launched in 2009. It serves as a primer for those entering the Banking and Financial Services industry from the Northern province. The project intends to uplift the skills of the entire industry especially in the Northern province through skills development. | 2009-ongoing          | In 2010, the 3rd batch of participants commenced their programme of study. To date the programme has trained 130 participants, some of whom have been recruited by the Bank, whilst others have found employment within the Financial Services Sector.   |
| Grievance Reporting                  | Employees have the ability to report grievances to the top management through the grievance reporting process.  | Ongoing               | During the year, the Grievance Reporting process was revamped to ensure that it is more accessible and easier for employees to report should the need arise.   |
| Work, Life Balance                   | The Bank's Work Life Balance Policy dictates the need for a harmonious balance between employees' work and personal responsibilities.   | Ongoing               | In 2010, the Bank laid greater emphasis on achieving a middle ground between official and personal accountability. As such encouragement was given to develop employees' aesthetic and sporting talents. The HNB Toastmaster Club, Vesak Bakthi Gee, Carol Services for Christmas, regional level sports days and Inter-branch Quiz were some of the elements of the approach towards achieving work-life balance. |
| Staff Welfare                        | The Hatna Family is the crux of the Bank. Welfare activities assist towards the creation of content employees, and heightens the Hatna family concept   | Ongoing               | In 2010, as in other years a multitude of welfare initiatives were undertaken.   |

### Succession Planning through Human Resource Development

In anticipation of future growth, Hatton National Bank implemented a series of strategic HR initiatives in the year under review. The most significant of these initiatives has been the steps taken towards the fortification of the Management team through infusion of greater expertise. In 2010, the appointment of a Chief Operating Officer strengthened the operational efficiency of the Bank. To complement this strategic appointment and to enhance efficiencies further, three core vacant positions on the organisational structure were filled at the level of Corporate Management. These appointments are considered critical to the strategic direction of the Bank, especially in light of the rapid expansion of the Branch network and the service offer. The Executive Team at the Bank was enlarged through the infusion of 150 trainees, all of whom were recruited speedily through the e-recruitment system.

### Performance Culture

The Bank pursues a management philosophy attuned towards participatory management which creates a conducive environment for performance management. The Bank's orientation towards a performance management philosophy has been a fundamental reason for its status as a preferred employer, especially in the financial services industry. Where career progression is a constant where performance management is practiced, the Bank ensures that employees meet personal career growth expectations in tandem with commendable performance towards achieving business objectives,

### Remuneration

During the year, a remuneration survey was conducted by Hewitt Consultants to determine Hatton National Bank's position within the Sri Lankan Financial Services Industry.

Formal recognition in the form of awards and career enhancements continued to be complemented with direct financial rewards. The Bank also provides an array of facilities that enhances the remunerative benefits to employees; these include staff welfare schemes, medical insurance for employees and immediate families, concessionary financial credit, housing finance, and educational finance.

### Industrial Relations

The Bank adheres strictly to the International Labour Organisation (ILO) labour practices and standards as well as local labour laws and regulations. The Bank has and continues to establish a continuous dialogue with the Unions, which have supported the Bank's efforts towards realising the business strategy and goals. In 2010, the Collective Agreements between the Bank and the Ceylon Bank Employees Union and the Officers Union resulted in the prevalence of a harmonious working environment.

### Ethics and Code of Conduct

The introduction of a Code of Conduct for all employees in addition to the existing Code of Ethics in 2010 is expected to enhance the Bank's focus on Anti-corruption Practices, Compliance and Transparency.





## Curriculum of Management Development Programmes

### 3-month Certificate Course in Management Development at the Post-Graduate Institute of Management, University of Sri Jayewardenepura.

86 managers and assistant managers have followed these programmes over a period of 3 years since 2008 – 2010.

- the nature of and need for planning
- productivity enhancement practices
- decision-making techniques
- marketing and sales
- human resource management
- budgeting and costing
- enhancing communication skills including analytical thinking and business writing and presentation skills
- enhancing inter personal relationship skills
- improving personal effectiveness and accountability

### MDP for Junior Executives

The experience of the MDP programmes for Managers highlighted the need for harnessing skills at a junior level. A programme designed and formulated in-house at the Training Centre was implemented in 2010 for 36 officers identified with potential for graduation to the Executive grade. It was conducted by both internal and external resource persons.

The course included a mix of theoretical and practical skills development such as

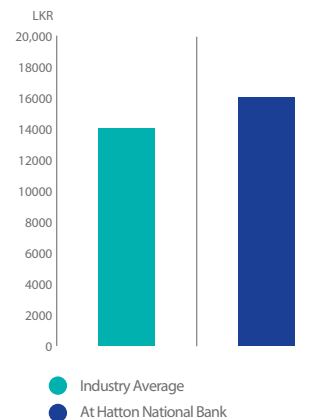
- Bank management
- Managerial economics, planning and budgeting
- Marketing and selling
- Managing customer relationships
- Leadership and motivation
- Teams and team building
- Personal effectiveness
- Communication and Presentation skills
- Business etiquette and personality development

Follow up will be based on personal action plans to be reviewed on a monthly basis. Action taken to develop subordinates is also taken into account in this follow up process. The programme will be continued in 2011 as well

## Staff distribution by Province

| Province      | 2010        |              | 2009        |              | 2008        |              |
|---------------|-------------|--------------|-------------|--------------|-------------|--------------|
|               | No          | %            | No          | %            | No          | %            |
| Central       | 305         | 7.0          | 303         | 7.0          | 308         | 7.0          |
| Eastern       | 171         | 3.9          | 144         | 3.3          | 135         | 3.1          |
| North Central | 133         | 3.1          | 88          | 2.0          | 91          | 2.1          |
| North Western | 217         | 5.0          | 234         | 5.4          | 211         | 4.8          |
| Northern      | 155         | 3.6          | 139         | 3.2          | 112         | 2.5          |
| Sabaragamuwa  | 143         | 3.3          | 140         | 3.3          | 145         | 3.3          |
| Southern      | 233         | 5.4          | 232         | 5.4          | 237         | 5.4          |
| Uva           | 117         | 2.7          | 117         | 2.7          | 119         | 2.7          |
| Western       | 2863        | 65.8         | 2892        | 67.2         | 3024        | 68.8         |
| Overseas      | 15          | 0.3          | 13          | 0.3          | 13          | 0.3          |
| <b>Total</b>  | <b>4352</b> | <b>100.0</b> | <b>4302</b> | <b>100.0</b> | <b>4395</b> | <b>100.0</b> |

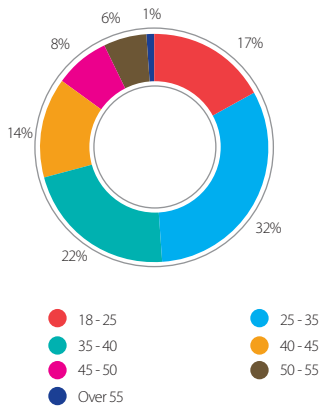
## Comparison of salaries at entry level



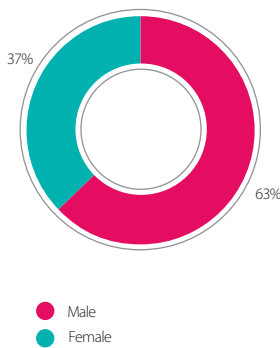
# EMPLOYEE RESPONSIBILITY



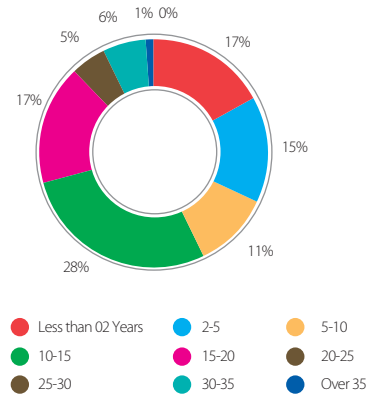
Age-wise Analysis of Employees



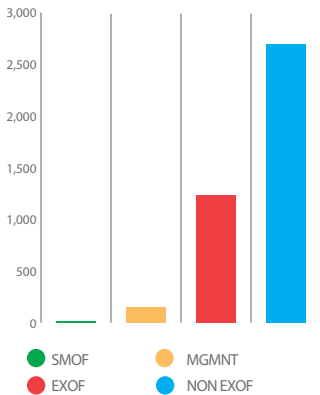
Gender-wise Analysis of Employees



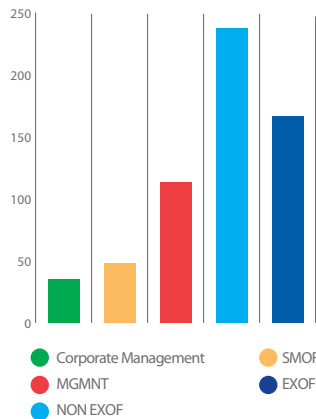
Servicewise Analysis of Employees



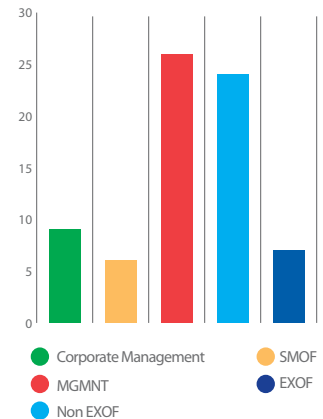
In-house Training



Local Training



Overseas Training







### Staff Strength , Gender Analysis

| As at 31st December                 | 2010        |             |             | 2009        |             |             | 2008        |             |             |
|-------------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
|                                     | Male        | Female      | Total       | Male        | Female      | Total       | Male        | Female      | Total       |
| Corporate Management                | 19          | 7           | 26          | 17          | 4           | 21          | 16          | 4           | 20          |
| Senior Management                   | 25          | 5           | 30          | 30          | 4           | 34          | 31          | 4           | 35          |
| Managers & Executives               | 459         | 128         | 587         | 447         | 123         | 570         | 431         | 117         | 548         |
| Officers                            | 687         | 324         | 1011        | 657         | 323         | 980         | 665         | 328         | 993         |
| Banking Assistants                  | 1036        | 690         | 1726        | 1019        | 581         | 1600        | 984         | 496         | 1480        |
| Trainees                            | 155         | 92          | 247         | 152         | 165         | 317         | 253         | 252         | 505         |
| Secretaries, Stenographers, Typists | 9           | 367         | 376         | 11          | 389         | 400         | 11          | 401         | 412         |
| Support Staff                       | 314         | 0           | 314         | 341         | 0           | 341         | 362         | 0           | 362         |
| Contract Staff                      | 30          | 5           | 35          | 28          | 11          | 39          | 34          | 6           | 40          |
| <b>Total</b>                        | <b>2734</b> | <b>1618</b> | <b>4352</b> | <b>2702</b> | <b>1600</b> | <b>4302</b> | <b>2787</b> | <b>1608</b> | <b>4395</b> |

### Percentage of staff covered by Collective Agreements

| Year | Total | No.  | %   |
|------|-------|------|-----|
| 2008 | 4395  | 3105 | 71% |
| 2009 | 4302  | 3152 | 73% |
| 2010 | 4352  | 3267 | 75% |

### No. of employees

| Year | No.  |
|------|------|
| 2007 | 4334 |
| 2008 | 4395 |
| 2009 | 4302 |
| 2010 | 4352 |

### Permanent staff vs. Contract staff

|              |             |
|--------------|-------------|
| Permanent    | 4317        |
| Contract     | 35          |
| <b>Total</b> | <b>4352</b> |

Full time vs Part time staff -

All Staff including contract staff work a full day

### Achievements of the HNB Toastmasters Club

- Achieved "President's Distinguished Club" status for the third consecutive year
- Won the "Golden Gavel" (the highest achievement for a club) for achieving all ten goals of the Distinguished Club Program, for the second consecutive year
- Won the "Smedley Award" for achieving new membership growth target for the first time

## EMPLOYEE RESPONSIBILITY



### Achievements in Sports 2010

#### Basketball

- Winner - Delmege Super League Champions - B Division (men)
- Champions Mercantile Basketball Knockout Tournament (women)
- Champions Mercantile Basketball Semi-league (women)
- Champions Super League (women)

#### Cricket

- Champions Mercantile G Division Cricket Tournament

#### Hockey

- Champions Mercantile League Hockey Tournament Singer Trophy
- Champions Mercantile Knockout Tournament Hatna Trophy
- Runner-up Mercantile Seven A Side Hockey Tournament
- Mr M M Gazzali (attached to the Central Cash department) was awarded the most outstanding Young Player of the Year 2010 by the Mercantile Hockey Association
- Mr Esanka Jayasuriya attached to the Navam Mawatha customer centre was awarded a very special award of merit for continuously playing 10 years for Mercantile Hockey Association Team.

#### Netball

- Runner up – Nationals
- Runner up – Open Club Championship

#### Soccer

- Champions Football Association A Division Knockout Tournament 2010

#### Badminton

- Overall Champions Mercantile Badminton Overall Championship 2010
- Winner Mercantile Badminton Overall Championship 2010 - men's singles
- Winner Mercantile Badminton Overall Championship 2010 - men's doubles
- Winner Mercantile Badminton Overall Championship 2010 -mixed doubles
- Winner Mercantile Badminton Overall Championship 2010 -women's doubles
- Overall Champions Mercantile Badminton Team Championship 2010
- Winner Mercantile Badminton Team Championship 2010 - Men's A Division
- Runner Up Mercantile Badminton Team Championship 2010 - Men's E Division
- Runner Up Mercantile Badminton Team Championship 2010 - Men's H Division
- Winner Mercantile Badminton Team Championship 2010 – Women's A Division
- Winner Mercantile Badminton Team Championship 2010 - Women's D Division
- Third Place Mercantile Badminton Team Championship 2010 - Women's Veterans
- Runner up Central Bank Inter Bank Badminton Tournament 2010 – Men
- Third place Central Bank Inter Bank Badminton Tournament 2010 – Women



## Case in Point: “Certificate Course in Elementary Banking and Finance” empowers Jaffna youth and builds HR capacity for the financial services industry

Anticipating a greater demand for trained financial services sector professionals in the North and East, the Bank established a three-month taught-course titled “Certificate in Elementary Banking and Finance”, launched at the HNB customer centre in Chunnakam in 2009.

Resource persons from the Bank and several senior lecturers from the University of Jaffna form the programme’s faculty. The course is provided free for all candidates that complete the programme of study. Consisting of four subjects - Business of Banking, Accounting, Economics and Management and Organisation, the programme is the first in the peninsula to use the internet with video conferencing as a support medium in youth education. By the end of the financial year 2010, 2 batches of students amounting to 130 participants have been trained under the programme, some of whom have been recruited by the Bank, whilst others have found employment within the Financial Services Sector. Training of a third batch is in progress.

The programme has empowered intelligent and qualified youth who hereto lacked the opportunity to grow and enter into a career. The following quote by a parent of a participant is testimony to the impact of the programme on the lives of these participants:

“I wish to extend my gratitude and appreciation for the School Leavers Training Programme. This has proved a boon to the unemployed youth of Jaffna, where many school leavers with fair A/L results have no opportunities to either continue their education in a meaningful way or find employment. HNB, in training our children and providing them with opportunities for employment will stand out for its social responsibility”. – T. Thurairajasingham, father of Mr T.Thurenthirra attached to the Bank’s Velanai branch.

# OTHER STAKEHOLDERS' PERSPECTIVE

## INVESTOR RESPONSIBILITY



In the year 2010, as in previous years, the focus of the Bank's investor relations lay in creating consistent value to shareholders. The process of shareholder value creation is one that stems from the alignment of the Bank's business strategy towards maximisation of returns to shareholders. Hatton National Bank's consistent pursuit of business excellence - from optimised profitability to improved internal efficiencies - and the general realisation of the Bank's business objectives in line with its business strategy, leads to satisfaction of investor and shareholder expectations. Where enhanced profitability leads to enhanced wealth creation for shareholders, the Bank's strategy towards investor relations works hand in hand with that of the overall business strategy. Therefore, investor relations are an on-going and inherent process.

### Shareholder Value Creation

As a responsible corporate, the Bank has consistently enhanced shareholder value over the long-term, reflecting a cohesive and strategic approach to shareholder value creation. This consistency in value creation demonstrates the viability of the Bank's business strategy. In recognition of the Bank's commitment to shareholder value creation, The Asian Banker ranked Hatton National Bank as the First in Asia in terms of Shareholder Return in the last five years (2005-2009) under the category of 'Small Cap Banks'.

### Binding Business Strategy to National Priorities

The year 2010 was a hallmark year for corporate Sri Lanka. The year was reflective of the post conflict opportunities that await the nation in the years ahead. As Sri Lanka, united as one, progressed in economic and social indicators, Hatton National Bank continued to drive its Business Strategy in alignment with the national strategy primarily along the key pillars of infrastructure development, SME and microfinance as these sectors are considered focal business drivers in the medium term.

The Bank's post conflict development strategy has seen an increased momentum of operations in the Northern and Eastern provinces. With 29 customer centres operational in the two provinces, Hatton National

Bank leads the revival of commercial spirit in the region through diverse and far reaching strategies to revive the provincial economy. Persistent strategies to ensure consistency in shareholder value creation were deployed with a concerted growth strategy for the Northern and Eastern provinces reinforcing the Bank's business strategy with that of the national development plan.

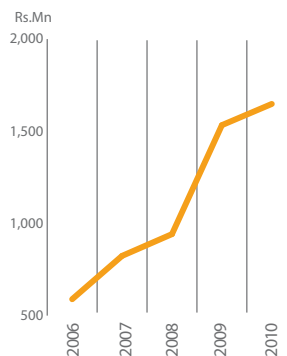
### Investor Engagement in 2010

The Bank undertook a proactive approach to investor engagement in 2010. With sound economic and political scenarios at play, coupled with the exuberance of the Colombo Stock Exchange, the ambience for investor engagement was positive. The Bank's focus for engagement was primarily to be transparent in its operation and in communicating its long term growth strategy to its investors. An aggressive engagement strategy was followed amongst credible and internationally recognised investor forums. The Bank also utilised information technology to make headway in investor engagement locally as well as internationally.

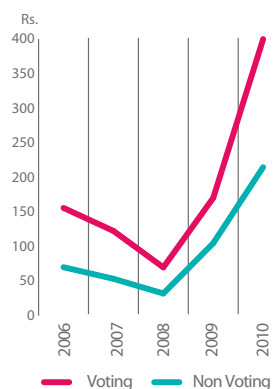
Internationally, the Bank carried out a concerted drive to enhance its image from an investment perspective. International road shows in Europe and the United States of America garnered exposure for Hatton National Bank as a sound investment and as a consequence, placed Sri Lanka in the consideration set amongst top global investors. Participation in investor forums in Asia allowed the Bank capitalise on its reputation as a sound performing stock and as a viable investment.

|                         |   |
|-------------------------|---|
| Road shows              | Europe  |
|                         | Singapore   |
| Investor Forums         | DB Access Asia Conference organised by Deutsche Bank, Singapore   |
|                         | 'Discover Sri Lanka' investor forum organised by India Infoline Ltd, Colombo  |
| One to one interactions | Large scale local and international investors and fund managers   |
| Email updates           | Quarterly emails to institutional investors with performance updates – database of 49 recipients  |
| Webex Presentations     | The Bank organised several Webex presentations during the year on the Bank's performance and the future direction to local and foreign investors/analysts |
| Website                 | The website was re-designed in 2010 with the intention to be more user friendly, informative and interactive  |

Gross Dividends



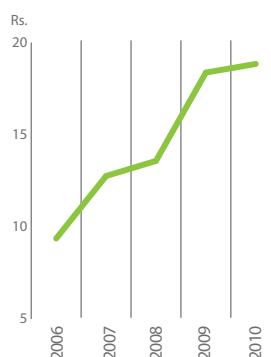
Share Price



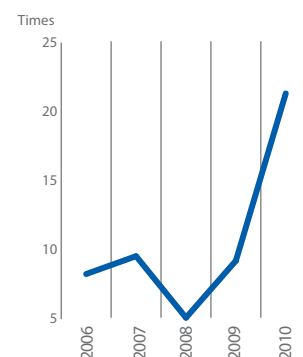
|  | 2006   | 2007   | 2008    | 2009     | 2010     |
|--|--------|--------|---------|----------|----------|
| Earnings per Share (Adjusted) (Rs) *   | 9.37   | 12.76  | 13.58   | 18.37    | 18.84    |
| Dividend Yield (%) - Voting            | 3.21   | 2.86   | 5.73    | 3.82     | 1.75     |
| Dividend Yield (%) - Non Voting        | 7.14   | 6.57   | 12.50   | 6.21     | 3.26     |
| Assets Growth (YOY) (%)                | 18.11  | 18.79  | 10.22   | 9.18     | 12.00    |
| Holding Period Return - Voting (%)     | 42.89  | 61.80  | (39.80) | 153.41   | 139.00   |
| Holding Period Return - Non Voting (%) | 80.72  | 62.14  | (32.39) | 247.66   | 111.55   |
| Operating Cost - Efficiency Ratio (%)  | 57.80  | 56.21  | 54.22   | 54.34    | 56.51    |
| Share Price - Voting (Rs)              | 155.75 | 122.50 | 69.75   | 170.25   | 399.90   |
| Share Price - Non Voting (Rs)          | 70.00  | 53.25  | 32.00   | 104.75   | 214.60   |
| Gross Dividends (Rs Mn)                | 588.82 | 824.35 | 942.12  | 1,533.06 | 1,647.69 |

\* Earnings per share has been adjusted for weighted Average number of shares during the current year.

Earnings Per Share

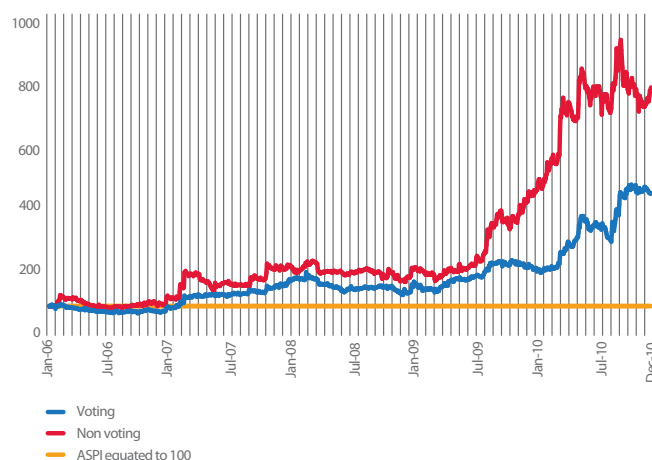


Price Earnings Ratio



\* Earnings per share has been adjusted for weighted Average number of shares during the current year.

HNB share price performance against ASPI







## Awards and Recognition

- MD / CEO Mr. Rajendra Theagarajah was awarded Qatar Financial Centre (QFC) – Asian Banker Leadership Achievement Award for Sri Lanka 2010.
- HNB was rated “Strongest Bank in the Country 2010” by Asian Banker.
- HNB has been ranked First in Asia in terms of Shareholder Return in the last five years (2005-2009) under the category of ‘Small Cap Banks’ according to the Investor Audit Services of The Asian Banker.
- “Best Retail Bank in Sri Lanka - 2009” presented by “The Asian Banker” at The Asian Banker Excellence in Retail Financial Services Awards 2010.
- Recognised as the “Best Bank in Sri Lanka” by the Euromoney Finance Magazine at the Euromoney awards for Excellence 2010.
- Gold Award Winner at the HRM 2010 Awards organised by Human Resources Professionals and Hewitt’s Associates.
- Award for Excellence in Customer Service presented by MoneyGram International Inc.
- Winner (Large category) - ACCA Sri Lanka Sustainability Reporting Awards 2009
- Business Today ranked 2nd among Top 20 companies
- Top 10 Best Corporate Citizens Award 2010 organised by the Ceylon Chamber of Commerce.
  - 1st Runner up in the Overall Category
  - Winner – Employee Relations Category
- Annual Report Awards of the Institute of Chartered Accountants in Sri Lanka
  - Overall Winner of the Gold Award for the Best-presented Annual Report 2009
  - The Gold Award for the Best presented Annual Report in Banking Sector
  - The Gold Award for the Best presentation in Management Discussion and Analysis
  - The Gold Award for the Best presentation in Corporate Governance
- South Asian Federation of Accountants (SAFA) Best Presented Accounts and Corporate Governance Awards 2009.
  - First Runner up in the Banking Sector



### **Case in point: Shareholder value creation endorsed by The Asian Banker**

In 2010, the Bank's endeavour towards enhanced shareholder value creation was given third party endorsement by the Asian Banker. Hatton National Bank was ranked as the first in Asia in terms of Shareholder Return in the last five years (2005-2009) under the category of 'Small Cap Banks'.

The Asian Banker Shareholder Return Ranking is an annual assessment of the relative total shareholder return (RTSR) of listed Asian banks with market capitalisation of more than \$100 million, and the top 25 largest banks (by market cap) in other parts of the world.

The Asian Banker utilises a tried and tested methodology to determine the return ranking based on total shareholder returns (TSR).

TSR takes into consideration the total shareholder return of a stock relative to the local market – accounting for the impact of the local stock market - in ranking each stock.



# OTHER STAKEHOLDERS' PERSPECTIVE COMMUNITY RESPONSIBILITY



The Community has been Hatton National Bank's raison d'être from its inception in the rural hillsides of Hatton. For over 12 decades it has created opportunities for communities across Sri Lanka from the rural hinterland to towns and cities. As the "partner in progress", Hatton National Bank has focused not only on creating access to finance but also strived to achieve social inclusiveness for rural communities. The Bank has, through a concerted strategic approach, determined a community responsibility strategy that encapsulates programmes of action aimed at better healthcare, education and support for entrepreneurship.



## Pillar 1: Healthcare

Improved healthcare remains a critical national priority and falls within the United Nations Millennium Development Goals, especially Target 6 "Combat HIV/AIDS, Malaria and other diseases" and Target 7 "providing safe drinking water and sanitation facilities". Hatton National Bank's focus on healthcare as a strategic pillar, stems from the Bank's recognition of the criticality of healthcare for the sustenance of less-privileged communities. In supporting the national agenda towards healthcare, Hatton National Bank has consistently partnered national and provincial authorities to enhance the effectiveness of healthcare projects to ensure that through corporate action, national agendas towards healthcare are met, both in terms of creating awareness of issues as well as in cascading the benefits of state-led initiatives. Moreover, the Bank has consciously taken upon itself numerous projects that have been solely identified and initiated to assist the communities within which it operates.



| Project:                                | Description  | Period of Implementation | Activities undertaken in 2010  | Investment in 2010 (Rs) | Investment to date (Rs)                              |
|---|--|--------------------------|--|-------------------------|--|
| Cancer Counseling Centre                | The Cancer Counseling Centre is the first and only facility of its nature in Sri Lanka. Established in association with Maharagama National Cancer Hospital with support from Arbeiter Samariter Bund (ASB) Germany, the counseling centre caters to both the patients as well as their families in overcoming the psychological trauma associated with the diagnosis of cancer. | 2007-ongoing             | The Bank increased its commitment to the project by becoming more involved in the operational aspects of the Centre with the departure of ASB from the project in 2009. The Bank undertook to bear all financial commitments arising from operational and maintenance related activities. Four of the Bank's employees continue to be involved in the counseling process.<br><br>The Bank sponsored a training programme on counseling conducted by the Counseling and Care Centre, Singapore. Four of the Bank's employees volunteered for training and attended the training programme, subsequently becoming counselors at the Cancer Counseling Centre. Refer Case in point on page 118. | 5,000,000/-             | 8,000,000/-  |
| Financial Assistance to Cancer Patients | The Bank assists patients and their families to overcome the financial burden of daily expenses especially in cases where the sole breadwinner is afflicted.   | 2009-ongoing             | The Bank extended financial assistance to 36 families for up to six months each. Upon the completion of the six month period, each recipient was re-evaluated for extension of the programme.  |                         | From the proceeds of Rs 15,000,000/- Investment Fund |
| National Cancer Institute, Maharagama   | The Bank completed the renovation of Ward 12 (the male surgical ward) of the National Cancer Institute of Sri Lanka, and continues to assist in its maintenance.   | 2008- ongoing            | In 2010, the Bank continued to invest towards maintaining Ward 12.   | 1,250,000/-             | 2,450,000/-  |
| HIV AIDS Awareness                      | The Bank is a member of the Lanka Business Coalition on HIV/AIDS and works to raise awareness on HIV and AIDS in the workplace.  | 2009-ongoing             | In 2010, the Bank upheld and propagated the principles of the Business Coalition. To commemorate World AIDS Day, the Bank distributed awareness ribbons throughout the week and conducted awareness programmes amongst employees.  | 100,000/-               | 170,000/-  |

## COMMUNITY RESPONSIBILITY



| Project:                                   | Description  | Period of Implementation | Activities undertaken in 2010   | Investment in 2010 (Rs) | Investment to date (Rs) |
|--|--|--------------------------|---|-------------------------|-------------------------|
| Post Flood Drinking Water purification     | The Bank initiated a project to ensure the sanitation of drinking water especially where communities rely on wells and ground water as primary sources of drinking water. Wells in identified localities were dredged to ensure the communities reliant on these water sources were safe from water-borne diseases that were rampant in the aftermath of floods during the year under review.  | 2010-ongoing             | The Bank dredged 55 wells within two days benefiting several families in the areas of Bemmulla, Magalagoda and Daraluwa.  | 475,000/-               | 475,000/-               |
| Safe Drinking Water and Sanitation Project | The lack of water and the high incidence of bowel diseases propelled Hatton National Bank to undertake its Safe Drinking Water and Sanitation Programme as part of its community development initiatives in 2008. To date the project has directly impacted in excess of 1000 families across the nation whilst impacting an estimated 50,000 people who are categorised pilgrims and travelers.   | 2008-ongoing             | In 2010, the Bank completed its 7th safe drinking water project for villagers of Karavila Ella, a small hamlet in Moneragala. With 63 families dependant on the polluted waters of Kumbukkan Oya, the Bank identified a new water source and constructed a well and pump room for more convenient use of the villagers. | 2,000,000/-             | 12,000,000/-            |
| S-H-A-R-E Foundation                       | The S-H-A-R-E (Samarasinghe Healthcare Assistance and Rehabilitation for the Elderly) Foundation is a UK and Sri Lankan registered charity and is modelled on the District Nursing Service in the United Kingdom. It is involved in community health projects in under privileged areas. The main objective of the project is to assist in the support and care of the patients in their homes and promote prevention of ill health through public health education. | 2007-ongoing             | The Bank continued its commitment to the Foundation by funding the work of three nursing sisters at Kotahena (Colombo), Payagala (Kalutara) and Alagollawa (Anuradhapura).  | 300,000                 | 900,000                 |

## Pillar 2: Education

Education remains an area of intense interest for Hatton National Bank. Over the years the Bank has viewed the development of the quality of education as key to the success of national progress especially in light of Target 2 "Achieve Universal Primary Education" of the Millennium Development Goal. In 2010, the Bank reiterated its focus on education by continuing to accelerate progress on flagship projects such as "Nana

Pubuduwa" whilst also taking on board more diverse projects with pervasive effects such as the National Trust of Sri Lanka. The latter is considered by the Bank to be a fundamental step towards the creation of a younger generation that is more empathic to the conservation of national culture and heritage, in the years ahead.

| Project:  | Description   | Period of Implementation | Activities undertaken in 2010  | Investment in 2010 (Rs) | Investment to date (Rs) |
|---|---|--------------------------|--|-------------------------|-------------------------|
| National Trust of Sri Lanka   | The National Trust for Cultural and Natural Heritage was founded in May 2005 to operate as a national body for protecting and safe guarding the tangible and intangible heritage of Sri Lanka. The services rendered by the organisation are focused towards protecting and preserving the cultural heritage of the country.  | 2010-2012                | During the year, the Bank partnered with the National Trust of Sri Lanka with a view to grasp the opportunity to participate in a project worthy of national importance.   | 1,500,000/-             | 1,500,000/-             |
| Nana Pubuduwa   | Nana Pubuduwa project aimed at providing a hundred libraries to schools lacking in facilities and financial resources, predominantly those placed in remote areas. The project has progressively enhanced the literacy skills of over 40,000 children annually across Sri Lanka. In addition, the project has carried out renovations to buildings, donated books and furniture, equipment and fittings.<br><br>The project scope has been broadened to include computer literacy, and the Bank has donated computers to several schools. The project has evolved to include the addition of computer laboratories to selected schools.<br><br>Through needs-analysis the Bank continues to add to the Nana Pubuduwa project and enhance the educational evolution of Sri Lanka's children. | 2005-ongoing             | By end of 2010, the project had provided 168 libraries to less privileged schools across Sri Lanka. During the year 13 libraries and 11 computer centres were gifted.<br><br>Higher literacy rates, greater English literacy and an IT enabled environment are just a few of the long-term benefits the Bank foresees as a result of the Nana Pubuduwa project.  | 9,025,000/-             | 33,725,000/-            |
| Financial Services Skills Development in the Northern and Eastern provinces | Anticipating a greater demand for trained financial services sector professionals in the North and East, the Bank established a three-month academic programme entitled "Certificate Course in Elementary Banking and Finance". The programme is open to youth interested in seeking employment in the financial services sector. The Bank considers the programme to be instrumental in the human resource development of the Northern and Eastern provinces.  | 2009-ongoing             | The project was inaugurated to benefit the youth of Jaffna Peninsula in the last financial year. In 2010, the second batch of participants graduated from the programme whilst a third batch is currently undergoing training. The Bank's intention to uplift the resources available to the financial services sector in the Northern and Eastern provinces has been partially realised with over 130 trainees currently employed and seeking employment. In the upcoming financial year, the project will be scaled out to the Eastern province. | 550,000/-               | 1,250,000/-             |





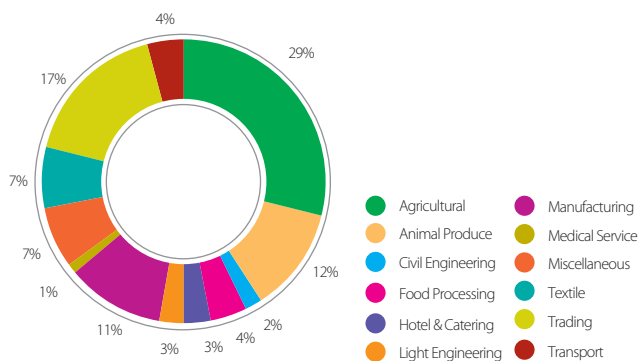
**Pillar 3: Entrepreneurship**

Hatton National Bank was borne from the spirit of entrepreneurship over a century ago. Now in the present day commercial environment, the Bank strives to instill and inculcate this same spirit and enthusiasm for entrepreneurial dynamism. By extending its support to communities that lack the very basic of infrastructure and are held back by the lack of financial inclusion, the Bank has over the years nurtured entrepreneurs

from the most rural of settings. This structured entrepreneurial development programme has been instrumental in positioning Hatton National Bank as an icon in imparting financial literacy and in creating sustainable financial inclusiveness. Recognised for its capabilities in the global arena, the Bank continues to forge ahead to commercially catalyse thousands across the nation.

| Project:                                   | Description  | Period of Implementation | Activities undertaken in 2010  |
|--|--|--------------------------|--|
| Gami Pubuduwa                              | The Bank introduced "Gami Pubuduwa" (village re-awakening), a micro finance programme, to extend financial services to micro enterprises in the rural and semi-rural areas, with the objective of forging closer links with those classed as "non-bankable" by other financial service providers. The scheme emphasises the harnessing the skills of the rural community, assisting them towards the achievement of self-reliance. | 1989-on going            | In 2010, the Banks "Barefoot Banker" concept was further developed. With over 130 Barefoot Bankers assisting the rural community, Gami Pubuduwa is now a programme that is a sustainability tool precipitating financial awareness amongst village folk. Moving away from the pure commercial aspects of micro-finance, the programme has created a culture of acceptance for entrepreneurship and financial literacy amongst the rural community. |
| Financial Literacy to Indigenous Community | Promotion of financial literacy and the savings habit amongst the indigenous "aadiwasii" Veddah community has been an initiative aimed at assisting this community to integrate with society in a more sustainable manner.   | Longstanding             | During the year the Bank sponsored the initial investment required to open 60 minors' savings accounts, as well as the gifting of a Jumbo till, whilst a microfinance loan was extended to the aadiwasi veddah chief Uruwarige Wannileththo for cultivation purposes.  |

**Gami Pubuduwa Review  
Sectorwise Distribution of  
Number of Loans**



## Short-term Projects

The Bank undertook numerous projects for the greater benefit of the communities within which it operates during the year on a one-off basis. These projects whilst falling within the overall strategy for

community responsibility are not projects that are long-term in nature and are specific to the year under review.

| Strategic Pillar | Project  | Project Description  | Investment  |
|------------------|--|--|-------------|
| Health           | Cardiology Unit of the Teaching Hospital, Anuradhapura                       | The Cardiology unit (Ward 29) of the Hospital sought assistance to install curtains for cubicles.  | Rs. 60,000  |
| Health           | The Safe Bottle Lamps Foundation   | Nearly a million households in Sri Lanka do not have electricity and rely on makeshift kerosene-oil bottle lamps to light their dwellings. These lamps are unstable and when they topple the highly inflammable oil spills and quickly ignites causing disfiguring burns or even death to many people each year. The Safe Bottle Lamp Foundation, inspired by Dr Wijeya Godakumbura addresses this critical issue by substituting the home-made lamps with a safe and inexpensive model.<br>2,000 safe bottle lamps were purchased and donated to 1000 households in the villages in North Central Province.   | Rs. 100,000 |
| Education        | Institute of Fundamental Studies (IFS), Kandy                                | The Bank assisted the publication of a trilingual science magazine "Scientia". Primarily aimed at school children it contains articles written by researchers, academics and young scientists and is intended to encourage and stimulate awareness of science amongst students. The magazine will be distributed free of charge to schools that offer Science for Advanced Levels and other similar institutions and 150 copies were distributed amongst the Bank's sponsored libraries as well.   | Rs. 200,000 |
| Health/Education | St. John's School, Jaffna  | The school is in the process of implementing a programme to assist poor and under privileged students of the internally displaced communities. Up to date the school has admitted 520 such children including 222 in the hostel.<br>As a first step the project will provide sanitation facilities for displaced children who are being educated at this school.   | Rs. 300,000 |
| Health           | General Hospital, Vavuniya   | The General Hospital Vavuniya, is the only fully equipped Hospital in the area, serving all the nearby towns and villages as well. It caters to patients from Vavuniya, Killinochi, Chetikulam, Mannar, Mallave. The Bank donated 25 trolleys to upgrade its equipment.  | Rs. 120,000 |
| Health           | Equality-Based Community Support and Training (ECSAT)                        | The Equality-Based Community Support and Training (ECSAT) is a disability-focused organisation that works towards inclusion of disabled people into society. It focuses on involving disabled and non-disabled people together and making disability a visible part of everyday life in communities and breaking down the barriers of stigma and misunderstanding that exclude disabled people from leading the lives they want.<br>The ECSAT organised a special event to raise funds for its projects in Galle to make communities more accessible, by funding activities like the building of ramps and accessible toilets in private and public settings.<br>The Bank as a platinum sponsor for the event invested towards the sponsorship for building wheel chairs, ramps and accessible toilets whilst 12 employees volunteered their time and participation. | Rs. 200,000 |
| Health           | National Cancer Institute, Maharagama  | CCC Foundation Inc. Australia and Sri Lanka, a not-for-profit charitable organisation undertook to build a transit home for underprivileged outpatients (children) and their carers, within the hospital premises.<br>The Bank's employees contributed towards the project through the sale of cards.  | Rs. 120,000 |
| Health           | Colours of Courage Trust in aid of the National Cancer Institute, Maharagama | The Banks employees participated in the Colours of Courage six a side Cricket Tournament to raise funds for the National Cancer Institute.   | Rs. 120,000 |



### Employee voluntarism

The culture of community service is inbred in every one of the Bank's employees. The employees voluntarily participate in community development and social activities in excess of their considerable involvement in the CSR programmes initiated at corporate level and the numerous customer awareness and financial literacy programmes carried out. With 4,352 employees, these activities are too many to enumerate. Nearly all branches engage in the following:

- organising a variety of Almsgivings for Vesak and Poson as well as sponsoring and taking part in Bakthi Gee programmes
- sponsoring sports days, prize giving and other events in schools in their command area with the Branch Manager being invited as Chief Guest at the occasion
- providing meals for the inmates of a charitable institution in the locality to mark significant milestones such as the branch anniversary
- organising or actively participating in blood donation campaigns

### Case in point : Care through the Cancer Counseling Centre

Inaugurated in the year 2007, under the Bank's community responsibility initiatives, the Cancer Counseling Centre is the first and only facility of its nature in Sri Lanka. Established in association with Maharagama National Cancer Hospital with support from Arbeiter Samariter Bund (ASB) Germany, the counseling centre caters to both the patients as well as their families in overcoming the psychological trauma associated with the diagnosis of cancer.

The availability of a professional Counseling Centre dedicated to those afflicted by the disease has enhanced the mental wellbeing of those concerned through the cumulative effects of guidance, support and reassurance. The Bank has incrementally increased its commitment to the project by progressively enhancing its role by becoming more involved in the operational aspects of the Centre. The Counseling Centre came wholly under the purview of the Bank in mid 2009. Thereafter, the Bank has undertaken to bear the maintenance and operational costs. A number of initiatives were undertaken to renovate and upgrade the infrastructure at the counseling centre whilst the Bank also contributed immensely to the renovation and maintenance of Ward No. 12 at the Maharagama Cancer Hospital. Notably, the Bank's commitment to the project is reflected in the involvement of its staff members in the counseling process. A training programme on counseling was organized by the Cancer Counseling Centre (Patients Advise and Liaison Services Unit (PALS) of the National Cancer Institute, Maharagama). The objective of this programme was to equip the participants with generic and specific components of counseling skills and greater personal self-awareness for use in the counseling relationship when attending to the emotional and psychosocial needs of patients visiting at the National Cancer Institute of Sri Lanka. The programme was a combination of theoretical learning and practical application and was conducted by trainers from the Counseling and Care Centre, Singapore. The Bank sponsored 5 modules out of the 8 module programme with four of the Bank's employees volunteering as participants in the programme. As volunteers the Bank's four employees assured their services as volunteer Counselors. All 4 participants successfully completed the programme and now dedicate an average of 6 hours per week per person for counseling. The dedication and generosity of these individuals in volunteering to counsel demonstrates how far sustainability is ingrained in the work ethos of the Bank.

The Bank's programme of financial assistance to the families of cancer afflicted patients has been supported by the Cancer Counseling Centre. Through the Centre, the Bank is introduced to and identifies potential recipients. Where the sole breadwinner of a family is the afflicted party and has been ear-marked by the Cancer Counseling Centre as families in need of financial assistance, the Bank intervenes to provide a monthly financial supplement enabling patients and their families to overcome the financial burden of daily expenses. This supplement is afforded for a period of 6 months and renewed subject to review of the family's life situation. To date 36 families have been recipients of the programme.

# OTHER STAKEHOLDERS' PERSPECTIVE SUPPLIER RESPONSIBILITY



Supplier responsibility has been gaining ground as a vital cog in the wheel of viable business practice across the world. In the financial services sector, supplier relations remains as critical as in any other industry due to the need for credibility, trust and value in forging partnerships. Suppliers play a fundamental role in how Hatton National Bank executes its commercial activities and are a core element in the various facets that promote sound commercial well-being. However, for Hatton National Bank supplier relations go beyond the mere commercial function. As an organisation that has always looked to contribute to the broader perspective of national development, the Bank considers supplier relations as an avenue to promote and stimulate greater economic activity especially in the arena of micro-enterprise.

## Ethical Procurement Practices

The Bank considers ethical conduct as the pivot upon which supplier relations are built. A code of conduct governs the ethical expectations of the Bank and its tenets are shared between employees as well as suppliers through frequent engagement activities, a process which strives to impart and maintain the highest standards of integrity across every aspect of the business relationship. The Bank is of the view that ethical behaviour must be promoted and supported by appropriate systems and procedures. Likewise the Bank expects the highest ethical standards from its suppliers. The following outlines the practices and process followed by Hatton National Bank towards the upholding of ethical practices in procurement.

| Expectation                              | Process  |
|--|--|
| Transparency                             | <ul style="list-style-type: none"> <li>Tender process ensures transparency of expectations</li> <li>More than one procurement evaluation committee</li> <li>Final approval by Board of Directors</li> </ul>  |
| Confidentiality                          | <ul style="list-style-type: none"> <li>Suppliers and supplier information treated with confidentiality and fair trading</li> </ul>   |
| Supplier concerns/discontent             | <ul style="list-style-type: none"> <li>Raised through supplier engagement</li> <li>Appeal schemes allow suppliers to directly raise issue or whistle-blow to the Deputy General Manager Services and thereafter to the Managing Director/Chief Executive Office</li> </ul> |
| Facilities to promote supplier relations | <ul style="list-style-type: none"> <li>Credit accommodation</li> </ul>   |
| Termination of suppliers                 | <ul style="list-style-type: none"> <li>Based a stringent review process that allows for a dialogue with the supplier and subsequent to other mechanism such as penalties</li> </ul>  |
| Service quality Improvements             | <ul style="list-style-type: none"> <li>Operation and procedure manuals on service quality checks</li> </ul>  |

## SUPPLIER RESPONSIBILITY

### Sustainable Procurement Policy

Hatton National Bank recognises its responsibility to carry out its procurement activities in an environmentally and socially responsible manner. Thus, in accordance with the Bank's Sustainability Strategy and Corporate Procurement Strategy it strives to incorporate environmental and social considerations into the procurement process. The Bank recognises its responsibility to encourage suppliers to minimise negative environmental and social effects associated with the products and services they provide. The Bank's strategic sourcing strategy promotes sustainable procurement by taking into consideration

environmental, ethical and social factors when making sourcing decisions.

In the year under review, the Bank implemented a Green Procurement Policy with a view to promote and pass preference to products and services that can be manufactured, used, and disposed of in an environmentally and socially responsible manner. The Green procurement policy ensures that sustainability criteria are included in specifications to suppliers and that sustainability criteria are met in the award of contracts by ensuring that suppliers' environmental credentials are considered in the supplier appraisal process.

| Objective   | Process   |
|---|---|
| Sustainable practice at supplier level                        | <ul style="list-style-type: none"> <li>Pre-evaluation of suppliers' business processes</li> <li>Inspection of suppliers premises and business practices on an ongoing basis</li> </ul>  |
| Selection of suppliers  | <ul style="list-style-type: none"> <li>Selection process goes beyond the financial benefits to take into account other social and environmental factors.</li> </ul>   |
| Creating greater awareness of the "green" aspects of business | <ul style="list-style-type: none"> <li>Engagement with suppliers that have a turnover in excess of Rs. 1 million through a comprehensive engagement process.</li> </ul>   |
| Determining one supplier over another                         | <ul style="list-style-type: none"> <li>Through a rating process based on criteria laid out in the Bank's procurement policy</li> </ul>  |
| Policy of non-discrimination                                  | <ul style="list-style-type: none"> <li>Encourage SME and micro enterprises to enter into partnership with the Bank. Currently 10% of the total supplier portfolio falls into the SME category and they account for over 2% of the Banks' procurements.</li> </ul> |
| Upholding of Human Rights and containment of social risks     | <ul style="list-style-type: none"> <li>During evaluation of the supplier's business process the Bank also considers practices such as child labour, forced labour, Environment, Health and Safety issues.</li> </ul>  |

### Case in point: sustainable procurement for equitable share of wealth

The sustainable procurement policy was progressively implemented in 2010 with criteria and processes aimed towards the assurance of an equitable share of wealth to a larger number of suppliers. Through the enhancement of the supplier base by a further 25 per cent in 2009, the Bank afforded a greater number of enterprises the ability to supply to the Bank. Furthermore, the Bank extends supplier credit at zero cost on the strength of the Bank's advance payment bond. This initiative has enabled small-scale suppliers who lack the financial wherewithal of large-scale enterprises to confidently accept and provision goods and services to the Bank.

The Bank follows a concerted policy of non-discrimination against small-scale suppliers. Whilst 10 per cent of the supplier portfolio is categorised as small-scale entrepreneurs, in fact over 60 per cent of the supplier portfolio is composed of Small and Medium Enterprises (SMEs).

W.U. Seneviratne Company (Pvt) Ltd is a prime example of how well the Bank's sustainable procurement strategy has strengthened supplier relations. The Company, established in 1994 with just 3 employees initiated its journey with the "partner in progress" in 1995 as a customer of the Pettah branch. Later as a supplier, the Company benefited from a host of services meted out to SME suppliers and is now a leader in courier delivery and paper related services. With a workforce of 150, W.U. Seneviratne Company credits the Bank for its success and hopes to grow its business into the areas of statement delivery and variable data printing.

# OTHER STAKEHOLDERS' PERSPECTIVE ENVIRONMENTAL RESPONSIBILITY



In the backdrop of policy implementation in 2009 towards the creation of a more pervasive and structured environmental responsibility strategy, Hatton National Bank in 2010 sharpened its focus by introducing numerous best practices with a view to determine and establish key performance indicators in environmental sustainability. The thrust of the Bank's Environmental Responsibility strategy during the year was two pronged; firstly, the intention of the Bank was to record and monitor its role in environmental management whilst secondly, the Bank, as in previous years undertook initiatives aimed at broader role in environmental stewardship.

## Resource Efficiency

### 1. Energy

At Hatton National Bank we believe that the efficient utilisation of energy across the business provides a number of benefits including the protection of global energy reserves and in the reduction of the Bank's environmental impact. Through the effective implementation of a range of energy efficiency principles and processes, the Bank has successfully achieved upto 33 percent in energy efficiencies in the year under review in comparison with that of the previous year.

| Best Practice     | Description of Measures adopted                          | Savings                        | Annual Savings                |
|-------------------|--|--------------------------------|-------------------------------|
| Energy Efficiency | Introduction of energy efficient lights                  | 1471.2 kWh per day             | 370,754.5 kWh or Rs 8,156,600 |
|                   | Power factor correction in 4 premises                    | 71 kVA per month               | 852 kVA                       |
|                   | Introduction of Electronic Ballasts to Corporate Signage | 643.85 kWh per day             | 235,000 kWh                   |
|                   | Use of Bio-gas for branch usage                          | 3.48 kWh in 2 branches per day | Rs. 9,646.56 per branch       |

As a result of concerted efforts to utilise energy efficiently, the Bank accrued a total of 605,750 kWh and 71 kVA annually amounting to a monetary saving of Rs. 13,965,700/- per annum. The Bank reduced its dependency on the National Grid for power demand by 334 kVA. Total electricity consumption at the HNB customer centres is 11,939,943.76 units per year in 2010.

### 2. Water

As a pilot project, rain water harvesting is being carried out at Hatton National Bank's Buttala Branch office. The Branch utilises harvested water for its operations during the rainy seasons and has initiated a model project within its premises to create greater awareness of the concept amongst customers. As the Branch is located in an area where people are sensitive to the scarcity of water, and given that over eighty five percent of the population engages in farming activities, the model has become a point of interest. In the year under review, the Buttala Branch office saved approximately five to ten percent of water avoiding consumption from the national water supply. In the upcoming financial year, rain water harvesting will be carried out at the Nittambuwa Green Building.

Anaerobic waste water treatment systems were installed in five branches at Marawila, Gampaha, Negambo, Wattala and Kahawatta during the year with approximate 1,000,000 litres per annum of treated waste water discharged to the environment whilst at the Wattala branch the treated water is used for gardening purposes (treated water capacity of Anaerobic filter system at Wattala branch – 30,000 litres per month). Anaerobic filter technology and biological treatment of organic matter is a well accepted concept adopted throughout the world. Anaerobic biological filters are considered the most efficient biological filter treatment systems available especially with respect to treatment of sewerage. In addition, the fact that the process requires no additional infrastructure, and therefore was



## ENVIRONMENTAL RESPONSIBILITY



suitable for implementation within the Branch premises was a further favourable point for implementation. (Refer Case in point “ Bio-gas as an alternative energy source” in page 124).

### 3. Recycle, Re-use and Reduce

The Bank adopts a 3R policy – Recycle, Reuse, Reduce - towards all tangible resources.

| Process | Description of Initiatives undertaken  |
|---------|--|
| Recycle | Paper Recycling - 151,609 Kg of waste paper was recycled over a period of 12 months resulting in the effective saving of 2577 trees, 4, 818,436 litres of water, 606, 436 kWh of electricity and 266,073 litres of oil   |
| Re-use  | Reconditioned printer cartridges and toners were used at the Bank's head office (number of reconditioned toners used in 2010 – 127). Further arrangements were made with a Supplier to collect all used toners and cartridges from the branch network for refill and reuse.<br>Recondition and re-use office furniture, prolonging lifetime and thereby reducing the waste generated through routine replacement |
| Reduce  | To overcome the detrimental effects of paint pollution a direct by-product of the process of paint application, the Bank continues to use cladding as a safer alternative.<br>33 buildings with a total surface area of 53,925 Sqft cladded at an expected saving of Rs. 323,550 and 600 liters of paint 3 Kg to 4.2 Kg of toxic emissions (Note that a zero VOC paint emits approx 5-7grams of toxic emissions) |

In looking to the future, the Bank is in the initial stages of implementing a Management Information System with the intention of creating a paperless office.

### The Green Pledge cascades sustainable business practice

In the year 2009, Hatton National initiated a two-pronged environmental responsibility ethics programme designed to educate the employees of the Bank as well as to garner commitment towards the sustainable business practice. All employees made a pledge, to unite towards combating climate change through the practice of twelve tenets outlined in the Green Pledge. In addition to an integrated communications effort that reached across the organisation as well to the homes of employees, the Green Pledge was embraced by the Bank and has successfully defined its sustainability business practices in 2010.

Exactly one year after taking the Green Pledge and implementing internal best practices, the Bank launched an extensive tree planting campaign in a bid to reduce and reverse its carbon footprint. This would ensure that the Bank in addition to reducing its consumption would also be replanting the number of trees inevitably used in the course of business. Under the aegis of the Pledge, 1000 Kumbuk trees were planted on the banks of the Ma Oya in Mawanella to contain soil erosion stemming from over mining of the river for sand. Further planting is envisaged in the upcoming year to conserve the downstream sector of the river. On World Environment Day, the Bank twinned tree-planting with awareness creation by actively involving over 100 school children from Mayurapada College, Ravisada College, Baminiwatte College and Thammita Maha Vidyalaya of Mawanella. A special awareness programme was conducted at Mayurapada College, Mawanella by Dr Sudarma Yatigamma, Senior Lecturer, Zoology Department, University of Peradeniya. In addition, a further 350 trees such as Mango, Jak, Jambu, Amberalla and Teak were planted in Vavuniya within the premises of children's and elders' homes throughout the town.

To mark the opening of Hatton National Bank's 200th branch, 200 trees were planted in Yakkala and Gampaha. The Bank engaged other stakeholders from the localities to ensure the maintenance of the young saplings, such that the plants will continue to grow and support the environment over a planned period of time. In addition, the Bank carried

out a project to grow mangroves in water bodies under the authority of National Aquatic Resources, Research and Development Agency.

### Carbon Neutral Publication

The Bank in its journey towards implementing better environmental management practices and took a significant step by quantifying the emissions of this Annual Report and invested in its carbon credit equivalent. Certification to this effect is given on page 125 of this report.

### Business Going Green: Green Buildings

The HNB Tower sets the precedence as an energy efficient high rise building and is one of the few buildings in Sri Lanka that utilises revolutionary technology from variable air volume units that control ambient temperature, a demand controlled ventilation system, an intelligent illumination control microprocessor to energy efficient exterior features. Whilst previously the Bank targeted 2010 as the year for Leadership in Energy and Environment Design (LEEDS) Green Building Certification it postponed the application process in a bid to carry out rain water harvesting pilot evaluation. It is expected that LEEDS accreditation will follow in the year 2011.

The construction of the Bank's second green building commenced in 2009 in Nittambuwa and is currently at completion. The building is expected to achieve efficiencies of 30 per cent reduction in energy utilisation and 56 per cent reduction in water utilisation when compared with an average bank branch. Meanwhile, planning is currently underway for the construction of a third green building in Jaffna. This will be the first of its sort in the Northern province and will act as an icon of sustainable business practice for the area.

The green building concept encompasses the following in design and outcome:

- an eco-friendly structure and environment
- the minimum utilisation of natural resources and preservation of these resources for future generations
- the sustainability of having internal means to generate resources as far as possible
- the conservation of energy by means of smart devices
- the use of recyclable materials
- a user-friendly environment, work practice and discipline

| Tangible Benefits   | Intangible Benefits  |
|---|--|
| Central chiller air conditioning system that is arguably the most efficient system in Sri Lanka.                                      | Enhanced brand image of the Bank   |
| Installation of water-efficient fixtures to reduce water consumption.   | Enhanced organisational performance  |
| Less contribution to heat island effect (roof and hardcape) on the environment.   | Ample access to views of outdoors to maintain visual connection to surrounding environment |
| Reduced light pollution of exterior lighting.   |  |
| Appropriate selection of air conditioning refrigerant - low ozone depleting potential and minimal direct global warming potential.    |  |
| Use of high-recycled content steel for pre-engineered structure.  |  |
| Discharge of CO <sub>2</sub> to environment expected to be reduced by approximately 40%.  |  |
| Annual energy index of 6 kWh/square feet as opposed to an approximate 8 to 9 kWh/square feet for a normal building.                   |  |
| Extensive use of day lighting resulting in efficient lighting system.   |  |
| Rain water harvesting system for the use of garden and flushing systems.  |  |
| Installation of meters and implementation of verification mechanism to monitor and verify energy and water savings.                   |  |
| Maximum use of locally extracted/harvested and manufactured materials for construction.   |  |
| Indoor air quality monitoring with CO <sub>2</sub> sensor and automatic control of fresh air introduction with increased ventilation. |  |

The Bank considers the green building concept as a strategic differentiator and competence for the future success of its business. As such, in 2010, the Bank's engineering staff were exposed to specialist training in green building technologies with the intent to enlarge the know-how and build capacity. Training programmes included subject matter such as solar power systems, Durra products, 3D Sim Software Energy Modeling, 3D Energy and Building modelling, BMS systems, automatic solar light/heat control systems and solar air conditioning mechanisms. The Bank has a valuable team that has both technical and practical experience to effectively implement green building technology. Going forward, it is the intention of the Bank to continue to grow this knowledge base so that the team can lend its support to green construction outside the periphery of the Bank.



## ENVIRONMENTAL RESPONSIBILITY

### Green Procurement Policy

A green procurement policy was implemented during the year under review. The policy aims to inculcate green business practices amongst the supplier base. Approaches to supplier engagement prior to selection of suppliers were many and based on the requirements of the green procurement policy. During the year, awareness of the procurement policy was created amongst suppliers with a turnover in excess of Rs. 1 million through surveys, focus groups, community panels, written communication and union structures. Currently 191 suppliers are registered and comply with the requirements of the green procurement policy. The procurement policy provides preference to suppliers who manufacture or follow principles that minimise their impact on mother earth.

### Reducing impact on land-fills

Sanitact - a chemically charged bin - provides an effective, hygienic and discreet method to dispose of sanitary waste. The Bank introduced Sanitact across the branch network, thus allowing for the eco-friendly disposal of sanitary waste, reducing the impact of land-fill and hazardous emissions due to inappropriate disposal. Sanitact utilises modern hydro clave technology which disposes of sanitary waste by converting it in to a powder for use at land fills reducing the effect of

environmental pollution. The technology is approved for use by the Central Environmental Authority.

### Preservation of Natural Habitats

The Hatton National Bank continued to partner a project aimed at the eradication of two invasive plant species – Cacti and Andara (*Prosopis Juliflora*) – which cover an estimated 10,000 hectares or 60 per cent of the total area of the Bundala National Park. Responsible corporate citizens including the Hatton National Bank supported the project, an initiative of renowned nature photographer Sarinda Unamboowe, the Department of Wildlife Conservation and International Conservation Union (IUCN).

The Bank re-invested into the conservation of the Bundala National Park during the year in review re-affirming its commitment towards the protection of Sri Lanka's natural and biodiversity resources. To date the Bank has invested into the clearing of approximately 25 hectares of the Bundala National Park – the first wetland in Sri Lanka to be declared as a RAMSAR site under the Convention on Wetlands of International Importance thus recognising the ecological importance of the Park as a habitat for water birds. During the year, the Bank further invested into the clearing of 5 hectares and replanting of the cleared area with trees, re-introducing sustainable species that will allow for the natural regeneration of plants local to the habitat.

### Case in point “Bio Gas as an alternative energy source”

The world is in need of a sustainable, efficient, carbon-neutral fuel source. Biogas, harvested from agriculture and food industries, not only fits this criteria, it is readily available and affordable for people around the world. Also known as biofuel, natural methane holds promise for the future. As an industry innovator, Hatton National Bank has not only led the way in terms of greening the value chain but has firmly established its position as an organisation constantly seeking alternatives to the conventional energy sources. Whilst the Bank's Green Building initiatives have led to a dramatic decline in the energy consumption, it has concurrently sought to establish alternative energy sources. As such in 2010, the Bank introduced the usage of biogas at two branches – Marawila and Wattala. The bio-gas is a by-product of a pilot project into anaerobic waste water treatment. The pilot project is a bid to determine the viability of consuming this alternative energy for the Bank's operations in the years ahead.

Bio gas offers a number of advantages over conventional fuel sources, including:

- Reduction in Greenhouse Gasses: methane is a significantly more powerful greenhouse gas than carbon dioxide, with greater potential for increasing global warming effects. Containing methane and converting it to CO<sub>2</sub> will neutralise its effect on global warming.
- Biogas is Carbon Neutral: Because CO<sub>2</sub> is returned to the atmosphere via incineration at approximately the same rate it is taken up during photosynthesis, biogas is generally considered to be carbon neutral.
- A Renewable Resource: As biofuel is the product of recently consolidated atmospheric carbon, it is also considered to be a highly renewable resource.
- Zero Organic Waste: Unlike traditional bio-gas production systems, the special anaerobic waste water treatment system employed by the Bank, ensures zero organic waste as all waste is digested by the special bacteria planted inside the system.

During the year, the Bank's Marawila and Wattala branches produced bio-gas through the application of anaerobic filter technology. The end-product was utilised for cooking purposes. The Bank envisages significant energy savings once the project is fully implemented.

# Certificate

Name of organisation: Hatton National Bank Plc

**Certified**

CarbonNeutral® publication- Annual Report

The certified organisation has measured greenhouse gas (GHG) emissions and reduced them to net zero through internal change and/or externally, through carbon offsetting in accordance with the requirements of the CarbonNeutral Protocol for the stated activity.

**Greenhouse gas emissions assessment**

An emissions assessment/audit has been undertaken by an independent third party in accordance with the WBCSD-WRI GHG Protocol.

**Emissions reduced through carbon offsetting**

95 tonnes CO<sub>2</sub>e

Biomass Renewable Energy, Sri Lanka, VCS (95 tCO<sub>2</sub>e)

Carbon Footprint Calculated and Offset By:



[www.carbonconsultingcompany.com](http://www.carbonconsultingcompany.com)



publication  
[CarbonNeutral.com](http://CarbonNeutral.com)

Certificate number  
CN2011022522

# KEY PERFORMANCE INDICATORS

| Section                             | KPI   |
|-------------------------------------|---|
| <b>CUSTOMER RESPONSIBILITY</b>      | <p>Number of new products introduced or relaunched during the year - 8</p> <p>Number of customer centres opened during the year - 19</p> <p>Number of ATMs established during the year - 40</p> <p>Number of written customer complaints received and resolved - 102</p> <p>Sectorwise distribution of Gami Pubuduwa Loans - page 116</p> |
| <b>EMPLOYEE RESPONSIBILITY</b>      | Locationwise, Categorywise, Agewise, Genderwise, Service-wise and Permanent/Contract staff analyses -pages 103-105  |
| <b>INVESTOR RESPONSIBILITY</b>      | Economic performance indicators of the Bank - page 109  |
| <b>COMMUNITY RESPONSIBILITY</b>     | <p>The investment committed for community projects - pages 113-115,117</p> <p>Number of Safe Drinking Water and Sanitation Projects completed during the year - 1</p> <p>Number of School Libraries completed during the year – 13</p> <p>Number of School computer centres completed during the year – 11</p>                            |
| <b>SUPPLIER RESPONSIBILITY</b>      | Supplies from Micro Entrepreneurs - 10%   |
| <b>ENVIRONMENTAL RESPONSIBILITY</b> | <p>Savings on the practices of 3R policies - page 122</p> <p>Savings from Energy efficient practices - page 121</p> <p>Treatment of waste water for reuse - page 121</p> <p>Number of hectares reclaimed at the Bundala National Park during 2010 - 5 hectares</p>  |

# INDEPENDENT ASSURANCE REPORT



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## INDEPENDENT ASSURANCE REPORT TO HATTON NATIONAL BANK PLC

### Introduction

We were engaged by the Board of Directors Hatton National Bank PLC ("Bank") to provide assurance on the following elements of the Sustainability Report 2010 ("Report") for the year ended 31 December 2010:

- Reasonable assurance on the data on financial performance, as specified on page 109 of the Report 2010;
- Limited assurance on Key Performance Indicators ("KPIs") specified on page 126 and other information presented in the Report.

### Managements' responsibilities and the criteria applied

Management is responsible for the preparation and presentation of the Report in accordance with the GRI Sustainability Reporting Guidelines as described in pages 82-83 of the Report and the information and assertions contained within it: for determining the Bank's objectives in respect of sustainable development performance and reporting, including the identification of stakeholder and material issues, and for establishing and maintaining appropriate performance management and internal control systems from which the reported performance information is derived.

### Our responsibilities and compliance with SLAE 3000

Our responsibility is to carry out a reasonable & limited assurance engagement and to express a conclusion based on the work performed. We conducted our engagement in accordance with the Sri Lanka Standard on Assurance Engagements 3000: Assurance Engagements Other Than Audits or Reviews of Historical Financial Information, issued by the Institute of Chartered Accountants of Sri Lanka

This Standard requires amongst others that we comply with applicable ethical requirements,

including independence requirements, and plan and perform the engagement to obtain reasonable & limited assurance about whether the Report is free of material misstatement.

### Summary of work performed

#### Financial data

A reasonable assurance engagement on financial performance reported on page 109 of the Report involves verification that they were properly derived from the audited financial statements of the Bank for the year ended 31 December 2010.

#### Key Performance Indicators and the other information

A limited assurance engagement on Key Performance Indicators and other information in the Report consists of making inquiries, primarily of persons responsible for the preparation of information presented in the sustainability report, and applying analytical and other evidence gathering procedures, as appropriate. These procedures included:

- Inquiries of management to gain an understanding of the Bank's processes for determining the material issues for the Bank's key stakeholder groups.
- Interviews with senior management and relevant staff at group level and selected business unit level concerning sustainability strategy and policies for material issues, and the implementation of these across the business.
- Interviews with relevant staff at corporate and business unit level responsible for providing the information in the Report.
- Inquiries about the design and implementation of the systems and methods used to collect and process the information reported, including the aggregation of data into information as presented in the Report.

- Comparing the information presented in the Report to corresponding information in the relevant underlying sources to determine whether all the relevant information contained in such underlying sources has been included in the Report.
- Reading the information presented in the Report to determine whether it is in line with our overall knowledge of, and experience with, the sustainability performance of the Bank
- Visits to selected project sites and branches to review systems and data;

### Our conclusion

Based on the procedures performed, as described above, we conclude that

- The data on financial performance, as specified on page 109 of the Report 2010 are properly derived from the financial statements of the Bank for the year ended 31 December 2010 for which the independent auditors have issued an unqualified audit opinion dated 18 February, 2011 on page 157 of the Annual Report;
- Nothing has come to our attention that causes us to believe that the Key Performance Indicators for 2010 specified on page 126 and other information presented in the Report are not fairly presented, in all material respects, in accordance with the GRI Sustainability Reporting Guidelines as described in page 82-83 of the Report.

*Ford Rhodes Thornton & Co.*

### CHARTERED ACCOUNTANTS

Colombo  
18 February 2011

KPMG Ford, Rhodes, Thornton & Co., a Sri Lankan Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International cooperative ("KPMG International"), a Swiss entity.

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## Statement GRI Application Level Check

GRI hereby states that **Hatton National Bank** has presented its report "Sustainability Report - Caring Partner" to GRI's Report Services which have concluded that the report fulfills the requirements of Application Level B+.

GRI Application Levels communicate the extent to which the content of the G3 Guidelines has been used in the submitted sustainability reporting. The Check confirms that the required set and number of disclosures for that Application Level have been addressed in the reporting and that the GRI Content Index demonstrates a valid representation of the required disclosures, as described in the GRI G3 Guidelines.

Application Levels do not provide an opinion on the sustainability performance of the reporter nor the quality of the information in the report.

17 February 2011, Amsterdam

A handwritten signature in dark ink, appearing to be "N. Arbex", is written over a light blue circular background.

Nelmara Arbex  
Deputy Chief Executive  
Global Reporting Initiative



The "+" has been added to this Application Level because Hatton National Bank has submitted (part of) this report for external assurance. GRI accepts the reporter's own judgment for choosing its assurance Provider and for deciding the scope of the assurance.

*The Global Reporting Initiative (GRI) is a network-based organization that has pioneered the development of the world's most widely used sustainability reporting framework and is committed to its continuous improvement and application worldwide. The GRI Guidelines set out the principles and indicators that organizations can use to measure and report their economic, environmental, and social performance. [www.globalreporting.org](http://www.globalreporting.org)*

***Disclaimer:** Where the relevant sustainability reporting includes external links, including to audio visual material, this statement only concerns material submitted to GRI at the time of the Check on 7 February 2011. GRI explicitly excludes the statement being applied to any later changes to such material.*

# G3 INDEX WITH FINANCIAL SERVICES SECTOR SUPPLEMENT

## STANDARD DISCLOSURES PART I: Profile Disclosures

### 1. Strategy and Analysis

| Profile Disclosure | Description  | Reported | Cross-reference/Direct answer | If applicable, indicate the part not reported Reason for omission Explanation |
|--------------------|--|----------|-------------------------------|---|
| 1.1                | Statement from the most senior decision-maker of the organization. | Fully    | Page No. 80-81                |   |
| 1.2                | Description of key impacts, risks, and opportunities.              | Fully    | Page No. 49-50, 86-87         |   |

### 2. Organizational Profile

| Profile Disclosure | Description  | Reported | Cross-reference/Direct answer   | If applicable, indicate the part not reported Reason for omission Explanation |
|--------------------|--|----------|---|---|
| 2.1                | Name of the organization.  | Fully    | Hatton National Bank PLC  |   |
| 2.2                | Primary brands, products, and/or services.   | Fully    | Description of each product/service is given in detail in the Management Discussion & Analysis section under each key business function, from Page No. 22-34  |   |
| 2.3                | Operational structure of the organization, including main divisions, operating companies, subsidiaries, and joint ventures.  | Fully    | Operational structure of the Bank - Page No. 59<br>Details of the group structure - Inner back cover<br>Operations of Group entities - Page No. 35-38   |   |
| 2.4                | Location of organization's headquarters.   | Fully    | Inner back cover  |   |
| 2.5                | Number of countries where the organization operates, and names of countries with either major operations or that are specifically relevant to the sustainability issues covered in the report. | Fully    | Page No. 39-40  |   |
| 2.6                | Nature of ownership and legal form.  | Fully    | Inner back cover  |   |
| 2.7                | Markets served (including geographic breakdown, sectors served, and types of customers/beneficiaries).   | Fully    | Page No. 39-41, 55  |   |
| 2.8                | Scale of the reporting organization.   | Fully    | Number of employees - 4,352<br>Income statement - Page No.158<br>10 year summary - Page No. 257<br>20 largest shareholders Page No. 264-265<br>Breakdowns of operating income & expenses - Page No. 180 |   |
| 2.9                | Significant changes during the reporting period regarding size, structure, or ownership.   | Not      |   | Does not exist  |
| 2.10               | Awards received in the reporting period.   | Fully    | Page No. 110  |   |

### 3. Report Parameters

| Profile Disclosure | Description   | Reported | Cross-reference/Direct answer      | If applicable, indicate the part not reported Reason for omission Explanation |
|--------------------|---|----------|------------------------------------|---|
| 3.1                | Reporting period (e.g., fiscal/calendar year) for information provided.   | Fully    | 1 January 2010 to 31 December 2010 |   |
| 3.2                | Date of most recent previous report (if any).   | Fully    | 31 December 2009.                  |   |
| 3.3                | Reporting cycle (annual, biennial, etc.)  | Fully    | Annual                             |   |
| 3.4                | Contact point for questions regarding the report or its contents.   | Fully    | Inner back cover                   |   |
| 3.5                | Process for defining report content.  | Fully    | Page No. 82-83                     |   |
| 3.6                | Boundary of the report (e.g., countries, divisions, subsidiaries, leased facilities, joint ventures, suppliers). See GRI Boundary Protocol for further guidance.  | Fully    | Page No. 83                        |   |
| 3.7                | State any specific limitations on the scope or boundary of the report (see completeness principle for explanation of scope).  | Fully    | Page No. 83                        |   |
| 3.8                | Basis for reporting on joint ventures, subsidiaries, leased facilities, outsourced operations, and other entities that can significantly affect comparability from period to period and/or between organizations.   | Fully    | Page No. 83                        |   |
| 3.9                | Data measurement techniques and the bases of calculations, including assumptions and techniques underlying estimations applied to the compilation of the Indicators and other information in the report. Explain any decisions not to apply, or to substantially diverge from, the GRI Indicator Protocols. | Fully    | Page No. 82-83                     |   |
| 3.10               | Explanation of the effect of any re-statements of information provided in earlier reports, and the reasons for such re-statement (e.g., mergers/acquisitions, change of base years/periods, nature of business, measurement methods).   | Fully    | None                               |   |
| 3.11               | Significant changes from previous reporting periods in the scope, boundary, or measurement methods applied in the report.   | Not      |                                    | Does not exist  |
| 3.12               | Table identifying the location of the Standard Disclosures in the report.   | Fully    | This GRI Table                     |   |
| 3.13               | Policy and current practice with regard to seeking external assurance for the report.   | Fully    | Page No. 83,127                    |   |



## G3 INDEX WITH FINANCIAL SERVICES SECTOR SUPPLEMENT

| 4. Governance, Commitments, and Engagement |  |          |   |   |
|--|--|----------|---|---|
| Profile Disclosure                         | Description  | Reported | Cross-reference/Direct answer                       | If applicable, indicate the part not reported Reason for omission Explanation |
| 4.1  | Governance structure of the organization, including committees under the highest governance body responsible for specific tasks, such as setting strategy or organizational oversight.   | Fully    | Page No. 59   |   |
| 4.2  | Indicate whether the Chair of the highest governance body is also an executive officer.  | Fully    | Page No. 59   |   |
| 4.3  | State the number of members of the highest governance body that are independent and/or non-executive members.  | Fully    | Page No; 59, 85                                     |   |
| 4.4  | Mechanisms for shareholders and employees to provide recommendations or direction to the highest governance body.  | Fully    | Page No. 91, Investor Feedback Form                 |   |
| 4.5  | Linkage between compensation for members of the highest governance body, senior managers, and executives (including departure arrangements), and the organization's performance (including social and environmental performance).  | Fully    | Page No. 65-66,102                                  |   |
| 4.6  | Processes in place for the highest governance body to ensure conflicts of interest are avoided.  | Fully    | Page No. 70   |   |
| 4.7  | Process for determining the qualifications and expertise of the members of the highest governance body for guiding the organization's strategy on economic, environmental, and social topics.  | Fully    | Page No. 61   |   |
| 4.8  | Internally developed statements of mission or values, codes of conduct, and principles relevant to economic, environmental, and social performance and the status of their implementation.   | Fully    | Page No. 1, 89                                      |   |
| 4.9  | Procedures of the highest governance body for overseeing the organization's identification and management of economic, environmental, and social performance, including relevant risks and opportunities, and adherence or compliance with internationally agreed standards, codes of conduct, and principles.                 | Fully    | Page No. 70-74, 85                                  |   |
| 4.10                                       | Processes for evaluating the highest governance body's own performance, particularly with respect to economic, environmental, and social performance.  | Fully    | Page No. 64-65                                      |   |
| 4.11                                       | Explanation of whether and how the precautionary approach or principle is addressed by the organization.   | Fully    | Page No. 84-89                                      |   |
| 4.12                                       | Externally developed economic, environmental, and social charters, principles, or other initiatives to which the organization subscribes or endorses.  | Fully    | Page No. 82-83                                      |   |
| 4.13                                       | Memberships in associations (such as industry associations) and/or national/international advocacy organizations in which the organization: * Has positions in governance bodies; * Participates in projects or committees; * Provides substantive funding beyond routine membership dues; or * Views membership as strategic. | Fully    | Page No. 93   |   |
| 4.14                                       | List of stakeholder groups engaged by the organization.  | Fully    | Page No. 91   |   |
| 4.15                                       | Basis for identification and selection of stakeholders with whom to engage.  | Fully    | Page No. 82-83                                      |   |
| 4.16                                       | Approaches to stakeholder engagement, including frequency of engagement by type and by stakeholder group.  | Fully    | Page No. 90-93                                      |   |
| 4.17                                       | Key topics and concerns that have been raised through stakeholder engagement, and how the organization has responded to those key topics and concerns, including through its reporting.  | Fully    | Page No. 82-83, 90-93, 94-98, 100-102, 108, 112-124 |   |

### STANDARD DISCLOSURES PART II: Disclosures on Management Approach (DMAs)

| G3 DMA                  | Description   | Reported | Cross-reference/Direct answer | If applicable, indicate the part not reported Reason for omission Explanation |
|-------------------------|---|----------|-------------------------------|---|
| DMA PS                  | Disclosure on Management Approach PS  |          | Page No. 87-89                |   |
| Aspects                 | Product Portfolio   |          |                               |   |
| FS1                     | Policies with specific environmental and social components applied to business lines.   | Fully    | Page No. 91-92                |   |
| FS2                     | Procedures for assessing and screening environmental and social risks in business lines.  | Fully    | Page No. 92                   |   |
| FS3                     | Processes for monitoring clients' implementation of and compliance with environmental and social requirements included in agreements or transactions. | Fully    | Page No. 92                   |   |
| FS4                     | Process(es) for improving staff competency to implement the environmental and social policies and procedures as applied to business lines.            | Fully    | Page No. 92-93                |   |
| FSS                     | Interactions with clients/investees/business partners regarding environmental and social risks and opportunities.                                     | Fully    | Page No. 93                   |   |
| <b>Audits</b>           |   |          |                               |   |
| <b>Active Ownership</b> |   |          |                               |   |
| DMA EC                  | Disclosure on Management Approach EC  |          | Page No. 87-89                |   |
| Aspects                 | Economic Performance/COMM   |          |                               |   |
|                         | Market presence   |          |                               |   |
|                         | Indirect economic impacts   |          |                               |   |
| DMA EN                  | Disclosure on Management Approach EN  |          | Page No. 87-89                |   |
| Aspects                 | Materials   |          |                               |   |
|                         | Energy  |          |                               |   |

|         |   |       |                |  |
|---------|---|-------|----------------|--|
|         | Water   |       |                |  |
|         | Biodiversity  |       |                |  |
|         | Emissions, effluents and waste  |       |                |  |
|         | Products and services   |       |                |  |
|         | Compliance  |       |                |  |
|         | Transport   |       |                |  |
|         | Overall   |       |                |  |
| DMA LA  | Disclosure on Management Approach LA                                      |       | Page No. 87-89 |  |
| Aspects | Employment  |       |                |  |
|         | Labor/management relations  |       |                |  |
|         | Occupational health and safety  | COMM  |                |  |
|         | Training and education  |       |                |  |
|         | Diversity and equal opportunity   |       |                |  |
| DMA HR  | Disclosure on Management Approach HR                                      |       | Page No. 87-89 |  |
| Aspects | Investment and procurement practices                                      |       |                |  |
|         | Non-discrimination  |       |                |  |
|         | Freedom of association and collective bargaining                          |       |                |  |
|         | Child labor   |       |                |  |
|         | Forced and compulsory labor   |       |                |  |
|         | Security practices  |       |                |  |
|         | Indigenous rights   |       |                |  |
| DMA SO  | Disclosure on Management Approach SO                                      |       | Page No. 87-89 |  |
| Aspects | Community   |       |                |  |
|         | Corruption  |       |                |  |
|         | Public policy   |       |                |  |
|         | Anti-competitive behavior   |       |                |  |
|         | Compliance  |       |                |  |
| DMA PR  | Disclosure on Management Approach PR                                      |       | Page No. 87-89 |  |
| Aspects | Customer health and safety  |       |                |  |
|         | Product and service labelling   |       |                |  |
| FS15    | Policies for the fair design and sale of financial products and services. | Fully | Page No. 88    |  |
|         | Marketing communications  |       |                |  |
|         | Customer privacy  |       |                |  |
|         | Compliance  |       |                |  |

## STANDARD DISCLOSURES PART III: Performance Indicators

### Product and Service Impact

| Performance Indicator | Description | Reported | Cross-reference/Direct answer | If applicable, indicate the part not reported Reason for Omission Explanation |
|-----------------------|-------------|----------|-------------------------------|---|
|-----------------------|-------------|----------|-------------------------------|---|

### Product portfolio

|     |   |       |                          |  |
|-----|---|-------|--------------------------|--|
| FS6 | Percentage of the portfolio for business lines by specific region, size (e.g. micro/SME/ large) and by sector.                              | Fully | Page No. 55, 252-253     |  |
| FS7 | Monetary value of products and services designed to deliver a specific social benefit for each business line broken down by purpose.        | Fully | Page No. 27-28, 194, 217 |  |
| FS8 | Monetary value of products and services designed to deliver a specific environmental benefit for each business line broken down by purpose. | Fully | Page No. 88-89, 194, 217 |  |

### Audit

|     |  |       |                     |  |
|-----|--|-------|---------------------|--|
| FS9 | Coverage and frequency of audits to assess implementation of environmental and social policies and risk assessment procedures. | Fully | Page No. 72, 74, 85 |  |
|-----|--|-------|---------------------|--|

### Active ownership

|      |   |       |                  |                |
|------|---|-------|------------------|----------------|
| FS10 | Percentage and number of companies held in the institution's portfolio with which the reporting organization has interacted on environmental or social issues.    | Fully | Page No. 229-231 |                |
| FS11 | Percentage of assets subject to positive and negative environmental or social screening.  | Not   |                  | Not available  |
| FS12 | Voting polic(ies) applied to environmental or social issues for shares over which the reporting organization holds the right to vote shares or advises on voting. | Not   |                  | Not applicable |

## G3 INDEX WITH FINANCIAL SERVICES SECTOR SUPPLEMENT

| Economic                              |   |           |   |   |
|---------------------------------------|---|-----------|---|---|
| Performance Indicator                 | Description   | Reported  | Cross-reference/Direct answer   | If applicable, indicate the part not reported Reason for Omission Explanation |
| <b>Economic performance</b>           |   |           |   |   |
| EC1COMM                               | Direct economic value generated and distributed, including revenues, operating costs, employee compensation, donations and other community investments, retained earnings, and payments to capital providers and governments. | Fully     | Page No. 255  |   |
| EC2                                   | Financial implications and other risks and opportunities for the organization's activities due to climate change.   | Not       |   | Not available   |
| EC3                                   | Coverage of the organization's defined benefit plan obligations.  | Fully     | Page No. 222-223  |   |
| EC4                                   | Significant financial assistance received from government.  | Not       |   | Not applicable  |
| <b>Market presence</b>                |   |           |   |   |
| EC5                                   | Range of ratios of standard entry level wage compared to local minimum wage at significant locations of operation.  | Fully     | Page No. 103  | As defined in the Collective Agreements                                       |
| EC6                                   | Policy, practices, and proportion of spending on locally-based suppliers at significant locations of operation.   | Partially | Page No. 119-120  | Complete data not available Significant sourcing from local suppliers         |
| EC7                                   | Procedures for local hiring and proportion of senior management hired from the local community at significant locations of operation.   | Fully     | 100%. Confirmed that all hiring is done locally at significant locations of operation   |   |
| <b>Indirect economic impacts</b>      |   |           |   |   |
| EC8                                   | Development and impact of infrastructure investments and services provided primarily for public benefit through commercial, in-kind, or pro bono engagement.  | Fully     | Page No. 112-118  |   |
| EC9                                   | Understanding and describing significant indirect economic impacts, including the extent of impacts.  | Fully     | Page No. 112-118  |   |
| <b>Environmental</b>                  |   |           |   |   |
| Performance Indicator                 | Description   | Reported  | Cross-reference/Direct answer   | If applicable, indicate the part not reported Reason for Omission Explanation |
| <b>Materials</b>                      |   |           |   |   |
| EN1                                   | Materials used by weight or volume.   | Not       |   | Not applicable  |
| EN2                                   | Percentage of materials used that are recycled input materials.   | Fully     | Page No. 122  |   |
| <b>Energy</b>                         |   |           |   |   |
| EN3                                   | Direct energy consumption by primary energy source.   | Not       |   | Not applicable  |
| EN4                                   | Indirect energy consumption by primary source.  | Fully     | Total electricity consumption at the HNB customer centres was 11,939,943 units per year in 2010. The source of electricity energy used by the Bank is from the National Grid of the Ceylon Electricity Board, the Country's only electricity supplier. The source producing the electricity is mostly hydro. To fulfill any excess requirement fuel (petroleum based) generated electricity is also supplied through the National Grid. |   |
| EN5                                   | Energy saved due to conservation and efficiency improvements.   | Fully     | Page No. 121  |   |
| EN6                                   | Initiatives to provide energy-efficient or renewable energy based products and services, and reductions in energy requirements as a result of these initiatives.  | Fully     | Page No. 88-89  |   |
| EN7                                   | Initiatives to reduce indirect energy consumption and reductions achieved.  | Fully     | Page No. 121  |   |
| <b>Water</b>                          |   |           |   |   |
| EN8                                   | Total water withdrawal by source.   | Not       |   | Not available   |
| EN9                                   | Water sources significantly affected by withdrawal of water.  | Not       |   | Not applicable  |
| EN10                                  | Percentage and total volume of water recycled and reused.   | Fully     | Page No. 121-122  |   |
| <b>Biodiversity</b>                   |   |           |   |   |
| EN11                                  | Location and size of land owned, leased, managed in, or adjacent to, protected areas and areas of high biodiversity value outside protected areas.  | Not       |   | Not applicable  |
| EN12                                  | Description of significant impacts of activities, products, and services on biodiversity in protected areas and areas of high biodiversity value outside protected areas.   | Not       |   | Not applicable  |
| EN13                                  | Habitats protected or restored.   | Fully     | Page No. 124  |   |
| EN14                                  | Strategies, current actions, and future plans for managing impacts on biodiversity.   | Fully     | Page No. 86, 121-124  |   |
| EN15                                  | Number of IUCN Red List species and national conservation list species with habitats in areas affected by operations, by level of extinction risk.  | Not       |   | Not applicable  |
| <b>Emissions, effluents and waste</b> |   |           |   |   |
| EN16COMM                              | Total direct and indirect greenhouse gas emissions by weight.   | Not       |   | Not available   |
| EN17                                  | Other relevant indirect greenhouse gas emissions by weight.   | Not       |   | Not available   |
| EN18                                  | Initiatives to reduce greenhouse gas emissions and reductions achieved.   | Fully     | Page No. 121-124  |   |
| EN19                                  | Emissions of ozone-depleting substances by weight.  | Not       |   | Not applicable  |

|                              |   |       |                  |                |
|------------------------------|---|-------|------------------|----------------|
| EN20                         | NOx, SOx, and other significant air emissions by type and weight.   | Not   |                  | Not applicable |
| EN21                         | Total water discharge by quality and destination.   | Not   |                  | Not material   |
| EN22COMM                     | Total weight of waste by type and disposal method.  | Fully | Page No. 121-124 |                |
| EN23                         | Total number and volume of significant spills.  | Not   |                  | Not applicable |
| EN24                         | Weight of transported, imported, exported, or treated waste deemed hazardous under the terms of the Basel Convention Annex I, II, III, and VIII, and percentage of transported waste shipped internationally. | Not   |                  | Not applicable |
| EN25                         | Identity, size, protected status, and biodiversity value of water bodies and related habitats significantly affected by the reporting organization's discharges of water and runoff.                          | Not   |                  | Not applicable |
| <b>Products and services</b> |   |       |                  |                |
| EN26                         | Initiatives to mitigate environmental impacts of products and services, and extent of impact mitigation.  | Not   |                  | Not applicable |
| EN27                         | Percentage of products sold and their packaging materials that are reclaimed by category.   | Not   |                  | Not applicable |
| <b>Compliance</b>            |   |       |                  |                |
| EN28                         | Monetary value of significant fines and total number of non-monetary sanctions for non-compliance with environmental laws and regulations.  | Not   |                  | Not applicable |
| <b>Transport</b>             |   |       |                  |                |
| EN29                         | Significant environmental impacts of transporting products and other goods and materials used for the organization's operations, and transporting members of the workforce.                                   | Not   |                  | Not material   |
| <b>Overall</b>               |   |       |                  |                |
| EN30                         | Total environmental protection expenditures and investments by type.  | Fully | Page No. 121-124 |                |

## Social: Labor Practices and Decent Work

| Performance Indicator                  | Description   | Reported | Cross-reference/Direct answer  | If applicable, indicate the part not reported Reason for Omission Explanation |
|--|---|----------|--|---|
| <b>Employment</b>                      |   |          |  |   |
| LA1                                    | Total workforce by employment type, employment contract, and region.  | Fully    | Page No. 103-105   |   |
| LA2                                    | Total number and rate of employee turnover by age group, gender, and region.  | Not      |  | Not disclosed   |
| LA3                                    | Benefits provided to full-time employees that are not provided to temporary or part-time employees, by major operations.  | Not      | Complete quantification not available.   | Not available   |
| <b>Labor/management relations</b>      |   |          |  |   |
| LA4                                    | Percentage of employees covered by collective bargaining agreements.  | Fully    | Page No. 105   |   |
| LA5                                    | Minimum notice period(s) regarding significant operational changes, including whether it is specified in collective agreements.   | Fully    | The Bank endeavours to give a minimum of 1 month notice regarding significant operational changes. It is not defined in collective agreements except for notice regarding resignations |   |
| <b>Occupational health and safety</b>  |   |          |  |   |
| LA6                                    | Percentage of total workforce represented in formal joint management-worker health and safety committees that help monitor and advise on occupational health and safety programs. | Not      | Complete quantification not available.   | Not available   |
| LA7                                    | Rates of injury, occupational diseases, lost days, and absenteeism, and number of work-related fatalities by region.  | Not      |  | Not applicable  |
| LA8                                    | Education, training, counseling, prevention, and risk-control programs in place to assist workforce members, their families, or community members regarding serious diseases.     | Fully    | Page No. 101, 113  |   |
| LA9                                    | Health and safety topics covered in formal agreements with trade unions.  | Fully    | Medical leave, medical insurance, annual health check up & reimbursement of medical expenses including hospitalisation   |   |
| <b>Training and education</b>          |   |          |  |   |
| LA10                                   | Average hours of training per year per employee by employee category.   | Fully    | Page No. 104   |   |
| LA11                                   | Programs for skills management and lifelong learning that support the continued employability of employees and assist them in managing career endings.                            | Fully    | Page No. 100-103   |   |
| LA12                                   | Percentage of employees receiving regular performance and career development reviews.   | Fully    | 100%   |   |
| <b>Diversity and equal opportunity</b> |   |          |  |   |
| LA13                                   | Composition of governance bodies and breakdown of employees per category according to gender, age group, minority group membership, and other indicators of diversity.            | Fully    | Page No. 103-105   |   |
| LA14                                   | Ratio of basic salary of men to women by employee category.   | Fully    | The Bank is an equal opportunity employer  |   |

## G3 INDEX WITH FINANCIAL SERVICES SECTOR SUPPLEMENT

| Social: Human Rights                                    |  |          |  |   |
|---|--|----------|--|---|
| Performance Indicator                                   | Description  | Reported | Cross-reference/Direct answer  | If applicable, indicate the part not reported<br>Reason for Omission<br>Explanation |
| <b>Diversity and equal opportunity</b>                  |  |          |  |   |
| HR1COMM   | Percentage and total number of significant investment agreements that include human rights clauses or that have undergone human rights screening.                                | Not      | Complete quantification not available.   | Not available   |
| HR2   | Percentage of significant suppliers and contractors that have undergone screening on human rights and actions taken.   | Fully    | 100%   |   |
| HR3   | Total hours of employee training on policies and procedures concerning aspects of human rights that are relevant to operations, including the percentage of employees trained.   | Fully    | 100%. At induction stage   |   |
| <b>Non-discrimination</b>                               |  |          |  |   |
| HR4   | Total number of incidents of discrimination and actions taken.   | Fully    | None reported during the year  |   |
| <b>Freedom of association and collective bargaining</b> |  |          |  |   |
| HR5   | Operations identified in which the right to exercise freedom of association and collective bargaining may be at significant risk, and actions taken to support these rights.     | Fully    | Collective Agreements are adhered to   |   |
| <b>Child labor</b>                                      |  |          |  |   |
| HR6   | Operations identified as having significant risk for incidents of child labor, and measures taken to contribute to the elimination of child labor.                               | Not      |  | Not applicable  |
| <b>Forced and compulsory labor</b>                      |  |          |  |   |
| HR7   | Operations identified as having significant risk for incidents of forced or compulsory labor, and measures taken to contribute to the elimination of forced or compulsory labor. | Not      |  | Not applicable  |
| <b>Security practices</b>                               |  |          |  |   |
| HR8   | Percentage of security personnel trained in the organization's policies or procedures concerning aspects of human rights that are relevant to operations.                        | Fully    | Security Coordinators are employed to monitor the security functions which are outsourced. |   |
| <b>Indigenous rights</b>                                |  |          |  |   |
| HR9   | Total number of incidents of violations involving rights of indigenous people and actions taken.   | Not      |  | Not applicable  |
| <b>Social: Society</b>                                  |  |          |  |   |
| Performance Indicator                                   | Description  | Reported | Cross-reference/Direct answer  | If applicable, indicate the part not reported<br>Reason for Omission<br>Explanation |
| <b>Community</b>  |  |          |  |   |
| SO1   | Nature, scope, and effectiveness of any programs and practices that assess and manage the impacts of operations on communities, including entering, operating, and exiting.      | Fully    | Page No. 86, 112-118   |   |
| FS13  | Access points in low-populated or economically disadvantaged areas by type.  | Fully    | Page No. 40-41   |   |
| FS14  | Initiatives to improve access to financial services for disadvantaged people.  | Fully    | Page No. 94, 97-98   |   |
| <b>Corruption</b>                                       |  |          |  |   |
| SO2   | Percentage and total number of business units analyzed for risks related to corruption.  | Fully    | 100%. Page No. 56  |   |
| SO3   | Percentage of employees trained in organization's anti-corruption policies and procedures.   | Fully    | 100%. At induction stage   |   |
| SO4   | Actions taken in response to incidents of corruption.  | Fully    | None reported during the year  |   |
| <b>Public policy</b>                                    |  |          |  |   |
| SO5   | Public policy positions and participation in public policy development and lobbying.   | Not      |  | Not material  |
| SO6   | Total value of financial and in-kind contributions to political parties, politicians, and related institutions by country.   | Fully    | None reported during the year  |   |
| <b>Anti-competitive behavior</b>                        |  |          |  |   |
| SO7   | Total number of legal actions for anti-competitive behavior, anti-trust, and monopoly practices and their outcomes.  | Fully    | None reported during the year  |   |
| <b>Compliance</b>                                       |  |          |  |   |
| SO8   | Monetary value of significant fines and total number of non-monetary sanctions for non-compliance with laws and regulations.   | Fully    | None reported during the year  |   |

## Social: Product Responsibility

| Performance Indicator                | Description  | Reported | Cross-reference/Direct answer | If applicable, indicate the part not reported<br>Reason for omission<br>Explanation |
|--------------------------------------|--|----------|-------------------------------|---|
| <b>Customer health and safety</b>    |  |          |                               |   |
| PR1                                  | Life cycle stages in which health and safety impacts of products and services are assessed for improvement, and percentage of significant products and services categories subject to such procedures. | Fully    | Page No. 94-98                |   |
| PR2                                  | Total number of incidents of non-compliance with regulations and voluntary codes concerning health and safety impacts of products and services during their life cycle, by type of outcomes.           | Fully    | None reported during the year |   |
| <b>Product and service labelling</b> |  |          |                               |   |
| PR3                                  | Type of product and service information required by procedures, and percentage of significant products and services subject to such information requirements.  | Not      |                               | Not available   |
| PR4                                  | Total number of incidents of non-compliance with regulations and voluntary codes concerning product and service information and labeling, by type of outcomes.   | Fully    | None reported during the year |   |
| PR5                                  | Practices related to customer satisfaction, including results of surveys measuring customer satisfaction.  | Fully    | Page No. 94-98                |   |
| FS16                                 | Initiatives to enhance financial literacy by type of beneficiary.  | Fully    | Page No. 92                   |   |
| <b>Marketing communications</b>      |  |          |                               |   |
| PR6                                  | Programs for adherence to laws, standards, and voluntary codes related to marketing communications, including advertising, promotion, and sponsorship.   | Not      |                               | Not available   |
| PR7                                  | Total number of incidents of non-compliance with regulations and voluntary codes concerning marketing communications, including advertising, promotion, and sponsorship by type of outcomes.           | Fully    | None reported during the year |   |
| <b>Customer privacy</b>              |  |          |                               |   |
| PR8                                  | Total number of substantiated complaints regarding breaches of customer privacy and losses of customer data.   | Fully    | None reported during the year |   |
| <b>Compliance</b>                    |  |          |                               |   |
| PR9                                  | Monetary value of significant fines for non-compliance with laws and regulations concerning the provision and use of products and services.  | Fully    | None reported during the year |   |



# **FINANCIAL INFORMATION**

# **SUSTAINING GROWTH**

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## Financial Calendar - 2010

|  |                    |
|--|--------------------|
| Rs 5.00 per share Final Dividend for 2009 paid on      | 12th April 2010    |
| Rs 1.50 per share Interim Dividend for 2010 paid on    | 24th November 2010 |
| Audited Financial Statements signed on                 | 18th February 2011 |
| 42nd Annual General Meeting to be held on              | 31st March 2011    |
| Rs 5.50 per share Final Dividend for 2010 payable on * | 11th April 2011    |

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 | 12th May 2010      |
| 2nd Quarter Interim Results released on | 12th August 2010   |
| 3rd Quarter Interim Results released on | 11th November 2010 |

## Proposed Financial Calendar - 2011

|   |               |
|---|---------------|
| Interim Dividend for 2011 to be payable in ** | December 2011 |
| 43rd Annual General Meeting to be held in     | March 2012    |
| Final Dividend for 2011 to be payable in ***  | April 2012    |

Interim Financial Statements to be 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 2011      |
| 2nd Quarter Interim Results to be released in | August 2011   |
| 3rd Quarter Interim Results to be released in | November 2011 |

\* Subject to confirmation by Shareholders

\*\* Subject to confirmation by Directors

\*\*\* Subject to confirmation by Directors and Shareholders

# ANNUAL REPORT OF THE BOARD OF DIRECTORS ON THE AFFAIRS OF THE COMPANY

The Board of Directors of Hatton National Bank PLC has pleasure in presenting their Annual Report to the members for the financial year ended 31st December 2010, together with the audited Financial Statements of the Bank and Consolidated Financial Statements of the Group for that year, and the Auditors' Report on those Financial Statements, conforming to the requirements of the Companies Act. The Financial Statements were reviewed and approved by the Board of Directors on 18th February 2011. The Report also includes certain disclosures required to be made under the Banking Act direction on Corporate Governance, Listing Rules of the Colombo Stock Exchange and is guided by the recommended best practices on Corporate Governance.

Hatton National Bank PLC (Bank) is a Public Limited Company incorporated in Sri Lanka in March 1970 under the Companies Ordinance. The Bank was re-registered as required under the provisions of the Companies Act No 7 of 2007, on 27th September 2007.

The ordinary shares and the majority of the unsecured subordinated redeemable debentures of the Bank are listed on the Colombo Stock Exchange in Sri Lanka. Global Depository Receipts of the Bank are listed on the Luxembourg Stock Exchange.

The Bank's implied long term unsecured senior debt has been assigned AA-(lka) by Fitch Ratings Lanka Ltd.

## Principal Activities

The principal activities of the Bank and the Group during the year were general banking, development banking, offshore banking, mortgage financing, lease financing, corporate banking, dealing in government securities and listed equities, pawn broking, credit card facilities, stock broking, providing life and general insurance services, other financial services and property development. There were no significant changes in the nature of the principal activities of the Bank and the Group during the financial year under review.

## Changes to the Group Structure

In September 2010 the Bank transferred its shareholding of 49.99% in Acuity Securities Ltd (formerly known as HNB Securities Ltd) to Acuity Partners (Pvt) Ltd ("Acuity") thereby completing the business model adopted between the DFCC Bank and the Bank in 2008 to promote interalia investment banking, corporate finance, stock broking and fixed income securities business, jointly. The shares were transferred at the net book value. Accordingly, with effect from 1st October 2010, Acuity Securities Ltd was treated as a fully owned subsidiary of Acuity.

The Bank held 20.07% of the ordinary shares of Lanka Ventures PLC (LVL) in 2009 and this investment was classified as an investment in Associate in that year. Hatton National Bank sold its stake in LVL to Acuity on 18th January 2010. Acuity has also purchased a further 58% shareholding in LVL from DFCC Bank on the same day, thus increasing its stake in LVL to 78%. Accordingly, HNB's ownership in LVL has now increased to an indirect shareholding of 39% through the joint venture Acuity,

consequent to these transactions. During the year the Bank increased its capital contribution (direct / through conversion of loans) to Acuity by Rs 405 Mn and retained its ownership in the joint venture.

The Bank took a strategic decision to cease commercial operations in Canada through its investment in Commercial Interlink Services Inc (O/A of Delma Exchange Canada), due to the fierce competition in the high volume, low margin remittance business. The commercial operations were progressively scaled down during the latter part of the year. This Company has been classified as a subsidiary of the Bank up to the balance sheet date and the Bank has made the required provision of Rs 28,948,000 for impairment in the Income Statement.

The Bank also invested a further sum of Rs 12.1 Mn in the equity of Delma Exchange in Abu Dhabi, United Arab Emirates during the year as part of a capital augmentation plan to support the expansion of distribution network. As at balance sheet date the company had 4 branches in the UAE. The Bank continues to own 20% of this company and classifies it as an Associate.

## Review of Operations

A review of the operations of the Bank during the financial year 2010 and results of its operations are contained in the Chairman's Message (pages 04 to 07), the Chief Executive Officer's Review (pages 08 to 11) and Management Discussion (pages 20 to 45). These reports form an integral part of the Annual Report of the Board.

## Future Developments

An overview of the future developments of the Bank is given in the Chairman's Message (pages 04 to 07), the Chief Executive Officer's Review (pages 08 to 11) and Management Discussion (pages 20 to 45).

## Financial Statements

The Financial Statements of the Bank and the Group for the year ended 31st December 2010 duly signed by the Chief Financial Officer, two of the Directors of the Bank and the Board Secretary are given on pages 158 to 245 which form an integral part of the Annual Report of the Board.

## Significant Accounting Policies

The significant accounting policies adopted in the preparation of the Financial Statements and the impact of the changes in Sri Lanka Accounting Standards during the year are given on pages 164 to 178.

## Going Concern

The Board is satisfied that the Bank has adequate resources to continue its operations in the foreseeable future. Therefore, we continue to adopt the going-concern basis in preparing these Financial Statements.

## Auditors' Report

Bank's Auditors, Messrs KPMG Ford, Rhodes, Thornton & Company carried out the audit on the Financial Statements of the Bank and the

Consolidated Financial Statements of the Group for the year ended 31st December 2010 and their report on those Financial Statements which forms an integral part of the Report of the Board of Directors, is given on page 157 of this Annual Report.

## Income

The Income of the Group for 2010 was Rs 38,104,665,000/= (2009 - Rs 41,300,773,000/=) while the Bank's income was Rs 35,581,621,000/= (2009 - Rs 39,357,863,000/=). An analysis of the income is given in Note 9 to the Financial Statements.

## Financial Results and Appropriations

The Bank has recorded a profit before tax and profit after tax growth of 13.8% and 2.6% respectively in 2010. The Group's profit before tax and profit after tax for the year too recorded a growth of 17.6% and 7.3% respectively over 2009.

|   | 2010<br>Rs '000 | 2009<br>Rs '000 |
|---|-----------------|-----------------|
| The Group profit for the year ended 31st December 2010 after payment of all expenses of management and providing for depreciation and contingencies | 7,251,667       | 6,166,824       |
| Less: Taxation  | (2,364,839)     | (1,613,464)     |
| Group net profit after taxation   | 4,886,828       | 4,553,360       |
| Minority Interest   | (100,058)       | (70,083)        |
|   | 4,786,770       | 4,483,277       |
| Unappropriated profit brought forward from previous year  | 3,550,268       | 2,616,620       |
| Balance available before appropriation / adjustments  | 8,337,038       | 7,099,897       |
| Transfer to General Reserve   | (2,300,000)     | (2,210,947)     |
| Transfer to Reserve Fund  | (250,000)       | (277,293)       |
| Final dividend  | (1,179,807)     | (706,588)       |
| Interim dividend  | (338,570)       | (353,415)       |
| Dividend reversal   | 175,712         | -               |
| Reduction in reserves from disposal of Associate company and long term investment to Joint Venture  | (88,637)        | -               |
| Acquisition of minority interest in Subsidiary by Group   | (712)           | -               |
| Disposal of Subsidiaries  | -               | (1,386)         |
| Balance carried forward as at 31st December   | 4,355,024       | 3,550,268       |

## Reserves

The Group Reserves consist of:

|                               | 2010<br>Rs '000 | 2009<br>Rs '000 |
|-------------------------------|-----------------|-----------------|
| Capital Reserve               | 5,791,791       | 5,773,882       |
| Statutory Reserve Fund        | 1,510,000       | 1,260,000       |
| Exchange Equalisation Reserve | 2,744           | 5,505           |
| Revenue Reserve               | 17,355,024      | 14,250,268      |
| Total                         | 24,659,559      | 21,289,655      |

The movement in these reserves is shown in the Statement of Changes in Equity on page 160 of the Annual Report.

The Directors propose to transfer Rs 250,000,000 (2009 - Rs 277,293,000/=) to Statutory Reserve Fund and Rs 2,300,000,000 (2009 - Rs 2,210,947,000/=) to General Reserve Account.

## Corporate Donations

During the year the Bank made donations amounting to Rs 20,303,000/= (2009 - Rs 29,184,000/=) in terms of the resolution passed at the last Annual General Meeting. Donations made by the Group during the year amounted to Rs 20,661,000 (2009 - Rs 29,542,000/=).

The donations made to Government approved charities from the above sum amount to Rs 400,000/= (2009 - Rs 325,000/=).

## Taxation

The income tax rate applicable on the Bank's domestic operations and FCBU on-shore banking operations is 35% (2009 - 35%). The off-shore operations of the FCBU are taxed at 20% (2009 - 20%).

It is the Bank's policy to provide for deferred taxation on all known temporary differences under the liability method.

The Bank is also liable for Financial VAT at 20% (2009 - 20%).

## 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.

## Dividends

An interim dividend of Rs 1.50 per share (2009 - Rs 1.50) was paid on 24th November 2010 to the holders of the ordinary shares (both voting and non-voting) for the financial year 2010. A part of the interim dividend paid for the year represents a redistribution of the exempt dividends received by the Bank and will therefore be free of income tax in the hands of the shareholders. On this basis 47.0% of the interim dividend paid for 2010 is subject to income tax.

The Directors recommend for shareholder approval at the Annual General Meeting, a Final Dividend of Rs 5.50 per share (2009 - Rs 5.00 per



# ANNUAL REPORT OF THE BOARD OF DIRECTORS ON THE AFFAIRS OF THE COMPANY

share) for the financial year 2010 and the dividend to be paid on 11th April 2011 to the holders of ordinary shares (voting and non-voting) of the Bank as at the close of business on 31st March 2011, subject to withholding tax.

The Board of Directors was satisfied that the Bank would meet the solvency test immediately after the interim dividend was paid in November 2010 and the final dividend proposed which will be paid in April 2011 in terms of the provisions of the Companies Act No 7 of 2007. The Board provided the Statements of Solvency to the Auditors and obtained Certificates of Solvency from the Auditors in respect of each dividend payment conforming to the statutory provision.

## 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 Rs 1,052,876,000/= and Rs 1,139,281,000/= respectively (2009 Bank - Rs 1,182,121,000/= and Group - Rs 1,290,885,000/=) details of which are given in Notes 33, 34 and 35 to the Financial Statements. The capital expenditure approved and contracted for, after the year end is given in Note 47 (a) to the Financial Statements.

## Property, Plant and Equipment (PPE)

Details of property, plant and equipment are given in Note 34 to the Financial Statements. There was no significant change in the property, plant and equipment of the Bank.

## Market Value of Freehold Properties

The net book value of freehold properties owned by the Bank and the Group as at 31st December 2010 is included in the accounts at Rs 5,058,275,000/= and Rs 10,207,154,000/= respectively (2009 Bank - Rs 4,747,287,000/= and Group Rs 9,951,149,000/=).

A panel of Chartered Valuers / Licensed Surveyors carried out a revaluation of the Bank's freehold properties in 2007. The details of freehold properties owned by the Bank are given in Note 34 (b) to the Financial Statements.

## Outstanding Litigation

In the opinion of the Directors and the Bank's Lawyers, pending litigation against the Bank disclosed in Note 47 (e) of the Financial Statements will not have a material impact on the financial position of the Bank or its future operations.

## Events after the Balance Sheet Date

No circumstances have arisen since the Balance Sheet date which would require adjustments to, or disclosure in, the accounts, except those disclosed in Note 52 to the financial statements.

## Stated Capital and Debentures

The stated capital of the Bank as at 31st December 2010 was Rs 5,318,550,000/=, consisting of 237,969,022 ordinary shares, 191,275,606

– (voting) and 46,693,416 – (non-voting), (2009 Rs 5,084,084,000/= consisting of 235,770,147 ordinary shares, 189,520,615 – voting and 46,249,532 – non-voting). The Bank issued 2,198,875 ordinary shares during the year, 1,754,991 shares (voting) at a consideration of Rs 209,650,000/= and 443,884 shares (non-voting) at a consideration of Rs 24,816,000/= under the approved Employee Share Option Plan. Thereby the Stated Capital of the Bank increased by Rs 234,466,000/= (2009 Rs 24,694,000/=)

## Share Information

Information relating to earnings, dividend, net assets and market price per share is given in the Financial Highlights on page 03 of the Annual Report. Information on share trading is given on page 261 of the Annual Report.

## Shareholdings

As at 31st December 2010 there were 4,380 and 11,536 registered voting and non-voting shareholders respectively. The distribution is indicated on pages 260 and 261 of the Annual Report. The twenty largest voting and non-voting shareholders of the Bank as at 31st December 2010, together with an analysis are given on pages 264 and 265 of the Annual Report.

## Equitable Treatment to Shareholders

The Bank has at all times ensured that all shareholders (both voting and non-voting) are treated equitably.

## The Board of Directors

The Board of Directors of the Bank consists of nine (2009 – eight) Directors with wide financial and commercial knowledge and experience. The following Directors held office as at the Balance Sheet date and their brief profiles appear on pages 14 and 15 of the Annual Report.

| Name of the Director                                       | Status    |
|--|-----------|
| Mr Rienzie T. Wijetilleke (Chairman)                       | NED       |
| Mr Rajendra Theagarajah (MD / CEO)                         | ED        |
| Mr D H S Jayawardena                                       | NED       |
| Mr M V Theagarajah   | IND / NED |
| Mr R K Obeyesekere   | NED       |
| Ms Pamela C. Cooray (Senior Director)                      | IND / NED |
| Mr Ranjeevan Seevaratnam                                   | IND / NED |
| Mr N G Wickremeratne                                       | IND / NED |
| Ms M A R C Cooray<br>(appointed w.e.f. 15th February 2010) | IND / NED |

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

## Retirement and re-election / re-appointment of Directors

Mr R K Obeyesekere, Ms Pamela C. Cooray and Mr Ranjeevan Seevaratnam retire by rotation at the AGM under the Articles of Association of the

Bank. Mr R K Obeyesekere and Ms Pamela C. Cooray offer themselves for re-election, with the unanimous support of the Board. Mr Ranjeevan Seevaratnam has informed the Board that he would not offer himself for re-election.

Mr Rienzie T. Wijetilleke and Mr M V Theagarajah – Directors having attained the age of 70 years retire at the AGM under the provision of the Companies Act. The Directors have declared that they would not be offering themselves for re-appointment at the AGM.

## Board Committees

The Board while assuming the overall responsibility and accountability in the management of the Bank has also appointed Board Committees to ensure oversight, control over certain affairs of the Bank, conforming to corporate governance standards of the Monetary Board of the Central Bank of Sri Lanka, and adopting the best practices. Accordingly, the following Committees have been constituted by the Board:

Audit Committee - Comprises -

- Mr Ranjeevan Seevaratnam (Chairman)
- Mr D H S Jayawardena
- Ms Pamela C. Cooray (Senior Director)
- Mr N G Wickremeratne

The Report of the Audit Committee is given on page 153 which forms part of the Annual Report of the Board.

Nomination Committee - Comprises -

- Mr Rienzie T. Wijetilleke (Chairman)
- Mr D H S Jayawardena
- Mr M V Theagarajah
- Mr R K Obeyesekere

The Report of the Nomination Committee is given on page 151 which forms part of the Annual Report of the Board.

Remuneration Committee - Comprises -

- Ms Pamela C. Cooray (Chairperson)
- Mr Rienzie T. Wijetilleke
- Mr R K Obeyesekere
- Mr N G Wickremeratne

The Report of the Remuneration Committee is given on page 150 which forms part of the Annual Report of the Board.

Integrated Risk Management Committee - Comprises -

- Mr M V Theagarajah (Chairman)
- Mr Rienzie T. Wijetilleke
- Ms M A R C Cooray
- Mr R Theagarajah (MD/CEO)
- Mr J D N Kekulawela Senior DGM - Strategy & Compliance
- Mr D P N Rodrigo DGM - Risk

Mr R K Obeyesekere who was a member of the above committee resigned from the committee on 31st March 2010. Ms M A R C Cooray was appointed to the committee on 31st March 2010. The Report of the Integrated Risk Management Committee is given on page 152 which forms part of the Annual Report of the Board.

Mr R Theagarajah, Mr J D N Kekulawela and Mr D P N Rodrigo represent the Management on the Committee.

## Directors' Meetings

The number of Directors' meetings which comprise Board meetings, Audit Committee meetings, Nomination Committee meetings, Remuneration Committee meetings and Integrated Risk Management Committee meetings and the attendance of Directors at these meetings are given on page 74 of the Annual Report. Furthermore, the Directors contributed towards policy advocacy and direction by participating in the deliberations of the Board appointed sub committees on Strategic Review, Procurement and Disposal of Assets.

## Directors' Responsibility for Financial Reporting

The Directors are responsible for the preparation of the Financial Statements of the Bank to present a true and fair view of the state of its affairs. The Directors are of the view that these Financial Statements have been prepared in conformity with the requirements of the Sri Lanka Accounting Standards, Companies Act No 7 of 2007, Sri Lanka Accounting and Auditing Standards Act No 15 of 1995, Banking Act No 30 of 1988 and amendments thereto and the Listing Rules of the Colombo Stock Exchange. The Statement of Directors' Responsibility for Financial Reporting is given on page 156 which forms an integral part of the Annual Report of the Board of Directors.

## Directors' Interest Register

The Bank maintains Directors' Interest Register conforming to the provisions of the Companies Act. The Directors of the Bank have disclosed their interests in other companies to the Board and those interests are recorded in the interest register conforming to the provisions of the Companies Act. The particulars of those entries are set out on pages 146 to 149 of the Annual Report which form an integral part of the Annual Report of the Board.

# ANNUAL REPORT OF THE BOARD OF DIRECTORS ON THE AFFAIRS OF THE COMPANY

## Directors' interests in the Ordinary Shares

The Shareholdings of Directors were as follows:-

|                           | As at 31st<br>December 2010 | As at 31st<br>December 2009 |
|---------------------------|-----------------------------|-----------------------------|
| Mr Rienzie T. Wijetilleke | 7,806                       | 7,806                       |
| Mr Rajendra Theagarajah   | 21,820                      | 18,644                      |
| Mr D H S Jayawardena      | 10,010                      | 10,010                      |
| Mr M V Theagarajah        | 294,948                     | 289,948                     |
| Mr R K Obeyesekere        | 10,010                      | 10,010                      |
| Ms Pamela C. Cooray       | 46,599                      | 46,599                      |
| Mr Ranjeevan Seevaratnam  | 500                         | 500                         |
| Mr N G Wickremeratne      | 2,000                       | 2,000                       |
| Ms M A R C Cooray         | -                           | -                           |

There has been no change in their interests in shares between 31st December 2010 and 18th February 2011, being the date of this Report.

## Related Party Transactions

The Directors have also disclosed the transactions if any, that could be classified as related party transactions in terms of Sri Lanka Accounting Standard 30 (Revised 2005) "Related Party Disclosures" which is adopted in the preparation of the Financial Statements. Those transactions disclosed by the Directors are given in Note 48 to the Financial Statements forming part of the Annual Report of the Board.

## Directors' Remuneration

Details of Directors' emoluments paid during the year are given in Note 15 to the Financial Statements.

## Human Resources

The employment strategies of the Bank are framed to employ, train, develop and retain the best talent available. Towards this end, employment policies are reviewed periodically to be aligned with organisational needs.

## Employee Share Ownership Plan

The Bank established an Employee Share Ownership Plan in the year 2005 for the benefit of the staff members in the grade of Executive and above with the approval of the shareholders.

The scheme was formulated to pass certain benefits (dividends, bonus shares etc) on the ordinary shares (non-voting) of the Bank to the staff without transferring the ownership. For this purpose, the Bank created a Trust and the Trustees were entrusted to acquire ordinary shares (non-voting) of the Bank in the secondary market or otherwise and to allocate the shares to the staff on a basis determined by the Board. The Trustees were granted a special loan at a commercial rate of interest to acquire the shares. The benefits from the shares are given to the staff members during their employment. On cessation of employment they

are paid the market value of the shares allocated. Any part of the loan outstanding, interest and statutory payments are recovered prior to transferring the benefits. From inception upto 31st December 2010, 209 staff members have received benefits from this scheme.

The loan outstanding as at end 2010 was Rs 197,284,000/= (2009 – Rs 136,518,000/=). The amount released to the employees who left the services of the Bank during 2010 was Rs 105,782,437/= (2009 – Rs 23,162,639/=).

## Employee Share Option Plan

In the year 2008 with the approval of the shareholders, the Bank formulated an Employee Share Option Plan for the staff in the Management grades, recognising and rewarding them for their contribution. The Scheme was aimed at further motivating the Management staff. This gives an option to the Management staff to acquire ownership in the ordinary shares (both voting and non-voting) of the Bank, provided the Bank has met certain set profit goals. It is operative for 5 years and the Management staff has the option to purchase ordinary shares (voting and non-voting) of the Bank each year up to a limit of 1.25% of the shares issued up to a maximum of 5% of the shares issued. Based on the performance achieved for the year 2007, first option to purchase shares, has been offered to 175 Management Officers. The option to purchase shares is exercisable up to 1st October 2013. As at 31st December 2010, 141 Management Officers have exercised the option (some fully, some partly) and purchased shares.

Based on the performance achieved for the year 2009, second option to purchase shares has been offered to 182 Management Officers. The option to purchase shares is exercisable up to 31st March 2015. As at 31st December 2010, 10 Management Officers have exercised the option and purchased shares.

The details of the options offered to the employees as at 31st December 2010 are as follows:

|                                       | 2008 Allocation |            | 2010 Allocation |            |
|---------------------------------------|-----------------|------------|-----------------|------------|
|                                       | Voting          | Non voting | Voting          | Non voting |
| No of options brought forward         | 1,963,198       | 476,143    | -               | -          |
| No of options granted in 2010         | -               | -          | 2,366,458       | 577,367    |
| No of options exercised               | 1,620,059       | 410,960    | 134,932         | 32,924     |
| No of options expired during the year | -               | -          | -               | -          |
| No of options remaining               | 343,139         | 65,183     | 2,231,526       | 544,443    |
| Allotment Price (Rs)                  | 115.54          | 52.51      | 166.51          | 98.31      |
| Funding granted to employees          | None            | None       | None            | None       |

## Environmental Protection

The Bank has used its best endeavours to comply with the relevant environmental laws and regulations. The Bank has not engaged in any activity that is harmful or hazardous to the environment.

## Statutory Payments

The Board of Directors confirms that all statutory payments to the Government and the employees have been made up to date.

## Risk and Internal Control

The Board considers that strong internal controls are integral to the sound management of the Bank and it is committed to maintain strict financial, operational and risk management controls over all its activities.

The Directors are ultimately responsible for the Bank's system of internal control and for reviewing its effectiveness. Such a system is designed to manage, rather than eliminate, the risk of failure to achieve business objectives and can provide only reasonable and not absolute assurance against material misstatement or loss. There is an ongoing process for identifying, recording, evaluating and managing the risks that are faced by the Bank, and the Directors have reviewed this process, through the Audit Committee.

The Board of Directors is satisfied with the effectiveness of the system of internal control for the year under review and up to the date of approval of the Annual Report and Financial Statements.

## Directors' Statement on Internal Control

The Board has issued a report on the internal control mechanism of the Bank as per Section 3 (8) (ii) (b) of Banking Act Direction No 11 of 2007 on Corporate Governance. The Board has confirmed that the financial reporting system has been designed to provide reasonable assurance regarding the reliability of the financial reporting, and that the preparation of financial statements for external purposes has been done in accordance with relevant accounting principles and regulatory requirements. The above report, which forms an integral part of the Annual Report of the Board of Directors, is given on page 76 to 77. The Board has obtained an assurance report from the External Auditors on Directors' Statement on Internal Control.

## Corporate Governance

In the management of the Bank, the Directors have placed emphasis in conforming to the best corporate governance practices and procedures. Accordingly, systems and structures have been introduced / improved from time to time to enhance risk management measures and to improve accountability and transparency. A separate report on governance is given on pages 59 to 75.

## Compliance with Laws and Regulations

The Bank has at all times ensured that it complied with the applicable laws and regulations including the listing rules of the Colombo Stock Exchange as a listed company. The Management Officers responsible

for compliance, table a report on compliance at the quarterly meetings of the Board Audit Committee.

## Auditors

The Bank's Auditors during the period under review were Messrs KPMG Ford, Rhodes, Thornton & Company (KPMG), Chartered Accountants.

Audit fees and reimbursement of expenses paid to KPMG during the year under review by the Bank and the Group amounted to Rs 8,666,000/= (2009 - Rs 7,401,000/=) and Rs 12,017,000/= (2009 - Rs 10,108,000/=) respectively. Further Rs 3,294,000/= (2009 - Rs 575,000/=) and Rs 3,294,000/= (2009 - Rs 575,000/=) were paid by the Bank and the Group respectively for Audit related and non-audit services including reimbursement of expenses.

Based on the declaration provided by Messrs KPMG Ford, Rhodes, Thornton & Company (KPMG), and as far as the Directors are aware, the Auditors do not have any relationship with or interest with the Bank that in our judgment, 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, applicable on the date of this Report.

The retiring Auditors, Messrs KPMG Ford, Rhodes, Thornton & Company, have expressed their willingness to continue in office. A resolution relating to their re-appointment and authorising the Directors to fix their remuneration, will be proposed at the forthcoming Annual General Meeting.

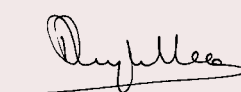
## Notice of Meeting

The 42nd Annual General Meeting of the Bank is convened on Thursday the 31st day of March, 2011, 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 42nd Annual General Meeting is on page 270 of the Annual Report.

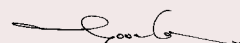
For and on behalf of the Board of Directors.



**Rajendra Theagarajah**  
Managing Director /  
Chief Executive Officer



**Rienzie T. Wijetilleke**  
Chairman



**Indrani Goonesekera**  
Deputy General Manager (Legal) / Board Secretary

Colombo, Sri Lanka  
18th February 2011

# DIRECTORS' INTEREST IN CONTRACTS WITH THE BANK

## Directors' Interest in Contracts with the Bank

"The Bank carries out transactions in the ordinary course of business at commercial rates with entities in which a Director of the Bank is the Chairman or a Director of such entities. The transactions with entities where a Director of the Bank either has control or exercises significant influence, have been classified as related party transactions and disclosed in Note 48 to the Financial Statements.

The transactions with entities where a Directors of the Bank neither have control nor exercise significant influence, but only hold directorships are disclosed below:

### 1. Lending Transactions with the Bank

| Company                       | Name of Director (Relationship)   | Nature of Transaction        | Aggregate Amount of Accommodation as at 31st December 2010 |                     | Security   |
|-------------------------------|---|------------------------------|--|---------------------|--|
|                               |   |                              | Limit (Rs Mn)  | Outstanding (Rs Mn) |  |
| Mahaweli Reach Hotels PLC     | Mr Rienzie T. Wijetilleke (Director)  | Overdraft                    | 15.00  | 12.57               | Immovable property   |
|                               |   | Term Loans                   | 34.37  | 34.37               |  |
|                               |   | Term Loans                   | 5.79   | 5.79                |  |
|                               |   | Term Loans                   | 19.95  | 19.95               |  |
|                               |   | E Friends I Revolving        | 10.22  | 4.00                |  |
|                               |   | <b>Total</b>                 | <b>85.33</b>   | <b>76.68</b>        |  |
| Convenience Foods (Lanka) Ltd | Subsidiary of Ceylon Biscuits Ltd in which company Mr Rienzie T. Wijetilleke is a Director    | Overdraft                    | 20.00  | 4.64                | Negative pledge over the project assets  |
|                               |   | Letters of Credit            | 80.00  | 81.64               |  |
|                               |   | Letters of Guarantee         | 23.00  | 20.00               |  |
|                               |   | Short Term Loan              | (20.00)  | -                   |  |
|                               |   | Import Loan                  | (20.00)  | -                   |  |
| <b>Total</b>                  | <b>123.00</b>   | <b>106.28</b>                |  |                     |  |
| Watawala Plantations PLC      | Subsidiary of Sunshine Holding PLC in which company Mr Rienzie T. Wijetilleke is the Chairman | Overdraft                    | 85.00  | 30.59               | Immovable property<br>Equipment<br>Indemnity of the company<br>*Could be utilised in US \$ as well |
|                               |   | Letters of Credit            | 5.00   | -                   |  |
|                               |   | Letters of Guarantee         | 15.00  | 5.16                |  |
|                               |   | Packing Credit               | *50.00   | -                   |  |
|                               |   | Short Term Money Market Loan | (50.00)  | 25.00               |  |
|                               |   | Term Loan 1                  | 1.27   | 1.27                |  |
|                               |   | Term Loan 11                 | 35.41  | 35.41               |  |
|                               |   | Revolving Lease              | 15.00  | 0.58                |  |
|                               |   | <b>Total</b>                 | <b>206.68</b>  | <b>98.01</b>        |  |
| Swiss Biogenics Ltd           | Subsidiary of Sunshine Holding PLC in which company Mr Rienzie T. Wijetilleke is the Chairman | Overdraft                    | (105.00)   | 1.61                | Stocks & book debts  |
|                               |   | Letters of Credit            | 200.00   | 208.03              |  |
|                               |   | Import Loan                  | (100.00)   | -                   |  |
|                               |   | Letters of Guarantee         | (10.00)  | -                   |  |
|                               |   | Forex Forward Contracts      | (180.00)   | -                   |  |
|                               |   | Short Term Loan              | 100.00   | -                   |  |
|                               |   | Block Lease                  | 10.00  | -                   |  |
|                               |   | <b>Total</b>                 | <b>310.00</b>  | <b>209.64</b>       |  |
| Sunshine Travels & Tours Ltd  | Subsidiary of Sunshine Holding PLC in which company Mr Rienzie T. Wijetilleke is the Chairman | Overdraft                    | 10.00  | 8.32                | Corporate guarantee  |
|                               |   | Letters of Guarantee         | 10.00  | 10.00               |  |
|                               |   | <b>Total</b>                 | <b>20.00</b>   | <b>18.32</b>        |  |

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

## 1. Lending Transactions with the Bank (Contd.)

| Company                             | Name of Director<br>(Relationship)   | Nature of Transaction                 | Aggregate Amount of Accommodation<br>as at 31st December 2010 |                        | Security                       |  |
|-------------------------------------|--|---------------------------------------|---|------------------------|--------------------------------|--|
|                                     |  |                                       | Limit<br>(Rs Mn)  | Outstanding<br>(Rs Mn) |                                |  |
| Sunshine Teas (Pvt) Ltd             | Subsidiary of<br>Swiss Biogenics Ltd<br>which is a Subsidiary of<br>Sunshine Holding PLC<br>in which company<br>Mr Rienzie T. Wijetilleke<br>is the Chairman | Overdraft                             | 25.00   | 23.92                  | Stock in trade & book<br>debts |  |
|                                     |  | Letters of Credit                     | (50.00)   | 18.56                  |                                |  |
|                                     |  | Letters of Guarantee                  | 10.00   | -                      |                                |  |
|                                     |  | Term Loan                             | 10.54   | 10.54                  |                                |  |
|                                     |  | Short Term Loan                       | 100.00  | 75.00                  |                                |  |
|                                     |  | <b>Total</b>                          | <b>145.54</b>   | <b>128.02</b>          |                                |  |
|                                     |  | Packing Credit Loan                   |   |                        |                                |  |
|                                     |  | US \$ Mn                              | 3.00  | 1.05                   |                                |  |
|                                     |  | Export Bill Discounting               |   |                        |                                |  |
|                                     |  | US\$ Mn                               | (1.50)  | -                      |                                |  |
|                                     |  | Forex Forward                         |   |                        |                                |  |
|                                     |  | Contracts US \$ Mn                    | 0.60  | 0.20                   |                                |  |
|                                     |  | <b>Total US \$ Mn</b>                 | <b>3.60</b>   | <b>1.25</b>            |                                |  |
|                                     |  | One off Letters of Credit (Euro)      | 0.59  | 0.59                   |                                |  |
| <b>Total Euro Mn</b>                | <b>0.59</b>  | <b>0.59</b>                           |   |                        |                                |  |
| New Nawaloka<br>Hospitals (Pvt) Ltd | Subsidiary of<br>Nawaloka Hospitals PLC<br>in which company<br>Mr Rienzie T. Wijetilleke<br>is a Director  | Letter of Credit                      | 10.00   | 9.10                   | Immovable property             |  |
|                                     |  | Letter of Credit                      | 130.00  | 94.37                  | Documents of title to goods    |  |
|                                     |  | Term Loan                             | (130.00)  | 100.53                 | Cash - Rs 31.5 Mn              |  |
|                                     |  | Term Loan                             | 35.00   |                        |                                |  |
|                                     |  | Overdraft                             | 55.00   | 55.02                  | Corporate guaratnee            |  |
|                                     |  | <b>Total</b>                          | <b>230.00</b>   | <b>259.02</b>          |                                |  |
| Tea Smallholder<br>Factories PLC    | Mr Ranjeevan Seevaratnam<br>(Director)   | Overdraft                             | 50.00   | -                      | Immovable property             |  |
|                                     |  | Short Term Money Market Loan          | (50.00)   | 50.00                  |                                |  |
|                                     |  | Temp. Short Term<br>Money Market Loan | 10.00   | 10.00                  |                                |  |
|                                     |  | <b>Total</b>                          | <b>60.00</b>  | <b>60.00</b>           |                                |  |
|                                     |  |                                       |   |                        |                                |  |
| Diesel and Motor<br>Engineering PLC | Mr Ranjeevan Seevaratnam<br>(Director)   | Letter of credit                      | 1,750.00  | 1,046.00               | Immovable property,            |  |
|                                     |  | Import Loans                          | *1,000.00   | 809.44                 |                                |  |
|                                     |  | Short Term Money Market Loan          | -   | 131.50                 | Demand promissory note         |  |
|                                     |  | Overdraft                             | (45.00)   | -                      | *Temporary facility            |  |
|                                     |  | Letter of Guarantee                   | (150.00)  | 323.48                 |                                |  |
|                                     |  | Forward Exchange Contracts            | (100.00)  | -                      |                                |  |
|                                     |  | Term Loan I                           | 17.94   | 17.94                  |                                |  |
|                                     |  | Term Loan II                          | (130.00)  | 130.00                 |                                |  |
|                                     |  | Leases                                | 1.80  | -                      |                                |  |
|                                     |  | <b>Total</b>                          | <b>2,769.74</b>   | <b>2,458.36</b>        |                                |  |
| Shaw Wallace<br>Marketing PLC       | Mr Ranjeevan Seevaratnam<br>(Director)   | Overdraft                             | 15.00   | 12.72                  | Stocks and book debts          |  |
|                                     |  | Letter of Credit                      | 270.00  | 177.14                 |                                |  |
|                                     |  | Letter of Credit                      | 40.00   | -                      | Title to goods imported,       |  |
|                                     |  | Letter of Guarantee                   | 5.00  | 0.20                   | Indemnity of the company       |  |
|                                     |  | Short Term Money Market Loan          | 100.00  | 100.00                 | Corporate guarantee            |  |
|                                     |  | Short Term Money Market Loan          | 200.00  | 147.50                 | Immovable property             |  |
|                                     |  | <b>Total</b>                          | <b>630.00</b>   | <b>437.56</b>          |                                |  |

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



## DIRECTORS' INTEREST IN CONTRACTS WITH THE BANK

### 1. Lending Transactions with the Bank (Contd.)

| Company                         | Name of Director (Relationship)     | Nature of Transaction            | Aggregate Amount of Accommodation as at 31st December 2010 |                     | Security  |
|---------------------------------|-------------------------------------|----------------------------------|--|---------------------|---|
|                                 |                                     |                                  | Limit (Rs Mn)  | Outstanding (Rs Mn) |   |
| Acme Printing and Packaging PLC | Mr Ranjeevan Seevaratnam (Director) | Overdraft                        | 30.00  | 32.63               |   |
|                                 |                                     | Term Loan                        | 4.38   | 4.38                | Title to goods imported   |
|                                 |                                     | Letter of Credit                 | 270.00   | 30.66               | Cash  |
|                                 |                                     | Import Loan                      | (270.00)   | 137.14              |   |
|                                 |                                     | Short Term Loan                  | (270.00)   | 100.12              |   |
|                                 |                                     | Cheque Discounting               | 10.00  | -                   |   |
|                                 |                                     | <b>Total</b>                     | <b>314.38</b>  | <b>304.93</b>       |   |
| Dipped Products PLC             | Mr Ranjeevan Seevaratnam (Director) | Overdraft                        | 20.00  | -                   | Demand promissory note  |
|                                 |                                     | Overdraft                        | (30.00)  | -                   | Letter of hypothecation /   |
|                                 |                                     | Packing Credit                   | 100.00   | -                   | lodgement of confirmed  |
|                                 |                                     | Short Term Money Market Loan     | (100.00)   | 100.00              | export order / lodgement of   |
|                                 |                                     | Neg. of Documentary Bills        | (15.00)  | -                   | of exprot LC issued by other  |
|                                 |                                     | Letters of Guarantee             | (5.00)   | -                   | banks   |
|                                 |                                     | <b>Total</b>                     | <b>120.00</b>  | <b>100.00</b>       | Money market loan agreement<br>Documentary bills drawn on<br>buyers approved by Banks<br>indemnity of the company |
| Kelani Valley Plantations PLC   | Mr Ranjeevan Seevaratnam (Director) | Overdraft                        | 50.00  | 2.38                | Demand promissory note  |
|                                 |                                     | Letter of Credit                 | (15.00)  | -                   | Title to goods imported   |
|                                 |                                     | <b>Total</b>                     | <b>50.00</b>   | <b>2.38</b>         |   |
| Hayleys MGT Knitting Mills PLC  | Mr Ranjeevan Seevaratnam (Director) | Overdraft                        | 50.00  | 44.52               | Corporate guarantee   |
|                                 |                                     | Money Market Loan                | 100.00   | 100.00              |   |
|                                 |                                     | <b>Total</b>                     | <b>150.00</b>  | <b>144.52</b>       |   |
|                                 |                                     | Multi Limit - US \$ Mn           | 0.50   |                     | Immovable property and machinery  |
|                                 |                                     | Import Letter of Credit US\$ Mn  |  | 0.15                | LC indemnity  |
|                                 |                                     | Import Bills US\$ Mn             |  | -                   |   |
|                                 |                                     | Import Loans US\$ Mn             |  | 0.09                |   |
|                                 |                                     | EFC                              | 0.40   | 0.27                |   |
|                                 |                                     | Overdraft US\$ Mn                | 0.10   | -                   |   |
|                                 |                                     | <b>Total US\$ Mn</b>             | <b>1.00</b>  | <b>0.51</b>         |   |
|                                 |                                     |                                  |  |                     |   |
| Classic Teas (Pvt) Ltd          | Mr Ranjeevan Seevaratnam (Director) | Short Term Export Loan           | 50.00  | 37.83               | Stock in trade,   |
|                                 |                                     | Negotiation of Documentary Bills | (50.00)  | -                   | Assignment of book debts  |
|                                 |                                     | Standby Short term Export Loan   | 50.00  | -                   | Deposit of irrevocable LC / confirmed export orders   |
|                                 |                                     | <b>Total</b>                     | <b>100.00</b>  | <b>37.83</b>        | Documentary bills drawn on buyers<br>Letter of hypothecation<br>Indemnity   |

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

## 1. Lending Transactions with the Bank (Contd.)

| Company                                 | Name of Director<br>(Relationship)      | Nature of Transaction       | Aggregate Amount of Accommodation<br>as at 31st December 2010 |                        | Security  |
|---|---|-----------------------------|---|------------------------|-----------|
|   |   |                             | Limit<br>(Rs Mn)  | Outstanding<br>(Rs Mn) |           |
| Finlays Colombo PLC                     | Mr N G Wickremeratne<br>(Director)      | Short Term Loan             | 75.00   | -                      | Indemnity |
|   |   | Export Bill Discounting     | (50.00)   | -                      |           |
|   |   | <b>Total</b>                | <b>75.00</b>  | <b>-</b>               |           |
| Nawaloka Hospitals PLC                  | Mr Rienzie T. Wijethileke<br>(Director) | Temporary Overdraft         | 31.00   | 16.43                  | -         |
|   |   | <b>Total</b>                | <b>31.00</b>  | <b>16.43</b>           |           |
| Ceylon Guardian<br>Investment Trust PLC | Ms M A R C Cooray<br>(Director)         | Overdraft / Revolving Short | 300.00  | 266.31                 | -         |
|   |   | <b>Total</b>                | <b>300.00</b>   | <b>266.31</b>          |           |
| Ceylon Investment PLC                   | Ms M A R C Cooray<br>(Director)         | Overdraft / Revolving Short | (300.00)  | 30.11                  | -         |
|   |   | <b>Total</b>                | <b>300.00</b>   | <b>30.11</b>           |           |
| Lanka Aluminium<br>Industries Ltd       | Mr Ranjeevan Seevaratnam<br>(Director)  | Overdraft                   | 61.00   | 50.76                  | Cash      |
|   |   | <b>Total</b>                | <b>61.00</b>  | <b>50.76</b>           |           |

## 2 Trading Transactions with the Bank

| Company                             | Name of Director  | Nature of Transaction<br>(Relationship) | Amount<br>(Rs Mn) |
|-------------------------------------|---|---|-------------------|
| Diesel and Motor<br>Engineering PLC | Mr Ranjeevan Seevaratnam<br>(Director)  | Repairs and maintenance of<br>vehicles  | 0.41              |
| Finlays Colombo PLC                 | Mr N G Wickremeratne<br>(Director)  | Pest control services                   | 0.10              |
| Finlay Rentokil<br>Ceylon (Pvt) Ltd | Subsidiary of<br>Finlays Colombo PLC<br>in which company<br>Mr N G Wickremeratne<br>is a Director | Pest control services                   | 0.14              |
| Acme Printing<br>& Packaging PLC    | Mr Ranjeevan Seevaratnam<br>(Director)  | Repurchase agreements                   | 95.80             |
|                                     |   | Interest paid                           | 2.01              |
| Nawaloka Hospitals PLC              | Mr Rienzie T. Wijetilleke<br>(Director)   | Merchant commission                     | 3.80              |
| Mahawali Reach Hotels PLC           | Mr Rienzie T. Wijetilleke<br>(Director)   | Accommodation charges                   | 0.40              |

Figures in brackets indicate sub limits granted to the respective entities

# REMUNERATION COMMITTEE REPORT

The Remuneration Committee, appointed by and responsible to the Board of Directors comprises of four Non Executive Directors, two of whom, including the Chairperson, are also independent.

**Ms Pamela C. Cooray** Chairperson (IND / NED)

**Mr Rienzie T. Wijetilleke** (NED)

**Mr R K Obeyesekere** (NED)

**Mr N G Wickremeratne** (IND / NED)

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

Brief profiles of the members are given on pages 14 and 15 of the Annual Report.

## Policy

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

It is the focus of the Committee to ensure that the total package is sufficiently competitive to attract the best available talent for the benefit of the Bank.

The Bank's remuneration framework for the CEO and Corporate Management is designed to create and enhance value for all stakeholders of the Bank and to ensure alignment between the short and long-term interests of the Bank and its Executives.

## Scope

The Committee reviews all significant Human Resource policies and initiatives, salary structures and terms and conditions relating to staff at senior executive level. In this process, necessary information and recommendations are obtained from the CEO and DGM - Human Resources and Administration. The Committee deliberates and recommends to the Board of Directors the remuneration packages, annual increments and bonuses of the MD / CEO, members of the Corporate Management and senior executive staff.

The MD / CEO who is responsible for the overall management of the Bank attends meetings by invitation and participates in the deliberations except when his own interest, performance and compensation is discussed.

Recruitment and promotions of staff at management level are also considered and approved based on the proposals submitted by DGM - Human Resources and Administration following a formal process of evaluation. When necessary, interviews are held to assess the core competencies of the proposed applicant. During the year under review, the Committee was responsible for the recruitment of Chief Operating Officer to assist the MD / CEO, AGM - Information Technology, AGM - Treasury and Markets, AGM - Human Resources, AGM - Legal to assist the MD / CEO and strengthened the Corporate Management team.

The Committee may undertake the deliberation of other matters dealing with HR and compensation at the request of the Board.

## Fees

All Non Executive Directors receive a fee for attendance at Board meetings and serving on sub-committees, special committees and / or subsidiary boards. They do not receive any performance or incentive payments.

## Meetings

The Committee met seven times during 2010. The reports of the decisions approved and recommended to the Board by the Committee are circulated and ratified by the Board of Directors.

Attendances at the meetings are given in table on page 74 of the Annual Report.

## Professional Advice

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

## Committee Evaluation

The Committee completed the evaluation process with self assessment in 2010, which was conducted by the Chairman and Committee Members and was deemed to be satisfactory.



**Pamela C. Cooray**  
Chairperson  
Remuneration Committee

Colombo, Sri Lanka  
18th February 2011

# NOMINATION COMMITTEE REPORT

## Composition of the Nomination Committee

The Nomination Committee comprises four Non Executive Directors appointed by the Board of Directors of the Bank. The following Directors serve on the Nomination Committee:

**Mr Rienzie T. Wijetilleke** Chairman (NED)

**Mr D H S Jayawardena** (NED)

**Mr M V Theagarajah** (IND / NED)

**Mr R K Obeyesekere** (NED)

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

Brief profiles of the members of the Committee are given on pages 14 to 15 of the Annual Report.

## The Primary Responsibilities of the Nomination Committee

The mandate of the Nomination Committee includes the following:

- 1 To establish a procedure to select / appoint new Directors.
- 2 To consider and recommend (or not recommend) the re-election of current Directors, taking into account the performance and contribution made by the Director concerned.
- 3 To assess at the time of appointment and annually thereafter whether a Director is fit and proper to hold office.
- 4 To recommend from time to time, the requirements of additional / new expertise and the succession arrangements for retiring Directors.
- 5 To look into and make recommendations to any other matters referred to it by the Board of Directors.

## Nomination Committee Meeting

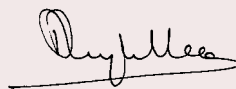
The Nomination Committee met once during the year under review to consider and recommend the appointment of an additional Independent / Non Executive Director to the Board and to assess the fitness and propriety of each of the Directors holding office in terms of the provisions of the Banking Act and the Directions of the Monetary Board relating to Corporate Governance. Attendance by the Committee members at the meeting is given in the table on page 74 of the Annual Report. The Chief Executive Officer also attended the meeting by invitation.

## Re-election / Re-appointment of Directors at the 42nd Annual General Meeting

Since three Directors out of the four Nomination Committee members should be re-elected / re-appointed at the 42nd Annual General Meeting to be held on 31st March 2011, the Committee decided to recommend that this matter be discussed at and decided by the full Board.

## Committee Evaluation

The Committee commenced the evaluation process with self assessment in 2010, which was conducted by the Chairman and Committee Members and was deemed to be satisfactory.



**Rienzie T. Wijetilleke**  
Chairman  
Nomination Committee

Colombo, Sri Lanka  
18th February 2011

# THE BOARD INTEGRATED RISK MANAGEMENT COMMITTEE REPORT

The Board Integrated Risk Management Committee (BIRMC) comprises six members of which three members are Non-Executive Directors.

**Mr M V Theagarajah** Chairman (IND / NED)

**Mr Rienzie T. Wijetilleke** (NED)

**Mr R K Obeyesekere** (NED)  
resigned from committee w.e.f. 31st March 2010

**Ms M A R C Cooray** (IND / NED)  
appointed w.e.f. 31st March 2010

**Mr Rajendra Theagarajah** CEO / MD

**Mr J D N Kekulawela** Senior DGM - Strategy

**Mr D P N Rodrigo** DGM - Risk

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

Brief profiles of the Directors representing the Committee are given on pages 14 to 15 of the Annual Report.

## Terms of Reference

The Terms of Reference set out by the Board of Directors, includes the following:

- 1 To ensure that the Bank has a comprehensive risk management framework, appropriate compliance policies and systems in place.
- 2 To assess all risk types, including but not limited to: credit, market, liquidity, operational and strategic risks to the Bank through appropriate risk indicators and management information.
- 3 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, on the basis of Bank's policies and regulatory and supervisory requirements.
- 4 To monitor and assess the effectiveness of the Bank's Risk Management System and the robustness of the risk management function.
- 5 Periodically assess performance against internally defined risk appetite.
- 6 To establish a compliance function to assess the Bank's compliance with applicable laws, regulations, regulatory guidelines, internal controls and approved policies relating to all areas of business operations.
- 7 To review progress on Basel II Roadmap implementation.

## Meetings

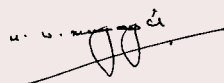
For the year a meeting was held for each quarter.

Attendances at the meetings are given in table on page 74 of the Annual Report.

The discussions and conclusions reached at the meeting are recorded in minutes and circulated to the Board of Directors for information and advice.

## Committee Evaluation

The Committee completed the evaluation process with self assessment in 2010, which was conducted by the Chairman and Committee Members and was deemed to be satisfactory.



**M V Theagarajah**

Chairman  
Integrated Risk Management Committee

Colombo, Sri Lanka  
18th February 2011

# AUDIT COMMITTEE REPORT

## Committee Composition

The Audit Committee comprises of four Non Executive Directors, a majority of whom are independent including the Chairman. The Committee is chaired by Mr Ranjeevan Seevaratnam, who is a Fellow member of the Institute of Chartered Accountants of Sri Lanka and the Institute of Chartered Accountants in England and Wales.

The members of the Board appointed Audit Committee are:

**Mr Ranjeevan Seevaratnam** Chairman (IND / NED)

**Mr D H S Jayawardena** (NED)

**Ms Pamela C. Cooray** Senior Director (IND / NED)

**Mr N G Wickremeratne** (IND / NED)

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

Brief profiles of the members are given on pages 14 and 15 of the Annual Report.

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

## Meetings

The Audit Committee met five times during the year. Attendance by the Committee members at each of these meetings is given in the table on page 74 of the Annual Report. The Managing Director / Chief Executive Officer, Chief Operating Officer, Senior DGM Strategy, DGM Risk, Chief Financial Officer, Head of Internal Audit and External Auditor also attended these meetings by invitation.

## 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, including the extent of compliance with the Sri Lanka Accounting Standards, the Companies Act No 7 of 2007, the Banking Act No 30 of 1988. Matters of special interest in the current environment and the processes that support certifications of the Financial Statements by the Bank's Chief Executive Officer and Chief Financial Officer were also brought up for discussion.

The Committee also confirmed with the Chief Financial Officer that financial reporting requirements relating to the GDR listing have been complied with.

## Risks and Controls

During the year, the Committee reviewed the effectiveness of the Bank's internal control system and has reviewed quarterly reports on losses resulting from frauds or operational failures. Additionally the Committee also assessed the effectiveness of the Bank's internal

control over financial reporting as of 31st December 2010, 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. The result of the assessment is given on page 76 to 77 (Directors' Statement on Internal Control) in the Annual Report. The external auditors have issued an Assurance Report on Directors' Statement on Internal Controls.

The Committee has reviewed the processes for identification, recording, evaluation and management of all significant risks throughout the Bank and other Group entities. The Committee received and reviewed reports on all significant matters discussed by the Risk Committee.

## External Audit

The Audit Committee undertook the annual evaluation of the independence and objectivity of the External Auditor and the effectiveness of the audit process.

The Committee met with 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 Lead Audit Partner is required to be rotated every five years, in order to ensure the independence of the Auditor.

The Committee reviewed the audited financial statement with the External Auditors who are responsible for expressing an opinion on its conformity with the Sri Lanka Accounting Standards.

The Committee reviewed the Management Letter issued by the External Auditor together with the management responses thereto.

The Committee met the External Auditors twice during the year without the presence of the executive management to ensure that there was no limitation of scope or any incidents which could have had a negative impact on the effectiveness of the external audit, and concluded that there were no such causes for concern.

The Audit Committee reviewed the Non-Audit Services provided by the External Auditor and was of the view that such services were not within the category of services identified as restricted 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 as amended by Banking Act No 33 of 1995.
- 2 The Guidelines for Listed Companies on Audit and Audit Committees issued by the Securities and Exchange Commission of Sri Lanka.



## AUDIT COMMITTEE REPORT

The Letter of Representation and Independence confirmation issued to the External Auditor was tabled at the Audit Committee Meeting.

The Audit Committee has recommended to the Board of Directors that Messrs KPMG Ford, Rhodes, Thornton & Company, Chartered Accountant, be re-appointed for the financial year ending 31st December 2011 subject to the approval of shareholders at the next Annual General Meeting.

### Internal Audit

During the year, the Audit Committee reviewed the performance of the internal audit function, the findings of the internal audits completed and their evaluation of the Bank's internal control including internal control systems. The Audit Committee also reviewed the adequacy of coverage of the internal audit plan and approved the same. It also assessed the Department's resource requirements including succession planning.

### Regulatory Compliance

The Committee reviewed the procedures established by Management for compliance with the requirements of regulatory authorities. Senior Deputy General Manager – Strategy who has oversight of the Compliance function, submitted quarterly reports to the Audit Committee on the extent to which the Bank was in compliance with the regulatory requirements.

### Committee Evaluation

The annual evaluation of the Committee was conducted by the Non Executive Chairman, the Managing Director, the Chief Financial Officer, the Head of Internal Audit and the External Auditor in accordance with International best practices and was deemed to be satisfactory.

On behalf of the Audit Committee;



Ranjeevan Seevaratnam

Chairman

Colombo, Sri Lanka

18th February 2011

# CHIEF EXECUTIVE OFFICER'S AND CHIEF FINANCIAL OFFICER'S RESPONSIBILITY STATEMENT

The Financial Statements of Hatton National Bank PLC (Bank) and the Consolidated Financial Statements of the Bank and its Subsidiaries as at 31st December 2010 are prepared in compliance with the Sri Lanka Accounting Standards issued by the Institute of Chartered Accountants of Sri Lanka, Companies Act No 7 of 2007, Sri Lanka Accounting and Auditing Standards Act No 15 of 1995, the Banking Act No 30 of 1988 and amendments thereto, and the Listing Rules of the Colombo Stock Exchange. 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 Audit Committee and our 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 in a true and fair manner, the form and substance of transactions and that the Bank's state of affairs is 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 is reviewed, evaluated and updated on an ongoing basis. Our internal auditors have 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 control over financial reporting during the year ended 31st December 2010, as required by the Banking Act Direction No 11 of 2007, result of which is given on page 76 to 77 in the Annual Report.

The Financial Statements of the Group were audited by Messrs KPMG Ford, Rhodes, Thornton & Company ("KPMG"), Chartered Accountants, the independent external auditors. Their report is given on page 157 of the Annual Report.

The Audit Committee of the Bank meets periodically with the internal audit team and the independent external auditors 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 auditors and the internal auditors have full and free access to the members of the Audit Committee to discuss any matter of substance.

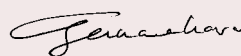
The Audit Committee pre-approves the audit and non audit services provided by our external auditors, KPMG, in order to ensure that the provision of such services does not impair KPMG's independence.

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 Notes 47 to the Financial Statements in this Annual Report.



**Rajendra Theagarajah**  
Managing Director / Chief Executive Officer



**Ajantha de Vas Gunasekara**  
Chief Financial Officer

Colombo, Sri Lanka  
18th February 2011

# 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 Auditors in relation to the Financial Statements are set out in the Report of the Auditors given on page 157 of the Annual Report.

As per the provisions 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 Balance Sheet as at 31st December 2010, and the Income Statement, Statement of Changes in Equity and Cash Flow 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 31 December 2010; 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 the appropriate accounting policies have been selected and applied in a consistent manner and material departures, if any, have been disclosed and explained;
- 2 judgments 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 are consistent with the underlying books of account 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. 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 2010 is given on page 76 to 77 of the Annual Report, "Directors Statement on Internal Control".

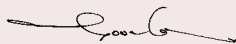
Directors are required to prepare the Financial Statements and to provide the Bank's External Auditors, Messrs KPMG Ford, Rhodes, Thornton & Company, with every opportunity to carry out whatever reviews and sample checks on the system of internal control they may consider appropriate and necessary for expressing their independent audit opinion on the Financial Statements.

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 5.50 per share for this year, to be paid on 11th April 2011.

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 Balance Sheet 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



**Indrani Goonesekera**

Deputy General Manager (Legal) / Board Secretary

Colombo, Sri Lanka  
18th February 2011

# INDEPENDENT AUDITORS' REPORT



**KPMG Ford, Rhodes, Thornton & Co.**  
(Chartered Accountants)  
32A, Sir Mohamed Macan Markar Mawatha,  
P. O. Box 186,  
Colombo 00300,  
Sri Lanka.

Tel : +94 - 11 242 6426  
+94 - 11 542 6426  
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+94 - 11 254 1249  
+94 - 11 230 7345  
Internet : [www.lk.kpmg.com](http://www.lk.kpmg.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 ("Company"), and the consolidated financial statements of the Company and its subsidiaries as at 31st December 2010, which comprise the balance sheet as at that date, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes as set out on pages 158 to 245 of this Annual Report.

### Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Sri Lanka Accounting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

### Scope of Audit and Basis of Opinion

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 plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting policies used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

We have obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purposes of our audit. We therefore believe that our audit provides a reasonable basis for our opinion.

### Opinion

In our opinion, so far as appears from our examination, the Company maintained proper accounting records for the year ended 31st December 2010 and the financial statements give a true and fair view of the Company's state of affairs as at 31st December 2010 and its profit and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs as at 31st December 2010 and the profit and cash flows for the year then ended, in accordance with Sri Lanka Accounting Standards, of the Company and its subsidiaries dealt with thereby, so far as concerns the members of the Company.

### Report on Other Legal and Regulatory Requirements

1. These financial statements also comply with the requirements of Section 153(2) to 153(7) of the Companies Act No. 07 of 2007.
2. These financial statements present the information required by the Banking Act, No 30 of 1988.

*Ford Rhodes Thornton & Co.*

CHARTERED ACCOUNTANTS

18th February 2011  
Colombo, Sri Lanka.

KPMG Ford, Rhodes, Thornton & Co., a Sri Lankan Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International cooperative ("KPMG International"), a Swiss entity.

A.N. Fernando FCA  
Ms. M. P. Perera FCA  
T.J.S. Rajakarier FCA  
Ms. S.M.B. Jayasekara ACA  
G.A.U. Karunaratne ACA

S. Sirikananathan FCA  
P.Y.S. Perera FCA  
W.W.J.C. Perera FCA  
W.K.D.C. Abeyrathne ACA

M.R. Mihular FCA  
C.P. Jayatilake FCA  
Ms. S. Joseph FCA  
S.T.D.L. Perera FCA

# INCOME STATEMENT

| For the year ended 31st December                           | Note | BANK              |                   | GROUP             |                   |
|--|------|-------------------|-------------------|-------------------|-------------------|
|  |      | 2010<br>Rs 000    | 2009<br>Rs 000    | 2010<br>Rs 000    | 2009<br>Rs 000    |
| <b>INCOME</b>  | 9    | <b>35,581,621</b> | <b>39,357,863</b> | <b>38,104,665</b> | <b>41,300,773</b> |
| Interest income  | 10   | 30,249,230        | 34,620,276        | 30,563,795        | 34,836,422        |
| Less: Interest expenses                                    | 11   | 14,703,256        | 20,039,646        | 14,777,155        | 20,280,948        |
| <b>Net interest income</b>                                 |      | <b>15,545,974</b> | <b>14,580,630</b> | <b>15,786,640</b> | <b>14,555,474</b> |
| Foreign exchange profit                                    |      | 1,015,987         | 903,210           | 1,014,208         | 903,381           |
| Fee and commission income                                  | 12   | 2,809,330         | 2,331,278         | 3,115,443         | 2,377,510         |
| Dividend income  | 13   | 209,762           | 217,353           | 199,012           | 195,879           |
| Other income   | 14   | 1,297,312         | 1,285,746         | 3,212,207         | 2,987,581         |
| <b>Operating Income</b>                                    |      | <b>20,878,365</b> | <b>19,318,217</b> | <b>23,327,510</b> | <b>21,019,825</b> |
| Less:  |      |                   |                   |                   |                   |
| <b>OPERATING EXPENSES</b>                                  | 15   |                   |                   |                   |                   |
| Personnel expenses   | 16   | 4,624,286         | 4,093,737         | 5,090,220         | 4,446,059         |
| Premises, equipment and establishment expenses             |      | 2,978,363         | 2,840,613         | 2,821,552         | 2,641,070         |
| Fee and commission expenses                                |      | 134,572           | 137,736           | 135,314           | 346,960           |
| Provision for employee retirement benefits                 | 17   | 882,815           | 815,682           | 893,742           | 823,365           |
| Provision for loan losses                                  | 18   | 481,309           | 708,227           | 481,309           | 708,227           |
| Diminution / (appreciation) in value of investments        |      | 8,025             | 2,038             | 1,088             | 2,038             |
| Impairment of goodwill                                     |      | -                 | -                 | -                 | 5,199             |
| Loans written off  |      | 274               | 285               | 274               | 285               |
| Other expenses   |      | 5,037,270         | 4,802,380         | 6,649,915         | 5,887,478         |
|  |      | <b>14,146,914</b> | <b>13,400,698</b> | <b>16,073,414</b> | <b>14,860,681</b> |
| <b>PROFIT FROM OPERATIONS</b>                              |      | <b>6,731,451</b>  | <b>5,917,519</b>  | <b>7,254,096</b>  | <b>6,159,144</b>  |
| Share of profit / (loss) of associates (net of income tax) | 19   | -                 | -                 | (2,429)           | 7,680             |
| <b>PROFIT BEFORE INCOME TAX</b>                            |      | <b>6,731,451</b>  | <b>5,917,519</b>  | <b>7,251,667</b>  | <b>6,166,824</b>  |
| Less: Income tax expense                                   | 20   | 2,267,484         | 1,565,867         | 2,364,839         | 1,613,464         |
| <b>PROFIT FOR THE YEAR</b>                                 |      | <b>4,463,967</b>  | <b>4,351,652</b>  | <b>4,886,828</b>  | <b>4,553,360</b>  |
| <b>Attributable to:</b>                                    |      |                   |                   |                   |                   |
| Equity holders of the Bank                                 |      | 4,463,967         | 4,351,652         | 4,786,770         | 4,483,277         |
| Minority interest  |      | -                 | -                 | 100,058           | 70,083            |
| <b>PROFIT FOR THE YEAR</b>                                 |      | <b>4,463,967</b>  | <b>4,351,652</b>  | <b>4,886,828</b>  | <b>4,553,360</b>  |
| <b>BASIC EARNINGS PER SHARE (Rs)</b>                       | 21   | <b>18.84</b>      | <b>18.47</b>      | <b>20.20</b>      | <b>19.03</b>      |
| <b>DILUTED EARNINGS PER SHARE (Rs)</b>                     | 21   | <b>18.71</b>      | <b>18.46</b>      | <b>20.07</b>      | <b>19.02</b>      |
| <b>DIVIDEND PER SHARE (Rs)</b>                             |      | <b>*7.00</b>      | <b>6.50</b>       | <b>*7.00</b>      | <b>6.50</b>       |

The Notes to the Financial Statements from pages 164 to 245 form an integral part of these Financial Statements.

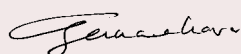
\*Calculated on interim dividend paid and final dividend proposed, which is to be approved at the Annual General Meeting.

# BALANCE SHEET

| As at 31st December  | Note | BANK               |                    | GROUP              |                    |
|--|------|--------------------|--------------------|--------------------|--------------------|
|  |      | 2010<br>Rs 000     | 2009<br>Rs 000     | 2010<br>Rs 000     | 2009<br>Rs 000     |
| <b>ASSETS</b>  |      |                    |                    |                    |                    |
| Cash and cash equivalents                                      | 22   | 18,005,640         | 27,152,248         | 18,506,511         | 27,598,197         |
| Statutory deposit with Central Banks                           | 23   | 12,491,644         | 11,063,948         | 12,506,052         | 11,078,805         |
| Government treasury bills                                      |      | -                  | -                  | 976,447            | 305,810            |
| Dealing securities   | 24   | 1,457,502          | 39,485             | 2,504,283          | 687,731            |
| Securities purchased under re-sale agreements                  |      | 1,185,831          | 500,000            | 2,713,591          | 950,703            |
| Non-current assets held for sale                               | 25   | -                  | -                  | 2,875              | 2,875              |
| Bills of exchange  | 26   | 1,401,130          | 1,447,490          | 1,401,130          | 1,447,490          |
| Commercial papers  |      | 158,963            | 209,099            | 212,045            | 282,936            |
| Lease receivable within one year                               | 27   | 4,630,492          | 3,931,110          | 4,630,492          | 3,931,110          |
| Lease receivable after one year                                | 27   | 8,816,761          | 5,013,132          | 8,816,761          | 5,013,132          |
| Loans and advances   | 28   | 188,033,851        | 159,247,361        | 185,982,734        | 156,560,522        |
| Investment securities  | 29   | 58,704,102         | 53,959,680         | 60,250,684         | 55,847,724         |
| Investments in Associates                                      | 30   | 83,651             | 203,806            | 196,009            | 226,129            |
| Investment in Joint Venture                                    | 31   | 655,000            | 250,000            | -                  | -                  |
| Investments in Subsidiaries                                    | 32   | 2,179,086          | 2,179,326          | -                  | -                  |
| Investment properties  | 33   | 353,563            | 350,760            | 173,595            | 172,555            |
| Property, plant and equipment                                  | 34   | 7,473,947          | 7,179,502          | 14,535,778         | 14,332,929         |
| Intangible assets  | 35   | 577,015            | 675,272            | 702,930            | 710,009            |
| Other assets   | 36   | 7,705,316          | 6,886,678          | 9,146,091          | 8,059,113          |
| <b>Total Assets</b>  |      | <b>313,913,494</b> | <b>280,288,897</b> | <b>323,258,008</b> | <b>287,207,770</b> |
| <b>LIABILITIES</b>   |      |                    |                    |                    |                    |
| Deposits from customers  | 37   | 234,071,085        | 210,506,805        | 233,880,554        | 210,363,145        |
| Dividends payable  | 38   | 49,558             | 215,607            | 51,121             | 215,607            |
| Securities sold under re-purchase agreements                   |      | 11,951,727         | 8,685,000          | 13,523,113         | 9,413,416          |
| Borrowings   | 39   | 10,810,554         | 8,310,128          | 10,803,498         | 8,313,440          |
| Current tax liabilities  |      | 3,127,622          | 2,921,234          | 3,258,984          | 2,977,237          |
| Bills payable  |      | 1,305,161          | 1,161,151          | 1,305,161          | 1,161,151          |
| Subordinated debentures  | 40   | 2,724,293          | 2,673,192          | 2,697,543          | 2,653,192          |
| Insurance provision - Life                                     | 41   | -                  | -                  | 2,385,246          | 1,853,513          |
| Insurance provision - General                                  | 42   | -                  | -                  | 730,658            | 599,364            |
| Deferred tax liabilities                                       | 43   | 735,884            | 939,253            | 734,376            | 938,366            |
| Other liabilities  | 44   | 21,863,843         | 20,976,437         | 23,321,053         | 21,945,731         |
| <b>Total Liabilities</b>                                       |      | <b>286,639,727</b> | <b>256,388,807</b> | <b>292,691,307</b> | <b>260,434,162</b> |
| <b>EQUITY</b>  |      |                    |                    |                    |                    |
| Stated capital   | 46   | 5,318,550          | 5,084,084          | 5,318,550          | 5,084,084          |
| Statutory reserve fund   |      | 1,510,000          | 1,260,000          | 1,510,000          | 1,260,000          |
| Retained earnings  |      | 4,420,248          | 3,848,946          | 4,355,024          | 3,550,268          |
| Other reserves   |      | 16,024,969         | 13,707,060         | 18,794,535         | 16,479,387         |
| <b>Total equity attributable to equity holders of the Bank</b> |      | <b>27,273,767</b>  | <b>23,900,090</b>  | <b>29,978,109</b>  | <b>26,373,739</b>  |
| Minority interest  |      | -                  | -                  | 588,592            | 399,869            |
| <b>Total Equity</b>  |      | <b>27,273,767</b>  | <b>23,900,090</b>  | <b>30,566,701</b>  | <b>26,773,608</b>  |
| <b>Total Liabilities and Equity</b>                            |      | <b>313,913,494</b> | <b>280,288,897</b> | <b>323,258,008</b> | <b>287,207,770</b> |
| Commitments and contingencies                                  | 47   | 124,170,550        | 63,027,220         | 124,170,550        | 63,039,700         |

The Notes to the Financial Statements from pages 164 to 245 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 and give a true and fair view of the state of affairs of Hatton National Bank PLC and the Group as at 31st December 2010 and the profits for the year then ended.

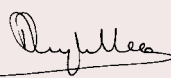


Ajantha de Vas Gunasekara  
Chief Financial Officer

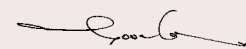
For and on behalf of the Board



Rajendra Theagarajah  
Managing Director /  
Chief Executive Officer



Rienzie T. Wijetilleke  
Chairman



Indrani Goonesekera  
Deputy General Manager (Legal) /  
Board Secretary

Colombo, Sri Lanka  
18th February 2011



# STATEMENT OF CHANGES IN EQUITY

For the year ended 31st December 2010

| BANK   | Attributable to Equity Holders of the Bank |                   |                        |                 |                 |                                |                               | Minority Interest | Total |                   |
|--|--|-------------------|------------------------|-----------------|-----------------|--------------------------------|-------------------------------|-------------------|-------|-------------------|
|  | Stated Capital                             |                   | Statutory Reserve Fund | Other Reserves  |                 |                                |                               |                   |       | Retained Earnings |
|  | Voting Shares                              | Non-Voting Shares |                        | Capital Reserve | General Reserve | Repairs and Renovation Reserve | Exchange Equalisation Reserve |                   |       |                   |
|  | Rs 000                                     | Rs 000            | Rs 000                 | Rs 000          | Rs 000          | Rs 000                         | Rs 000                        |                   |       | Rs 000            |
| Balance as at 31st December 2008                             | 2,881,387                                  | 2,178,003         | 982,707                | 3,004,250       | 8,482,353       | 6,700                          | -                             | 3,045,537         | -     | 20,580,937        |
| Final dividend for 2008                                      | -  | -                 | -                      | -               | -               | -                              | -                             | (706,588)         | -     | (706,588)         |
| Deferred tax liability for revaluation reserve [Note 43 (a)] | -  | -                 | -                      | 2,810           | -               | -                              | -                             | -                 | -     | 2,810             |
| Net profit for the year 2009                                 | -  | -                 | -                      | -               | -               | -                              | -                             | 4,351,652         | -     | 4,351,652         |
| Interim dividend for 2009                                    | -  | -                 | -                      | -               | -               | -                              | -                             | (353,415)         | -     | (353,415)         |
| Shares issued under ESOP                                     | 22,093                                     | 2,601             | -                      | -               | -               | -                              | -                             | -                 | -     | 24,694            |
| Transfers during the year 2009                               | -  | -                 | 277,293                | -               | 2,217,647       | (6,700)                        | -                             | (2,488,240)       | -     | -                 |
| Balance as at 31st December 2009                             | 2,903,480                                  | 2,180,604         | 1,260,000              | 3,007,060       | 10,700,000      | -                              | -                             | 3,848,946         | -     | 23,900,090        |
| Final dividend for 2009                                      | -  | -                 | -                      | -               | -               | -                              | -                             | (1,179,807)       | -     | (1,179,807)       |
| Deferred tax liability for revaluation reserve [Note 43 (a)] | -  | -                 | -                      | 2,248           | -               | -                              | -                             | -                 | -     | 2,248             |
| Impact on rate change [Note 43 (a)]                          | -  | -                 | -                      | 15,661          | -               | -                              | -                             | -                 | -     | 15,661            |
| Net profit for the year 2010                                 | -  | -                 | -                      | -               | -               | -                              | -                             | 4,463,967         | -     | 4,463,967         |
| Interim dividend for 2010                                    | -  | -                 | -                      | -               | -               | -                              | -                             | (338,570)         | -     | (338,570)         |
| Shares issued under ESOP                                     | 209,650                                    | 24,816            | -                      | -               | -               | -                              | -                             | -                 | -     | 234,466           |
| Dividend reversal [Note 38 (c)]                              | -  | -                 | -                      | -               | -               | -                              | -                             | 175,712           | -     | 175,712           |
| Transfers during the year 2010                               | -  | -                 | 250,000                | -               | 2,300,000       | -                              | -                             | (2,550,000)       | -     | -                 |
| Balance as at 31st December 2010                             | 3,113,130                                  | 2,205,420         | 1,510,000              | 3,024,969       | 13,000,000      | -                              | -                             | 4,420,248         | -     | 27,273,767        |

| GROUP  | Attributable to Equity Holders of the Bank |                   |                        |                 |                 |                                |                               | Minority Interest | Total    |                   |
|--|--|-------------------|------------------------|-----------------|-----------------|--------------------------------|-------------------------------|-------------------|----------|-------------------|
|  | Stated Capital                             |                   | Statutory Reserve Fund | Other Reserves  |                 |                                |                               |                   |          | Retained Earnings |
|  | Voting Shares                              | Non-Voting Shares |                        | Capital Reserve | General Reserve | Repairs and Renovation Reserve | Exchange Equalisation Reserve |                   |          |                   |
|  | Rs 000                                     | Rs 000            | Rs 000                 | Rs 000          | Rs 000          | Rs 000                         | Rs 000                        |                   |          | Rs 000            |
| Balance as at 31st December 2008   | 2,881,387                                  | 2,178,003         | 982,707                | 5,771,072       | 8,482,353       | 6,700                          | 2,459                         | 2,616,620         | 347,816  | 23,269,117        |
| Final dividend for 2008  | -  | -                 | -                      | -               | -               | -                              | -                             | (706,588)         | (18,750) | (725,338)         |
| Deferred tax liability for revaluation reserve [Note 43 (a)]                                       | -  | -                 | -                      | 2,810           | -               | -                              | -                             | -                 | -        | 2,810             |
| Disposal of Subsidiaries   | -  | -                 | -                      | -               | -               | -                              | -                             | (1,386)           | -        | (1,386)           |
| Exchange gain / (loss) on translation of Financial Statements of foreign operations                | -  | -                 | -                      | -               | -               | -                              | 3,046                         | -                 | 981      | 4,027             |
| Net profit for the year 2009   | -  | -                 | -                      | -               | -               | -                              | -                             | 4,483,277         | 70,083   | 4,553,360         |
| Interim dividend for 2009  | -  | -                 | -                      | -               | -               | -                              | -                             | (353,415)         | -        | (353,415)         |
| Shares issued under ESOP   | 22,093                                     | 2,601             | -                      | -               | -               | -                              | -                             | -                 | -        | 24,694            |
| Transfers during the year 2009   | -  | -                 | 277,293                | -               | 2,217,647       | (6,700)                        | -                             | (2,488,240)       | -        | -                 |
| Minority interest's portion of pre acquisition reserve   | -  | -                 | -                      | -               | -               | -                              | -                             | -                 | (261)    | (261)             |
| Balance as at 31st December 2009   | 2,903,480                                  | 2,180,604         | 1,260,000              | 5,773,882       | 10,700,000      | -                              | 5,505                         | 3,550,268         | 399,869  | 26,773,608        |
| Final dividend for 2009  | -  | -                 | -                      | -               | -               | -                              | -                             | (1,179,807)       | (30,158) | (1,209,965)       |
| Deferred tax liability for revaluation reserve [Note 43 (a)]                                       | -  | -                 | -                      | 2,248           | -               | -                              | -                             | -                 | -        | 2,248             |
| Impact on rate change [Note 43 (a)]  | -  | -                 | -                      | 15,661          | -               | -                              | -                             | -                 | -        | 15,661            |
| Exchange gain / (loss) on translation of Financial Statements of foreign operations                | -  | -                 | -                      | -               | -               | -                              | (2,761)                       | -                 | (1,905)  | (4,666)           |
| Minority interest on additional investment in Subsidiaries through Joint Venture                   | -  | -                 | -                      | -               | -               | -                              | -                             | -                 | 22,974   | 22,974            |
| Reduction in reserves from disposal of Associate company and long term investment to Joint Venture | -  | -                 | -                      | -               | -               | -                              | -                             | (88,637)          | -        | (88,637)          |
| Acquisition of minority interest in Subsidiary by Bank   | -  | -                 | -                      | -               | -               | -                              | -                             | (712)             | 712      | -                 |
| Minority Interest as at the date of acquisition of Subsidiary through Joint Venture                | -  | -                 | -                      | -               | -               | -                              | -                             | -                 | 97,042   | 97,042            |
| Net profit for the year 2010   | -  | -                 | -                      | -               | -               | -                              | -                             | 4,786,770         | 100,058  | 4,886,828         |
| Interim dividend for 2010  | -  | -                 | -                      | -               | -               | -                              | -                             | (338,570)         | -        | (338,570)         |
| Shares issued under ESOP   | 209,650                                    | 24,816            | -                      | -               | -               | -                              | -                             | -                 | -        | 234,466           |
| Dividend reversal [Note 38 (c)]  | -  | -                 | -                      | -               | -               | -                              | -                             | 175,712           | -        | 175,712           |
| Transfers during the year 2010   | -  | -                 | 250,000                | -               | 2,300,000       | -                              | -                             | (2,550,000)       | -        | -                 |
| Balance as at 31st December 2010   | 3,113,130                                  | 2,205,420         | 1,510,000              | 5,791,791       | 13,000,000      | -                              | 2,744                         | 4,355,024         | 588,592  | 30,566,701        |

The Notes to the Financial Statements from page 164 to 245 form an integral part of these Financial Statements.

In accordance with Section 58 of Companies Act No 7 of 2007, share capital and share premium have been classified as stated capital.

Statutory reserve fund represents the statutory requirement in terms of Section 20 (1) and (2) of the Banking Act No 30 of 1988.

Capital reserve relates to revaluation of freehold land and buildings carried out in 1989, 1993 and 2007 and includes the surplus on revaluation of those assets.

General reserve comprises the amounts appropriated by the Board of Directors as a general banking reserve.

Exchange equalisation reserve consists of foreign exchange differences resulting from translation of foreign Subsidiary and Associate financial statements to functional currency of the Group (Sri Lankan Rupees)

Voting and non voting shares included under stated capital include share premium on shares issued of Rs 988 Mn and Rs 1,716 Mn respectively.

# CASH FLOW STATEMENT

| For the year ended 31st December  | BANK                |                     | GROUP               |                     |
|---|---------------------|---------------------|---------------------|---------------------|
|   | 2010<br>Rs 000      | 2009<br>Rs 000      | 2010<br>Rs 000      | 2009<br>Rs 000      |
| <b>Cash Flows from Operating Activities</b>   |                     |                     |                     |                     |
| Interest and commission receipts  | 29,351,427          | 31,735,949          | 29,813,744          | 31,770,910          |
| Interest payments   | (15,894,274)        | (16,131,045)        | (15,967,635)        | (16,372,345)        |
| Receipts from other operating activities  | 1,080,673           | 1,003,539           | 3,000,373           | 2,607,287           |
| Cash payments to employees  | (5,524,247)         | (5,257,678)         | (5,979,839)         | (5,609,996)         |
| Cash payments to suppliers  | (2,155,209)         | (2,089,604)         | (1,840,568)         | (1,738,014)         |
| Recoveries from loans written off in previous years   | 6,549               | 7,283               | 6,549               | 7,283               |
| Cash payments to other operating activities   | (3,902,232)         | (2,686,220)         | (4,842,127)         | (3,350,666)         |
| <b>Operating Profit before Changes in Operating Assets and Liabilities [Note (a)]</b>                                   | <b>2,962,687</b>    | <b>6,582,224</b>    | <b>4,190,497</b>    | <b>7,314,459</b>    |
| <b>(Increase) / Decrease in Operating Assets</b>  |                     |                     |                     |                     |
| Commercial papers and reverse repos   | (635,695)           | 916,809             | (1,354,410)         | 1,599,037           |
| Deposits held for regulatory or monetary control purpose  | (1,427,696)         | 783,375             | (1,427,247)         | 783,193             |
| Loans and advances  | (33,303,017)        | 5,192,190           | (33,936,494)        | 6,038,957           |
| Other short term assets   | (1,177,048)         | 4,092,063           | (1,316,993)         | 3,644,154           |
|   | (36,543,456)        | 10,984,437          | (38,035,144)        | 12,065,341          |
| <b>Increase / (Decrease) in Operating Liabilities</b>   |                     |                     |                     |                     |
| Deposits from customers   | 23,427,782          | 22,567,119          | 23,380,911          | 22,578,778          |
| Negotiable certificates of deposits   | 136,498             | 1,169,824           | 136,498             | 1,169,824           |
| Other liabilities   | 1,235,060           | (2,620,327)         | 1,602,831           | (2,128,230)         |
|   | 24,799,340          | 21,116,616          | 25,120,240          | 21,620,372          |
| <b>Net Cash Generated from / (Used in) Operating Activities before Income Tax</b>                                       | <b>(8,781,429)</b>  | <b>38,683,277</b>   | <b>(8,724,407)</b>  | <b>41,000,172</b>   |
| Income taxes paid   | (1,807,700)         | (623,535)           | (1,814,307)         | (613,246)           |
| <b>Net Cash Generated from / (Used in) Operating Activities</b>   | <b>(10,589,129)</b> | <b>38,059,742</b>   | <b>(10,538,714)</b> | <b>40,386,926</b>   |
| <b>Cash Flows from Investing Activities</b>   |                     |                     |                     |                     |
| Dividend receipts   | 216,557             | 202,365             | 205,806             | 180,891             |
| Net proceeds from sale of dealing securities  | (640,338)           | 275,701             | (216,052)           | 24,882              |
| Net purchase of investment securities   | (1,352,171)         | (25,230,973)        | (1,431,652)         | (25,902,385)        |
| Purchase of property, plant and equipment   | (977,446)           | (1,071,026)         | (1,033,680)         | (1,163,844)         |
| Purchase of intangible assets   | (68,183)            | (110,432)           | (100,105)           | (126,378)           |
| Improvements to investment properties   | (7,247)             | (663)               | (5,496)             | (663)               |
| Investment in Associate company   | -                   | (12,860)            | (48,500)            | (12,860)            |
| Net proceeds from sale of Associate company   | 179,907             | -                   | 89,954              | -                   |
| Investment in Joint Venture company   | (405,000)           | -                   | -                   | -                   |
| Net cash effect on investment / increase percentage held in Subsidiary company by Joint Venture [Note (b) i and (b) ii] | -                   | -                   | (416,086)           | -                   |
| Net cash effect on investment in Subsidiary company [Note (c)]  | -                   | (240)               | -                   | 471                 |
| Net cash effect on disposal of DNH Financial (Pvt) Ltd (former HNB Stockbrokers (Pvt) Ltd) [Note (d)]                   | -                   | -                   | -                   | 43,474              |
| Proceeds from sale of property, plant and equipment   | 6,077               | 19,663              | 7,835               | 24,724              |
| <b>Net Cash Used in Investing Activities</b>  | <b>(3,047,844)</b>  | <b>(25,928,465)</b> | <b>(2,947,976)</b>  | <b>(26,931,688)</b> |
| <b>Cash Flows from Financing Activities</b>   |                     |                     |                     |                     |
| Decrease in debentures  | -                   | (127,627)           | -                   | (1,127,627)         |
| Increase / (decrease) of other borrowings   | 5,767,154           | (7,206,116)         | 5,677,415           | (7,323,573)         |
| Dividends paid  | (1,508,713)         | (971,699)           | (1,537,309)         | (990,451)           |
| Proceeds from issue of shares under ESOP  | 234,466             | 24,694              | 234,466             | 24,694              |
| Share issue expenses  | (2,542)             | (233)               | (2,542)             | (233)               |
| Proceeds from Issue of shares to minority share holders   | -                   | -                   | 22,974              | -                   |
| <b>Net Cash Generated from / (Used in) Financing Activities</b>   | <b>4,490,365</b>    | <b>(8,280,981)</b>  | <b>4,395,004</b>    | <b>(9,417,190)</b>  |
| Net increase / (decrease) in cash and cash equivalents  | (9,146,608)         | 3,850,296           | (9,091,686)         | 4,038,048           |
| Cash and cash equivalents at the beginning of the year  | 27,152,248          | 23,301,952          | 27,598,197          | 23,560,149          |
| Cash and Cash Equivalents at the end of the Year  | 18,005,640          | 27,152,248          | 18,506,511          | 27,598,197          |

## CASH FLOW STATEMENT

| For the year ended 31st December   | BANK             |                  | GROUP            |                  |
|--|------------------|------------------|------------------|------------------|
|  | 2010<br>Rs 000   | 2009<br>Rs 000   | 2010<br>Rs 000   | 2009<br>Rs 000   |
| <b>Note (a) Reconciliation of Operating Profit</b>                                     |                  |                  |                  |                  |
| Profit before taxation   | 6,731,451        | 5,917,519        | 7,251,667        | 6,166,824        |
| Dividend received  | (216,557)        | (202,365)        | (205,806)        | (180,891)        |
| Profit on sale of property, plant and equipment  | (4,674)          | (11,917)         | (5,691)          | (13,157)         |
| Bad debts recovered  | (421,433)        | (736,571)        | (421,433)        | (736,571)        |
| Depreciation of property, plant and equipment  | 657,360          | 579,993          | 806,143          | 722,872          |
| Amortisation of intangible assets  | 168,761          | 166,636          | 179,997          | 175,765          |
| Depreciation of investment properties  | 4,444            | 4,380            | 4,456            | 4,421            |
| Bad debts written off  | 274              | 285              | 274              | 285              |
| Provision for loan losses  | 481,309          | 708,227          | 481,309          | 708,227          |
| Gain on marked to market valuation of dealing securities                               | (90,053)         | (17,451)         | (90,053)         | (25,696)         |
| Diminution / (appreciation) in value of investments                                    | 8,025            | 2,038            | 1,088            | 2,038            |
| Capital gain from sale of investment securities  | (101,710)        | -                | (63,186)         | -                |
| Capital gain from sale of dealing securities   | (18,462)         | (9,197)          | (56,847)         | (9,197)          |
| Capital gain from sale of government securities  | (6,089)          | (2,590)          | (37,754)         | (15,460)         |
| Capital gain from sale of Associate company  | (47,581)         | -                | (23,791)         | -                |
| Capital gain from sale of investment securities transferred to dealing securities      | (497,114)        | -                | (497,114)        | -                |
| (Profit)/ Loss on FCBU revaluation   | (29,902)         | 16,572           | (29,902)         | 16,572           |
| Property, plant and equipment written off  | 20,717           | -                | 20,717           | -                |
| Capital gain from sale of Subsidiaries   | -                | -                | -                | (67,659)         |
| Recovery of unclaimed VAT written off  | -                | (200,309)        | -                | (200,309)        |
| Recovery of Aquila investment  | -                | (216,674)        | -                | (216,674)        |
| Share issue expenses   | 2,542            | 233              | 2,542            | 233              |
| Discount accrual on government securities  | (3,454,466)      | (2,812,437)      | (3,540,277)      | (3,001,193)      |
| Share of Associate (profit) / loss   | -                | -                | 2,429            | (7,680)          |
| Non life insurance reserve fund  | -                | -                | 663,027          | 622,166          |
| Notional tax and withholding tax credit  | (438,856)        | (332,070)        | (476,242)        | (370,730)        |
| Accrual for interest receivable  | 201,261          | (2,071,098)      | 164,847          | (2,071,098)      |
| Accrual for other receivable   | (12,593)         | (14,986)         | 6,003            | (14,986)         |
| Accrual for interest payable   | (1,191,018)      | 3,908,601        | (1,190,479)      | 3,908,601        |
| Accrual for other payable  | 1,217,051        | 1,905,405        | 1,251,853        | 1,912,557        |
| Goodwill written off / (negative goodwill recognised)<br>on investment in Subsidiaries | -                | -                | (7,280)          | 5,199            |
| <b>Operating Profit before Changes in<br/>Operating Assets and Liabilities</b>         | <b>2,962,687</b> | <b>6,582,224</b> | <b>4,190,497</b> | <b>7,314,459</b> |

2010  
Rs 000

### Note (b) Net Cash Effect on Investment in Subsidiaries by Joint Venture Company

#### Note (b) i Investment in Lanka Venturers PLC

|   |                  |
|---|------------------|
| Property plant and equipment            | 247              |
| Reverse re-purchase agreements          | 5,043            |
| Investment securities                   | 139,890          |
| Investment in Associates                | 47,645           |
| Cash and cash equivalents               | 31,504           |
| Commercial papers                       | 10,961           |
| Government securities                   | 61,716           |
| Other receivable                        | 13,363           |
| Other liabilities                       | (2,260)          |
| Retirement benefit obligations          | (571)            |
| Minority Interest                       | (18,128)         |
| Net identifiable assets and liabilities | 289,410          |
| Goodwill on acquisition                 | 70,187           |
| Consideration paid in cash              | (359,597)        |
| Cash acquired                           | 31,504           |
| <b>Net cash outflow</b>                 | <b>(328,093)</b> |

|   | 2010<br>Rs 000  |
|---|-----------------|
| <b>Note (b) ii Increase in Percentage held in Acuity Securities Limited</b>   |                 |
| Property plant and equipment  | 1,124           |
| Intangible assets   | 266             |
| Reverse re-purchase agreements  | 288,748         |
| Cash and cash equivalents   | 355             |
| Government securities   | 739,981         |
| Loans and advances  | 2,246           |
| Other receivable  | 14,842          |
| Re-purchase agreements  | (922,344)       |
| Current tax liability   | (21,308)        |
| Defferred tax liability   | (71)            |
| Other liabilities   | (8,211)         |
| Net identifiable assets and liabilities   | 95,628          |
| Negative goodwill on acquisition  | (7,280)         |
| Consideration paid in cash  | (88,348)        |
| Cash acquired   | 355             |
| <b>Net cash outflow</b>   | <b>(87,993)</b> |
|   | 2009<br>Rs 000  |
| <b>Note (c) Net Cash Effect on Investment in Subsidiary Company -<br/>Commercial Interlink Services Inc (o/a Delma Exchange Canada)</b> |                 |
| Cash and cash equivalents   | 711             |
| Trade and other receivables   | 249             |
| Property, plant and equipment   | 3,855           |
| Trade and other payables  | (9,774)         |
| Net identifiable assets and liabilities   | (4,959)         |
| Goodwill on acquisition   | 5,199           |
| Consideration paid in cash  | (240)           |
| Cash acquired   | 711             |
| <b>Net cash inflow</b>  | <b>471</b>      |
| <b>Note (d) Net Cash Effect on Disposal of DNH Financial (Pvt) Ltd<br/>[former HNB Stockbrokers (Pvt) Ltd]</b>                          |                 |
| Property, plant and equipment   | 461             |
| Reverse re-purchase agreements  | 1,137           |
| Trade and other receivables   | 37,360          |
| Deferred tax asset  | 1,214           |
| Cash and cash equivalents   | 34,534          |
| Retirement benefit obligation   | (59)            |
| Current taxation  | (95)            |
| Trade and other payables  | (23,165)        |
| Net identifiable assets and liabilities   | 51,387          |
| Consideration received in cash  | 78,008          |
| Cash disposed off   | (34,534)        |
| <b>Net cash inflow</b>  | <b>43,474</b>   |

Comparative information in the Cash Flow Statement has been amended based on the reclassified figures.

The Notes to the Financial Statements from pages 164 to 245 form an integral part of these Financial Statements.

# NOTES TO THE FINANCIAL STATEMENTS

## 1. REPORTING ENTITY

Hatton National Bank PLC ("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 regulated under the Banking Act No. 30 of 1988 and amendments thereto. The Company 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, while the Global Depository Receipts (GDRs) issued by the Bank have a primary listing on the Luxemburg Stock Exchange.

The staff strength of the Bank as at 31st December 2010 is 4,352 (2009 - 4,302).

The Consolidated Financial Statements of the Bank for the year ended 31st December 2010 include the Bank and its Subsidiaries (together referred to as the "Group" and individually as "Group entities") and the Group's interest in its Associate and Joint Venture. The Financial Statements of all companies in the Group have a common financial year which ends on December 31.

The Bank does not have an identifiable parent of its own.

There were no significant changes in the nature of the principal activities of the Bank and the Group during the financial year under review.

### 1.1 Principal Activities

#### 1.1.1 Bank

The principal activities of the Bank continued to be banking and related activities such as accepting deposits, 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 etc.

#### 1.1.2 Subsidiaries

| Name of Subsidiary           | Principle Activities   |
|------------------------------|--|
| HNB Assurance PLC            | Insurance services   |
| Sithma Development (Pvt) Ltd | Property development   |
| Majan Exchange LLC           | Provision of remittances and foreign currency related services |

The commercial activities of Commercial Interlink Services Inc were ceased on 1st October 2010.

#### 1.1.3 Associate

The Associate of the Bank, Delma Exchange's principal activities are provision of remittances and foreign currency related services

Bank disposed its investment in Lanka Ventures PLC on 18th January 2010.

#### 1.1.4 Joint Venture

The Joint Venture of the Bank, Acuity Partners (Pvt) Ltd's principal activities are operating as an investment company and providing financial services.

## 2. BASIS OF PREPARATION

### 2.1 Statement of Compliance

The Balance Sheet, Income Statement, Statement of Changes in Equity and Cash Flow Statement have been prepared in accordance with the Sri Lanka Accounting Standards laid down by the Institute of Chartered Accountants of Sri Lanka, and comply with the requirements of Companies Act No 7 of 2007 and Banking Act No 30 of 1988 and amendments thereto.

### 2.2 Approval of Financial Statements by Directors

The Financial Statements were authorised for issue by the Board of Directors in accordance with the resolution of the directors on 18th February 2011.

### 2.3 Basis of Measurement

The Financial Statements have been prepared on the historical cost basis and applied consistently with no adjustments being made for inflationary factors affecting the Financial Statements, except for the following;

- Land and buildings are measured at cost at the time of acquisition and subsequently at revalued amounts, which are the fair values at the date of revaluation less accumulated depreciation and impairment losses, if any.
- Dealing securities are measured at market value.
- Non-current assets held for sale are measured at lower of its carrying amount and fair value less costs to sell.

### 2.4 Functional and Presentation Currency

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

### 2.5 Use of Estimates and Judgements

The preparation of Financial Statements in conformity with Sri Lanka Accounting Standards requires management to make judgements, estimates and assumptions that affect the

application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected. Information about significant areas of estimation and uncertainty that have the most significant effect on the amounts recognised in the Financial Statements are described in Notes 2.5.1 to 2.5.5.

### 2.5.1 Provision for Loan Losses

In addition to the specific provisions for possible loan losses made on the basis of continuous review of all loans and advances to customers in accordance with the Sri Lanka Accounting Standard 23 "Revenue Recognition and Disclosures in the Financial Statements of Banks" and the directions issued by the Central Bank of Sri Lanka, the Bank evaluates the need for additional provisions for loans and advances based upon management's best estimate of recoverability. In estimating the recoverability the management makes judgments about the borrower's financial situation, the workout strategy and the net realisable value of any underlying collateral.

The general provisions cover loan losses inherent in portfolios with similar credit risk characteristics (portfolios of pawning, lease receivables and Shanthy Housing loans) when there is objective evidence to suggest that they contain impaired loans, but the individual impaired loans cannot yet be identified. In assessing the need for general provision for loan losses, management considers factors such as credit quality, portfolio size, concentrations, and economic factors. In order to estimate the required provisions, assumptions are made to define the way inherent losses are determined based on historical experience.

### 2.5.2 Classification of Dealing (Trading) and Investment Securities

In classifying securities as "Dealing" (Trading), the Bank has determined that it meets the description set out in Note 4.6.1.

In classifying securities as "Investment", the Bank has determined that it has both the positive intention and ability to hold the securities until their maturity date as required by Note 4.6.2.

### 2.5.3 Assessment of Impairment

The Bank assesses at each Balance Sheet date whether there is objective evidence that an asset or portfolio of assets is impaired. The recoverable amount of an asset or Cash Generating Unit (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 present value using appropriate discount rates that reflects the current market assessments of the time value of money and risks specific to the asset.

The carrying value of goodwill is reviewed at each Balance Sheet date and is written down to the extent that it is no longer supported by probable future benefits. Goodwill is allocated to CGU for the purpose of impairment testing.

### 2.5.4 Employee Retirement Benefits

The liability in respect of employee retirement benefits of the Bank's Pension Fund which is a separate entity, as at Balance Sheet date was actuarially valued based on the assumptions set out in Note 45 (a) v. Bank makes contributions to the Pension Fund based on the actuarial valuation and the unfunded pension fund liability as at the Balance Sheet date is set out in Note 45 (a) i.

### 2.5.5 Classification of Investment Property

Classification of Investment Property is based on the description set out in Note 4.11.

## 3. MATERIALITY AND AGGREGATION

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.

## 4. SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below have been applied consistently to all periods presented in these Financial Statements. The accounting policies of the Bank have been consistently applied by Group entities where applicable and deviations if any, have been disclosed accordingly.

### 4.1 Basis of Consolidation

#### 4.1.1 Subsidiaries

Subsidiaries are entities that are controlled by the Bank. Control exists when the Bank has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable are taken into account. The Financial Statements of Subsidiaries are included in the Consolidated Financial Statements from the date that control effectively commences until the date that control effectively ceases.

The Minority Interest is presented in the Consolidated Balance Sheet within equity, separately from the equity attributable to the Equity Holders of the Bank. Minority Interest in the profit or loss of the Group is disclosed separately in the Consolidated Income Statement.



## NOTES TO THE FINANCIAL STATEMENTS

The Consolidated Financial Statements are prepared to common financial year end of 31st December. The accounting policies of Subsidiaries have been changed where ever necessary to align them with the policies adopted by the Bank.

Where Subsidiaries have been sold or acquired during the year, their operating results have been included to the date of disposal or from the date of acquisition.

The carrying amount of the investment at the date that such entity ceases to be a Subsidiary would be regarded as the cost on initial measurement of a financial asset in accordance with Sri Lanka Accounting Standard 22 "Accounting for Investments".

A list of Subsidiaries within the Group is provided in Note 32.

### 4.1.2 Associate

Associate is an entity in which the Bank has significant influence, but no control over the financial and operating policies. Significant influence is presumed to exist when the Bank holds between 20 and 50 percent of the voting power of another entity. The Associate is accounted for using the Equity method and is recognised initially at cost. The Bank's investments include goodwill identified on acquisition, net of any accumulated impairment losses. The Consolidated Financial Statements include the Bank's share of the income and expenses and equity movements of the Associate, after adjustments being made to align the accounting policies with those of the Group from the date that significant influence effectively commences until the date that significant influence effectively ceases.

When the Bank's share of losses exceeds its interest in the Associate, the carrying amount of that interest is reduced to nil and the recognition of further losses is discontinued except to the extent that Bank has an obligation or made payments on behalf of the Associate. If the Associate subsequently reports profits, the Bank resumes recognising its share of those profits only after its share of the profits equals the share of losses not recognised.

The Bank discontinues the use of the Equity method from the date that it ceases to have significant influence over an Associate and re-classifies the investment as "Investment Securities" in accordance with Sri Lanka Accounting Standard 22 "Accounting for Investments".

Details of the Associate within the Group is provided in Note 30.

### 4.1.3 Joint Venture

Joint Venture is an entity over whose activities the Bank has joint control, established by contractual arrangement and requiring unanimous consent for strategic, financial and operating decisions. The Bank recognises its interest in the Joint Venture using the line by line reporting format for

Proportionate Consolidation method and is recognised initially at cost.

The Bank combines its share of each of the assets, liabilities, income and expenses of the Joint Venture with similar items, line by line in the Consolidated Financial Statements from the date that joint control commences, until the date joint control ceases.

Details of the Joint Venture are provided in Note 31.

### 4.1.4 Transactions Eliminated on Consolidation

Intra-group balances and transactions, income, expenses and any unrealised gains arising from intra-group transactions and transactions with Joint Venture are eliminated in preparing the Consolidated Financial Statements. Unrealised gains arising from transactions with Associates are eliminated to the extent of the Group's interest in the Associates against the investment in the Associate. Unrealised losses are eliminated in the same way as unrealised gains except that they are only eliminated to the extent that there is no evidence of impairment.

## 4.2 Foreign Currency Translation

### 4.2.1 Foreign Currency Transactions

Transactions in foreign currencies are translated to Sri Lankan Rupees at the middle rate of exchange ruling at the dates of the transactions.

Monetary assets and liabilities denominated in foreign currencies at the Balance Sheet date are translated to Sri Lankan Rupees at the middle rate of exchange ruling at that date. Foreign exchange differences arising on the settlement or resulting due to unrealised gains or losses from revaluation of the Bank's monetary items at rates different from those at which they were initially recognised in the financial statements, are recognised in the Income Statement in the period in which they arise.

Non-monetary assets and liabilities denominated in foreign currency that are stated at historical cost at the Balance Sheet date are translated to Sri Lankan Rupees at the foreign exchange rates ruling at the date of the initial transaction.

### 4.2.2 Foreign Operations

The Financial Statements of foreign entities within the Group whose functional currency is different to presentation currency, (Sri Lankan Rupees) are translated to Sri Lankan Rupees as follows:

- Assets and liabilities are translated at the middle rate of exchange at the date of Balance Sheet.
- Income and expenses are translated at the average exchange rate ruling during the period under consideration.

- All resulting foreign exchange differences are recognised directly in equity.

When a foreign operation is disposed of, the cumulative relevant exchange differences recognised in equity is transferred to Income Statement as part of the gain or loss on disposal.

#### 4.2.3 Foreign Currency Banking Unit

The Income Statement and the Balance Sheet of the Foreign Currency Banking Unit is translated to Sri Lankan Rupees at the middle rate of exchange ruling at the Balance Sheet date.

#### 4.2.4 Forward Exchange Contracts

Forward exchange contracts are valued at the forward market rates ruling on the date of the Balance Sheet. Resulting net unrealised gains and losses are dealt with through the Income Statement.

### ASSETS AND BASES OF THEIR VALUATION

#### 4.3 Cash and Cash Equivalents

Cash and cash equivalents include cash in hand, balances with banks, placements with banks, money at call and short notice. They are brought to account at the face value or the gross value where appropriate

#### 4.4 Statutory Deposit with Central Banks

The Monetary Law Act requires that all Commercial Banks operating in Sri Lanka maintain reserves against all deposit liabilities denominated in Sri Lankan Rupees. The licensing regulations for Exchange Houses issued by the Central Bank of Oman require that all Exchange Houses maintain a deposit with the Central Bank of Oman.

The details of reserve requirements are given in Note 23.

#### 4.5 Government of Sri Lanka Treasury Bills and Bonds

##### 4.5.1 Investment in Treasury Bills and Treasury Bonds Held for Dealing

Investments in treasury bills and treasury bonds in dealing portfolio are those investments that the Group acquires or incurs principally for the purpose of selling, or holds as part of a portfolio that is managed for short term profit. These investments are initially recognised and subsequently measured at market value in the Balance Sheet. Gains and losses on marked to market valuation are dealt with through the Income Statement.

##### 4.5.2 Securities Purchased under Re-sale Agreements

Securities purchased under re-sale agreements are recorded separately in the Financial Statements at cost. The difference between the purchase and re-sale price represents interest

income and is recognised in the Income Statement over the period of the resale agreement.

#### 4.6 Investments

An investment is an asset held by the Bank / Group for the accretion of wealth through distribution [such as interest, royalties, dividends and rentals (other than leases)] for capital appreciation or for other benefits to the Bank / Group such as those obtained through trading relationships.

##### 4.6.1 Dealing (Trading) Securities

Dealing (trading) securities are those investments that are acquired or incurred principally for the purpose of selling or holding as part of a portfolio that is managed for short term profit. These investments are initially recognised at cost and subsequently measured at market value. Gains and losses on marked to market valuations are dealt with through the Income Statement.

The Bank's Subsidiary HNB Assurance PLC measures dealing securities at cost / market value whichever is lower.

##### 4.6.2 Investment Securities

These are securities which are acquired and held for yield or capital growth in the medium / long term with the positive intent and ability to hold until maturity. Such securities are recorded at cost. Interest and dividend income are accrued. Changes in market values of these securities are not taken into account, unless there is considered to be a diminution in value which is other than temporary.

Investments in treasury bills / bonds in the investment portfolio are initially measured at market value of bills / bonds at the date of purchase and the discount / premium accrued thereon.

On disposal of an investment the difference between net disposal proceeds and the carrying amount is recognised as income or expense.

Sale of more than insignificant amount of would result in reclassification of all such securities as "Trading securities". However, sales and reclassification in any of the following circumstances would not trigger a reclassification:

- Sale or reclassification that are so close to maturity that changes in the market rate of interest would not have a significant effect on the securities' market value
- Sale or reclassification after the Bank has collected substantially all of the securities' original principal
- Sale or reclassification attributable to non-recurring isolated events beyond the Bank's control that could not have been reasonably anticipated.

# NOTES TO THE FINANCIAL STATEMENTS

## 4.6.3 Investments in Subsidiaries

Investments in Subsidiaries are stated at cost in the Bank's Financial Statements.

## 4.6.4 Investment in Associate

Investment in Associate is accounted for at cost in the Bank's Financial Statements and under the Equity method in the Consolidated Financial Statements.

Under the Equity method, the investment in Associate is initially accounted for at cost and the carrying amount is adjusted for post acquisition changes in the Bank's share of net assets of the Associate, less any impairment in the Bank's net investment in Associate.

## 4.6.5 Investment in Joint Venture

Investment in Joint Venture is accounted for at cost in the Bank's Financial Statements and under the Proportionate Consolidation method in the Consolidated Financial Statements.

## 4.7 Non-current Assets Held for Sale

Non-current assets that are expected to be recovered primarily through sale rather than through continuing use are classified as "Held for Sale" once identified that the carrying amount will be recovered principally through a sale transaction rather than through continuing use. 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 and their sale is highly probable.

"Non-Current Assets Held for Sale" are presented separately on the face of the Balance Sheet at the lower of its carrying amount and fair value less costs to sell.

Assets classified as "Non-Current Assets Held for Sale" are neither amortised nor depreciated.

Impairment losses on initial classification as held for sale and subsequent gains and losses on remeasurement are recognised in the Income Statement.

## 4.8 Loans and Advances to Customers

Loans and advances to customers are stated in the Balance Sheet at the recoverable amount represented by the gross value of the outstanding balance adjusted for provision of loan losses and interest in suspense (interest which is not accrued to revenue).

### 4.8.1 Non Performing Loans and Advances

The loans and advances are classified as Non Performing Advances (NPA) based on the criteria set out in Direction No 3 of 2008 dated 8th May 2008, issued by the Central Bank of Sri Lanka on "Classification of Loans and Advances, Income

Recognition and Provisioning". Details of the criteria referred to above are given in Note 28 (c).

Provision for possible loan losses are made on the basis of a continuous review of all loans and advances to customers in accordance with the Sri Lanka Accounting Standard 23, "Revenue Recognition and Disclosures in the Financial Statements of the Banks" and the Directions issued by the Central Bank of Sri Lanka and disclosed in the Financial Statements of the Bank.

### 4.8.2 Foreclosed Properties

Foreclosed properties represent properties acquired in full or partial settlement of loans and advances up to 2001 and are yet to be disposed. From 2001 onwards this practice was discontinued whereby loans and advances in satisfaction of which properties are acquired, continue to be classified as non-performing loans and advances. These are accounted for at the lower of cost or forced sale value on an individual property basis. The shortfall between the prevailing forced sale value of the property and the related loan outstanding is recognised as a provision for loan losses in the Income Statement during the year of acquiring the said property in satisfaction of the loan. Any shortfall between the carrying amount of these properties and their respective forced sale values identified subsequently is charged as a provision for loan losses in the Income Statement. Subsequent recoveries on the disposal of the said properties are treated as provisions written back and any shortfall between capital outstanding and amount recovered if not provided is charged to the Income Statement. These properties are recorded under loans and advances until those are disposed off. Any subsequent expenditure on these properties are capitalised and provisions are made for such subsequent additions.

### 4.8.3 Provision for Loan Losses

#### 4.8.3 (a) Specific Provisions for Loan Losses are Made as Follows:

In accordance with the Direction No 3 of 2008 dated 8th May 2008, issued by the Central Bank of Sri Lanka on "Classification of Loans and Advances, Income Recognition and Provisioning" specific provisions on NPA are made as follows.

| Category of NPA Credit Quality | Minimum Specific Provision Requirement |
|--------------------------------|--|
| Substandard                    |  |
| Credit cards                   | 25%                                    |
| Other advances                 | 20%                                    |
| Doubtful                       | 50%                                    |
| Loss                           | 100%                                   |

The provision made relates to all categories of loans and advances including pawning and leasing identified as substandard, doubtful and loss.

Where necessary, specific provisions have been made over and above the minimum percentages stipulated above, on a case by case basis.

#### **4.8.3 (b) General Provision**

The amount of potential losses not specifically identified but which experience indicates are present in the portfolio of pawning, lease receivables and Shanthi housing loans are recognised as a general provision in the Income Statement. Accordingly, a general provision of 0.1% of the total portfolio of pawning facilities, 2% of the lease receivables (net of specific provision) and 0.2% of the total portfolio of Shanthi housing loans is made in the Income Statement.

The Direction issued by the Monetary Board of the Central Bank of Sri Lanka on 5th December 2006, in terms of Section 46 of the Banking Act No 30 of 1988, as amended, in "Requirements to Maintain a General Provision for Advances" requires all Licensed Commercial Banks to maintain a general provision of 1% of the total on balance sheet performing loans and advances and on balance sheet overdue loans and advances, net of interest in suspense and credit facilities secured by cash deposits, gold or government securities with the same Bank. This policy was reiterated by the Direction issued on 8th May 2008 on "Classification of Loans and Advances, Income Recognition and Provisioning". The general provision was commenced with a minimum of 0.1% provision as at 31st December 2006 and thereafter incremental provisions were being made on the same basis till 31st March 2009, with the view of meeting the total provision requirement of 1% not later than 31st March 2009.

Thereafter the said 1% provision was maintained on such loans and advances.

This requirement was amended by the Direction issued by the Monetary Board of the Central Bank of Sri Lanka on 27th September 2010 in terms of Section 46(1) and 46A of the Banking Act No 30 of 1988, as amended, by "Amendments to Directions on Classification of Loans and Advances, Income Recognition and Provisioning for Licensed Commercial Banks in Sri Lanka". The above Direction requires all Licensed Commercial Banks to maintain general provision at 0.5% of the total outstanding of on balance sheet performing loans and advances and on balance sheet overdue loans and advances net of interest in suspense and credit facilities secured by cash deposits, gold or government securities with the same bank commencing from 1st January 2012. For this purpose banks shall reduce the exiting general provision requirement of 1% to 0.5% at a rate of 0.1% per quarter during the five quarters commencing 1st October 2010.

Accordingly, general provision was maintained at 0.9% (after reducing 0.1% during the quarter ended 31st December 2010) as at 31st December 2010.

#### **4.8.4 Revenue Recognition on Non-Performing Loans**

When an advance is classified as non performing, based on criteria set out in Direction No 3 of 2008 dated 8th May 2008 issued by the Central Bank of Sri Lanka on "Classification of Loans and Advances, Income Recognition and Provisioning" as explained in Note 28 (c), interest ceases to be accrued and is taken to income thereafter on cash basis.

#### **4.8.5 Write-Off Policy**

The Bank writes off a loan (net of any related loan loss provisions), when it determines that the loan is uncollectible. This determination is reached after considering information such as the occurrence of significant changes in the borrower's financial position such that the borrower can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure.

#### **4.9 Finance Leases**

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 included under "Lease Receivable". Leasing balances are stated in the Balance Sheet after deduction of initial rentals received, unearned lease income and the provisions for rentals doubtful of recovery.

##### **4.9.1 Provision for Lease Receivables**

Specific provision has been made in relation to identified non performing leases as stated above in Note 4.8.3 (a). In addition, a general provision has been made as stated above in Note 4.8.3 (b).

#### **4.10 Intangible Assets**

An intangible asset is an identifiable non monetary asset without physical substance held for use in the production or supply of goods or services, for rental to others or for administrative purposes.

##### **4.10.1 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 entity and the cost of the assets can be measured reliably. An intangible asset is initially measured at cost.

##### **4.10.1 (a) Goodwill**

Goodwill arising on the acquisition represents the excess of the cost of acquisition over the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities at the date of acquisition. Upon transition to revised Sri Lanka Accounting Standard 25 "Business Combinations", goodwill is no longer amortised. Instead, goodwill is tested for impairment annually and assessed for any indication of impairment at each reporting date to ensure that its carrying amount does not exceed its recoverable amount.

## NOTES TO THE FINANCIAL STATEMENTS

If an impairment loss is identified, it will be recognised immediately in the Income Statement.

The negative goodwill is recognised immediately in the Income Statement.

### 4.10.1 (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 they will lead to future economic benefits, are included in the Balance Sheet under the category intangible assets and carried at cost less accumulated amortisation and any accumulated impairment losses.

### 4.10.2 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.

### 4.10.3 Amortisation

Intangible assets, except for goodwill, are amortised on a straight line basis in the Income Statement from the date when the asset is available for use, over the best estimate of its useful economic life based on a pattern in which the asset's economic benefits are consumed by the Bank. The estimated useful life of software is six years. Expenditure on an intangible item that was initially recognised as an expense by the Bank in previous Annual Financial Statements or Interim Financial Reports are not recognised as part of the cost of an intangible asset at a later date.

### 4.10.4 Retirement and Disposal

An intangible asset is derecognised on disposal or when no future economic benefits are expected from its use and subsequent disposal.

## 4.11 Investment Properties

Investment properties are properties held either to earn rental income or for capital appreciation or both but not for sale in the ordinary course of business, used in the production or supply of goods or services or for administrative purposes.

### 4.11.1 Basis of Recognition

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.

### 4.11.2 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 complete.

The Group applies the cost model for investment properties in accordance with Sri Lanka Accounting Standard 40 (Revised 2005) "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 losses.

### 4.11.3 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.

#### Hatton National Bank PLC

Freehold buildings 2.5% per annum  
[Refer Note 33 (a)]

#### Sithma Development (Pvt) Ltd\*

Freehold buildings (Smart building) 2.5% per annum  
[Refer Note 33 (b)]

Plant, machinery and equipment integral to freehold buildings referred to above 20% per annum

#### \* Sithma Development (Pvt) Ltd

The HNB towers which is owned by Sithma Development (Pvt) Ltd ("Sithma"), is leased to occupants including the Bank. However, the ancillary services provided by Sithma Development (Pvt) Ltd to the occupants of HNB towers, is a significant component of the arrangement as a whole. Therefore, HNB towers is not classified as investment property in the financial statements of Sithma, but has been classified under property, plant and equipment in accordance with Sri Lanka Accounting Standard 40 (Revised 2005) "Investment Property".

### 4.11.4 Derecognition

Investment properties are derecognised when disposed of, or permanently withdrawn from use because no future economic benefits are expected. Transfers are made to and from investment properties only when there is a change in use.

## 4.12 Property, Plant and Equipment

Property, plant and equipment are tangible items that are held for servicing, or for administrative purposes and are expected to be used during more than one period.

#### 4.12.1 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.

#### 4.12.2 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 they are located. Purchased software that is integral to the functionality of the related equipment is capitalised as part of computer equipment.

#### 4.12.3 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.

#### 4.12.4 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 losses. Freehold land and buildings of the Group are revalued every seven years on a roll over basis to ensure that the carrying amounts do not differ materially from the fair values at the Balance Sheet date. On revaluation of an asset, any increase in the carrying amount is credited directly to equity, under capital reserve or used to reverse a previous revaluation decrease relating to the same asset, which was charged to the Income Statement. 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 Income Statement or debited directly to equity under revaluation reserve to the extent of any credit balance existing in the capital reserve in respect of that asset.

#### 4.12.5 Subsequent Costs

The cost of replacing part 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 Income Statement as incurred. Costs incurred in using or redeploying an item are not

included under carrying amount of an item.

#### 4.12.6 Derecognition

The carrying amount of an item of property, plant and equipment is derecognised on disposal or when no future economic benefits are expected from its use or disposal. The gain or loss arising from the derecognition of an item of property, plant and equipment is included in Income Statement when the item is derecognised.

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 derecognised. Major inspection costs are capitalised. At each such capitalisation, the remaining carrying amount of the previous cost of inspections is derecognised.

#### 4.12.7 Depreciation

The Group provides depreciation from the date the assets are available for use up to the date of disposal, 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 Bank of the different types of assets, except for which are disclosed separately. Depreciation does not cease when the assets become idle or is retired from active use unless the asset is fully depreciated.

#### Hatton National Bank PLC and its Subsidiary Companies (except for Sithma Development (Pvt) Ltd)

|  | % per annum              |
|--|--------------------------|
| Freehold buildings                     | 2.5                      |
| Motor vehicles                         | 25                       |
| Computer equipment                     | 16.7                     |
| Office equipment                       | 20                       |
| Furniture and fittings                 | 10                       |
| Fixtures                               | 10                       |
| Civil works (Majan Exchange LLC)       | 10                       |
| Improvements to<br>leasehold buildings | over the<br>lease period |

Depreciation is not provided for freehold land.

#### Sithma Development (Pvt) Ltd

|   | % per annum |
|---|-------------|
| Freehold buildings - Sithma building                        | 1           |
| Generators, generator panels<br>and associated power cables | 2           |
| Chillers, cooling towers and<br>associated equipment        | 4           |
| Lifts and escalator   | 4           |
| Building management systems                                 | 4           |
| Plant and machinery   | 20          |
| Equipment   | 20          |
| Furniture and fittings                                      | 10          |



# NOTES TO THE FINANCIAL STATEMENTS

## 4.12.8 Capital Work-in-Progress

Capital work-in-progress is stated at cost. These are expenses of a capital nature directly incurred in the construction of buildings, major plant and machinery and system development, 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.

## 4.12.9 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 20 "Borrowing Costs". Capitalisation of borrowing costs ceases when substantially all the activities necessary to prepare the qualifying asset for its intended use are completed.

## 4.13 Work-in-Progress - Residential Apartment Complex

Sithma Development (Pvt) Ltd commenced a project to develop a residential apartment complex. The expenses relating to this project are accounted for as work-in-progress until the completion of the project.

On completion, the value of apartments is transferred to inventories - residential apartment complex. Inventories are shown under other assets in the Balance Sheet.

## 4.14 Impairment

### 4.14.1 Financial Assets

The Group assesses at each Balance Sheet date whether there is objective evidence that a financial asset is impaired. A financial asset is impaired and impairment losses are incurred if and only if, there is objective evidence of impairment as a result of one or more loss events that occurred after the initial recognition of the asset and prior to the Balance Sheet date ("a loss event"), and that loss event or events have had an impact on the estimated realisable value of the asset.

The Group first assesses whether objective evidence of impairment exists for financial assets that are significant (except for loans and advance explained below).

For loans and advances, impairment loss is measured individually and collectively as explained in Note 4.8.3. When a loan is uncollectible, it is written off against the related provision. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of the amounts previously written off are included under "Other Income" in the Income Statement.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed by adjusting the impairment provision account. The amount of the reversal is recognised in the Income Statement.

### 4.14.2 Non Financial Assets

Tangible and intangible assets (excluding deferred tax assets which are explained in Note 4.27.2) are written down to recoverable amount where their carrying value exceeds recoverable amounts.

The carrying values of property, plant and equipment are reviewed for impairment annually or when events or changes in circumstances indicate that the carrying value may not be recoverable. If such indications exist and where the carrying values exceed the estimated recoverable amount, the assets are written down to their recoverable amount. Impairment losses are recognised in the Income Statement unless it reverses a previous revaluation surplus for the same asset.

Assets with an indefinite useful life, including goodwill, are not subject to amortisation and are tested on an annual basis for impairment and additionally whenever an indication of impairment exists. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

The recoverable amount of an asset is the higher of its fair value less costs to sell or its value in use. Any decrease in the carrying value is recognised as an expense in the Income Statement in the reporting period in which the impairment loss occurs.

For assets that do not generate largely independent cash inflows, the recoverable amount is determined for the cash generating unit to which that asset belongs. Management judgement is applied to establish cash generating units. Each of these cash generating units is represented by an individual primary reporting segment, or a subdivision of a primary segment.

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 balance sheet 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 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.

## LIABILITIES AND PROVISIONS

### 4.15 Deposits from Customers

Deposits include non interest bearing deposits, savings deposits, term deposits, deposits redeemable at call and certificates of deposit. They are brought to account at the gross value of the outstanding balance. Interest paid is charged to the Income Statement.

### 4.16 Deposit Insurance Scheme

In terms of the Banking Act Direction No 5 of 2010 "Insurance of Deposit Liabilities" issued on 27th September 2010 all Licensed Commercial Banks are required to insure their deposit liabilities in the Deposit Insurance Scheme operated by the Monetary Board in terms of Sri Lanka Deposit Insurance Scheme Regulations No 1 of 2010 issued under Sections 32A to 32E of the Monetary Law Act with effect from 1st October 2010. Deposits to be insured include demand, time and savings deposit liabilities and exclude the following.

- deposit liabilities to member institutions
- deposit liabilities to Government of Sri Lanka
- deposit liabilities to shareholders, directors, key management personnel and other related parties as defined in Banking Act Direction No 11 of 2007 on Corporate Governance of Licensed Commercial Banks
- deposit liabilities held as collateral against any accommodation granted
- deposit liabilities falling within the meaning of abandoned property in terms of the Banking Act and dormant deposits in terms of the Finance Companies Act funds of which have been transferred to Central Bank of Sri Lanka

Banks are required to pay a premium of 0.10% on eligible deposit liabilities if the bank maintains a capital adequacy ratio of 14% or above as at the end of the immediately preceding financial year and a premium of 0.125% on eligible deposit liabilities for all other Licensed Commercial Banks calculated on the total amount of eligible deposits as at the end of the quarter to be payable within a period of 15 days from the end of the quarter.

### 4.17 Dividends Payable

Provision for dividends is recognised at the time the dividend recommended and declared by the Board of Directors is approved by the Shareholders.

### 4.18 Borrowings

Borrowings include refinance borrowings, call and time deposits, vostro balances and borrowings from financial institutions. They are brought to account at the gross value of the outstanding balance.

### 4.19 Securities Sold under Re-purchase Agreement

Securities sold under agreements to re-purchase are recorded separately in the Financial Statements. The difference between the sale and the re-purchase price represents interest expense, which is recognised in the Income Statement over the period of the re-purchase agreement.

### 4.20 Bills Payable and Other Liabilities

Bills payable and other liabilities include all financial liabilities, interest, fees, expenses payable and securities purchased but not delivered. These liabilities are recorded at the cash value to be realised when settled.

### 4.21 Employee Retirement Benefits

#### 4.21.1 Defined Benefit Plan

A defined benefit plan is a post employment benefit plan other than a defined contribution plan.

#### 4.21.1 (a) Pension Fund

The Bank operates an approved Pension Fund to facilitate the following payments for permanent staff of the Bank:

- a) Pensions to retiring staff
- b) Benefits to staff who opted for the optional scheme for pension introduced in 2005
- c) Gratuity  
The gratuity would include both gratuity payments to pensionable staff who have not opted for optional scheme for pension introduced in 2005 in the event such staff member leaving before the age of 55 and satisfy the criteria as per Gratuity Act and gratuity payments for non pensionable staff who have satisfied the criteria as per Gratuity Act.

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. 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 which is the method recommended by Sri Lanka Accounting Standard 16 (Revised 2006) "Employee Benefits" (SLAS 16).

When the benefits of a plan are improved, the portion of the increased benefit relating to past service by employees is recognised in the Income Statement on a straight line basis over the average period until the benefits become vested. To the extent that the benefits vest immediately, the expense is recognised immediately in Income Statement.

## NOTES TO THE FINANCIAL STATEMENTS

In respect of actuarial gains and losses that arise in calculating the Bank's obligation in respect of a plan, to the extent that any cumulative unrecognised actuarial gain or loss exceeds 10% of the greater of the present value of the defined benefit obligation and the fair value of plan assets, that portion is recognised in Income Statement over the expected average remaining working lives of the employees participating in the plan. Otherwise, the actuarial gain or loss is not recognised.

Monthly provision is made by the Bank to the Pension Fund, based on a percentage of the gross salary of employees. The percentage of contributions are determined by the same actuary and retirement benefits are provided to all permanent staff. The Bank carries out an actuarial valuation of the Pension Fund in December each year to ascertain the full liability of the fund. The valuation method used by the actuary to value the fund is the Projected Unit Credit method, the method recommended by SLAS 16.

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 Subsidiaries do not operate pension funds.

### **Transitional provisions applied on first time adopting of Sri Lanka Accounting Standard 16 - (Revised 2006) "Employee Benefits" on 1st January 2008**

On first adopting the standard, the Bank determined its transitional liability for defined benefit plans as at 1st January 2008. As the transitional liability was more than the liability that would have been recognised on 1st January 2008 under the entity's previous accounting policy, the Bank made an irrevocable choice to recognise that increase in its defined benefit liability, as an expense on a straight line basis over a period of five years from 1st January 2008.

#### **4.21.1 (b) 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.

The actuarial valuation of the Widows, Widowers' and Orphans' Pension Scheme is carried out by the same actuary who carried out the actuarial valuation of the Pension Fund using the same method and same assumptions detailed in Note 4.21.1 (a) above.

#### **4.21.1 (c) Majan Exchange LLC**

The Company's obligation in respect of non-Omani terminal benefits which is an unfunded defined benefit retirement plan, is made in accordance with Omani Labour Laws and is calculated by estimating the amount of future benefit that such employees have earned in return for their service in the

current and prior periods. The obligation is calculated using the Projected Unit Credit method and is discounted to its present value.

#### **4.21.2 Defined Contribution Plans**

A defined contribution plan is a post employment plan under which an entity pays fixed contributions into a separate entity and will have no legal or constructive obligation to pay a further amount. Obligations for contributions to defined contribution plans are recognised as expense in the Income Statement as and when they are due.

##### **4.21.2 (a) Employees' Provident Fund**

The Bank and employees contribute 12% and 8% respectively on the salary of each employee to the approved private Provident Fund while the Group entities and their employees contribute the same percentages to Employees' Provident Fund.

##### **4.21.2 (b) Employees' Trust Fund**

The Bank / Group contributes 3% of the salary of each employee to the Employees' Trust Fund.

##### **4.21.2 (c) Majan Exchange LLC**

In respect of Majan Exchange LLC, contributions to a defined contribution retirement plan for Omani employees in accordance with the Omani Social Insurance Scheme are recognised as expense in the Income Statement as and when they are due.

#### **4.21.3 Gratuities**

No 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 gratuity of all permanent employees through its own non-contributory pension scheme which is in force.

Based on the Sri Lanka Accounting Standard 16 (Revised 2006) – "Employee Benefits" which became effective from financial years commencing after 1st July 2007, the Subsidiaries other than HNB Assurance PLC have adopted the Gratuity Formula method while HNB Assurance PLC continues to apply Actuarial Valuation method. Accordingly provisions have been made based on the above methods.

The gratuity liabilities are not externally funded.

#### **4.21.4 Employee Share Ownership Plan**

The Employee Share Ownership Plan introduced in 2005 offered shares to executive and high rank officers of the Bank. The shares allotted to the respective employee under the plan would remain within the plan while the beneficial interest will be with the employee. At the time the employee leaves the

Bank the difference between the issue price and the market price is paid to the employee. Therefore the said Employee Share Ownership Plan has no potential dilutive effect on the earnings per share of the Bank.

#### 4.21.5 Employee Share Option Plan

At the Annual General Meeting held on 28th March 2008 a resolution was passed to formulate an Employee Share Option Plan (ESOP) apart from the Employee Share Ownership Plan enabling the staff in the management rank and above of the Bank to take part in the voting and non voting ordinary shares of the Bank. The total number of share options available to the eligible employees per year will be 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 will accrue to eligible employees of the Bank in any particular year only if the conditions set out in the ESOP are met.

An eligible employee will qualify to receive share options in a particular year by achieving a positive performance rating in the annual performance assessment. The amount of share options to be granted to each qualified eligible employee will depend on his / her seniority in the Bank. This employee share option plan has potential dilutive effect on the earnings per share of the Bank.

Details of share options are given in Note 46 (a) and (b).

#### 4.22 Provisions

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

A provision for onerous contracts is recognised when the expected benefits to be derived by the Group from a contract are lower than the unavoidable cost of meeting its obligations under the contract. The provision is measured at the present value of the lower of the expected cost of terminating the contract and the expected net cost of continuing with the contract. Before a provision is established, the Group recognises any impairment loss on the assets associated with that contract.

Provisions for non performing loans and advances are made as set out in Note 4.8.3.

#### 4.23 Operational Risk Events

Provisions for operational risk events are recognised for losses incurred by the Bank which do not relate directly to amounts of principal outstanding for loans and advances.

The amount recognised as a provision is the best estimate of the expenditure required to settle the present obligation as at the Balance Sheet date, taking into account the risks and uncertainties that surround the events and circumstances that affect the provision.

#### 4.24 Commitments and Contingencies

All discernible risks are accounted for in determining the amount of all known liabilities. The Bank's share of any contingencies and capital commitments of a Subsidiary, Associate or Joint Venture for which the Bank is also liable severally or otherwise are also included with appropriate disclosures.

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 Balance Sheet but are disclosed unless they are remote.

#### 4.25 Income Recognition

##### 4.25.1 Interest

Interest receivable is recognised on an accrual basis. Interest from loans and advances ceases to be accrued when they are classified as non performing as explained in Note 4.8.4. Interest on non performing loans and advances is accounted for on a cash basis. Interest on non performing loans and advances is credited to the "Interest in Suspense Account" which is netted in the Balance Sheet against the relevant loans and advances.

Interest income from investments is recognised on an accrual basis.

##### 4.25.2 Dividend Income

Dividend income is recognised in the Income Statement on an accrual basis when the Bank's right to receive the dividend is established.

##### 4.25.3 Lease Income

The excess of aggregate lease rentals receivable over the cost of the leased assets constitutes the total unearned lease income at the commencement of a lease. The unearned lease income is taken into income over the term of the lease commencing with the month in which the lease is executed in proportion to the declining receivable balance.

Gross earnings under finance leases in respect of lease rentals due, cease to be taken to revenue when they are in arrears for ninety days. Thereafter, such income is recognised on a cash basis.

## NOTES TO THE FINANCIAL STATEMENTS

### 4.25.4 Discount on Bills of Exchange

Income on discounting bills of exchange is recognised proportionately over the period of the instrument.

### 4.25.5 Trading Income

Gains or losses arising from the sale of investment securities, dealing securities, shares and units are accounted for on the date of transaction in the Income Statement.

### 4.25.6 Fee and Commission Income

Fees and commission income, including account servicing fees, investment management fees, sales commission, placement fees and syndication fees are recognised as the related services are performed.

### 4.25.7 Profit / Loss from Sale of Property, Plant and Equipment

Profit / loss from sale of property, plant and equipment is recognised in the period in which the sale occurs and is classified as other income.

### 4.25.8 Profit / Loss from Sale of Investment Properties

Any gains or losses on retirement or disposal of investment properties are recognised in the month of retirement or disposal.

### 4.25.9 Rental Income

Rental income is recognised on an accrual basis.

## 4.26 Expenses

### 4.26.1 Interest Expenses and Other Expenses

Interest payable and other expenses are recognised on an accrual basis.

### 4.26.2 Lease Payments

Payments made under operating leases are recognised in the Income Statement on a straight line basis over the term of the lease.

The future monthly commitments on operating leases are shown in Note 47 (b).

Minimum lease payments made under finance leases are apportioned between the finance expense and the reduction of the outstanding liability. The finance expense is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability. Contingent lease payments are accounted for by revising the minimum lease payments over the remaining term of the lease when the lease adjustment is confirmed.

### 4.26.3 Fee and Commission Expenses

Fee and commission expenses are recognised on an accrual basis.

## 4.27 Income Tax Expense

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

### 4.27.1 Current Tax

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

Provision for taxation is based on the profit for the year 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 in Note 20.

### 4.27.2 Deferred Tax

Deferred taxation is provided using the liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the tax base of assets and liabilities, which is the amount attributed to those assets and liabilities for tax purposes. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted by the reporting date.

Deferred tax liabilities are not recognised for the following temporary differences: the initial recognition of goodwill, the initial recognition of assets and liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit and differences relating to investments in Subsidiaries to the extent that they probably will not reverse in the foreseeable future.

Deferred tax assets, including those related to temporary tax effects of income tax losses and credits available to be carried forward, are recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

### 4.27.3 Offsetting

Current and deferred tax assets and liabilities are offset only to the extent that they relates to income taxes imposed by the same taxation authority, there is a legal right and intentions to settle on a net basis and it is allowed under the tax law of the relevant jurisdiction.

#### 4.27.4 Withholding Tax on Dividends

Dividend distributed out of taxable profit of the local Subsidiaries attracts a 10% deduction at source and is not available for set off against the tax liability of the Bank. Thus, the withholding tax deducted at source is added to the tax expense of the Subsidiaries in the Consolidated Financial Statements as a consolidation adjustment.

Withholding tax that arise from the distribution of dividends by the Bank are recognised at the same time as the liability to pay the related dividend is recognised.

#### 4.27.5 Value Added Tax on Financial Services

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

#### 4.28 Earnings per Share

The Group presents Basic and Diluted Earnings per Share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the Bank by the weighted average number of ordinary shares outstanding during the period. 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.

#### 4.29 Segment Reporting

A segment is a distinguishable component of the Group that is engaged either in providing related products or services (business segment), or in providing products and services within a particular economic environment (geographical segment), which is subject to risks and returns different from those of other business segments. For the purposes of segment reporting disclosures, the information is presented in respect of the Group's business segments, which is based on the Group's management and internal reporting structure. The Group comprises the following major business segments; banking, leasing, dealing, property and insurance.

Inter-segment pricing is determined on an arms length basis.

Measurement of segment assets, liabilities, segment revenue and results is based on the accounting policies set out above. Segment revenue results, assets and liabilities include items directly attributable to segments as well as those that can be allocated on a reasonable basis.

#### 4.30 Cash Flow Statement

The Cash Flow Statement has been prepared using the "Direct Method" of preparing Cash Flows in accordance with the Sri Lanka Accounting Standard 9 "Cash Flow Statements". Cash and

cash equivalents comprise short term, highly liquid investments that are readily convertible to known amounts of cash and are subject to an insignificant risk of changes in value. The cash and cash equivalent include cash in hand, balances with banks, placements with banks, money at call and short notice.

### PRESENTATION

#### 4.31 Offsetting Income and Expenses

Income and expenses are not offset unless required or permitted by accounting standards.

#### 4.32 Offsetting Assets and Liabilities

Assets and liabilities are offset and the net amount reported in the Balance Sheet only where there is :

- a current enforceable legal right to offset the asset and liability; and
- an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously.

### 5. SIGNIFICANT ACCOUNTING POLICIES THAT ARE SPECIFIC TO THE BUSINESS OF THE SUBSIDIARY – HNB ASSURANCE PLC

#### 5.1 General Insurance Business

##### 5.1.1 Gross Written Premium

Gross written premium is generally recognised as written upon inception of the policy. Upon inception of the contract, premiums are recorded as written and are earned primarily on a pro-rata basis over the term of the related policy coverage. However, for those contracts for which the period of risk differs significantly from the contract period, premiums are earned over the period of risk in proportion to the amount of insurance protection provided.

##### 5.1.2 Reinsurance Premium

Premiums ceded to reinsurers are recognised as an expense in accordance with the pattern of reinsurance services received. Reinsurance premiums are decided based on rates agreed with reinsurers.

##### 5.1.3 Unearned Premium

The unearned premium reserve represents the portion of the premiums net of outward reinsurance premiums written in the current year in respect of risks related to subsequent periods. Unearned premiums are calculated on the 1/24th basis in accordance with the Regulation of Insurance Industry Act No 43 of 2000.

##### 5.1.4 Unexpired Risk

Provision is made where appropriate for the estimated amount required over and above unearned premiums to meet future claims and related expenses on the business in force as at end of the year.



### 5.1.5 Title Insurance Reserve

Title insurance reserve is maintained by the Company 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 recognized in first three years of the policy given the high probability for claims according to the nature of the business. From the 4th year onwards, profit recognition is started by amortising the premium received and will be distributed throughout the balance loan period using the straight line method. Profit up to the 3rd year will be recognized in the 4th year.

### 5.1.6 Net Deferred Acquisition Expenses

Acquisition expenses, representing commissions, which vary with and 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.

### 5.1.7 Claims

Claims include provisions for the estimated cost of claims and related handling expenses in respect of Incidents up to the year end, including those which have not been notified, net of salvage, anticipated reinsurance and other recoveries. 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) is 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 semi-annual basis.

Whilst the directors consider that the provision 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 that period. The methods used and the estimates made are reviewed regularly.

## 5.2 Life Insurance Business

### 5.2.1 Gross Written Premium

Premium from traditional life insurance contracts, including participating contracts and annuity policies with life contingencies, are recognised as revenue when cash is received from the policyholder. Benefits and expenses are provided against such revenue to recognise profits over the estimated life of the policies.

### 5.2.2 Reinsurance Premium

Outward reinsurance premiums are recognised when payable. Reinsurance recoveries are credited to match the relevant gross claims.

### 5.2.3 Benefits, Losses and Expenses

Expenses on the life insurance revenue account relate to the acquisition and maintenance of life insurance business and include investment expenses not treated as a part of the capital

cost of investment. Claims by death and maturity are charged against revenue on notification of death or on expiry of the term. The interim payments and surrenders are accounted for only at the time of settlement.

### 5.2.4 Actuarial Valuation for Long Term Insurance Provision

The directors agree to the long term insurance provision for the company at the year end on the recommendations of the independent consultant actuary following his annual investigation of the life insurance business. The actuarial valuation takes into account all liabilities and is based on assumptions recommended by the independent consultant actuary.

## 6. COMPARATIVE INFORMATION

The comparative information is re-classified wherever necessary to conform with the current year's presentation in order to provide a better presentation. The details of such re-classifications have been provided in Note 50.

## 7 DIRECTIONS ISSUED BUT NOT EFFECTIVE / APPLIED AS AT BALANCE SHEET DATE

The Central Bank of Sri Lanka issued Banking Act Direction No 9 of 2008 on 30th December 2008 on "Amendments to Directions on Classification of Loans Income Recognition and Provisioning". The following section of the direction has not become effective as at balance sheet date, hence not applied by the Bank in preparing these Financial Statements.

### 7.1 Classification of NPA Based on Aggregated Exposure

According to Section 1 of the above Direction, with effect from 1st January 2011 all credit facilities extended to a borrower should be classified as NPA when one or more of the credit facilities has / have been classified as NPA and if the aggregate amount of the outstanding of such NPA (excluding interest in suspense) exceeds 30% of the total credit facilities extended to such borrower (excluding interest in suspense).

## 8 NEW ACCOUNTING STANDARDS ISSUED BUT NOT EFFECTIVE AS AT BALANCE SHEET DATE

The Institute of Chartered Accountants of Sri Lanka has issued a new volume of Sri Lanka Accounting Standards which will become applicable for financial periods beginning on or after 1st January 2012. Accordingly, these Standards have not been applied in preparing these financial statements as they were not effective for the year ended 31st December 2010.

These Sri Lanka Accounting Standards comprise Accounting Standards prefixed both SLFRS (corresponding to IFRS) and LKAS (corresponding to IAS). Application of Sri Lanka Accounting Standards prefixed SLFRS and LKAS for the first time shall be deemed to be an adoption of SLFRSs.

The Bank is currently in the process of evaluating the potential effects of these Standards on its financial statements and the impact on the adoption of these Standards have not been quantified as at Balance Sheet date.

| For the year ended 31st December    | Bank              |                   | Group             |                   |
|-------------------------------------|-------------------|-------------------|-------------------|-------------------|
|                                     | 2010<br>Rs 000    | 2009<br>Rs 000    | 2010<br>Rs 000    | 2009<br>Rs 000    |
| <b>9 INCOME</b>                     |                   |                   |                   |                   |
| Interest income (Note 10)           | 30,249,230        | 34,620,276        | 30,563,795        | 34,836,422        |
| Foreign exchange profit             | 1,015,987         | 903,210           | 1,014,208         | 903,381           |
| Fee and commission income (Note 12) | 2,809,330         | 2,331,278         | 3,115,443         | 2,377,510         |
| Dividend income (Note 13)           | 209,762           | 217,353           | 199,012           | 195,879           |
| Other income (Note 14)              | 1,297,312         | 1,285,746         | 3,212,207         | 2,987,581         |
|                                     | <b>35,581,621</b> | <b>39,357,863</b> | <b>38,104,665</b> | <b>41,300,773</b> |

|                                 |                   |                   |                   |                   |
|---------------------------------|-------------------|-------------------|-------------------|-------------------|
| <b>10 INTEREST INCOME</b>       |                   |                   |                   |                   |
| Loans and advances to customers | 23,535,452        | 28,348,045        | 23,267,708        | 28,010,206        |
| Government securities           | 5,605,876         | 4,982,682         | 6,062,711         | 5,447,232         |
| Placements with banks           | 607,443           | 865,307           | 664,115           | 914,401           |
| Other interest income           | 500,459           | 424,242           | 569,261           | 464,583           |
|                                 | <b>30,249,230</b> | <b>34,620,276</b> | <b>30,563,795</b> | <b>34,836,422</b> |

#### Notional 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 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 434.17 Mn (2009 - Rs 332.07 Mn) for Bank and Rs 471.56 Mn (2009 - Rs 370.73 Mn) for Group.

| For the year ended 31st December | Bank              |                   | Group             |                   |
|----------------------------------|-------------------|-------------------|-------------------|-------------------|
|                                  | 2010<br>Rs 000    | 2009<br>Rs 000    | 2010<br>Rs 000    | 2009<br>Rs 000    |
| <b>11 INTEREST EXPENSES</b>      |                   |                   |                   |                   |
| Deposits from customers          | 12,780,463        | 17,499,991        | 12,773,745        | 17,492,541        |
| Short term borrowings            | 878,574           | 1,304,101         | 962,370           | 1,384,230         |
| Refinance borrowings             | 457,899           | 544,189           | 457,899           | 544,188           |
| Subordinated debentures          | 361,959           | 387,455           | 358,815           | 555,069           |
| Other interest expenses          | 224,361           | 303,910           | 224,326           | 304,920           |
|                                  | <b>14,703,256</b> | <b>20,039,646</b> | <b>14,777,155</b> | <b>20,280,948</b> |

|                                     |                  |                  |                  |                  |
|-------------------------------------|------------------|------------------|------------------|------------------|
| <b>12 FEE AND COMMISSION INCOME</b> |                  |                  |                  |                  |
| Fee income                          | 5,907            | 7,367            | 14,998           | 22,938           |
| Commission income                   | 2,803,423        | 2,323,911        | 3,100,445        | 2,354,572        |
|                                     | <b>2,809,330</b> | <b>2,331,278</b> | <b>3,115,443</b> | <b>2,377,510</b> |

|                                  |                |                |                |                |
|----------------------------------|----------------|----------------|----------------|----------------|
| <b>13 DIVIDEND INCOME</b>        |                |                |                |                |
| Dealing securities               | 1,208          | -              | 3,600          | 323            |
| Investment securities - quoted   | 145,634        | 117,991        | 140,595        | 92,644         |
| Investment securities - unquoted | 62,920         | 99,362         | 54,817         | 102,912        |
|                                  | <b>209,762</b> | <b>217,353</b> | <b>199,012</b> | <b>195,879</b> |

## NOTES TO THE FINANCIAL STATEMENTS

| For the year ended 31st December   | Bank             |                  | Group            |                  |
|--|------------------|------------------|------------------|------------------|
|  | 2010<br>Rs 000   | 2009<br>Rs 000   | 2010<br>Rs 000   | 2009<br>Rs 000   |
| <b>14 OTHER INCOME</b>   |                  |                  |                  |                  |
| Capital gain from sale of dealing securities   | 18,462           | 9,197            | 56,847           | 9,197            |
| Capital gain from sale of investment securities<br>(disposal through dealing securities) [Note 29 (b)] | 497,114          | -                | 497,114          | -                |
| Capital gain from sale of Government securities  | 6,089            | 2,590            | 37,754           | 15,460           |
| Capital gain from sale of Subsidiaries   | -                | -                | -                | 67,659           |
| Capital gain from sale of Associate company [Note 30 (a) i]  | 47,581           | -                | 23,791           | -                |
| Capital gain from sale of investment securities [Note 29 (d)]  | 101,710          | -                | 63,186           | -                |
| Gain on marked to market valuation of dealing securities   | 90,053           | 17,451           | 90,053           | 25,696           |
| Rent received  | 8,439            | 5,026            | 91,237           | 89,336           |
| Rent received from investment properties   | 41,951           | 39,412           | 40,079           | 37,881           |
| Auditorium hire income   | 3,420            | 2,133            | 3,420            | 2,133            |
| Profit from sale of property, plant and equipment  | 4,674            | 11,917           | 5,691            | 13,157           |
| Profit from sale of gold   | 24,351           | 26,503           | 24,351           | 26,503           |
| Recovery of bad debts [Note 26 (a), 27 (c) and 28 (a)] *   | 421,433          | 736,571          | 421,433          | 736,571          |
| Recovery of loans written off in prior years   | 6,549            | 7,283            | 6,549            | 7,283            |
| Recovery of investment in Aquila fund provided for in prior years                                      | -                | 216,674          | -                | 216,674          |
| Recovery of VAT written off in prior year  | -                | 200,309          | -                | 200,309          |
| Recovery of operational losses provided for in prior year  | 7,024            | -                | 7,024            | -                |
| Insurance premium income   | -                | -                | 1,813,089        | 1,524,635        |
| Miscellaneous  | 18,462           | 10,680           | 30,589           | 15,087           |
|  | <b>1,297,312</b> | <b>1,285,746</b> | <b>3,212,207</b> | <b>2,987,581</b> |

\* Bad debts recovered in 2009 includes the write back of provision made against Kabool Lanka (Pvt) Ltd's loan exposure as explained in Note 28 (j).

### 15 OPERATING EXPENSES

Operating expenses, among others, include the following:

|   |         |         |         |         |
|---|---------|---------|---------|---------|
| Legal expenses and professional fees                                      | 81,061  | 77,585  | 86,884  | 85,050  |
| Depreciation of investment property (Note 33)                             | 4,444   | 4,380   | 4,456   | 4,421   |
| Depreciation of property, plant and equipment (Note 34)                   | 657,360 | 579,993 | 806,143 | 722,872 |
| Amortisation of intangible assets (Note 35)                               | 168,761 | 166,636 | 179,997 | 175,765 |
| Provision for operational risk event losses                               | 43,169  | 60,083  | 43,189  | 60,083  |
| Provision for receivable from Commercial Interlink Services Inc (Note 36) | 18,885  | -       | -       | -       |
| Property, plant and equipment written off (Note 34)                       | 20,717  | -       | 21,702  | -       |
| Directors' emoluments   | 81,979  | 55,993  | 98,087  | 67,657  |
| Auditors' remuneration [Note 15 (a)]                                      | 11,960  | 7,976   | 15,775  | 10,893  |
| Advertising and related expenses  | 256,904 | 210,900 | 308,287 | 213,710 |
| Donations   | 20,303  | 29,184  | 20,661  | 29,542  |
| Direct operating expenses on investment property                          | 4,363   | 2,361   | 1,556   | 696     |
| Share issue expenses  | 2,542   | 233     | 2,542   | 233     |
| Impairment loss on inventory - residential apartment complex (Note 36)    | -       | -       | 8,367   | 6,813   |

#### 15 (a) Auditors' Remuneration

|   |               |              |               |               |
|---|---------------|--------------|---------------|---------------|
| Audit fees and expenses                 | 6,605         | 5,817        | 9,308         | 8,253         |
| Audit related fee and expenses          | 2,061         | 1,584        | 2,709         | 1,855         |
| Non-audit services                      | 3,294         | 575          | 3,294         | 575           |
| Audit fee and expenses - Other auditors | -             | -            | 464           | 210           |
|   | <b>11,960</b> | <b>7,976</b> | <b>15,775</b> | <b>10,893</b> |

### 16 PERSONNEL EXPENSES

In addition to salaries, personnel expenses include the following :

|   |         |         |         |         |
|---|---------|---------|---------|---------|
| Contribution to Employees' Provident Fund | 339,475 | 299,570 | 365,227 | 319,533 |
| Contribution to Employees' Trust Fund     | 84,869  | 74,885  | 91,249  | 79,767  |

Provision for employee retirement benefits is shown separately in Note 17.

| For the year ended 31st December                            | Bank           |                | Group          |                |
|---|----------------|----------------|----------------|----------------|
|   | 2010<br>Rs 000 | 2009<br>Rs 000 | 2010<br>Rs 000 | 2009<br>Rs 000 |
| <b>17 PROVISION FOR EMPLOYEE RETIREMENT BENEFITS</b>        |                |                |                |                |
| Current service cost  | 392,326        | 315,365        | 392,326        | 315,365        |
| Interest on obligation                                      | 727,413        | 747,129        | 727,413        | 747,129        |
| Expected return on plan assets                              | (520,399)      | (567,601)      | (520,399)      | (567,601)      |
| Amortisation of actuarial losses and transitional liability | 283,475        | 320,789        | 283,475        | 320,789        |
| Provision made for gratuities                               | -              | -              | 10,927         | 7,683          |
|   | <b>882,815</b> | <b>815,682</b> | <b>893,742</b> | <b>823,365</b> |

On first time adoption of Sri Lanka Accounting Standard 16 (Revised 2006) "Employee Benefits" (SLAS 16), the transitional liability of the Bank as at 1st January 2008 was Rs 1,417.37 Mn. According to the transitional provisions provided in SLAS 16, the said deficit is being amortised on a straight line basis over a period of 5 years, beginning from 2008. The annual charge is Rs 283.47 Mn.

The Subsidiaries did not have transitional liabilities as at 1st January 2008.

| For the year ended 31st December  | Bank           |                | Group          |                |
|---|----------------|----------------|----------------|----------------|
|   | 2010<br>Rs 000 | 2009<br>Rs 000 | 2010<br>Rs 000 | 2009<br>Rs 000 |
| <b>18 PROVISION FOR LOAN LOSSES</b>   |                |                |                |                |
| Specific provision for loans and advances*  | 296,308        | 665,845        | 296,308        | 665,845        |
| General provision for pawning advances  | 6,050          | 785            | 6,050          | 785            |
| General provision for housing advances  | 1,146          | (891)          | 1,146          | (891)          |
| Additional general provision for performing and overdue / special mention loans and advances to fulfill statutory requirement | 41,313         | 37,798         | 41,313         | 37,798         |
| Total provision for loans and advances [Note 28 (a)]  | 344,817        | 703,537        | 344,817        | 703,537        |
| Specific provision for bills of exchange [Note 26 (a)]  | -              | 4,270          | -              | 4,270          |
| General provision reversal for bills of exchange [Note 26 (a)]  | (1,784)        | (7,136)        | (1,784)        | (7,136)        |
| Specific provision for leases [Note 27 (c)]   | 46,376         | 59,702         | 46,376         | 59,702         |
| General provision charge / (reversal) for leases [Note 27 (c)]  | 91,900         | (52,146)       | 91,900         | (52,146)       |
| <b>Total provision made during the year</b>   | <b>481,309</b> | <b>708,227</b> | <b>481,309</b> | <b>708,227</b> |

\*Specific provisions against pawning and housing advances are included in specific provision for loans and advances.

## 19 SHARE OF PROFIT/(LOSS) OF ASSOCIATES (NET OF INCOME TAX)

|  |  |                |              |
|--|--|----------------|--------------|
| Share of profit of Associates before income tax                |  | 1,959          | 11,392       |
| Income tax expense on share of profit of Associates            |  | (4,388)        | (3,712)      |
| <b>Share of profit / (loss) of Associates after income tax</b> |  | <b>(2,429)</b> | <b>7,680</b> |

## 20 INCOME TAX EXPENSE

Recognised in the Income Statement

### 20 (a) Current Tax Expense

|   |                  |                  |                  |                  |
|---|------------------|------------------|------------------|------------------|
| Current tax on profits for the year [Note 20 (e)] | 2,555,321        | 1,791,919        | 2,660,366        | 1,838,850        |
| Over provision in the prior years reversed        | (102,377)        | (295,713)        | (109,388)        | (295,713)        |
| Under provision in the prior years charged        | -                | -                | -                | 3,029            |
|   | <b>2,452,944</b> | <b>1,496,206</b> | <b>2,550,978</b> | <b>1,546,166</b> |

### 20 (b) Deferred Tax Expense

|   |                  |                  |                  |                  |
|---|------------------|------------------|------------------|------------------|
| Adjustment to opening balance [Note 43 (b)]   | -                | -                | 156              | -                |
| Adjustment to opening deferred tax asset / liability resulting from change in tax rate [Note 43 (a), (b) and (c)] | (172,191)        | -                | (172,045)        | -                |
| Deferred tax asset recognised / (reversed) during the year [Note 43 (b)]  | (132,037)        | 3,189            | (132,908)        | 1,414            |
| Charge to deferred tax liability [Note 43 (a)]  | 118,768          | 66,472           | 118,658          | 65,884           |
|   | <b>(185,460)</b> | <b>69,661</b>    | <b>(186,139)</b> | <b>67,298</b>    |
| <b>Total income tax expense</b>   | <b>2,267,484</b> | <b>1,565,867</b> | <b>2,364,839</b> | <b>1,613,464</b> |

## NOTES TO THE FINANCIAL STATEMENTS

### 20 INCOME TAX EXPENSE (Contd.)

| For the year ended 31st December                      | Group          |                |
|---|----------------|----------------|
|   | 2010<br>Rs 000 | 2009<br>Rs 000 |
| <b>20 (c) Current Tax on Profits of Subsidiaries</b>  |                |                |
| HNB Assurance PLC                                     | 28,208         | 29,473         |
| <b>20 (d) Current Tax on Profits of Joint Venture</b> |                |                |
| Acuity Partners (Pvt) Ltd and Subsidiaries            | 76,837         | 17,458         |
| <b>Total</b>  | <b>105,045</b> | <b>46,931</b>  |

| For the year ended 31st December                                     | Bank           |                | Group          |                |
|--|----------------|----------------|----------------|----------------|
|  | 2010<br>Rs 000 | 2009<br>Rs 000 | 2010<br>Rs 000 | 2009<br>Rs 000 |
| <b>20 (e) Reconciliation of Accounting Profit and Taxable Income</b> |                |                |                |                |
| Profit before taxation   | 6,731,451      | 5,917,519      | 7,251,667      | 6,166,824      |
| Disallowable expenses  | 10,912,338     | 9,539,995      | 11,121,842     | 9,678,027      |
| Allowable expenses   | (5,927,023)    | (5,079,875)    | (5,971,227)    | (5,120,266)    |
| Tax exempt income  | (4,304,389)    | (3,658,607)    | (4,620,965)    | (3,807,637)    |
| Tax losses utilised [Note 20 (f)]                                    | -              | (1,459,754)    | (43,638)       | (1,505,102)    |
| Tax loss incurred during the year                                    | -              | -              | (19,920)       | (21,305)       |
| Taxable income   | 7,412,377      | 5,259,278      | 7,717,759      | 5,390,541      |
| Of which,  |                |                |                |                |
| Taxable income at 35%  | 6,887,878      | 4,757,227      | 7,170,775      | 4,888,490      |
| Taxable income at 20%  | 524,499        | 502,051        | 546,984        | 502,051        |
|  | 7,412,377      | 5,259,278      | 7,717,759      | 5,390,541      |

Income tax provision for the year is made up of the following:

|   |                  |                  |                  |                  |
|---|------------------|------------------|------------------|------------------|
| Income tax at 35%   | 2,410,757        | 1,665,027        | 2,509,771        | 1,710,972        |
| Income tax at 20%   | 104,900          | 100,410          | 109,397          | 100,410          |
|   | 2,515,657        | 1,765,437        | 2,619,168        | 1,811,382        |
| Social Responsibility Levy at 1.5% on current year's income tax liability | 37,735           | 26,482           | 39,269           | 27,468           |
| Social Responsibility Levy on dividend paid during the year               | 1,929            | -                | 1,929            | -                |
| <b>Current tax on profits for the year</b>                                | <b>2,555,321</b> | <b>1,791,919</b> | <b>2,660,366</b> | <b>1,838,850</b> |
| Effective tax rate  | 37.96%           | 30.28%           | 36.69%           | 29.82%           |
| Effective tax rate of current tax expense [Note 20 (a)]                   | 36.44%           | 25.28%           | 35.18%           | 25.07%           |
| Effective tax rate of total income tax expense                            | 33.68%           | 26.46%           | 32.61%           | 26.16%           |

### 20 (f) Tax Losses Brought Forward and Utilised during the Year

|  |          |             |                |                |
|--|----------|-------------|----------------|----------------|
| Tax losses brought forward                         | -        | -           | 292,923        | 311,973        |
| Adjustments for brought forward tax losses         | -        | 1,459,754   | 4,654          | 1,464,747      |
| Loss incurred during the year                      | -        | -           | 19,920         | 21,305         |
| Tax losses utilised during the year [Note 20 (e)]  | -        | (1,459,754) | (43,638)       | (1,505,102)    |
| <b>Tax losses not utilised and carried forward</b> | <b>-</b> | <b>-</b>    | <b>273,859</b> | <b>292,923</b> |

### 20 (g) Hatton National Bank PLC

The Bank's Domestic Banking Unit (DBU) is liable for taxation on its income from banking operations at the rate of 35% for the year (2009 - 35%). The taxable income of on shore operations of the Foreign Currency Banking Unit (FCBU) is liable for taxation at the rate of 35% for the year (2009 - 35%). The taxable income from off shore operations of FCBU is liable for taxation at the rate of 20% for the year (2009 - 20%).

## 20 INCOME TAX EXPENSE (Contd.)

### 20 (h) HNB Assurance PLC

HNB Assurance PLC is liable for income tax at the rate of 35% (2009 - 35%) on its taxable income. Provision has been made in the Financial Statements accordingly.

### 20 (i) Sithma Development (Pvt) Ltd

In accordance with the BOI agreement dated 28th December 1994, the profits and income of Sithma Development (Pvt) Ltd are exempt from taxation until Year of Assessment 2014 / 15. After the expiration of the said tax exempt period, the following options are available for the company for another 15 years;

(a) Income tax payable for the Year of Assessment shall be computed at 2% of the turnover of the Company, or

(b) The provisions of the Inland Revenue laws for the time being in force shall apply to the Company.

In the event the company elects option (a), no deferred tax liability will arise even after the expiration of the tax exempt period. The company needs to make the election only 90 days prior to the expiration of the said tax exemption period, after evaluating all tax implications prevailing at that time. Therefore, no provision has been made in the Financial Statements by the company for deferred tax liability which could arise after the tax exempt period in the event the company elects option (b).

### 20 (j) Acuity Partners (Pvt) Ltd

Acuity Partners (Pvt) Ltd is liable for income tax at the rate of 35% (2009 - 35%) on its taxable income. Provision has been made in the Financial Statements accordingly. Subsidiaries of Acuity Partners (Pvt) Ltd other than Lanka Ventures PLC (20%) are liable for income tax at the rate of 35%.

## 21 EARNINGS PER SHARE

### 21 (a) Basic Earnings per Share

Basic Earnings per Share has been calculated by dividing the profit for the year attributable to equity holders of the Bank by the weighted average number of ordinary shares on issue (both voting and non-voting) during the year, as per the requirements of the Sri Lanka Accounting Standard 34 - "Earnings per Share".

### 21 (b) Diluted Earnings per Share

The calculation of Diluted Earnings per Share as at Balance Sheet date was based on the profit attributable to equity holders of the Bank by the weighted average number of ordinary shares outstanding during the year, after adjusting for the effects of all potentially dilutive weighted average number of ordinary shares that would be issued on the conversion of all the dilutive ESOPs into ordinary shares.

The details of the options exercised and expired under Employee Share Option Plan during the year are given in Note 46 (b).

| For the year ended 31st December  | Bank         |              | Group        |              |
|---|--------------|--------------|--------------|--------------|
|   | 2010         | 2009         | 2010         | 2009         |
| Profit attributable to equity holders of the Bank (Rs 000)  | 4,463,967    | 4,351,652    | 4,786,770    | 4,483,277    |
| Weighted average number of ordinary shares during the year used as the denominator ('000) for Basic EPS   | 236,952      | 235,560      | 236,952      | 235,560      |
| <b>Basic Earnings per Share (Rs)</b>  | <b>18.84</b> | <b>18.47</b> | <b>20.20</b> | <b>19.03</b> |
| Profit attributable to equity holders of the Bank (Rs 000)  | 4,463,967    | 4,351,652    | 4,786,770    | 4,483,277    |
| Weighted average number of ordinary shares during the year used as the denominator ('000) for Basic EPS   | 236,952      | 235,560      | 236,952      | 235,560      |
| Weighted average number of shares under option ('000)   | 3,309        | 2,695        | 3,309        | 2,695        |
| Weighted average number of ordinary shares that would have been issued at average market price ('000)     | (1,727)      | (2,538)      | (1,727)      | (2,538)      |
| Weighted average number of ordinary shares during the year used as the denominator ('000) for Diluted EPS | 238,534      | 235,717      | 238,534      | 235,717      |
| <b>Diluted Earnings per Share (Rs)</b>  | <b>18.71</b> | <b>18.46</b> | <b>20.07</b> | <b>19.02</b> |



## NOTES TO THE FINANCIAL STATEMENTS

| As at 31st December                                  | Bank              |                   | Group             |                   |
|--|-------------------|-------------------|-------------------|-------------------|
|  | 2010<br>Rs 000    | 2009<br>Rs 000    | 2010<br>Rs 000    | 2009<br>Rs 000    |
| <b>22 CASH AND CASH EQUIVALENTS</b>                  |                   |                   |                   |                   |
| Local currency in hand                               | 5,541,469         | 4,791,813         | 5,567,435         | 4,807,027         |
| Foreign currency in hand                             | 299,083           | 388,270           | 299,083           | 388,270           |
| Balances with local banks                            | 80,295            | 43,367            | 81,407            | 91,664            |
| Fixed deposits with other banks in local currency    | 2,000,000         | -                 | 2,382,943         | 276,000           |
| Balances / placements with banks in foreign currency | 7,571,480         | 9,703,739         | 7,662,330         | 9,810,177         |
| Money at call and short notice                       | 2,000,000         | 7,175,000         | 2,000,000         | 7,175,000         |
| Placements with banks by FCBU                        | 513,313           | 5,050,059         | 513,313           | 5,050,059         |
|  | <b>18,005,640</b> | <b>27,152,248</b> | <b>18,506,511</b> | <b>27,598,197</b> |

All cash and cash equivalent balances held by the Group entities were available for use by the Group.

### 23 STATUTORY DEPOSIT WITH CENTRAL BANKS

|  |                   |                   |                   |                   |
|--|-------------------|-------------------|-------------------|-------------------|
| Statutory deposit with Central Bank of Sri Lanka | 12,491,644        | 11,063,948        | 12,491,644        | 11,063,948        |
| Statutory deposit with Central Bank of Oman      | -                 | -                 | 14,408            | 14,857            |
|  | <b>12,491,644</b> | <b>11,063,948</b> | <b>12,506,052</b> | <b>11,078,805</b> |

As required by the provisions of Section 93 of the Monetary Law Act, a cash balance is maintained with the Central Bank of Sri Lanka as explained in Note 4.4. The minimum cash reserve requirement on Rupee deposit liabilities was 7% as at 31st December 2010 (2009 - 7%). There are no reserve requirement for deposit liabilities of the Foreign Currency Banking Unit and foreign currency deposits liabilities in the Domestic Banking Unit.

Majan Exchange LLC is required to maintain a deposit of Omani Riyal 50,000 with the Central Bank of Oman (CB Oman) in accordance with its licensing regulations for exchange houses issued by the CB Oman. Interest is earned at the rate of 2% per annum.

### 24 DEALING SECURITIES

#### 24 (a) Dealing Securities - Summary

| As at 31st December  | 2010<br>Cost / Market<br>Value<br>Rs 000 | 2009<br>Cost / Market<br>Value<br>Rs 000 |
|--|--|--|
| Quoted shares - Bank [Note 24 (b)]                                   | 576,280                                  | 39,485                                   |
| Government of Sri Lanka treasury bills - Bank [Note 24 (c)]          | 877,998                                  | -  |
| Government of Sri Lanka treasury bonds - Bank [Note 24 (d)]          | 3,224                                    | -  |
| <b>Dealing Securities - Bank</b>                                     | <b>1,457,502</b>                         | <b>39,485</b>                            |
| Quoted shares - Subsidiaries [Note 24 (e)]*                          | 174,136                                  | 40,821                                   |
| Government of Sri Lanka treasury bills - Joint Venture [Note 24 (f)] | 567,210                                  | 492,338                                  |
| Government of Sri Lanka treasury bonds - Joint Venture [Note 24 (g)] | 305,435                                  | 115,087                                  |
| Dealing securities - Bank  | 1,457,502                                | 39,485                                   |
| <b>Dealing Securities - Group</b>                                    | <b>2,504,283</b>                         | <b>687,731</b>                           |

\*HNB Assurance PLC (HNBA) carries its dealing securities at cost or market value whichever is lower as explained in Note 4.6.1. These investments are held by the life fund, therefore any gains relating to these investments can not be taken to the Income Statement. Accordingly, a gain of Rs 34 Mn arising from adjustment required to the accounting policy of HNBA to be consistent with that of the Bank, had not been accounted for in the Consolidated Financial Statements.

Dealing securities through the Joint Venture reported above represent only 50% of the total dealing securities of the Joint Venture, being the shareholding of the Bank on the same.

## 24 DEALING SECURITIES (Contd.)

### 24 (b) Quoted Shares Held by the Bank

| As at 31st December                           | 2010                  |                           |                 |                     | 2009                  |                           |                     |
|---|-----------------------|---------------------------|-----------------|---------------------|-----------------------|---------------------------|---------------------|
|   | No of Ordinary Shares | Cost of Investment Rs 000 | % of Total Cost | Market Value Rs 000 | No of Ordinary Shares | Cost of Investment Rs 000 | Market Value Rs 000 |
| <b>Banks, Finance and Insurance</b>           |                       |                           |                 |                     |                       |                           |                     |
| Ceylinco Insurance PLC (Non Voting)           | 4,000                 | 700                       | 0.14            | 1,080               | -                     | -                         | -                   |
| Lanka Orix Leasing Company PLC                | 225,000               | 29,322                    | 5.84            | 28,755              | -                     | -                         | -                   |
| National Development Bank PLC                 | 100,000               | 36,253                    | 7.21            | 34,950              | -                     | -                         | -                   |
| Sampath Bank PLC                              | 201,738               | 40,053                    | 7.97            | 54,853              | -                     | -                         | -                   |
| Seylan Bank PLC                               | 533,400               | 40,230                    | 8.01            | 52,167              | -                     | -                         | -                   |
| <b>Beverage, Food and Tobacco</b>             |                       |                           |                 |                     |                       |                           |                     |
| Lion Brewery Ceylon PLC                       | 450,000               | 74,215                    | 14.77           | 83,295              | -                     | -                         | -                   |
| <b>Diversified Holdings</b>                   |                       |                           |                 |                     |                       |                           |                     |
| Aitken Spence PLC                             | 450,000               | 75,766                    | 15.08           | 76,455              | -                     | -                         | -                   |
| John Keells Holdings PLC                      | 282,900               | 77,644                    | 15.45           | 84,417              | -                     | -                         | -                   |
| <b>Health Care</b>                            |                       |                           |                 |                     |                       |                           |                     |
| Lanka Hospitals PLC                           | 298,742               | 7,513                     | 1.50            | 9,471               | 2,078,142             | 52,265                    | 39,485              |
| Nawaloka Hospitals PLC                        | 7,673,300             | 29,792                    | 5.93            | 28,391              | -                     | -                         | -                   |
| <b>Manufacturing</b>                          |                       |                           |                 |                     |                       |                           |                     |
| Ceylon Grain Elevators PLC                    | 352,800               | 18,062                    | 3.59            | 26,354              | -                     | -                         | -                   |
| Tokyo Cement PLC                              | 377,500               | 20,014                    | 3.98            | 20,763              | -                     | -                         | -                   |
| <b>Telecommunications</b>                     |                       |                           |                 |                     |                       |                           |                     |
| Dialog Axiata PLC                             | -                     | -                         | -               | -                   | 50                    | 1                         | -                   |
| <b>Trading</b>                                |                       |                           |                 |                     |                       |                           |                     |
| Browns & Co PLC                               | 305,100               | 52,778                    | 10.50           | 75,329              | -                     | -                         | -                   |
| Odd lots and delisted shares                  |                       | 135                       | 0.03            | -                   |                       | 135                       | -                   |
| <b>Total</b>                                  |                       | <b>502,477</b>            | <b>100.00</b>   | <b>576,280</b>      | -                     | <b>52,401</b>             | <b>39,485</b>       |
| Gain / (loss) from marked to market valuation |                       | <b>73,803</b>             |                 | <b>-</b>            |                       | <b>(12,916)</b>           | <b>-</b>            |
| <b>Total Quoted Shares - Bank</b>             |                       | <b>576,280</b>            |                 | <b>576,280</b>      |                       | <b>39,485</b>             | <b>39,485</b>       |

### 24 (c) Government of Sri Lanka Treasury Bills Held by the Bank

| As at 31st December | Face Value   | Year of Maturity | Discounted Value (Rs 000) | 2010                      |                     | 2009                      |                     |
|---------------------|--|------------------|---------------------------|---------------------------|---------------------|---------------------------|---------------------|
|                     |  |                  |                           | Cost of Investment Rs 000 | Market Value Rs 000 | Cost of Investment Rs 000 | Market Value Rs 000 |
|                     | Rs 900 Mn  | 2011             | 874,589                   | 874,589                   | 877,998             | -                         | -                   |
|                     | Gain from marked to market valuation                       |                  |                           | 3,409                     | -                   | -                         | -                   |
|                     | <b>Total Government of Sri Lanka Treasury Bills - Bank</b> |                  |                           | <b>877,998</b>            | <b>877,998</b>      | <b>-</b>                  | <b>-</b>            |

## NOTES TO THE FINANCIAL STATEMENTS

### 24 DEALING SECURITIES (Contd.)

#### 24 (d) Government of Sri Lanka Treasury Bonds Held by the Bank

As at 31st December

| Face Value   | Year of Maturity | Discounted Value (Rs 000) | 2010                         |                        | 2009                         |                        |
|--|------------------|---------------------------|------------------------------|------------------------|------------------------------|------------------------|
|  |                  |                           | Cost of Investment<br>Rs 000 | Market Value<br>Rs 000 | Cost of Investment<br>Rs 000 | Market Value<br>Rs 000 |
| Rs 3 Mn  | 2015             | 3,298                     | 3,298                        | 3,224                  | -                            | -                      |
| Loss from marked to market valuation                       |                  |                           | (74)                         | -                      | -                            | -                      |
| <b>Total Government of Sri Lanka Treasury Bonds - Bank</b> |                  |                           | <b>3,224</b>                 | <b>3,224</b>           | <b>-</b>                     | <b>-</b>               |

#### 24 (e) Quoted Shares Held by the Subsidiaries

As at 31st December

|   | 2010                  |                              |                 | 2009                   |                       |                              |                        |
|---|-----------------------|------------------------------|-----------------|------------------------|-----------------------|------------------------------|------------------------|
|   | No of Ordinary Shares | Cost of Investment<br>Rs 000 | % of Total Cost | Market Value<br>Rs 000 | No of Ordinary Shares | Cost of Investment<br>Rs 000 | Market Value<br>Rs 000 |
| Commercial Bank of Ceylon PLC             | 67,050                | 17,046                       | 9.79            | 17,426                 | 19,500                | 2,535                        | 3,695                  |
| Hemas Holdings PLC                        | 321,000               | 14,106                       | 8.10            | 14,285                 | 4,200                 | 447                          | 516                    |
| John Keells Holdings PLC                  | 81,193                | 20,472                       | 11.76           | 24,228                 | 40,393                | 5,310                        | 6,927                  |
| Dialog Axiata PLC                         | 217,500               | 5,243                        | 3.01            | 2,567                  | 217,500               | 5,243                        | 1,577                  |
| Asian Hotels & Properties PLC             | 5,000                 | 167                          | 0.10            | 970                    | 35,500                | 1,426                        | 3,355                  |
| National Development Bank PLC             | 17,100                | 2,646                        | 1.52            | 5,976                  | 36,100                | 4,489                        | 7,437                  |
| Royal Ceramics Lanka PLC                  | 12,000                | 633                          | 0.36            | 3,659                  | 46,000                | 2,000                        | 3,059                  |
| Stafford Hotels PLC                       | -                     | -                            | -               | -                      | 123,500               | 3,181                        | 3,396                  |
| Chemical Industries (Colombo) PLC         | 116,500               | 10,905                       | 6.26            | 16,392                 | 63,600                | 3,882                        | 4,007                  |
| ACL Cables PLC                            | 25,000                | 1,414                        | 0.81            | 2,128                  | 36,700                | 2,055                        | 2,817                  |
| Dipped Products PLC                       | 19,500                | 1,829                        | 1.05            | 2,334                  | 19,500                | 1,829                        | 1,677                  |
| Colombo Dockyard PLC                      | -                     | -                            | -               | -                      | 6,000                 | 974                          | 1,469                  |
| Hemas Power PLC                           | -                     | -                            | -               | -                      | 65,000                | 1,300                        | 1,268                  |
| Cargills Ceylon PLC                       | -                     | -                            | -               | -                      | 12,000                | 712                          | 783                    |
| Renuka Agri Foods PLC                     | 309,100               | 815                          | 0.47            | 2,071                  | 318,300               | 716                          | 716                    |
| Aitken Spence Hotels Holdings PLC         | 23,375                | 820                          | 0.47            | 2,471                  | 4,500                 | 1,073                        | 1,212                  |
| DFCC Bank                                 | 43,000                | 5,390                        | 3.10            | 8,609                  | 24,700                | 3,649                        | 4,125                  |
| Riverina Hotels PLC                       | 52,000                | 5,060                        | 2.91            | 5,476                  | -                     | -                            | -                      |
| The Lighthouse Hotel PLC                  | 21,400                | 1,433                        | 0.82            | 1,348                  | -                     | -                            | -                      |
| Sampath Bank PLC                          | 92,724                | 19,945                       | 11.44           | 25,212                 | -                     | -                            | -                      |
| Nations Trust Bank PLC                    | 180,000               | 11,767                       | 6.75            | 15,012                 | -                     | -                            | -                      |
| Singer Finance (Lanka) PLC                | 4,400                 | 66                           | 0.04            | 66                     | -                     | -                            | -                      |
| Richard Pieris and Company PLC            | 325,000               | 2,449                        | 1.41            | 3,413                  | -                     | -                            | -                      |
| Hayleys PLC                               | 22,000                | 7,258                        | 4.17            | 7,590                  | -                     | -                            | -                      |
| Haycarb PLC                               | 20,500                | 3,547                        | 2.04            | 3,454                  | -                     | -                            | -                      |
| Chevron Lubricants Lanka PLC              | 24,000                | 3,619                        | 2.08            | 3,828                  | -                     | -                            | -                      |
| Tokyo Cement Company (Lanka) PLC          | 304,512               | 12,764                       | 7.33            | 16,748                 | -                     | -                            | -                      |
| Kelani Cables PLC                         | 44,300                | 5,035                        | 2.89            | 4,652                  | -                     | -                            | -                      |
| ACL Plastics PLC                          | 3,600                 | 372                          | 0.21            | 586                    | -                     | -                            | -                      |
| Laugfs Gas PLC - (Voting Shares)          | 26,700                | 614                          | 0.35            | 692                    | -                     | -                            | -                      |
| Laugfs Gas PLC - (Non Voting Shares)      | 19,200                | 288                          | 0.17            | 355                    | -                     | -                            | -                      |
| PC House PLC                              | 178,800               | 1,967                        | 1.13            | 2,020                  | -                     | -                            | -                      |
| Renuka Holdings PLC                       | 70,000                | 2,970                        | 1.71            | 4,333                  | -                     | -                            | -                      |
| Asiri Hospital Holdings PLC               | 928,200               | 7,990                        | 4.59            | 8,168                  | -                     | -                            | -                      |
| Dolphin Hotels PLC                        | 149,900               | 5,506                        | 3.16            | 9,174                  | -                     | -                            | -                      |
| <b>Total Quoted Shares - Subsidiaries</b> |                       | <b>174,136</b>               | <b>100.00</b>   | <b>215,243</b>         |                       | <b>40,821</b>                | <b>48,036</b>          |

## 24 DEALING SECURITIES (Contd.)

### 24 (f) Government of Sri Lanka Treasury Bills held through Joint Venture

As at 31st December

| Face Value  | Year of Maturity | Discounted Value (Rs 000) | 2010               |                | 2009               |                |
|---|------------------|---------------------------|--------------------|----------------|--------------------|----------------|
|   |                  |                           | Cost of Investment | Market Value   | Cost of Investment | Market Value   |
|   |                  |                           | Rs 000             | Rs 000         | Rs 000             | Rs 000         |
| Rs 587 Mn   | 2011             | 567,210                   |                    |                |                    |                |
| <b>Total Government of Sri Lanka Treasury Bills - Joint Venture</b> |                  |                           | <b>567,210</b>     | <b>567,834</b> | <b>492,338</b>     | <b>492,338</b> |

### 24 (g) Government of Sri Lanka Treasury Bonds held through Joint Venture

As at 31st December

| Face Value  | Year of Maturity | Discounted Value (Rs 000) | 2010               |                | 2009               |                |
|---|------------------|---------------------------|--------------------|----------------|--------------------|----------------|
|   |                  |                           | Cost of Investment | Market Value   | Cost of Investment | Market Value   |
|   |                  |                           | Rs 000             | Rs 000         | Rs 000             | Rs 000         |
| Rs 144 Mn   | 2011             | 145,248                   |                    |                |                    |                |
| Rs 17 Mn  | 2012             | 16,798                    |                    |                |                    |                |
| Rs 1 Mn   | 2013             | 958                       |                    |                |                    |                |
| Rs 50 Mn  | 2014             | 47,566                    |                    |                |                    |                |
| Rs 100 Mn   | 2015             | 94,865                    |                    |                |                    |                |
| <b>Total Government of Sri Lanka Treasury Bonds - Joint Venture</b> |                  |                           | <b>305,435</b>     | <b>305,435</b> | <b>115,087</b>     | <b>115,122</b> |

## 25 NON CURRENT ASSETS HELD FOR SALE

As at 31st December

|  | Bank            |                 | Group           |                 |
|--|-----------------|-----------------|-----------------|-----------------|
|  | 2010            | 2009            | 2010            | 2009            |
|  | Carrying amount | Carrying amount | Carrying amount | Carrying amount |
|  | Rs 000          | Rs 000          | Rs 000          | Rs 000          |
| Balance as at 1st January                    | -               | 1,455           | 2,875           | 1,455           |
| Transferred to property, plant and equipment | -               | (1,455)         | -               | (1,455)         |
| Add : Additions                              | -               | -               | -               | 2,875           |
| <b>Balance as at 31st December</b>           | <b>-</b>        | <b>-</b>        | <b>2,875</b>    | <b>2,875</b>    |

### 25 (a) Freehold Land\*

|  | 2010      |              | 2009      |              |
|--|-----------|--------------|-----------|--------------|
|  | Extent    | Cost of land | Extent    | Cost of land |
|  | (perches) | Rs 000       | (perches) | Rs 000       |
| Lot - X, Survey plan - 6448, off Edirisinghe Rd, Mirihana* | 10        | 2,875        | 10        | 2,875        |
| <b>Total - Group</b>                                       |           | <b>2,875</b> |           | <b>2,875</b> |

\* Value of the above land (10 perches) amounted to Rs 5.75 Mn as at 31st January 2011 based on the valuation carried out by Messrs K C B Condegama AIV (Sri Lanka). As this land is held by Acuity Partners (Pvt) Ltd, the Joint Venture, only 50% of the value is taken to the Consolidated Financial Statements.

## NOTES TO THE FINANCIAL STATEMENTS

### 26 BILLS OF EXCHANGE

| As at 31st December                          | Bank             |                  | Group            |                  |
|--|------------------|------------------|------------------|------------------|
|  | 2010<br>Rs 000   | 2009<br>Rs 000   | 2010<br>Rs 000   | 2009<br>Rs 000   |
| Inland bills                                 | 508,138          | 500,790          | 508,138          | 500,790          |
| Import bills                                 | 240,343          | 358,903          | 240,343          | 358,903          |
| Export bills                                 | 584,411          | 633,750          | 584,411          | 633,750          |
|  | 1,332,892        | 1,493,443        | 1,332,892        | 1,493,443        |
| Foreign Currency Banking Unit bills          | 164,427          | 287,850          | 164,427          | 287,850          |
| Gross bills of exchange                      | 1,497,319        | 1,781,293        | 1,497,319        | 1,781,293        |
| Provision for bills of exchange              |                  |                  |                  |                  |
| Specific provision [Note 26 (a)]             | (74,458)         | (305,249)        | (74,458)         | (305,249)        |
| General provision [Note 26 (a)]              | (12,571)         | (14,355)         | (12,571)         | (14,355)         |
| <b>Total provision for bills of exchange</b> | <b>(87,029)</b>  | <b>(319,604)</b> | <b>(87,029)</b>  | <b>(319,604)</b> |
| Bills of exchange after provision            | 1,410,290        | 1,461,689        | 1,410,290        | 1,461,689        |
| Less : Interest in suspense [Note 26 (b)]    | 9,160            | 14,199           | 9,160            | 14,199           |
| <b>Net bills of exchange</b>                 | <b>1,401,130</b> | <b>1,447,490</b> | <b>1,401,130</b> | <b>1,447,490</b> |

#### 26 (a) Movement in Provision for Bills of Exchange - Bank / Group

| As at 31st December  | Bank           |                | Group          |                |
|--|----------------|----------------|----------------|----------------|
|  | 2010<br>Rs 000 | 2009<br>Rs 000 | 2010<br>Rs 000 | 2009<br>Rs 000 |
|  | Specific       | Specific       | General        | General        |
| Balance as at 1st January  | 305,249        | 297,546        | 14,355         | 21,491         |
| Exchange rate variance on foreign currency provision             | (2,042)        | 783            | -              | -              |
| Additional provision made / (reversed) during the year (Note 18) | -              | 4,270          | (1,784)        | (7,136)        |
| Recoveries made during the year                                  | (385)          | -              | -              | -              |
| Transfer from loan loss provision [Note 28 (a)]*                 | -              | 2,650          | -              | -              |
| Bills written off against provision                              | (228,364)      | -              | -              | -              |
| <b>Balance as at 31st December</b>                               | <b>74,458</b>  | <b>305,249</b> | <b>12,571</b>  | <b>14,355</b>  |

\*Specific provisions in respect of bills which were in loan loss provision were transferred to provision for bills of exchange in 2009.

#### 26 (b) Movement in Interest in Suspense for Bills of Exchange - Bank / Group

| As at 31st December                              | 2010         | 2009          |
|--|--------------|---------------|
|  | Rs 000       | Rs 000        |
| Balance as at 1st January                        | 14,199       | 5,902         |
| Interest suspended during the year               | 2,356        | 8,937         |
| Interest recovered                               | (4,773)      | (640)         |
| Interest written off                             | (2,622)      | -             |
| <b>Balance as at 31st December [Note 28 (g)]</b> | <b>9,160</b> | <b>14,199</b> |

## 27 LEASE RECEIVABLES

| As at 31st December                            | Bank              |                  | Group             |                  |
|--|-------------------|------------------|-------------------|------------------|
|  | 2010<br>Rs 000    | 2009<br>Rs 000   | 2010<br>Rs 000    | 2009<br>Rs 000   |
| Gross lease rentals receivable                 | 33,736,872        | 28,192,889       | 33,736,872        | 28,192,889       |
| Initial rentals received                       | (85,923)          | (92,363)         | (85,923)          | (92,363)         |
| Lease rentals received                         | (16,357,491)      | (16,469,523)     | (16,357,491)      | (16,469,523)     |
| Total lease rentals receivable                 | 17,293,458        | 11,631,003       | 17,293,458        | 11,631,003       |
| Unearned lease income                          | (3,374,141)       | (2,232,361)      | (3,374,141)       | (2,232,361)      |
| Gross lease receivable                         | 13,919,317        | 9,398,642        | 13,919,317        | 9,398,642        |
| Provisions for lease receivable                |                   |                  |                   |                  |
| Specific [Note 27 (c)]                         | (197,631)         | (271,867)        | (197,631)         | (271,867)        |
| General [Note 27 (c)]                          | (274,433)         | (182,533)        | (274,433)         | (182,533)        |
| <b>Net lease receivable</b>                    | <b>13,447,253</b> | <b>8,944,242</b> | <b>13,447,253</b> | <b>8,944,242</b> |
| Lease receivable within one year [Note 27 (a)] | 4,630,492         | 3,931,110        | 4,630,492         | 3,931,110        |
| Lease receivable after one year [Note 27 (b)]  | 8,816,761         | 5,013,132        | 8,816,761         | 5,013,132        |
|  | 13,447,253        | 8,944,242        | 13,447,253        | 8,944,242        |

### 27 (a) Lease Receivable within One Year

|   |                  |                  |                  |                  |
|---|------------------|------------------|------------------|------------------|
| Total lease rentals receivable within one year from |                  |                  |                  |                  |
| Balance Sheet date                                  | 6,637,506        | 5,597,641        | 6,637,506        | 5,597,641        |
| Unearned lease income                               | (1,714,883)      | (1,314,440)      | (1,714,883)      | (1,314,440)      |
| Provision for lease receivable                      |                  |                  |                  |                  |
| Specific [Note 27 (c)]                              | (197,631)        | (271,867)        | (197,631)        | (271,867)        |
| General   | (94,500)         | (80,224)         | (94,500)         | (80,224)         |
| <b>Balance as at 31st December</b>                  | <b>4,630,492</b> | <b>3,931,110</b> | <b>4,630,492</b> | <b>3,931,110</b> |

### 27 (b) Lease Receivable after One Year

|  |                  |                  |                  |                  |
|--|------------------|------------------|------------------|------------------|
| Total lease rentals receivable after one year from |                  |                  |                  |                  |
| Balance Sheet date                                 | 10,655,952       | 6,033,362        | 10,655,952       | 6,033,362        |
| Unearned lease income                              | (1,659,258)      | (917,921)        | (1,659,258)      | (917,921)        |
| Provision for lease receivable - General           | (179,933)        | (102,309)        | (179,933)        | (102,309)        |
| <b>Balance as at 31st December</b>                 | <b>8,816,761</b> | <b>5,013,132</b> | <b>8,816,761</b> | <b>5,013,132</b> |

There were no lease receivables beyond five years.

### 27 (c) Movement in Provision for Lease Receivable - Bank / Group

| As at 31st December  | Bank           |                | Group          |                |
|--|----------------|----------------|----------------|----------------|
|  | 2010<br>Rs 000 | 2009<br>Rs 000 | 2010<br>Rs 000 | 2009<br>Rs 000 |
|  | Specific       | Specific       | General        | General        |
| Balance as at 1st January  | 271,867        | 256,965        | 182,533        | 234,679        |
| Exchange rate variance on foreign currency provision             | (7)            | -              | -              | -              |
| Additional provision made / (reversed) during the year (Note 18) | 46,376         | 59,702         | 91,900         | (52,146)       |
| Recoveries made during the year                                  | (69,265)       | (43,873)       | -              | -              |
| Fully provided leases written off                                | (51,340)       | (927)          | -              | -              |
| <b>Balance as at 31st December</b>                               | <b>197,631</b> | <b>271,867</b> | <b>274,433</b> | <b>182,533</b> |



## NOTES TO THE FINANCIAL STATEMENTS

### 28 LOANS AND ADVANCES

| As at 31st December  | Bank               |                    | Group              |                    |
|--|--------------------|--------------------|--------------------|--------------------|
|  | 2010<br>Rs 000     | 2009<br>Rs 000     | 2010<br>Rs 000     | 2009<br>Rs 000     |
| <b>Sri Lanka Rupee loans and advances</b>  |                    |                    |                    |                    |
| Overdrafts   | 40,673,843         | 32,264,297         | 40,264,282         | 31,467,898         |
| Short term loans   | 11,223,962         | 9,704,995          | 11,223,961         | 9,704,995          |
| Trust receipts   | 7,461,863          | 6,347,877          | 7,461,863          | 6,347,877          |
| Packing credit loans   | 211,285            | 252,283            | 211,285            | 252,283            |
| Staff loans  | 8,594,691          | 7,556,419          | 8,728,096          | 7,665,980          |
| Term loans   | 54,108,307         | 46,850,546         | 52,333,347         | 44,850,546         |
| Housing loans  | 17,987,441         | 17,551,280         | 17,987,441         | 17,551,280         |
| Pawning advances   | 27,965,219         | 21,914,906         | 27,965,219         | 21,914,906         |
| Foreclosed properties [Note 28 (h)]  | 25,378             | 26,099             | 25,378             | 26,099             |
|  | <b>168,251,989</b> | <b>142,468,702</b> | <b>166,200,872</b> | <b>139,781,864</b> |
| <b>Foreign currency loans and advances</b>   |                    |                    |                    |                    |
| Overdrafts   | 2,273,268          | 1,458,805          | 2,273,268          | 1,458,805          |
| Short term loans   | 571,715            | 592,436            | 571,715            | 592,436            |
| Trust receipts   | 920,755            | 2,478,197          | 920,755            | 2,478,197          |
| Packing credit loans   | 5,755,495          | 5,053,984          | 5,755,495          | 5,053,984          |
| Term loans   | 15,584,006         | 12,725,573         | 15,584,006         | 12,725,573         |
| Housing loans  | 697,183            | 611,822            | 697,183            | 611,822            |
| Foreclosed properties [Note 28 (h)]  | 437,905            | 450,627            | 437,905            | 450,627            |
|  | <b>26,240,327</b>  | <b>23,371,444</b>  | <b>26,240,327</b>  | <b>23,371,444</b>  |
| <b>Sri Lanka Rupee and foreign currency loans and advances</b>   | <b>194,492,316</b> | <b>165,840,146</b> | <b>192,441,199</b> | <b>163,153,308</b> |
| Less:  |                    |                    |                    |                    |
| Specific provision for loans and advances [Note 28 (b) i]  | 3,157,152          | 3,348,876          | 3,157,152          | 3,348,876          |
| Specific provision for foreclosed properties [Note 28 (b) i]   | 448,778            | 461,768            | 448,778            | 461,768            |
| General provision for pawning advances   | 27,965             | 21,915             | 27,965             | 21,915             |
| General provision for housing loans  | 36,984             | 35,838             | 36,984             | 35,838             |
| Additional general provision for performing<br>and overdue / special mention<br>loans and advances to fulfill statutory requirement [Note 28 (b) ii] | 1,099,004          | 1,062,463          | 1,099,004          | 1,062,463          |
| <b>Total provision for loan losses [Note 28 (a)]</b>   | <b>4,769,883</b>   | <b>4,930,860</b>   | <b>4,769,883</b>   | <b>4,930,860</b>   |
| Loans and advances after provision   | 189,722,433        | 160,909,287        | 187,671,316        | 158,222,448        |
| Less: Interest in suspense [Note 28 (f)]   | 1,688,582          | 1,661,926          | 1,688,582          | 1,661,926          |
| <b>Net loans and advances</b>  | <b>188,033,851</b> | <b>159,247,361</b> | <b>185,982,734</b> | <b>156,560,522</b> |

#### 28 (a) Movement in Provision for Loan Losses

|   |                  |                  |                  |                  |
|---|------------------|------------------|------------------|------------------|
| Balance as at 1st January                             | 4,930,860        | 7,329,827        | 4,930,860        | 7,329,827        |
| Exchange rate variance on foreign currency provision  | (47,215)         | 87,577           | (47,215)         | 87,577           |
| Provision made during the year (Note 18)              | 344,817          | 703,537          | 344,817          | 703,537          |
| Fully provided loans written off                      | (106,796)        | (2,494,733)      | (106,796)        | (2,494,733)      |
| Recoveries made during the year                       | (351,783)        | (692,698)        | (351,783)        | (692,698)        |
| Transfer to bills of exchange provision [Note 26 (a)] | -                | (2,650)          | -                | (2,650)          |
| <b>Balance as at 31st December</b>                    | <b>4,769,883</b> | <b>4,930,860</b> | <b>4,769,883</b> | <b>4,930,860</b> |

## 28 LOANS AND ADVANCES (Contd.)

As at 31st December

|   | 2010      |                  | 2009      |                  |
|---|-----------|------------------|-----------|------------------|
|   | Rs 000    | Rs 000           | Rs 000    | Rs 000           |
| <b>28 (b) Total Provision for Loan Losses - Bank / Group</b>  |           |                  |           |                  |
| <b>28 (b) i Specific Provision</b>  |           |                  |           |                  |
| Bills of exchange [Note 26 (a)]   | 74,458    |                  | 305,249   |                  |
| Loans and advances (Note 28)  | 3,157,152 |                  | 3,348,876 |                  |
| Foreclosed properties   | 448,778   |                  | 461,768   |                  |
| Lease receivable within one year [Note 27 (c)]  | 197,631   | 3,878,019        | 271,867   | 4,387,760        |
| <b>28 (b) ii General Provision</b>  |           |                  |           |                  |
| Bills of Exchange [Note 26(a)]  | 12,571    |                  | 14,355    |                  |
| Loans and advances (pawning and housing loans)  | 64,949    |                  | 57,753    |                  |
| Lease receivable within one year [Note 27 (a)]  | 94,500    |                  | 80,224    |                  |
| Lease receivable after one year [Note 27 (b)]   | 179,933   |                  | 102,309   |                  |
| Additional general provision for performing and overdue / special mention loans and advances to fulfill statutory requirement | 1,099,004 | 1,450,957        | 1,062,463 | 1,317,104        |
| <b>Total provision [Note 26 (a), 27 (c) and 28 (a)]</b>   |           | <b>5,328,976</b> |           | <b>5,704,864</b> |

As explained in Note 4.8.3 (b), the Bank makes general provision for potential losses not specifically identified but which experience indicates are present in the portfolio of pawning, lease receivable and Shanthy Housing Loans. A further provision of Rs 35.01 Mn (2009 - Rs 30.7 Mn) was made during the year along with the above provisions to meet the regulatory requirement. The total general provision of Rs 1,450.9 Mn (2009 - Rs 1,317.1 Mn) was 0.9% (2009 - 1%) of the total performing and overdue loans and advances, net of interest in suspense as at the Balance Sheet date and was equal to the regulatory requirement (0.9%) as at 31st December 2010 (2009 - 1%).

## 28 (c) Non-performing Lending Portfolio

Loans, advances, bills of exchange and finance leases are classified as non-performing as explained in Note 4.8.1. The criteria used for the classification of lending portfolio of the Bank as non performing is set out below. This is in accordance with the direction issued by the Central Bank of Sri Lanka on 8th May 2008 on "Classification of Loans and Advances, Income Recognition and Provisioning".

In accordance with Section 4(7)(l) of Banking Act Direction No. 3 of 2008, Banks shall reclassify Non Performing Loans and Advances (NPL) as Performing Loans and Advances (PLA) if interest and principal in arrears are paid in full by the borrower. However, this direction was replaced by Section 2 of Banking Act Direction No 9 of 2008 which relaxed the basis for reclassification of NPL to PLA even when a part of arrears is repaid. This direction which became effective from 31st December 2008 till 31st December 2009, was subsequently extended to 31st December 2010 by the Direction No 6 of 2009. However, the Bank continued to apply the stringent policy of reclassification of NPA to PLA, only upon repayment of all arrears.

### 28 (c) i CBSL Classification of Advances into Non-performing Lending Portfolio

| Type of facility  | Point of classification  |
|---|--|
| Overdrafts  | Outstanding balance in excess of sanctioned limit continuously for a period of 90 days or more |
| Credit facilities repayable in monthly installments               | Three consecutive installments, principal and / or interest have not been paid                 |
| Credit facilities payable in quarterly / half yearly installments | An installment is not paid within 90 days from the due date                                    |
| Credit facilities repayable in one installment (bullet payments)  | Payment is not made within 90 days from the end of the agreed period or the due date.          |
| Credit cards  | Minimum payment is in arrears for 90 days from the due date                                    |

## NOTES TO THE FINANCIAL STATEMENTS

### 28 LOANS AND ADVANCES (Contd.)

#### 28 (c) Non-performing Lending Portfolio (Contd.)

##### 28 (c) ii Categorisation of Advances within Non-performing Lending Portfolio

| Type of facility                                    | Determinant   | Categorisation of NPA                                |  |   |                                  |
|---|---|--|--|---|----------------------------------|
|   |   | Overdue / special mention                            | Substandard  | Doubtful  | Loss                             |
| Overdrafts  | Period that the outstanding is in excess of the sanctioned limit continuously | Equal to or more than 90 days but less than 180 days | Equal to 180 days or more but less than 360 days     | Equal to or more than 360 days but less than 540 days | Equal to 540 days or more        |
| Credit facilities repayable in monthly installments | No of installments, principal and / or interest due and unpaid                | 3 installments or more but less than 6 installments  | 6 installments or more but less than 12 installments | 12 installments or more but less than 18 installments | Equal to 18 installments or more |
| Credit cards  | No of days minimum payment is in arrears for from due date                    | 90 days or more but less than 120 days               | 120 days or more but less than 180 days              | 180 days or more but less than 240 days               | Equal to 240 days or more        |
| Other credit facilities                             | No of days payments are in arrears from the due date                          | 90 days or more but less than 180 days               | 180 days or more but less than 360 days              | 360 days or more but less than 540 days               | Equal to 540 days or more        |

Provision for possible loan losses are made on the basis of a continuous review of all advances to customers, in accordance with the Sri Lanka Accounting Standard 23, "Revenue Recognition and Disclosures in Financial Statements of Banks" and the directions issued by the Central Bank of Sri Lanka and disclosed in the Financial Statements of the Bank, after considering the values of the collateral obtained against the respective non performing loans and advances.

Valuation of collateral is performed based on the direction issued by the Central Bank of Sri Lanka as explained in Note 28 (c) iii.

##### 28 (c) iii Valuation of Securities for Provisioning Purposes

As per Direction No 3 of 2008 dated 8th May 2008 issued by the Central Bank of Sri Lanka on Classification of Loans and Advances, Income recognition and provisioning, the initial and progressive discounts that need to be applied to the Forced Sale Value (FSV) of immovable property held as collateral are as follows:

| Category                             | % of FSV of immovable property that can be considered as the value of security                                   |                    |
|--------------------------------------|--|--------------------|
|                                      | Freehold Property  | Leasehold Property |
| At the first time of provisioning    | 75   | 60                 |
| Period in the loss section           |  |                    |
| Less than 12 months                  | 75   | 60                 |
| More than 12 but less than 24 months | 60   | 50                 |
| More than 24 but less than 36 months | 50   | 40                 |
| More than 36 but less than 48 months | 40   | 30                 |
| More than 48 months                  | Property should be reviewed on a regular basis and discounted further at the discretion of the bank's management | Nil                |

## 28 LOANS AND ADVANCES (Contd.)

### 28 (d) Asset Quality - Non Performing Lending Portfolio - Bank / Group

| As at 31st December                      | 2010      |            | 2009      |            |
|--|-----------|------------|-----------|------------|
|  | Rs 000    |            | Rs 000    |            |
| Bills of exchange                        |           | 100,559    |           | 381,105    |
| Loans and advances                       |           | 9,927,769  |           | 11,092,486 |
| Foreclosed properties                    |           | 463,283    |           | 476,726    |
| Lease receivable                         |           | 595,641    |           | 523,916    |
| Gross non-performing lending portfolio   |           | 11,087,252 |           | 12,474,233 |
| Less: Specific provisions                |           |            |           |            |
| Bills of exchange                        | 74,458    |            | 305,249   |            |
| Loans and advances                       | 3,157,152 |            | 3,348,876 |            |
| Foreclosed properties                    | 448,778   |            | 461,768   |            |
| Lease receivable                         | 197,631   | 3,878,019  | 271,867   | 4,387,760  |
|  |           | 7,209,233  |           | 8,086,473  |
| Less: Interest in suspense [Note 28 (f)] |           | 1,697,742  |           | 1,676,125  |
| Net non-performing lending portfolio     |           | 5,511,491  |           | 6,410,348  |
| NPA ratio                                |           | 4.51%      |           | 6.15%      |
| NPA ratio (revised)                      |           | 4.09%      |           | 5.43%      |

Net non-performing lending portfolio of Rs 5,511.5 Mn (2009 - Rs 6,410.3 Mn) is secured by immovable assets, movable assets and other registered securities, approved by the Central Bank of Sri Lanka for provisioning purposes. The values of the immovable properties are discounted for provisioning purposes as explained in Note 28 (c) iii.

NPA ratio (revised) refers to the NPA ratio of the Bank in the event the Bank had applied Section 2 of the Direction referred to in Note 28 (c).

### 28 (e) Credit Risk

#### 28 (e) i Collateral Wise Analysis of Gross Non-performing Lending Portfolio

The Bank holds collateral against its lending portfolio in the form of mortgage interest over property, other registered securities and assets. Estimation of fair values / realisable values are based on the value of collateral assessed at the time of lending and generally are not updated except when a loan is individually assessed as non-performing.

| As at 31st December         | 2010       |     | 2009       |     |
|-----------------------------|------------|-----|------------|-----|
|                             | Rs 000     | %   | Rs 000     | %   |
| Secured by immovable assets | 7,111,325  | 64  | 8,905,849  | 71  |
| Secured by movable assets   | 697,181    | 6   | 623,947    | 5   |
| Secured by cash / shares    | 110,691    | 1   | 338,216    | 3   |
| Other securities            | 1,729,624  | 16  | 1,707,107  | 13  |
| Clean                       | 1,413,599  | 13  | 812,967    | 7   |
| Pawning                     | 24,832     | -   | 86,147     | 1   |
|                             | 11,087,252 | 100 | 12,474,233 | 100 |

## NOTES TO THE FINANCIAL STATEMENTS

### 28 LOANS AND ADVANCES (Contd.)

#### 28 (e) Credit Risk (Contd.)

#### 28 (e) ii Sector / Product Wise Analysis of Gross Lending Portfolio - Bank 2010

The Bank monitors concentration of credit risk by sectors. An analysis of concentration of credit risk as at the Balance Sheet date is shown below:

| Sector /<br>Type of Loan   | Overdrafts        | Short Term        | Medium Term       | Long Term         | Pawning           | Leasing           | Total              |               |
|--|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|--------------------|---------------|
|  | Rs 000            | Loans<br>Rs 000   | Loans<br>Rs 000   | Loans<br>Rs 000   | Rs 000            | Rs 000            | Rs 000             | %             |
| Agriculture and fishing  | 4,341,287         | 7,469,118         | 6,117,361         | 571,954           | -                 | 780,835           | 19,280,555         | 9.25          |
| Manufacturing  | 5,399,197         | 9,668,639         | 8,143,561         | 1,079,785         | -                 | -                 | 24,291,182         | 11.66         |
| Tourism  | 720,931           | 852,611           | 6,189,300         | 4,426,970         | -                 | -                 | 12,189,812         | 5.85          |
| Transport  | 656,604           | 639,381           | 2,769,542         | 346,124           | -                 | 7,580,480         | 11,992,131         | 5.75          |
| Construction   | 2,565,157         | 2,198,428         | 5,921,233         | 20,238,811        | -                 | 2,856,613         | 33,780,242         | 16.21         |
| Traders  | 12,391,709        | 9,684,827         | 8,385,630         | 2,243,420         | -                 | 163,070           | 32,868,656         | 15.76         |
| New economy  | 451,803           | 261,615           | 961,572           | 141,912           | -                 | 807,093           | 2,623,995          | 1.26          |
| Financial and<br>business services                               | 3,754,775         | 2,727,599         | 8,046,167         | 1,053,103         | -                 | -                 | 15,581,644         | 7.48          |
| Infrastructure   | 1,447,533         | 518,119           | 1,094,962         | 2,539,863         | -                 | -                 | 5,600,477          | 2.69          |
| Other services   | 8,545,519         | 1,982,822         | 1,209,366         | 529,386           | -                 | 1,508,725         | 13,775,818         | 6.61          |
| Other customers  | 2,672,596         | 2,260,439         | 1,135,541         | 2,170,825         | 27,965,219        | 222,501           | 36,427,121         | 17.48         |
| <b>Total</b>   | <b>42,947,111</b> | <b>38,263,598</b> | <b>49,974,235</b> | <b>35,342,153</b> | <b>27,965,219</b> | <b>13,919,317</b> | <b>208,411,633</b> | <b>100.00</b> |
| Gross loans and advances (Note 28)                               |                   |                   |                   |                   |                   |                   | 194,492,316        | 93.32         |
| Gross lease receivable (Note 27)                                 |                   |                   |                   |                   |                   |                   | 13,919,317         | 6.68          |
|  |                   |                   |                   |                   |                   |                   | 208,411,633        | 100.00        |
| The "other customers" category comprises the following advances: |                   |                   |                   |                   |                   |                   |                    |               |
| Credit card  | -                 | 1,877,220         | -                 | -                 | -                 | -                 | 1,877,220          | 5.15          |
| Pawning*   | -                 | -                 | -                 | -                 | 27,965,219        | -                 | 27,965,219         | 76.77         |
| Others   | 2,672,596         | 383,219           | 1,135,541         | 2,170,825         | -                 | 222,501           | 6,584,682          | 18.08         |
| <b>Total</b>   | <b>2,672,596</b>  | <b>2,260,439</b>  | <b>1,135,541</b>  | <b>2,170,825</b>  | <b>27,965,219</b> | <b>222,501</b>    | <b>36,427,121</b>  | <b>100.00</b> |

\* Pawning includes facilities extended to agriculture and fishing sectors amounting to Rs 6.057 Mn.

**28 LOANS AND ADVANCES (Contd.)****28 (e) Credit risk (Contd.)****28 (e) iii Sector / Product Wise Analysis of Gross Lending Portfolio - Bank 2009**

| Sector /<br>Type of Loan           | Overdrafts        | Short Term        | Medium Term       | Long Term         | Pawning           | Leasing          | Total              |               |
|------------------------------------|-------------------|-------------------|-------------------|-------------------|-------------------|------------------|--------------------|---------------|
|                                    | Rs 000            | Loans<br>Rs 000   | Loans<br>Rs 000   | Loans<br>Rs 000   | Rs 000            | Rs 000           | Rs 000             | %             |
| Agriculture and fishing            | 3,732,097         | 3,423,359         | 3,948,907         | 5,627,242         | -                 | 1,044,203        | 17,775,808         | 10.14         |
| Manufacturing                      | 4,910,797         | 11,742,404        | 6,397,205         | 1,646,247         | -                 | 186,437          | 24,883,090         | 14.20         |
| Tourism                            | 2,547,010         | 1,233,348         | 3,564,879         | 3,962,657         | -                 | 310,300          | 11,618,194         | 6.63          |
| Transport                          | 411,868           | 594,295           | 885,143           | 829,108           | -                 | 2,844,678        | 5,565,092          | 3.18          |
| Construction                       | 5,017,161         | 3,377,520         | 8,022,185         | 14,681,988        | -                 | 295,461          | 31,394,315         | 17.92         |
| Traders                            | 9,043,564         | 6,081,538         | 2,514,654         | 2,809,181         | -                 | 849,160          | 21,298,097         | 12.14         |
| New economy                        | 322,333           | 304,632           | 2,358,963         | 239,930           | -                 | 511,206          | 3,737,064          | 2.13          |
| Financial and<br>business services | 1,197,718         | 2,596,828         | 3,830,985         | 1,963,048         | -                 | 249,890          | 9,838,469          | 5.62          |
| Infrastructure                     | 1,408,241         | 639,812           | 274,010           | 1,373,305         | -                 | 123,345          | 3,818,713          | 2.18          |
| Other services                     | 4,200,351         | 4,591,650         | 2,163,813         | 5,909,034         | -                 | 2,863,655        | 19,728,503         | 11.26         |
| Other customers                    | 931,962           | 2,327,408         | 233,464           | 53,396            | 21,914,906        | 120,307          | 25,581,443         | 14.60         |
| <b>Total</b>                       | <b>33,723,102</b> | <b>36,912,794</b> | <b>34,194,208</b> | <b>39,095,136</b> | <b>21,914,906</b> | <b>9,398,642</b> | <b>175,238,788</b> | <b>100.00</b> |
| Gross loans and advances (Note 28) |                   |                   |                   |                   |                   |                  | 165,840,146        | 94.64         |
| Gross lease receivable (Note 27)   |                   |                   |                   |                   |                   |                  | 9,398,642          | 5.36          |
|                                    |                   |                   |                   |                   |                   |                  | 175,238,788        | 100.00        |

The "other customers" category comprises the following advances:

|              |                |                  |                |               |                   |                |                   |               |
|--------------|----------------|------------------|----------------|---------------|-------------------|----------------|-------------------|---------------|
| Credit card  | -              | 1,942,243        | -              | -             | -                 | -              | 1,942,243         | 7.59          |
| Pawning      | -              | -                | -              | -             | 21,914,906        | -              | 21,914,906        | 85.67         |
| Others       | 931,962        | 385,165          | 233,464        | 53,396        | -                 | 120,307        | 1,724,294         | 6.74          |
| <b>Total</b> | <b>931,962</b> | <b>2,327,408</b> | <b>233,464</b> | <b>53,396</b> | <b>21,914,906</b> | <b>120,307</b> | <b>25,581,443</b> | <b>100.00</b> |



## NOTES TO THE FINANCIAL STATEMENTS

### 28 LOANS AND ADVANCES (Contd.)

#### 28 (e) Credit Risk (Contd.)

#### 28 (e) iv Sector / Product Wise Analysis of Gross Lending Portfolio - Group 2010

| Sector /<br>Type of Loan           | Overdrafts        | Short Term        | Medium Term       | Long Term         | Pawning           | Leasing           | Total              |               |
|------------------------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|--------------------|---------------|
|                                    | Rs 000            | Loans<br>Rs 000   | Loans<br>Rs 000   | Loans<br>Rs 000   | Rs 000            | Rs 000            | Rs 000             | %             |
| Agriculture and Fishing            | 4,341,287         | 7,469,118         | 6,117,361         | 571,954           | -                 | 780,835           | 19,280,555         | 9.34          |
| Manufacturing                      | 5,399,197         | 9,668,639         | 8,143,561         | 1,079,785         | -                 | -                 | 24,291,182         | 11.77         |
| Tourism                            | 720,931           | 852,611           | 6,189,300         | 4,426,970         | -                 | -                 | 12,189,812         | 5.91          |
| Transport                          | 656,604           | 639,381           | 2,769,542         | 346,124           | -                 | 7,580,480         | 11,992,131         | 5.81          |
| Construction                       | 2,155,596         | 2,198,428         | 5,921,233         | 18,463,851        | -                 | 2,856,613         | 31,595,721         | 15.31         |
| Traders                            | 12,391,709        | 9,684,827         | 8,385,630         | 2,243,420         | -                 | 163,070           | 32,868,656         | 15.93         |
| New Economy                        | 451,803           | 261,615           | 961,572           | 141,912           | -                 | 807,093           | 2,623,995          | 1.27          |
| Financial and Business Services    | 3,754,775         | 2,727,599         | 8,046,167         | 1,053,103         | -                 | -                 | 15,581,644         | 7.55          |
| Infrastructure                     | 1,447,533         | 518,119           | 1,094,962         | 2,539,863         | -                 | -                 | 5,600,477          | 2.71          |
| Other Services                     | 8,545,519         | 1,982,822         | 1,209,366         | 529,386           | -                 | 1,508,725         | 13,775,818         | 6.68          |
| Other Customers                    | 2,672,596         | 2,260,439         | 1,268,945         | 2,170,825         | 27,965,219        | 222,501           | 36,560,525         | 17.72         |
| <b>Total</b>                       | <b>42,537,550</b> | <b>38,263,598</b> | <b>50,107,639</b> | <b>33,567,193</b> | <b>27,965,219</b> | <b>13,919,317</b> | <b>206,360,516</b> | <b>100.00</b> |
| Gross loans and advances (Note 28) |                   |                   |                   |                   |                   |                   | 192,441,199        | 93.25         |
| Gross lease receivable (Note 27)   |                   |                   |                   |                   |                   |                   | 13,919,317         | 6.75          |
|                                    |                   |                   |                   |                   |                   |                   | 206,360,516        | 100.00        |
| Credit card                        | -                 | 1,877,220         | -                 | -                 | -                 | -                 | 1,877,220          | 5.13          |
| Pawning                            | -                 | -                 | -                 | -                 | 27,965,219        | -                 | 27,965,219         | 76.49         |
| Other                              | 2,672,596         | 383,219           | 1,268,945         | 2,170,825         | -                 | 222,501           | 6,718,086          | 18.38         |
| <b>Total</b>                       | <b>2,672,596</b>  | <b>2,260,439</b>  | <b>1,268,945</b>  | <b>2,170,825</b>  | <b>27,965,219</b> | <b>222,501</b>    | <b>36,560,525</b>  | <b>100.00</b> |

\* Pawning includes facilities extended to agriculture and fishing sectors amounting to Rs 6.057 Mn.

## 28 LOANS AND ADVANCES (Contd.)

### 28 (e) Credit Risk (Contd.)

#### 28 (e) v Sector / Product Wise Analysis of Gross Lending Portfolio - Group 2009

| Sector /<br>Type of Loan           | Overdrafts        | Short Term        | Medium Term       | Long Term         | Pawning           | Leasing          | Total              |               |
|------------------------------------|-------------------|-------------------|-------------------|-------------------|-------------------|------------------|--------------------|---------------|
|                                    | Rs 000            | Loans<br>Rs 000   | Loans<br>Rs 000   | Loans<br>Rs 000   | Rs 000            | Rs 000           | Rs 000             | %             |
| Agriculture and fishing            | 3,732,097         | 3,423,359         | 3,948,907         | 5,627,242         | -                 | 1,044,203        | 17,775,808         | 10.28         |
| Manufacturing                      | 4,910,797         | 11,742,404        | 6,397,205         | 1,646,247         | -                 | 186,437          | 24,883,090         | 14.38         |
| Tourism                            | 2,547,010         | 1,233,348         | 3,564,879         | 3,962,657         | -                 | 310,300          | 11,618,194         | 6.71          |
| Transport                          | 411,868           | 594,295           | 885,143           | 829,108           | -                 | 2,844,678        | 5,565,092          | 3.42          |
| Construction                       | 4,240,921         | 3,377,520         | 8,022,185         | 12,681,988        | -                 | 295,461          | 28,618,075         | 16.60         |
| Traders                            | 9,043,564         | 6,081,538         | 2,514,654         | 2,809,181         | -                 | 849,160          | 21,298,097         | 12.31         |
| New economy                        | 322,333           | 304,632           | 2,358,963         | 239,930           | -                 | 511,206          | 3,737,064          | 2.16          |
| Financial and<br>business services | 1,177,559         | 2,596,828         | 3,830,985         | 1,963,048         | -                 | 249,890          | 9,818,310          | 5.67          |
| Infrastructure                     | 1,408,241         | 639,812           | 274,010           | 1,373,305         | -                 | 123,345          | 3,818,713          | 2.21          |
| Other services                     | 4,200,351         | 4,591,650         | 2,163,813         | 5,909,034         | -                 | 2,863,655        | 19,728,503         | 11.40         |
| Other customers                    | 931,962           | 2,327,408         | 343,025           | 53,396            | 21,914,906        | 120,307          | 25,691,004         | 14.85         |
| <b>Total</b>                       | <b>32,926,703</b> | <b>36,912,794</b> | <b>34,303,769</b> | <b>37,095,136</b> | <b>21,914,906</b> | <b>9,398,642</b> | <b>172,551,950</b> | <b>100.00</b> |
| Gross loans and advances (Note 28) |                   |                   |                   |                   |                   |                  | 163,153,308        | 94.55         |
| Gross lease receivable (Note 27)   |                   |                   |                   |                   |                   |                  | 9,398,642          | 5.45          |
|                                    |                   |                   |                   |                   |                   |                  | 172,551,950        | 100.00        |

The "other customers" category comprises the following advances:

|              |                |                  |                |               |                   |                |                   |               |
|--------------|----------------|------------------|----------------|---------------|-------------------|----------------|-------------------|---------------|
| Credit card  | -              | 1,942,243        | -              | -             | -                 | -              | 1,942,243         | 7.56          |
| Pawning      | -              | -                | -              | -             | 21,914,906        | -              | 21,914,906        | 85.30         |
| Others       | 931,962        | 385,165          | 343,025        | 53,396        | -                 | 120,307        | 1,833,855         | 7.14          |
| <b>Total</b> | <b>931,962</b> | <b>2,327,408</b> | <b>343,025</b> | <b>53,396</b> | <b>21,914,906</b> | <b>120,307</b> | <b>25,691,004</b> | <b>100.00</b> |

## NOTES TO THE FINANCIAL STATEMENTS

### 28 LOANS AND ADVANCES (Contd.)

As at 31st December

2010  
Rs 000

2009  
Rs 000

#### 28 (f) Movement in Interest in Suspense for Loans - Bank / Group

|  |                  |                  |
|--|------------------|------------------|
| Balance as at 1st January                        | 1,661,926        | 1,244,823        |
| Interest suspended                               | 1,962,086        | 2,150,512        |
| Interest recovered                               | (1,924,285)      | (1,699,867)      |
| Interest written off                             | (11,145)         | (33,542)         |
| <b>Balance as at 31st December [Note 28 (g)]</b> | <b>1,688,582</b> | <b>1,661,926</b> |

#### 28 (g) Total Interest in Suspense - Bank / Group

|                                   |                  |                  |
|-----------------------------------|------------------|------------------|
| Bills of exchange [Note 26 (b)]   | 9,160            | 14,199           |
| Loans and advances [Note 28 (f)]  | 1,688,582        | 1,661,926        |
| <b>Total interest in suspense</b> | <b>1,697,742</b> | <b>1,676,125</b> |

As a policy, the Bank seals off interest on non-performing loans and advances after one year of classification into the loss category. However, at the time of recovery, further interest on such advances is calculated from the date on which interest was sealed off.

#### 28 (h) Movement in Foreclosed Properties - Bank / Group

As at 31st December

2010  
Rs 000

2009  
Rs 000

|                                    |               |               |
|------------------------------------|---------------|---------------|
| Balance as at 1st January          | 14,958        | 15,142        |
| Disposals during the year          | (721)         | (2,977)       |
| Exchange translation               | 436           | 183           |
| Provision during the year          | (889)         | -             |
| Provision reversed during the year | 721           | 2,610         |
| <b>Balance as at 31st December</b> | <b>14,505</b> | <b>14,958</b> |

The total of foreclosed properties and related provisions  
have been classified under loans and advances

|  |               |               |
|--|---------------|---------------|
| Sri Lanka Rupee loans and advances                         | 25,378        | 26,099        |
| Foreign currency loans and advances                        | 437,905       | 450,627       |
| Specific provision for foreclosed properties [Note 28 (i)] | (448,778)     | (461,768)     |
|  | <b>14,505</b> | <b>14,958</b> |

#### 28 (i) Movement in Provision for Foreclosed Properties - Bank / Group

|  |                |                |
|--|----------------|----------------|
| Balance as at 1st January                            | 461,768        | 459,046        |
| Exchange rate variance in foreign currency provision | (13,158)       | 5,332          |
| Provision during the year                            | 889            | -              |
| Recoveries made during the year                      | (721)          | (2,610)        |
| <b>Balance as at 31st December</b>                   | <b>448,778</b> | <b>461,768</b> |

#### 28 (j) Loans and Advances to Kabool Lanka (Pvt) Ltd

The Bank had an exposure of Rs 3.0 Bn to Kabool Lanka (Pvt) Ltd as at 29th December 2009, against which a provision of Rs 2.8 Bn had been made by the Bank as at that date. The assets jointly owned by the Bank and Bank of Ceylon and acquired through legal process were subsequently acquired by the Government under the provisions of Land Acquisition Act. The banks had lodged their claim for compensation.

On 29th December 2009, the Bank received treasury bonds redeemable in 18 months amounting to Rs 570.6 Mn (presented under Note 29 (f) - Investment Securities - Government of Sri Lanka Treasury Bonds held by the Bank) as the full and final settlement from the Government.

Accordingly, after setting off the net exposure against the provision made in the Financial Statements, in 2009 Rs 368 Mn was written back to Income Statement (presented under Note 14 - Other Income).

## 29 INVESTMENT SECURITIES

### 29 (a) Investment Securities Summary

As at 31st December

|   | 2010<br>Cost of<br>Investment<br>Rs 000 | 2009<br>Cost of<br>Investment<br>Rs 000 |
|---|---|---|
| Quoted shares - Bank [Note 29 (b)]  | 911,399                                 | 1,025,082                               |
| Quoted units in unit trusts - Bank [Note 29 (c)]                                      | 150,000                                 | 150,000                                 |
| Unquoted shares - Bank [Note 29 (d)]  | 387,956                                 | 642,941                                 |
| Sri Lanka Development bonds and Sovereign bonds - Bank [Note 29 (e)]                  | 10,183,798                              | 9,343,780                               |
| Government of Sri Lanka treasury bonds - Bank [Note 29 (f)]                           | 8,297,895                               | 7,798,138                               |
| Government of Sri Lanka treasury bills and CBSL securities - Bank [Note 29 (g)]       | 37,508,009                              | 34,498,745                              |
| Foreign government bonds - Bank [Note 29 (h)]   | 140,645                                 | -                                       |
| Other long term investments - Bank [Note 29 (i)]                                      | 1,124,400                               | 500,994                                 |
| <b>Investment Securities - Bank</b>   | <b>58,704,102</b>                       | <b>53,959,680</b>                       |
| Quoted shares - Joint Venture [Note 29 (j)]   | 580                                     | 580                                     |
| Unquoted shares - Joint Venture [Note 29 (k)]   | 46,303                                  | -                                       |
| Net asset value adjustment on Acuity Securities*                                      | -                                       | 74,985                                  |
| Quoted units in unit trusts - Subsidiaries and Joint Venture [Note 29 (l)]            | 32,203                                  | -                                       |
| Unquoted units in unit trusts - Subsidiaries [Note 29 (m)]                            | 56,500                                  | 50,000                                  |
| Quoted debentures - Subsidiaries and Joint Venture [Note 29 (n)]                      | 257,420                                 | 106,000                                 |
| Unquoted debentures - Subsidiaries and Joint Venture [Note 29 (o)]                    | 150,500                                 | 60,000                                  |
| Government of Sri Lanka treasury bonds - Subsidiaries and Joint Venture [Note 29 (p)] | 1,003,076                               | 1,596,479                               |
| Investment securities - Bank  | 58,704,102                              | 53,959,680                              |
| <b>Investment Securities - Group</b>  | <b>60,250,684</b>                       | <b>55,847,724</b>                       |

\* Bank's share holding of 49.99% in Acuity Securities Ltd (after the 50.01% share transfer to Acuity Partners (Pvt) Ltd, in 2008), was accounted for at cost in Bank's books while accounted for at net assets value at the date of share transfer in the Consolidated Financial Statements. The remaining 49.99% was disposed to Acuity Partners (Pvt) Ltd during 2010.

Based on the internal assessment carried out by the Board of Directors as at 31st December 2010, there was no indication of impairment other than those disclosed in Note 29 (d) which required provision for permanent diminution in value of investment securities of the Bank.

Investment securities through the Joint Venture reported above represent only 50% of the total investment securities of the Joint Venture, being the shareholding of the Bank on the same.

### 29 (b) Quoted Shares Held by the Bank

As at 31st December

|                                       | No of<br>Ordinary<br>Shares | 2010<br>Cost of<br>Investment<br>Rs 000 | Market<br>Value<br>Rs 000 | No of<br>Ordinary<br>Shares | 2009<br>Cost of<br>Investment<br>Rs 000 | Market<br>Value<br>Rs 000 |
|---------------------------------------|-----------------------------|---|---------------------------|-----------------------------|---|---------------------------|
| Ceylinco Insurance PLC                | -                           | -                                       | -                         | 50,000                      | 8,750                                   | 6,712                     |
| Commercial Bank of Ceylon PLC         | -                           | -                                       | -                         | 1,430,574                   | 95,813                                  | 271,809                   |
| DFCC Bank                             | 32,109,140                  | 911,399                                 | 6,428,250                 | 16,054,570                  | 911,399                                 | 2,681,113                 |
| Distilleries Company of Sri Lanka PLC | -                           | -                                       | -                         | 1,481,500                   | 11,158                                  | 155,928                   |
|                                       |                             | 911,399                                 | 6,428,250                 |                             | 1,027,120                               | 3,115,562                 |
| Provision for diminution in value     |                             | -                                       | -                         |                             | (2,038)                                 | -                         |
| <b>Total Quoted Shares - Bank</b>     |                             | <b>911,399</b>                          | <b>6,428,250</b>          |                             | <b>1,025,082</b>                        | <b>3,115,562</b>          |

During the year the Bank's investments in Ceylinco Insurance PLC, Commercial Bank of Ceylon PLC and Distilleries Company of Sri Lanka PLC were transferred to dealing securities and subsequently disposed except for 4,000 shares in Ceylinco Insurance PLC. The resultant gain of Rs 497.114 Mn is reported under "Capital gain from sale of investment securities (disposed through dealing securities)" in Note 14 - Other Income. The provision of Rs 2.038 Mn made in respect of Ceylinco Insurance PLC's shares in 2009 has been reversed during the year.

## NOTES TO THE FINANCIAL STATEMENTS

### 29 INVESTMENT SECURITIES (Contd.)

#### 29 (c) Quoted Units in Unit Trusts held by the Bank

| As at 31st December                             | 2010           |                                 |                           | 2009           |                                 |                           |
|---|----------------|---------------------------------|---------------------------|----------------|---------------------------------|---------------------------|
|   | No of<br>Units | Cost of<br>Investment<br>Rs 000 | Market<br>Value<br>Rs 000 | No of<br>Units | Cost of<br>Investment<br>Rs 000 | Market<br>Value<br>Rs 000 |
| Namal Acuity Value Fund                         | 3,000,000      | 150,000                         | 270,000                   | 3,000,000      | 150,000                         | 149,250                   |
| <b>Total Quoted Units in Unit Trusts - Bank</b> |                | <b>150,000</b>                  | <b>270,000</b>            |                | <b>150,000</b>                  | <b>149,250</b>            |

#### 29 (d) Unquoted Shares Held by the Bank

| As at 31st December                              | 2010                        |                                 |                                   | 2009                        |                                 |                                   |
|--|-----------------------------|---------------------------------|-----------------------------------|-----------------------------|---------------------------------|-----------------------------------|
|  | No of<br>Ordinary<br>Shares | Cost of<br>Investment<br>Rs 000 | Directors'<br>Valuation<br>Rs 000 | No of<br>Ordinary<br>Shares | Cost of<br>Investment<br>Rs 000 | Directors'<br>Valuation<br>Rs 000 |
| Browns' Group Motels Ltd                         | 50,000                      | 500                             | 500                               | 50,000                      | 500                             | 500                               |
| Credit Information Bureau of Sri Lanka           | 5,300                       | 530                             | 530                               | 5,300                       | 530                             | 530                               |
| Fitch Rating 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                             |
| S.W.I.F.T.                                       | 21                          | 2,051                           | 2,051                             | 21                          | 2,051                           | 2,051                             |
| Dialog Axiata PLC                                |                             |                                 |                                   |                             |                                 |                                   |
| Rated cumulative redeemable<br>preference shares | 360,000,000                 | 360,000                         | 360,000                           | 540,000,000                 | 540,000                         | 540,000                           |
| Acuity Securities Ltd *                          | -                           | -                               | -                                 | 7,498,500                   | 74,985                          | 74,985                            |
| Magpek Exports Ltd                               | 359,000                     | 14,360                          | -                                 | 359,000                     | 14,360                          | -                                 |
| Metal Recyclers Colombo Ltd                      | 69                          | 3                               | -                                 | 69                          | 3                               | -                                 |
| Provision for diminution in market value **      |                             | (14,363)                        |                                   |                             | (14,363)                        |                                   |
| <b>Total Unquoted Shares - Bank</b>              |                             | <b>387,956</b>                  | <b>387,956</b>                    |                             | <b>642,941</b>                  | <b>642,941</b>                    |

\* Bank's investment of 49.99% in Acuity Securities Limited of Rs 74.985 Mn was disposed to Acuity Partners (Pvt) Ltd a Joint Venture between the Bank and DFCC Bank on 30th September 2010. The resulting gain of Rs 101.71 Mn from this transaction is reported under "Capital gain from sale of investment securities" included in Note 14 - Other Income.

\*\* As shares of Magpek Exports Ltd and Metal Recyclers Colombo Ltd have been de-listed, the market values are shown as nil. Provision of Rs 14.363 Mn for diminution in market value has been made in the Financial Statements.

#### 29 (e) Sri Lanka Development Bonds and Sovereign Bonds Held by the Bank

| As at 31st December   | 2010       |                                 | 2009                |                              |                                 |
|---|------------|---------------------------------|---------------------|------------------------------|---------------------------------|
|   | Face Value | Cost of<br>Investment<br>Rs 000 | Year of<br>Maturity | Discounted<br>Value (Rs 000) | Cost of<br>Investment<br>Rs 000 |
| Rs 2,885 Mn   |            |                                 | 2011                | 2,884,570                    |                                 |
| Rs 7,299 Mn   |            |                                 | 2012                | 7,299,228                    |                                 |
| <b>Total Sri Lanka Development Bonds and Sovereign Bonds - Bank</b> |            |                                 |                     |                              | <b>10,183,798</b>               |
|   |            |                                 |                     |                              | <b>9,343,780</b>                |

## 29 INVESTMENT SECURITIES (Contd.)

### 29 (f) Government of Sri Lanka Treasury Bonds Held by the Bank

| As at 31st December  | 2010             |                            | 2009                         |                        |                              |                        |
|--|------------------|----------------------------|------------------------------|------------------------|------------------------------|------------------------|
| Face Value   | Year of Maturity | Discounted Value<br>Rs 000 | Cost of Investment<br>Rs 000 | Market Value<br>Rs 000 | Cost of Investment<br>Rs 000 | Market Value<br>Rs 000 |
| Rs 3,951 Mn  | 2011             | 3,955,278                  |                              |                        |                              |                        |
| Rs 450 Mn  | 2012             | 451,923                    |                              |                        |                              |                        |
| Rs 1,701 Mn  | 2013             | 1,750,994                  |                              |                        |                              |                        |
| Rs 2,100 Mn  | 2014             | 2,139,700                  |                              |                        |                              |                        |
| <b>Total Government of Sri Lanka Treasury Bonds - Bank</b> |                  |                            | <b>8,297,895</b>             | <b>8,314,671</b>       | <b>7,798,138</b>             | <b>8,098,828</b>       |

### 29 (g) Government of Sri Lanka Treasury Bills and CBSL Securities Held by the Bank

| Face Value   | Year of Maturity | Discounted Value<br>Rs 000 |                   |                   |                   |                   |
|--|------------------|----------------------------|-------------------|-------------------|-------------------|-------------------|
| Rs 38,187 Mn   | 2011             | 37,508,009                 |                   |                   |                   |                   |
| <b>Total Government of Sri Lanka Treasury Bills and CBSL Securities - Bank</b> |                  |                            | <b>37,508,009</b> | <b>37,547,622</b> | <b>34,498,745</b> | <b>34,663,641</b> |

### 29 (h) Foreign Government Bonds Held by the Bank

| Face Value                                   | Year of Maturity | Discounted Value<br>Rs 000 |                |                |          |          |
|--|------------------|----------------------------|----------------|----------------|----------|----------|
| Rs 148 Mn                                    | 2012             | 140,645                    |                |                |          |          |
| <b>Total Foreign Government Bonds - Bank</b> |                  |                            | <b>140,645</b> | <b>135,930</b> | <b>-</b> | <b>-</b> |

### 29 (i) Other Long Term Investments Held by the Bank

| As at 31st December                                    | 2010             |                                | 2009           |                                |
|--|------------------|--------------------------------|----------------|--------------------------------|
|  | Cost<br>Rs 000   | Directors' Valuation<br>Rs 000 | Cost<br>Rs 000 | Directors' Valuation<br>Rs 000 |
| Long term non-negotiable bonds maturing on 14.11.2016  | 489,000          | 489,000                        | 489,000        | 489,000                        |
| People's Leasing Co. Ltd. - securitised notes trust 29 | -                | -                              | 11,994         | 11,994                         |
| People's Leasing Co. Ltd. - securitised notes trust 65 | 365,400          | 365,400                        | -              | -                              |
| Singer Sri Lanka PLC Debentures                        | 270,000          | 270,000                        | -              | -                              |
| <b>Total Other Long Term Investments - Bank</b>        | <b>1,124,400</b> | <b>1,124,400</b>               | <b>500,994</b> | <b>500,994</b>                 |

### 29 (j) Quoted Shares Held through Joint Venture

| As at 31st December                        | 2010                  |                              |                        | 2009                  |                              |                        |
|--|-----------------------|------------------------------|------------------------|-----------------------|------------------------------|------------------------|
|  | No of Ordinary Shares | Cost of Investment<br>Rs 000 | Market Value<br>Rs 000 | No of Ordinary Shares | Cost of Investment<br>Rs 000 | Market Value<br>Rs 000 |
| John Keells Holdings PLC                   | 4,680                 | 22                           | 1,395                  | 4,680                 | 22                           | 803                    |
| Hayleys PLC                                | 7,491                 | 558                          | 2,585                  | 7,491                 | 558                          | 1,281                  |
| Central Finance PLC                        | 3                     | -                            | 2                      | -                     | -                            | -                      |
| <b>Total Quoted Shares - Joint Venture</b> |                       | <b>580</b>                   | <b>3,982</b>           |                       | <b>580</b>                   | <b>2,084</b>           |



## NOTES TO THE FINANCIAL STATEMENTS

### 29 INVESTMENT SECURITIES (Contd.)

#### 29 (k) Unquoted Shares Held through Joint Venture

| As at 31st December                             | 2010                        |                                 | 2009                        |                                 |
|---|-----------------------------|---------------------------------|-----------------------------|---------------------------------|
|   | No of<br>Ordinary<br>Shares | Cost of<br>Investment<br>Rs 000 | No of<br>Ordinary<br>Shares | Cost of<br>Investment<br>Rs 000 |
| Durdans Heart Surgical Centre (Private) Ltd     | 750,000                     | 7,313                           | -                           | -                               |
| Durdans Medical & Surgical Centre (Private) Ltd | 1,000,000                   | 12,500                          | -                           | -                               |
| E Services Lanka Limited                        | 1,250,000                   | 12,500                          | -                           | -                               |
| Tudawe Brothers Limited                         | 100,000                     | 10,000                          | -                           | -                               |
| Nividhu (Private) Limited                       | 1,640,000                   | 16,490                          | -                           | -                               |
|   |                             | 58,803                          | -                           | -                               |
| Provision for diminution in value               |                             | (12,500)                        | -                           | -                               |
| <b>Total Unquoted Shares - Joint Venture</b>    |                             | <b>46,303</b>                   |                             |                                 |

#### 29 (l) Quoted Units in Unit Trusts Held by Subsidiaries and through Joint Venture

| As at 31st December  | 2010           |                                 |                           | 2009           |                                 |                           |
|--|----------------|---------------------------------|---------------------------|----------------|---------------------------------|---------------------------|
|  | No of<br>Units | Cost of<br>Investment<br>Rs 000 | Market<br>Value<br>Rs 000 | No of<br>Units | Cost of<br>Investment<br>Rs 000 | Market<br>Value<br>Rs 000 |
| Namal Acuity Fund  | 114,400        | 7,203                           | 10,296                    | -              | -                               | -                         |
| Namal Income Fund  | 2,436,870      | 25,000                          | 27,050                    | -              | -                               | -                         |
| <b>Total Quoted Units - Subsidiaries and Joint Venture</b> |                | <b>32,203</b>                   | <b>37,346</b>             |                |                                 |                           |

#### 29 (m) Unquoted Units in Unit Trusts Held by Subsidiaries

| As at 31st December                                       | 2010           |                                 | 2009           |                                 |
|---|----------------|---------------------------------|----------------|---------------------------------|
|   | No of<br>Units | Cost of<br>Investment<br>Rs 000 | No of<br>Units | Cost of<br>Investment<br>Rs 000 |
| Namal Giltedge Funds                                      | 1,000,000      | 10,000                          | -              | -                               |
| Namal Optima  | -              | -                               | 1,000,000      | 10,000                          |
| Cey Bank  | 4,000,000      | 40,000                          | 4,000,000      | 40,000                          |
| Ceylon Asset Management                                   | 664,622        | 6,500                           | -              | -                               |
| <b>Total Unquoted Units in Unit Trusts - Subsidiaries</b> |                | <b>56,500</b>                   |                | <b>50,000</b>                   |

| As at 31st December | 2010                          |                                 |                           | 2009                          |                                 |                           |
|---------------------|-------------------------------|---------------------------------|---------------------------|-------------------------------|---------------------------------|---------------------------|
|                     | No of<br>Debentures<br>Rs 000 | Cost of<br>Investment<br>Rs 000 | Market<br>Value<br>Rs 000 | No of<br>Debentures<br>Rs 000 | Cost of<br>Investment<br>Rs 000 | Market<br>Value<br>Rs 000 |
|                     |                               |                                 |                           |                               |                                 |                           |

#### 29 (n) Quoted Debentures Held by Subsidiaries and through Joint Venture

|   |           |                |                |         |                |                |
|---|-----------|----------------|----------------|---------|----------------|----------------|
| DFCC Bank (Rs 1000/- each)                                      | 10,000    | 10,000         | 10,000         | 10,000  | 10,000         | 10,000         |
| Seylan Bank PLC (Rs 100/- each)                                 | 100,000   | 10,000         | 10,000         | 100,000 | 10,000         | 10,000         |
| Sampath Bank PLC (Rs 100/- each)                                | 240,000   | 24,000         | 24,000         | 240,000 | 24,000         | 24,000         |
| Singer (Sri Lanka) PLC (Rs 100/- each)                          | 250,000   | 25,000         | 25,000         | 250,000 | 25,000         | 25,000         |
| Bank of Ceylon (Rs 100/- each)                                  | 590,000   | 59,000         | 59,000         | 200,000 | 20,000         | 20,000         |
| Nations Trust Bank PLC (Rs 1000/- each)                         | 17,000    | 17,000         | 17,000         | 17,000  | 17,000         | 17,000         |
| Urban Development Authority (Rs 100/- each)                     | 1,124,200 | 112,420        | 112,420        | -       | -              | -              |
| <b>Total Quoted Debentures - Subsidiaries and Joint Venture</b> |           | <b>257,420</b> | <b>257,420</b> |         | <b>106,000</b> | <b>106,000</b> |

## 29 INVESTMENT SECURITIES (Contd.)

### 29 (o) Unquoted Debentures Held by Subsidiaries and through Joint Venture

As at 31st December

|   | 2010             |                           | 2009             |                           |
|---|------------------|---------------------------|------------------|---------------------------|
|   | No of Debentures | Cost of Investment Rs 000 | No of Debentures | Cost of Investment Rs 000 |
| Singer (Sri Lanka) PLC (Rs 100/- each)                            | -                | -                         | 50,000           | 5,000                     |
| Seylan Bank PLC (Rs 100/- each)                                   | 150,000          | 15,000                    | 150,000          | 15,000                    |
| Senkadagala Finance Co Ltd (Rs 1000/-each)                        | 40,000           | 40,000                    | 40,000           | 40,000                    |
| DSI Holdings Ltd (Rs 1000/-each)                                  | 30,000           | 25,500                    | -                | -                         |
| Ceylon Hospital PLC (Rs 10/- each)                                | 5,000,000        | 50,000                    | -                | -                         |
| Neluwa Cascade Hydro Power (Private) Limited                      | 2,000,000        | 20,000                    | -                | -                         |
| <b>Total Unquoted Debentures - Subsidiaries and Joint Venture</b> |                  | <b>150,500</b>            |                  | <b>60,000</b>             |

As at 31st December

|  | 2010                      |                     | 2009                      |                     |
|--|---------------------------|---------------------|---------------------------|---------------------|
|  | Cost of Investment Rs 000 | Market Value Rs 000 | Cost of Investment Rs 000 | Market Value Rs 000 |
|  |                           |                     |                           |                     |

### 29 (p) Government of Sri Lanka Treasury Bonds Held by Subsidiaries and through Joint Venture

Face Value

Year of Maturity

Discounted Value (Rs 000)

|  |      |         |                  |                  |
|--|------|---------|------------------|------------------|
| Rs 110 Mn  | 2011 | 110,040 |                  |                  |
| Rs 313 Mn  | 2012 | 295,561 |                  |                  |
| Rs 689 Mn  | 2013 | 588,725 |                  |                  |
| Rs 10 Mn   | 2015 | 8,750   |                  |                  |
| <b>Total Government of Sri Lanka Treasury Bonds - Subsidiaries and Joint Venture</b> |      |         | <b>1,003,076</b> | <b>1,182,725</b> |
|  |      |         | <b>1,596,479</b> | <b>1,724,195</b> |

### 29 (q) Assets Pledged as Security

Out of the treasury bills and bonds classified as dealing and investment securities, the following amount is pledged as security for re-purchase agreements entered into by the Bank / Group.

| As at 31st December | Bank              |                  | Group             |                  |
|---------------------|-------------------|------------------|-------------------|------------------|
|                     | 2010 Rs 000       | 2009 Rs 000      | 2010 Rs 000       | 2009 Rs 000      |
| Treasury bills      | 10,926,033        | 6,223,728        | 11,989,447        | 6,487,507        |
| Treasury bonds      | 1,025,694         | 2,461,272        | 1,631,688         | 2,971,980        |
|                     | <b>11,951,727</b> | <b>8,685,000</b> | <b>13,621,135</b> | <b>9,459,487</b> |

## 30 INVESTMENTS IN ASSOCIATES

As at 31st December

|  | Principal Activity | % Holding | 2010                      |                     | 2009                      |                     |
|--|--------------------|-----------|---------------------------|---------------------|---------------------------|---------------------|
|  |                    |           | Cost of Investment Rs 000 | Market Value Rs 000 | Cost of Investment Rs 000 | Market Value Rs 000 |
|  |                    |           |                           |                     |                           |                     |

### 30 (a) Bank

#### 30 (a) i Quoted

|   |                 |   |   |   |        |         |         |
|---|-----------------|---|---|---|--------|---------|---------|
| Lanka Ventures PLC (10,036,250 ordinary shares) | Venture Capital | - | - | - | 20.07% | 132,326 | 180,653 |
|   |                 | - | - | - |        | 132,326 | 180,653 |

## NOTES TO THE FINANCIAL STATEMENTS

### 30 INVESTMENTS IN ASSOCIATES (Contd.)

#### 30 (a) Bank (Contd.)

| As at 31st December   |                                |            | 2010          | Directors' |            | 2009           | Directors' |
|---|--------------------------------|------------|---------------|------------|------------|----------------|------------|
| Principal   | %                              | Cost of    | Valuation     | %          | Cost of    | Valuation      |            |
| Activity  | Holding                        | Investment | Rs 000        | Holding    | Investment | Rs 000         | Rs 000     |
| <b>30 (a) ii Unquoted</b>                                   |                                |            |               |            |            |                |            |
| Browns Engineering (Pvt) Ltd<br>(2,056,000 ordinary shares) | Engineering                    | 32.63%     | 20,560        | -          | 32.63%     | 20,560         | -          |
| Delma Exchange<br>(simple limited partnership)              | Dealing in<br>foreign exchange | 20.00%     | 83,651        | 83,651     | 20.00%     | 71,480         | 71,480     |
| Provision for diminution in value                           |                                |            | (20,560)      |            |            | (20,560)       |            |
|   |                                |            | 83,651        | 83,651     |            | 71,480         | 71,480     |
| <b>Total for the Bank [30 (a) i and 30 (a) ii]</b>          |                                |            | <b>83,651</b> |            |            | <b>203,806</b> |            |

#### Lanka Ventures PLC

Bank's investment in Lanka Ventures PLC was sold to Acuity Partners (Pvt) Ltd, a Joint Venture investment banking company of DFCC Bank and HNB on 18th January 2010 for Rs 18 per share. The gain from sale of this investment of Rs 47.581 Mn is disclosed in Note 14 - Other Income.

#### Browns Engineering (Pvt) Ltd

Browns Engineering (Pvt) Ltd is under liquidation and the Bank's investment in this company has been fully provided for.

#### Delma Exchange

Delma Exchange is a limited liability partnership incorporated in Abu Dhabi and the Bank holds 20% of this partnership. During the year receivable from Delma Exchange amounting to Rs 12.171 Mn was transferred to investment. Bank's holding in Delma Exchange of 20% remained the same after this transaction.

| As at 31st December  | Quoted<br>Investments |                | Unquoted<br>Investments |                | Total          |                |
|--|-----------------------|----------------|-------------------------|----------------|----------------|----------------|
|  | 2010<br>Rs 000        | 2009<br>Rs 000 | 2010<br>Rs 000          | 2009<br>Rs 000 | 2010<br>Rs 000 | 2009<br>Rs 000 |
| Investment in Associate companies (at cost)                                    | 132,326               | 132,326        | 71,730                  | 71,730         | 204,056        | 204,056        |
| Investment in Associate company<br>through Joint Venture                       | -                     | -              | 59,870                  | -              | 59,870         | -              |
| Additional investment in Associate company                                     | -                     | -              | 60,671                  | -              | 60,671         | -              |
| Negative goodwill on acquisition recognised<br>in Income Statement             | 5,830                 | 5,830          | 3,416                   | 3,416          | 9,246          | 9,246          |
| Group share of Associate company<br>retained profits balance as at 1st January | 14,206                | 922            | (4,648)                 | 956            | 9,558          | 1,878          |
| Current year's share of profits after tax                                      | (6,384)               | 13,284         | 3,955                   | (5,605)        | (2,429)        | 7,679          |
| Exchange effect on revaluation of investment                                   | -                     | -              | 1,015                   | 3,270          | 1,015          | 3,270          |
| Disposal of Associate company  | (145,978)             | -              | -                       | -              | (145,978)      | -              |
| <b>Group Investment in Associate<br/>companies (equity basis)</b>              | <b>-</b>              | <b>152,362</b> | <b>196,009</b>          | <b>73,767</b>  | <b>196,009</b> | <b>226,129</b> |

#### Splendor Media (Pvt) Ltd (Splendor Media)

The Bank's fully owned subsidiary Sithma Development (Pvt) Ltd (Sithma) holds 25% in Splendor Media. Accordingly Splendor Media has been accounted for as an Associate of Sithma.

The Board of Directors carried out an internal assessment of impairment as at 31st December 2010 and concluded that there was no indication of impairment of this investment.

### 30 INVESTMENTS IN ASSOCIATES (Contd.)

#### 30 (c) Summarised Financial Information of Associates

##### 30 (c) i Associates Held by the Bank

| As at 31st December               | Lanka<br>Ventures PLC | Delma Exchange<br>(Pvt) Ltd |                |
|-----------------------------------|-----------------------|-----------------------------|----------------|
|                                   | 2009<br>Rs 000        | 2010<br>Rs 000              | 2009<br>Rs 000 |
| Revenue                           | 117,874               | 17,670                      | 7,925          |
| Expenses                          | (53,816)              | (97,057)                    | (55,351)       |
| <b>Profit / (loss) before tax</b> | 64,058                | <b>(79,387)</b>             | (47,426)       |
| Current assets                    | 302,989               | 257,616                     | 312,295        |
| Non current assets                | 461,321               | 45,568                      | 18,358         |
| <b>Total assets</b>               | 764,310               | <b>303,184</b>              | 330,653        |
| Current liabilities               | 3,721                 | 5,676                       | 3,447          |
| Non current liabilities           | 1,435                 | -                           | 882            |
| <b>Total liabilities</b>          | 5,156                 | <b>5,676</b>                | 4,329          |

Lanka Ventures PLC which was an Associate of the Bank in 2009 became a subsidiary of Acuity Partners (Pvt) Ltd, the Joint Venture between DFCC Bank and HNB during the year.

##### 30 (c) ii Associate Held by Subsidiary

| As at 31st December      | Splendor Media<br>(Pvt) Ltd |                |
|--------------------------|-----------------------------|----------------|
|                          | 2010<br>Rs 000              | 2009<br>Rs 000 |
| Revenue                  | 86,290                      | 61,199         |
| Expenses                 | (73,531)                    | (36,933)       |
| <b>Profit before tax</b> | <b>12,759</b>               | 24,266         |
| Current assets           | 115,195                     | 88,280         |
| Non current assets       | 1,728                       | 646            |
| <b>Total assets</b>      | <b>116,923</b>              | 88,926         |
| Current liabilities      | 75,851                      | 54,596         |
| Non current liabilities  | 483                         | 320            |
| <b>Total liabilities</b> | <b>76,334</b>               | 54,916         |

##### 30 (c) iii Associates Held through Joint Venture

| As at 31st December               | Unit Energy<br>Lanka<br>(Pvt) Ltd | Hayles Hydro<br>Energy<br>(Pvt) Ltd | Neluwa<br>Cascade<br>Hydropower |
|-----------------------------------|-----------------------------------|-------------------------------------|---------------------------------|
|                                   | 2010<br>Rs 000                    | 2010<br>Rs 000                      | 2010<br>Rs 000                  |
| Revenue                           | 160,867                           | -                                   | 72,542                          |
| Expenses                          | (96,636)                          | (93)                                | (60,595)                        |
| <b>Profit / (loss) before tax</b> | 64,231                            | (93)                                | 11,947                          |
| Current assets                    | 76,336                            | 26                                  | 18,567                          |
| Non current assets                | 487,697                           | 119,100                             | 349,553                         |
| <b>Total assets</b>               | <b>564,033</b>                    | <b>119,126</b>                      | 368,120                         |
| Current liabilities               | 32,886                            | 844                                 | 87,625                          |
| Non current liabilities           | 284,553                           | -                                   | 185,085                         |
| <b>Total liabilities</b>          | <b>317,439</b>                    | <b>844</b>                          | 272,710                         |

The above companies are Associates of Lanka Ventures PLC which is a Subsidiary of Acuity Partners (Pvt) Ltd.

## NOTES TO THE FINANCIAL STATEMENTS

### 31 INVESTMENT IN JOINT VENTURE

| Bank                      |                    |         |                | 2010           |            | 2009           |                |
|---------------------------|--------------------|---------|----------------|----------------|------------|----------------|----------------|
| As at 31st December       |                    |         |                | Cost of        | Directors' | Cost of        | Directors'     |
|                           | Principal          | %       | Investment     | Valuation      | %          | Investment     | Valuation      |
|                           | Activity           | Holding | Rs 000         | Rs 000         | Holding    | Rs 000         | Rs 000         |
| <b>Unquoted</b>           |                    |         |                |                |            |                |                |
| Acuity Partners (Pvt) Ltd | Investment banking | 50%     | 655,000        | 655,000        | 50%        | 250,000        | 250,000        |
| <b>Total for the Bank</b> |                    |         | <b>655,000</b> | <b>655,000</b> |            | <b>250,000</b> | <b>250,000</b> |

During the year the Bank increased its capital contribution (direct / through conversion of loans) to Acuity Partners (Pvt) Ltd the Joint Venture between DFCC Bank and HNB by Rs 405 Mn. Bank's shareholding in Acuity Partners (Pvt) Ltd remained at 50% after this transaction.

Bank's interest in Acuity Partners (Pvt) Ltd include:

|             | 2010      | 2009      |
|-------------|-----------|-----------|
|             | Rs 000    | Rs 000    |
| Assets      | 2,985,433 | 1,199,570 |
| Liabilities | 2,051,891 | 915,811   |
| Income      | 484,785   | 151,750   |
| Expenses    | 225,641   | 100,960   |
| Tax         | 69,569    | 18,124    |

### 32 INVESTMENTS IN SUBSIDIARIES

#### 32 (a) Quoted

| Bank                                     |           |         |                | 2010      |         | 2009           |           |
|--|-----------|---------|----------------|-----------|---------|----------------|-----------|
| As at 31st December                      |           |         |                | Cost of   | Market  | Cost of        | Market    |
|  | Principal | %       | Investment     | Value     | %       | Investment     | Value     |
|  | Activity  | Holding | Rs 000         | Rs 000    | Holding | Rs 000         | Rs 000    |
| HNB Assurance PLC<br>(22,494,750 shares) | Insurance | 60%     | 149,965        | 1,754,591 | 60%     | 149,965        | 1,113,490 |
| <b>Total Quoted</b>                      |           |         | <b>149,965</b> |           |         | <b>149,965</b> |           |

## 32 INVESTMENTS IN SUBSIDIARIES (Contd.)

### 32 (b) Unquoted

| As at 31st December  |                             |           | 2010                         | Directors'          |           | 2009                         | Directors'          |
|--|-----------------------------|-----------|------------------------------|---------------------|-----------|------------------------------|---------------------|
|  | Principal Activity          | % Holding | Cost of Investment<br>Rs 000 | Valuation<br>Rs 000 | % Holding | Cost of Investment<br>Rs 000 | Valuation<br>Rs 000 |
| Sithma Development (Pvt) Ltd<br>(206,000,000 ordinary shares)                        | Property development        | 100%      | 1,973,000                    | 1,973,000           | 100%      | 1,973,000                    | 1,973,000           |
| Majan Exchange LLC<br>(200,000 shares)   | Dealing in foreign exchange | 40%       | 56,121                       | 56,121              | 40%       | 56,121                       | 56,121              |
| Commercial Interlink Services Inc<br>(o/a Delma Exchange Canada)<br>(100,001 shares) | Dealing in foreign exchange | 100%      | 10,063                       | -                   | 95%       | 240                          | 240                 |
| Provision for diminution in value  |                             |           | (10,063)                     |                     |           | -                            |                     |
| <b>Total Unquoted</b>  |                             |           | <b>2,029,121</b>             |                     |           | <b>2,029,361</b>             |                     |
| <b>Total for the Bank [32 (a) and 32 (b)]</b>  |                             |           |                              | <b>2,179,086</b>    |           |                              | <b>2,179,326</b>    |

Bank together with 40% shareholding in Majan Exchange LLC and management control over the activities of the company can govern the financial and operating policies of the company. Accordingly the investment in Majan Exchange LLC has been classified as investment in Subsidiary.

Rs 9.82 Mn which was receivable to Bank from Commercial Interlink Services Inc (o/a of Delma Exchange Canada) was converted to shares during the year. This resulted in the increase of Bank's holding in the company from 95% to 100%.

As directed by the Director Bank Supervision of the Central Bank of Sri Lanka, the Bank has taken steps to liquidate Commercial Interlink Services Inc (o/a of Delma Exchange Canada) and the commercial operation of the same has been ceased since 1st October 2010. The said entity has been treated as a subsidiary up to the Balance Sheet date and the results of the same have been consolidated. The Bank has made full provision of Rs 10.063 Mn against the investment and Rs 18.885 Mn (Note 36) against the receivable from the said subsidiary.

## 33 INVESTMENT PROPERTIES

| As at 31st December                            | Bank           |                | Group          |                |
|--|----------------|----------------|----------------|----------------|
|  | 2010<br>Rs 000 | 2009<br>Rs 000 | 2010<br>Rs 000 | 2009<br>Rs 000 |
| <b>Cost</b>                                    |                |                |                |                |
| Balance as at 1st January                      | 369,503        | 195,505        | 243,250        | 242,587        |
| Transferred from property, plant and equipment | -              | 173,335        | -              | -              |
| Improvements                                   | 7,247          | 663            | 5,496          | 663            |
| <b>Balance as at 31st December</b>             | <b>376,750</b> | <b>369,503</b> | <b>248,746</b> | <b>243,250</b> |
| <b>Accumulated depreciation</b>                |                |                |                |                |
| Balance as at 1st January                      | 18,743         | 8,038          | 70,695         | 66,274         |
| Transferred from property, plant and equipment | -              | 6,325          | -              | -              |
| Charge for the year                            | 4,444          | 4,380          | 4,456          | 4,421          |
| <b>Balance as at 31st December</b>             | <b>23,187</b>  | <b>18,743</b>  | <b>75,151</b>  | <b>70,695</b>  |
| <b>Net book value as at 31st December</b>      | <b>353,563</b> | <b>350,760</b> | <b>173,595</b> | <b>172,555</b> |



## NOTES TO THE FINANCIAL STATEMENTS

### 33 (a) Valuation of Investment Properties - Bank

|   | Building | Extent  | Cost / Carrying Amount |          |         | Fair Value |          |           |
|---|----------|---------|------------------------|----------|---------|------------|----------|-----------|
|   |          |         | Land                   | Building | Total   | Land       | Building | Total     |
| As at 31st December 2010                                  | sq.ft    | Perches | Rs 000                 | Rs 000   | Rs 000  | Rs 000     | Rs 000   | Rs 000    |
| 23 & 23 1/1,<br>Independence Avenue,<br>Colombo 7         | 10,800   | 105.00  | 37,081                 | 43,440   | 80,521  | 393,750    | 45,900   | 439,650   |
| 479 T B Jayah Mawatha,<br>Colombo 10 *                    | Land     | 112.96  | 75,781                 | -        | 75,781  | 519,616    | -        | 519,616   |
| 21, 21A, 23 & 25,<br>Janadhipathi Mawatha,<br>Colombo 1 * | Land     | 26.62   | 34,889                 | -        | 34,889  | 39,930     | -        | 39,930    |
| 10, Sri Uttarananda Mawatha,<br>Colombo 03 **             | 49,500   | 40.00   | 72,000                 | 90,372   | 162,372 | 240,000    | 100,237  | 340,237   |
|   |          |         | 219,751                | 133,812  | 353,563 | 1,193,296  | 146,137  | 1,339,433 |

### 33 (b) Valuation of Investment Properties - Group

|  | Building | Extent  | Cost / Carrying Amount |          |         | Fair Value |          |         |
|--|----------|---------|------------------------|----------|---------|------------|----------|---------|
|  |          |         | Land                   | Building | Total   | Land       | Building | Total   |
| As at 31st December 2010   | sq.ft    | Perches | Rs 000                 | Rs 000   | Rs 000  | Rs 000     | Rs 000   | Rs 000  |
| 23 & 23 1/1,<br>Independence Avenue,<br>Colombo 7                          | 10,800   | 105.00  | 37,081                 | 43,440   | 80,521  | 393,750    | 45,900   | 439,650 |
| Smart building,<br>21, 21A, 23 & 25,<br>Janadhipathi Mawatha,<br>Colombo 1 | 41,688   | -       | -                      | 93,074   | 93,074  | -          | 145,908  | 145,908 |
|  |          |         | 37,081                 | 136,514  | 173,595 | 393,750    | 191,808  | 585,558 |

The fair value of the investment properties are based on market valuations carried out as at 31st December 2009 by Messrs J M J Fernando, FIV, DIV (Sri Lanka), K C B Condegama, AIV (Sri Lanka), members of the Institute of Valuers of Sri Lanka, who are independent valuers not connected with the Bank. The Bank carries investment properties at cost.

The Directors have carried out an internal valuation as at 31st December 2010 based on the market conditions of similar properties situated within close proximity. Since the fair values of the investment properties were above the carrying value, the Board of Directors concluded there was no impairment in investment properties.

\* Land 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 to Sithma Development (Pvt) Ltd by the Bank and the Bank receives ground rent. Accordingly, these lands have been classified as investment property in the Balance Sheet of the Bank. However, according to Sri Lanka Accounting Standard 40 "Investment Property" (SLAS 40), the said lands are treated as property, plant and equipment in the Consolidated Balance Sheet, since these are leased to a Group entity. Accordingly, the revaluation impact of such property has not been adjusted in the Group since the classification is a consolidation adjustment.

\*\* Building situated at No 10, Sri Uttarananda Mw, Colombo 03 is leased out to HNB Assurance PLC and Royal Ceramics Lanka PLC. Accordingly this building is classified as investment property in the Balance Sheet of the Bank. However, according to SLAS 40, the said building is treated as property, plant and equipment in the Group Balance Sheet, since Group uses a significant portion of the building for use in the production or supply of goods and services.

### 34 PROPERTY, PLANT AND EQUIPMENT

| Bank   | Leasehold<br>Buildings | Freehold<br>Land and<br>Buildings | Computer<br>Equipment | Equipment<br>Furniture<br>and<br>Fixtures | Motor<br>Vehicles | Capital<br>Work-in<br>Progress | 2010<br>Total     | 2009<br>Total |
|--|------------------------|-----------------------------------|-----------------------|---|-------------------|--------------------------------|-------------------|---------------|
|  | Note 34 (c)            | Note 34 (b)                       | Note 34 (a)           |   |                   |                                |                   |               |
|  | Rs 000                 | Rs 000                            | Rs 000                | Rs 000                                    | Rs 000            | Rs 000                         | Rs 000            | Rs 000        |
| Cost / valuation   |                        |                                   |                       |   |                   |                                |                   |               |
| as at 1st January  | 1,055,642              | 4,847,904                         | 2,153,426             | 2,599,211                                 | 221,656           | 219,927                        | <b>11,097,766</b> | 10,327,944    |
| Transferred to investment property*                            | -                      | -                                 | -                     | -   | -                 | -                              | -                 | (173,335)     |
| Additions and improvements                                     | 97,800                 | 150,389                           | 135,825               | 280,109                                   | 7,512             | 305,811                        | <b>977,446</b>    | 1,071,026     |
| Disposals during the year                                      | (1,315)                | -                                 | (50,987)              | (53,377)                                  | -                 | -                              | <b>(105,679)</b>  | (125,446)     |
| Sub category transfers   |                        |                                   |                       |   |                   |                                |                   |               |
| during the year  | (43,194)               | 43,000                            | -                     | 194                                       | -                 | -                              | -                 | -             |
| Transferred from non current assets<br>held for sale (Note 25) | -                      | -                                 | -                     | -   | -                 | -                              | -                 | 1,455         |
| Transferred from capital<br>work-in-progress                   | 85,949                 | 176,430                           | -                     | 79,626                                    | -                 | (342,005)                      | -                 | -             |
| Written off during the year**                                  | -                      | -                                 | -                     | -   | -                 | (20,717)                       | <b>(20,717)</b>   | -             |
| Transferred to debtors   | -                      | -                                 | -                     | -   | -                 | (1,200)                        | <b>(1,200)</b>    | -             |
| Transferred to intangible assets                               | -                      | -                                 | -                     | -   | -                 | (2,321)                        | <b>(2,321)</b>    | (3,878)       |
| <b>Cost / valuation</b>  |                        |                                   |                       |   |                   |                                |                   |               |
| <b>as at 31st December</b>                                     | <b>1,194,882</b>       | <b>5,217,723</b>                  | <b>2,238,264</b>      | <b>2,905,763</b>                          | <b>229,168</b>    | <b>159,495</b>                 | <b>11,945,295</b> | 11,097,766    |
| Accumulated depreciation                                       |                        |                                   |                       |   |                   |                                |                   |               |
| as at 1st January  | 597,702                | 100,617                           | 1,252,169             | 1,844,279                                 | 123,497           | -                              | <b>3,918,264</b>  | 3,462,296     |
| Transferred to investment property*                            | -                      | -                                 | -                     | -   | -                 | -                              | -                 | (6,325)       |
| Charge for the year  | 122,353                | 46,877                            | 230,118               | 212,755                                   | 45,257            | -                              | <b>657,360</b>    | 579,993       |
| Sub category transfers   |                        |                                   |                       |   |                   |                                |                   |               |
| during the Year  | (12,041)               | 11,954                            | -                     | 87  | -                 | -                              | -                 | -             |
| Disposals during the year                                      | (1,315)                | -                                 | (50,758)              | (52,203)                                  | -                 | -                              | <b>(104,276)</b>  | (117,700)     |
| <b>Accumulated depreciation</b>                                |                        |                                   |                       |   |                   |                                |                   |               |
| <b>as at 31st December</b>                                     | <b>706,699</b>         | <b>159,448</b>                    | <b>1,431,529</b>      | <b>2,004,918</b>                          | <b>168,754</b>    | <b>-</b>                       | <b>4,471,348</b>  | 3,918,264     |
| <b>Net book value</b>  |                        |                                   |                       |   |                   |                                |                   |               |
| <b>as at 31st December 2010</b>                                | <b>488,183</b>         | <b>5,058,275</b>                  | <b>806,735</b>        | <b>900,845</b>                            | <b>60,414</b>     | <b>159,495</b>                 | <b>7,473,947</b>  | -             |
| Net book value   |                        |                                   |                       |   |                   |                                |                   |               |
| as at 31st December 2009                                       | 457,940                | 4,747,287                         | 901,257               | 754,932                                   | 98,159            | 219,927                        | -                 | 7,179,502     |

## NOTES TO THE FINANCIAL STATEMENTS

### 34 PROPERTY, PLANT AND EQUIPMENT (Contd.)

| Group  | Leasehold<br>Buildings<br>Note 34 (c)<br>Rs 000 | Freehold<br>Land and<br>Buildings<br>Note 34 (b)<br>Rs 000 | Computer<br>Equipment<br>Rs 000 | Equipment<br>Furniture<br>and<br>Fixtures<br>Rs 000 | Civil<br>Works<br>Rs 000 | Motor<br>Vehicles<br>Rs 000 | Capital<br>Work-in<br>Progress<br>Rs 000 | 2010<br>Total<br>Rs 000 | 2009<br>Total<br>Rs 000 |
|--|---|--|---------------------------------|---|--------------------------|-----------------------------|--|-------------------------|-------------------------|
| Cost / valuation as at 1st January<br>without exchange effect  | 1,075,981                                       | 10,259,006   | 2,261,973                       | 4,789,250   | 3,527                    | 236,765                     | 220,184                                  | 18,846,686              | 17,822,696              |
| Effect of movements in exchange rates  | 95  | -  | 186                             | 162   | 20                       | -                           | 65                                       | 528                     | -                       |
| Cost / Valuation<br>as at 1st January  | 1,076,076                                       | 10,259,006   | 2,262,159                       | 4,789,412   | 3,547                    | 236,765                     | 220,249                                  | 18,847,214              | 17,822,696              |
| Acquisitions of Subsidiaries   | -   | -  | 2,863                           | 2,928   | -                        | 1,563                       | -  | 7,354                   | 2,312                   |
| Additions and improvements   | 98,230  | 152,140  | 160,468                         | 306,182   | -                        | 10,849                      | 305,811                                  | 1,033,680               | 1,163,844               |
| Disposals during the year  | (1,315)   | -  | (51,058)                        | (55,848)  | -                        | (1,188)                     | -  | (109,409)               | (148,778)               |
| Written off during the year  | -   | -  | (692)                           | (293)   | -                        | -                           | (20,717)                                 | (21,702)                | -                       |
| Transferred from non current<br>assets held for sale   | -   | -  | -                               | -   | -                        | -                           | -  | -                       | 1,455                   |
| Transferred to Acuity Partners (Pvt) Ltd and<br>Acuity Stockbrokers (Pvt) Ltd from<br>DNH Financial (Pvt) Ltd<br>[former HNB Stockbrokers (Pvt) Ltd] | -   | -  | -                               | -   | -                        | -                           | -  | -                       | 10,988                  |
| Disposal of DNH Financial (Pvt) Ltd<br>[former HNB Stockbrokers (Pvt) Ltd]   | -   | -  | -                               | -   | -                        | -                           | -  | -                       | (1,953)                 |
| Sub category transfers during the year   | (43,194)  | 43,000   | -                               | 194   | -                        | -                           | -  | -                       | -                       |
| Transfers from capital<br>work-in-progress   | 85,949  | 176,430  | -                               | 79,626  | -                        | -                           | (342,005)                                | -                       | -                       |
| Transferred to debtors   | -   | -  | -                               | -   | -                        | -                           | (1,200)                                  | (1,200)                 | -                       |
| Transfer to intangible assets  | -   | -  | -                               | -   | -                        | -                           | (2,321)                                  | (2,321)                 | (3,878)                 |
| Effect of movements in exchange rates  | 16  | -  | (216)                           | (66)  | (107)                    | -                           | -  | (373)                   | 528                     |
| <b>Cost / Valuation<br/>as at 31st December</b>  | <b>1,215,762</b>                                | <b>10,630,576</b>  | <b>2,373,524</b>                | <b>5,122,135</b>                                    | <b>3,440</b>             | <b>247,989</b>              | <b>159,817</b>                           | <b>19,753,243</b>       | <b>18,847,214</b>       |
| Accumulated depreciation as at 1st January<br>without exchange effect  | 600,600   | 307,857  | 1,301,729                       | 2,174,313   | 355                      | 129,379                     | -  | 4,514,233               | 3,921,679               |
| Effect of movements in exchange rates  | 11  | -  | 29                              | 14  | (2)                      | -                           | -  | 52                      | -                       |
| Accumulated depreciation<br>as at 1st January  | 600,611   | 307,857  | 1,301,758                       | 2,174,327   | 353                      | 129,379                     | -  | 4,514,285               | 3,921,679               |
| Adjustment to opening balance  | -   | -  | (489)                           | (146)   | -                        | 15                          | -  | (620)                   | -                       |
| Acquisitions of subsidiaries   | -   | -  | 1,809                           | 2,550   | -                        | 1,563                       | -  | 5,922                   | 292                     |
| Transferred to Acuity Partners (Pvt) Ltd and<br>Acuity Stockbrokers (Pvt) Ltd from<br>DNH Financial (Pvt) Ltd<br>[former HNB Stockbrokers (Pvt) Ltd] | -   | -  | -                               | -   | -                        | -                           | -  | -                       | 8,094                   |
| Disposal of DNH Financial (Pvt) Ltd<br>[former HNB Stockbrokers (Pvt) Ltd]   | -   | -  | -                               | -   | -                        | -                           | -  | -                       | (1,493)                 |
| Charge for the year  | 126,972   | 103,611  | 247,138                         | 278,258   | 369                      | 49,795                      | -  | 806,143                 | 722,872                 |
| Disposals during the year  | (1,315)   | -  | (50,781)                        | (54,026)  | -                        | (1,143)                     | -  | (107,265)               | (137,211)               |
| Write offs during the year   | -   | -  | (661)                           | (266)   | -                        | -                           | -  | (927)                   | -                       |
| Sub category transfers during the year   | (12,041)  | 11,954   | -                               | 87  | -                        | -                           | -  | -                       | -                       |
| Effect of movements in exchange rates  | 5   | -  | (44)                            | (17)  | (17)                     | -                           | -  | (73)                    | 52                      |
| <b>Accumulated Depreciation<br/>as at 31st December</b>  | <b>714,232</b>                                  | <b>423,422</b>   | <b>1,498,730</b>                | <b>2,400,767</b>                                    | <b>705</b>               | <b>179,609</b>              | <b>-</b>                                 | <b>5,217,465</b>        | <b>4,514,285</b>        |
| <b>Net book value<br/>as at 31st December 2010</b>   | <b>501,530</b>                                  | <b>10,207,154</b>  | <b>874,794</b>                  | <b>2,721,368</b>                                    | <b>2,735</b>             | <b>68,380</b>               | <b>159,817</b>                           | <b>14,535,778</b>       | <b>-</b>                |
| Net book value<br>as at 31st December 2009   | 475,465   | 9,951,149  | 960,401                         | 2,615,085   | 3,194                    | 107,386                     | 220,249                                  | -                       | 14,332,929              |

\* Building situated at No 10, Sri Uttarananda Mw, Colombo 3 was transferred to investment property during the year ended 31st December 2009 by the Bank as it is now held primarily for generation of rent.

As set out in Note 4.12.4, the Bank / Group had revalued its freehold land and buildings as at 1st January 2007, by professionally qualified independent valuers. The revaluation was carried out by taking into account the observable prices in active market or recent market transactions on arm's length term. The revaluation surplus, amounting to Rs 2,778.7 Mn / Rs 5,545.5 Mn had been credited to the revaluation reserve account in respect of Bank / Group respectively in 2007. An impairment loss of Rs 87.76 Mn was recognised in that year in respect of freehold land and buildings based on revaluation of such properties.

\*\* Based on the internal assesment, Capital Work-in-progress (WIP) relating to system development of Rs 20.7 Mn was written off to the Income Statement during the year as it was concluded that the said WIP will not generate any future economic benefits to the Bank.

Based on the assessment of potential impairment carried out internally by the Board of Directors as at 31st December 2010, no provision was required to be made in the Financial Statements as at Balance Sheet date other than those disclosed above.

### 34 PROPERTY, PLANT AND EQUIPMENT (Contd.)

#### 34 (a) Computer Equipment - Bank

|   | Additions<br>Prior to<br>1st July 2000<br>Rs 000 | Additions<br>After<br>1st July 2000<br>Rs 000 | 2010<br>Total<br>Rs 000 | 2009<br>Total<br>Rs 000 |
|---|--|---|-------------------------|-------------------------|
| Rate of depreciation                      | 25.00%   | 16.67%  |                         |                         |
| Cost as at 1st January                    | 576,821  | 1,576,605                                     | 2,153,426               | 1,889,893               |
| Additions and improvements                | -  | 135,825                                       | 135,825                 | 320,347                 |
| Transferred from capital work-in-progress | -  | -   | -                       | 645                     |
| Disposals during the year                 | -  | (50,987)                                      | (50,987)                | (57,459)                |
| <b>Cost as at 31st December</b>           | <b>576,821</b>                                   | <b>1,661,443</b>                              | <b>2,238,264</b>        | <b>2,153,426</b>        |

#### 34 (b) Freehold Land and Buildings - Bank

|  | Buildings<br>Sq.ft. | Extent<br>(perches) | Cost /<br>Valuation of<br>Land<br>Rs 000 | Cost /<br>Valuation of<br>Buildings<br>Rs 000 | Total<br>Value<br>Rs 000 | Accumulated<br>Depreciation<br>Rs 000 | Net Book<br>Value<br>2010<br>Rs 000 | Net Book<br>Value<br>2009<br>Rs 000 |
|--|---------------------|---------------------|--|---|--------------------------|---------------------------------------|-------------------------------------|-------------------------------------|
| <b>Within Colombo City Limits</b>  |                     |                     |  |   |                          |                                       |                                     |                                     |
| <b>Bambalapitiya Branch</b><br>285, Galle Road, Colombo 4.                               | 14,801              | 20.00               | 80,000                                   | 107,451                                       | 187,451                  | 12,663                                | 174,788                             | 177,960                             |
| <b>Borella Branch</b><br>53/1, D S Senanayake Mawatha,<br>Borella.                       | 9,750               | 28.00               | 98,493                                   | 52,230  | 150,723                  | 5,471                                 | 145,252                             | 146,019                             |
| <b>Centralised Operations Building</b><br>90, Vinayalankara Mawatha,<br>Colombo 10.      | 10,250              | 249.00              | 996,000                                  | 36,088  | 1,032,088                | 3,642                                 | 1,028,446                           | 1,029,359                           |
| <b>City Office</b><br>16, Janadhipathi Mawatha,<br>Colombo 1.                            | 49,911              | 84.00               | 252,000                                  | 73,562  | 325,562                  | 8,802                                 | 316,760                             | 316,756                             |
| <b>Grandpass Branch</b><br>182, St Joseph Street,<br>Colombo 14.                         | 9,440               | 24.00               | 36,000                                   | 23,712  | 59,712                   | 2,536                                 | 57,176                              | 57,816                              |
| <b>Gunasinghepura Pay Office<br/>and Stores</b><br>11, Mohandiram's Road,<br>Colombo 12. | 6,990               | 37.53               | 112,600                                  | 17,764  | 130,364                  | 1,996                                 | 128,368                             | 128,911                             |
| <b>Panchikawatta Branch</b><br>168, Panchikawatta Road,<br>Colombo 10.                   | 8,000               | 23.67               | 101,538                                  | 29,145  | 130,683                  | 1,192                                 | 129,491                             | 123,426                             |
| <b>Pettah Branch</b><br>149-151, Main Street,<br>Colombo 11.                             | 13,535              | 13.03               | 85,000                                   | 46,280  | 131,280                  | 5,750                                 | 125,530                             | 126,967                             |
| <b>Pettah Extension Office</b><br>88, Main Street,<br>Colombo 11.                        | 6,848               | 6.29                | 47,100                                   | 18,211  | 65,311                   | 1,800                                 | 63,511                              | 63,972                              |
| <b>Sea Street Branch</b><br>60, Sea Street,<br>Colombo 11.                               | 9,000               | 6.93                | 48,500                                   | 24,920  | 73,420                   | 2,813                                 | 70,607                              | 71,262                              |
| <b>Wellawatte Branch</b><br>102, Galle Road,<br>Wellawatte.                              | 17,560              | 36.05               | 140,000                                  | 52,112  | 192,112                  | 5,490                                 | 186,622                             | 185,992                             |
| <b>Total freehold land and buildings<br/>within Colombo City Limits</b>                  |                     |                     | 1,997,231                                | 481,475                                       | 2,478,706                | 52,155                                | 2,426,551                           | 2,428,440                           |

## NOTES TO THE FINANCIAL STATEMENTS

### 34 PROPERTY, PLANT AND EQUIPMENT (Contd.)

#### 34 (b) Freehold Land and Buildings - Bank (Contd)

| As at 31st December 2010   | Buildings<br>Sq.ft. | Extent<br>(perches) | Cost /<br>Valuation of<br>Land<br>Rs 000 | Cost /<br>Valuation of<br>Buildings<br>Rs 000 | Total<br>Value<br>Rs 000 | Accumulated<br>Depreciation<br>Rs 000 | Net Book<br>Value<br>2010<br>Rs 000 | Net Book<br>Value<br>2009<br>Rs 000 |
|--|---------------------|---------------------|--|---|--------------------------|---------------------------------------|-------------------------------------|-------------------------------------|
| <b>Outside Colombo City Limits</b>   |                     |                     |  |   |                          |                                       |                                     |                                     |
| <b>Akkaraipattu Branch</b><br>1, Main Street,<br>Akkaraipattu.                     | 8,805               | 17.00               | 20,400                                   | 17,129  | 37,529                   | 1,613                                 | <b>35,916</b>                       | 35,493                              |
| <b>Ambalangoda Branch</b><br>94/1, New Galle Road, Ambalangoda.                    | 5,282               | 32.56               | 31,000                                   | 12,742  | 43,742                   | 1,353                                 | <b>42,389</b>                       | 42,333                              |
| <b>Anuradhapura Branch</b><br>30, Maithripala Senanayake<br>Mawatha, Anuradhapura. | 9,980               | 25.59               | 48,083                                   | 14,706  | 62,789                   | 1,678                                 | <b>61,111</b>                       | 61,007                              |
| <b>Badulla Branch</b><br>15, 15 1/1, Udayaraja Mawatha,<br>Badulla.                | 5,550               | 27.75               | 26,200                                   | 13,522  | 39,722                   | 1,365                                 | <b>38,357</b>                       | 38,228                              |
| <b>Boralesgamuwa Branch</b><br>24, Maharagama Road,<br>Boralesgamuwa.              | 5,500               | 30.34               | 33,375                                   | 15,721  | 49,096                   | 1,635                                 | <b>47,461</b>                       | 47,837                              |
| <b>Dambulla Branch</b><br>622, Anuradhapura Road,<br>Dambulla.                     | 6,862               | 94.50               | 42,525                                   | 16,479  | 59,004                   | 1,606                                 | <b>57,398</b>                       | 57,826                              |
| <b>Galle Branch</b><br>3, Wakwella Road,<br>Galle.                                 | 7,271               | 13.80               | 41,000                                   | 22,691  | 63,691                   | 2,624                                 | <b>61,067</b>                       | 61,762                              |
| <b>Gampaha Branch</b><br>150, Colombo Road,<br>Gampaha.                            | 16,685              | 25.00               | 24,959                                   | 115,281                                       | 140,240                  | 3,021                                 | <b>137,219</b>                      | 130,170                             |
| <b>Gampola Branch</b><br>12, Kandy Road,<br>Gampola.                               | 5,604               | 11.88               | 14,920                                   | 11,737  | 26,657                   | 1,459                                 | <b>25,198</b>                       | 25,564                              |
| <b>Gampola Bare Land</b><br>142,144,146, Kandy Road,<br>Gampola.                   | Bare land           | 17.05               | 28,028                                   | -   | 28,028                   | -                                     | <b>28,028</b>                       | 28,027                              |
| <b>Hatton Branch</b><br>78, Dambulla Road,<br>Hatton.                              | 10,141              | 69.48               | 35,179                                   | 14,518  | 49,697                   | 1,621                                 | <b>48,076</b>                       | 48,514                              |
| <b>Mount Bungalow</b><br>7, Mount Road,<br>Hatton.                                 | 5,088               | 160.00              | 16,000                                   | 8,044   | 24,044                   | 812                                   | <b>23,232</b>                       | 22,918                              |
| <b>Ja-Ela Branch</b><br>73, Old Negombo Road,<br>Ja-Ela.                           | 4,918               | 19.00               | 11,400                                   | 13,097  | 24,497                   | 1,507                                 | <b>22,990</b>                       | 23,379                              |
| <b>Jaffna Branch</b><br>181/5C, Ponnambalam Road,<br>Jaffna.                       | Bare land           | 62.36               | 48,839                                   | 34  | 48,873                   | 10                                    | <b>48,863</b>                       | 2,018                               |

### 34 PROPERTY, PLANT AND EQUIPMENT (Contd.)

#### 34 (b) Freehold Land and Buildings - Bank (Contd)

| As at 31st December 2010   | Buildings<br>Sq.ft. | Extent<br>(perches) | Cost /<br>Valuation of<br>Land<br>Rs 000 | Cost /<br>Valuation of<br>Buildings<br>Rs 000 | Total<br>Value<br>Rs 000 | Accumulated<br>Depreciation<br>Rs 000 | Net Book<br>Value<br>2010<br>Rs 000 | Net Book<br>Value<br>2009<br>Rs 000 |
|--|---------------------|---------------------|--|---|--------------------------|---------------------------------------|-------------------------------------|-------------------------------------|
| <b>Kandy Branch</b><br>1, Dalada Veediya,<br>Kandy.                  | 29,196              | 57.65               | 432,375                                  | 238,595                                       | 670,970                  | 15,466                                | <b>655,504</b>                      | 660,450                             |
| <b>Kalmunai Branch</b><br>30A, Batticaloa Road<br>Kalmunai           | Bare Land           | 136.50              | 19,779                                   | -   | 19,779                   | -                                     | <b>19,779</b>                       | -                                   |
| <b>Kahawatte Branch</b><br>77 2A, Main Street,<br>Kahawatte.         | 8,331               | 16.14               | 12,100                                   | 42,765  | 54,865                   | 3,146                                 | <b>51,719</b>                       | 43,536                              |
| <b>Kegalle Branch</b><br>Main Street,<br>Kegalle.                    | Bare Land           | 48.70               | 15,600                                   | -   | 15,600                   | -                                     | <b>15,600</b>                       | 15,600                              |
| <b>Kuliyapitiya Branch</b><br>225, Main Street,<br>Kuliyapitiya.     | 4,506               | 31.80               | 15,150                                   | 19,975  | 35,125                   | 1,657                                 | <b>33,468</b>                       | 31,400                              |
| <b>Kurunegala Branch</b><br>6, St. Anne's Street,<br>Kurunegala.     | 9,600               | 36.25               | 32,375                                   | 82,758  | 115,133                  | 5,915                                 | <b>109,218</b>                      | 111,261                             |
| <b>Mannar Branch</b><br>68, Main Street,<br>Mannar.                  | 5,466               | 23.00               | 619                                      | 17,214  | 17,833                   | 1,858                                 | <b>15,975</b>                       | 13,766                              |
| <b>Marawila Branch</b><br>534, Chilaw Road,<br>Marawila.             | 7,352               | 43.80               | 19,545                                   | 17,370  | 36,915                   | 1,848                                 | <b>35,067</b>                       | 34,744                              |
| <b>Maskeliya Branch</b><br>9, New Town,<br>Maskeliya.                | 4,757               | 20.32               | 4,100                                    | 32,183  | 36,283                   | 1,864                                 | <b>34,419</b>                       | 35,077                              |
| <b>Matale Branch</b><br>660, Trincomalee Road,<br>Matale.            | 8,493               | 22.80               | 13,700                                   | 28,125  | 41,825                   | 2,724                                 | <b>39,101</b>                       | 39,819                              |
| <b>Matara Branch</b><br>29, Anagarika Dharmapala Mawatha,<br>Matara. | 9,580               | 26.00               | 22,000                                   | 34,786  | 56,786                   | 3,479                                 | <b>53,307</b>                       | 53,587                              |
| <b>Mount Lavinia Branch</b><br>100, Galle Road,<br>Mount Lavinia.    | 12,674              | 22.66               | 34,000                                   | 34,432  | 68,432                   | 4,104                                 | <b>64,328</b>                       | 65,094                              |
| <b>Minuwangoda Branch</b><br>115A, Minuwangoda Road,<br>Ekala.       | 3,538               | 20.51               | 20,044                                   | 6,754   | 26,798                   | 298                                   | <b>26,500</b>                       | 25,561                              |
| <b>Monaragala</b><br>No 67/11, Kumaradola Road,<br>Monaragala.       | Bare Land           | 20.00               | 1,455                                    | -   | 1,455                    | -                                     | <b>1,455</b>                        | 1,455                               |

## NOTES TO THE FINANCIAL STATEMENTS

### 34 PROPERTY, PLANT AND EQUIPMENT (Contd.)

#### 34 (b) Freehold Land and Buildings - Bank (Contd)

| As at 31st December 2010   | Buildings<br>Sq.ft. | Extent<br>(perches) | Cost /<br>Valuation of<br>Land<br>Rs 000 | Cost /<br>Valuation of<br>Buildings<br>Rs 000 | Total<br>Value<br>Rs 000 | Accumulated<br>Depreciation<br>Rs 000 | Net Book<br>Value<br>2010<br>Rs 000 | Net Book<br>Value<br>2009<br>Rs 000 |
|--|---------------------|---------------------|--|---|--------------------------|---------------------------------------|-------------------------------------|-------------------------------------|
| <b>Nawalapitiya Branch</b><br>92, Gampola Road,<br>Nawalapitiya.                     | 3,900               | 7.00                | 6,400                                    | 6,959   | 13,359                   | 858                                   | 12,501                              | 12,717                              |
| <b>Negombo Branch</b><br>18, Rajapakse Broadway,<br>Negombo.                         | 5,440               | 8.88                | 11,100                                   | 19,938  | 31,038                   | 2,154                                 | 28,884                              | 53,421                              |
| <b>Negombo Metro Building</b><br>190, Colombo Road<br>Negombo                        | 24,416              | 51.98               | 25,479                                   | 178,865                                       | 204,344                  | 2,241                                 | 202,103                             | -                                   |
| <b>Nittambuwa Branch</b><br>22, Kandy Road,<br>Nittambuwa.                           | 5,840               | 12.30               | 49,624                                   | 9,990   | 59,614                   | 1,143                                 | 58,471                              | 57,896                              |
| <b>Nochchiyagama Branch</b><br>10, Puttalam Road,<br>Nochchiyagama.                  | 9,890               | 40.00               | 10,000                                   | 16,298  | 26,298                   | 1,856                                 | 24,442                              | 24,951                              |
| <b>Nugegoda Branch</b><br>181, High Level Road,<br>Nugegoda.                         | 11,560              | 15.71               | 58,500                                   | 71,752  | 130,252                  | 9,028                                 | 121,224                             | 123,470                             |
| <b>Nuwara Eliya Branch / Bungalow</b><br>42, Queen Elizabeth Drive,<br>Nuwara Eliya. | 13,507              | 149.03              | 41,700                                   | 28,871  | 70,571                   | 2,839                                 | 67,732                              | 64,084                              |
| <b>Polonnaruwa Branch</b><br>467, Main Street, Kaduruwela<br>Polonnaruwa.            | 7,296               | 18.43               | -  | 38,036  | 38,036                   | 5,219                                 | 32,817                              | -                                   |
| <b>Pussellawa Branch</b><br>409/9A, Pussellawa Road,<br>Pussellawa.                  | 6,163               | 15.90               | 10,599                                   | 19,561  | 30,160                   | 790                                   | 29,370                              | 28,979                              |
| <b>Ratnapura Branch</b><br>21 & 23, Senanayake Mawatha,<br>Ratnapura.                | 3,805               | 27.70               | 24,879                                   | 13,116  | 37,995                   | 901                                   | 37,094                              | 35,089                              |
| <b>Trincomalee Branch</b><br>59, Ahambraram Road,<br>Trincomalee.                    | 6,802               | 33.91               | 24,137                                   | 24,975  | 49,112                   | 5,313                                 | 43,799                              | 41,351                              |
| <b>Welimada Branch</b><br>35, Nuwara Eliya Road,<br>Welimada.                        | 4,415               | 14.37               | 20,747                                   | 11,863  | 32,610                   | 3,973                                 | 28,637                              | 28,402                              |
| <b>Wellawaya Branch</b><br>70, Kumaradasa Mawatha<br>Wellawaya.                      | 6,916               | 30.00               | 2,837                                    | 21,159  | 23,996                   | 4,413                                 | 19,583                              | -                                   |
| <b>Wattala Branch</b><br>270, 270/1, Negombo Road,<br>Wattala.                       | 8,090               | 53.00               | 60,605                                   | 35,619  | 96,224                   | 3,902                                 | 92,322                              | 92,061                              |
| <b>Total freehold land and buildings<br/>outside Colombo City Limits</b>             |                     |                     | 1,411,357                                | 1,327,660                                     | 2,739,017                | 107,293                               | 2,631,724                           | 2,318,847                           |
| <b>Total freehold land and buildings</b>   |                     |                     | 3,408,588                                | 1,809,135                                     | 5,217,723                | 159,448                               | 5,058,275                           | 4,747,287                           |



## 34 PROPERTY, PLANT AND EQUIPMENT (Contd.)

### 34 (c) Leasehold Buildings

| As at 31st December | Bank<br>2010                   |                                       |                             | Group<br>2010                  |                                       |                             | Bank<br>2009                |                             | Group<br>2009               |
|---------------------|--------------------------------|---------------------------------------|-----------------------------|--------------------------------|---------------------------------------|-----------------------------|-----------------------------|-----------------------------|-----------------------------|
|                     | Cost of<br>Buildings<br>Rs 000 | Accumulated<br>Depreciation<br>Rs 000 | Net Book<br>Value<br>Rs 000 | Cost of<br>Buildings<br>Rs 000 | Accumulated<br>Depreciation<br>Rs 000 | Net Book<br>Value<br>Rs 000 | Net Book<br>Value<br>Rs 000 | Net Book<br>Value<br>Rs 000 | Net Book<br>Value<br>Rs 000 |
| Up to 1 year        | -                              | -                                     | -                           | -                              | -                                     | -                           | 87                          |                             | 87                          |
| 01 - 05 years       | 291,807                        | 193,832                               | 97,975                      | 312,685                        | 201,363                               | 111,322                     | 64,123                      |                             | 81,648                      |
| 05 - 10 years       | 829,756                        | 469,223                               | 360,533                     | 829,758                        | 469,225                               | 360,533                     | 340,129                     |                             | 340,129                     |
| 10 - 15 years       | 61,059                         | 37,616                                | 23,443                      | 61,059                         | 37,616                                | 23,443                      | 46,847                      |                             | 46,847                      |
| 15 - 20 years       | 12,260                         | 6,028                                 | 6,232                       | 12,260                         | 6,028                                 | 6,232                       | 6,754                       |                             | 6,754                       |
|                     | 1,194,882                      | 706,699                               | 488,183                     | 1,215,762                      | 714,232                               | 501,530                     | 457,940                     |                             | 475,465                     |

### 34 (d) Fully Depreciated Property, Plant and Equipment

The initial cost of fully depreciated property, plant and equipment as at 31st December 2010, which are still in use as at Balance Sheet date is as follows.

| As at 31st December               | 2010<br>Rs 000 | 2009<br>Rs 000 |
|-----------------------------------|----------------|----------------|
| Motor vehicles                    | 70,697         | 37,523         |
| Leasehold building                | 192,658        | 209,795        |
| Computer equipment                | 682,961        | 1,285,773      |
| Equipment, furniture and fixtures | 1,165,032      | 670,153        |
| Intangible assets                 | 419,647        | -              |

### 34 (e) Temporarily Idle Property, Plant and Equipment

Two lands worth of Rs 17.055 Mn were idle as at 31st December 2010 (2009 - Nil) as these lands were not identified as available for immediate use.

### 34 (f) Property, Plant and Equipment Retired from Active Use

The carrying amount of property, plant and equipment which are retired from active use and not classified as held for sale as at 31st December 2010 is Rs 0.276 Mn (2009 - Rs 0.312 Mn).

| As at 31st December               | 2010<br>Rs 000 | 2009<br>Rs 000 |
|-----------------------------------|----------------|----------------|
| Computer equipment                | -              | 116            |
| Equipment, furniture and fixtures | 276            | 196            |
|                                   | 276            | 312            |

### 34 (g) Title Restriction on Property, Plant and Equipment

There were no restrictions on the title of property, plant and equipments as at 31st December 2010.

### 34 (h) Property, Plant and Equipment Pledged as Security for Liabilities

There were no items of property, plant and equipments pledged as securities for liabilities.

### 34 (i) Compensation from Third Parties for Items of Property, Plant and Equipment

Rs 5.3 Mn was received as compensation from third parties for items of property, plant and equipment that were impaired, lost or given up.

## NOTES TO THE FINANCIAL STATEMENTS

### 35 INTANGIBLE ASSETS

| As at 31st December   | Bank             |                  | Group            |                  |
|---|------------------|------------------|------------------|------------------|
|   | 2010<br>Rs 000   | 2009<br>Rs 000   | 2010<br>Rs 000   | 2009<br>Rs 000   |
| <b>Cost</b>   |                  |                  |                  |                  |
| Balance as at 1st January without exchange effect   | 1,399,071        | 1,284,761        | 1,470,140        | 1,337,891        |
| Effect of movements in exchange rates   | -                | -                | 301              | -                |
| Balance as at 1st January   | 1,399,071        | 1,284,761        | 1,470,441        | 1,337,891        |
| Additions and improvements during the year  | 68,183           | 110,432          | 100,105          | 126,378          |
| Acquisitions of Subsidiaries by Joint Venture   | -                | -                | 2,475            | 2,399            |
| Good will on acquisition through Joint Venture [Note 35 (b)]  | -                | -                | 70,188           | -                |
| Transferred from capital work-in-progress   | 2,321            | 3,878            | 2,321            | 3,878            |
| Disposal of Subsidiaries  | -                | -                | -                | (2,708)          |
| Transferred to Acuity Partners (Pvt) Ltd and<br>Acuity Stockbrokers (Pvt) Ltd from DNH Financial (Pvt) Ltd<br>[former HNB Stockbrokers (Pvt) Ltd] | -                | -                | -                | 2,307            |
| Effect of movement in exchange rates  | -                | -                | 54               | 296              |
| <b>Balance as at 31st December</b>  | <b>1,469,575</b> | <b>1,399,071</b> | <b>1,645,584</b> | <b>1,470,441</b> |
| <b>Accumulated amortisation</b>   |                  |                  |                  |                  |
| Balance as at 1st January without exchange effect   | 723,799          | 557,163          | 760,385          | 584,503          |
| Effect of movements in exchange rates   | -                | -                | 47               | -                |
| Balance as at 1st January   | 723,799          | 557,163          | 760,432          | 584,503          |
| Amortisation for the year   | 168,761          | 166,636          | 179,997          | 175,765          |
| Acquisition of Subsidiaries by Joint Venture  | -                | -                | 2,209            | 360              |
| Disposal of Subsidiaries  | -                | -                | -                | (1,247)          |
| Transferred to Acuity Partners (Pvt) Ltd and<br>Acuity Stockbrokers (Pvt) Ltd from DNH Financial (Pvt) Ltd<br>(former HNB Stockbrokers (Pvt) Ltd) | -                | -                | -                | 1,004            |
| Effect of movement in exchange rates  | -                | -                | 16               | 47               |
| <b>Balance as at 31st December</b>  | <b>892,560</b>   | <b>723,799</b>   | <b>942,654</b>   | <b>760,432</b>   |
| <b>Net book value as at 31st December</b>   | <b>577,015</b>   | <b>675,272</b>   | <b>702,930</b>   | <b>710,009</b>   |

#### 35 (a) Analysis of Intangible Assets

|                        |                |                |                |                |
|------------------------|----------------|----------------|----------------|----------------|
| Software               | 577,015        | 675,272        | 632,742        | 710,009        |
| Goodwill [Note 35 (b)] | -              | -              | 70,188         | -              |
|                        | <b>577,015</b> | <b>675,272</b> | <b>702,930</b> | <b>710,009</b> |

As stated in Note 4.10.1 (b), all computer software costs incurred by the Bank / Group which are not integrally related to associated hardware have been classified as intangible assets.

There were no restrictions on the title of the intangible assets as at the Balance Sheet date. Further there were no items pledged as securities for liabilities.

#### 35 (b) Goodwill

| As at 31st December                 | Bank           |                | Group          |                |
|-------------------------------------|----------------|----------------|----------------|----------------|
|                                     | 2010<br>Rs 000 | 2009<br>Rs 000 | 2010<br>Rs 000 | 2009<br>Rs 000 |
| Balance as at 1st January           | -              | -              | -              | -              |
| Goodwill recognised during the year | -              | -              | 70,188         | -              |
| <b>Balance as at 31st December</b>  | <b>-</b>       | <b>-</b>       | <b>70,188</b>  | <b>-</b>       |

Goodwill recognised during the year is in respect of acquisition of Lanka Ventures PLC by the Joint Venture Acuity Partners (Pvt) Ltd. 50% of the goodwill created through this transaction has been recognised in Consolidated Financial Statements being the shareholding of the Bank in the Joint Venture.

### 36 OTHER ASSETS

| As at 31st December                           | Bank             |                  | Group            |                  |
|---|------------------|------------------|------------------|------------------|
|   | 2010<br>Rs 000   | 2009<br>Rs 000   | 2010<br>Rs 000   | 2009<br>Rs 000   |
| Deposits, prepayments and interest receivable | 3,533,647        | 3,899,260        | 3,291,211        | 3,472,973        |
| Items in transit                              | 2,540,450        | 1,910,397        | 2,540,450        | 1,910,397        |
| Claims receivable                             | -                | -                | 71,759           | 24,698           |
| VAT recoverable                               | 1,109,223        | 566,427          | 1,114,337        | 569,987          |
| Related party receivable - exchange houses *  | 11,937           | 39,977           | -                | 3,720            |
| Items held for use                            | 141,023          | 158,937          | 142,090          | 160,679          |
| Inventory - residential apartment complex **  | -                | -                | 941,055          | 938,591          |
| Other debtors                                 | 369,036          | 311,680          | 1,045,189        | 978,069          |
|   | <b>7,705,316</b> | <b>6,886,678</b> | <b>9,146,091</b> | <b>8,059,113</b> |

\* Rs 18.885 Mn included under related party receivable from Commercial Interlink Services Inc (o/a Delma Exchange Canada) has been fully provided for during the year.

\*\* Rs 8.367 Mn has been charged as provision in the Consolidated Financial Statements for impairment of inventory - residential apartment complex held by the Subsidiary, Sithma Development (Pvt) Ltd.

### 37 DEPOSITS FROM CUSTOMERS

| As at 31st December              | Bank               |                    | Group              |                    |
|----------------------------------|--------------------|--------------------|--------------------|--------------------|
|                                  | 2010<br>Rs 000     | 2009<br>Rs 000     | 2010<br>Rs 000     | 2009<br>Rs 000     |
| <b>Local Currency Deposits</b>   |                    |                    |                    |                    |
| Current account deposits         | 24,214,105         | 15,090,759         | 24,134,386         | 15,038,532         |
| Savings deposits                 | 83,981,743         | 66,080,330         | 83,980,788         | 66,080,282         |
| Time deposits                    | 78,198,953         | 80,572,001         | 78,171,703         | 80,544,751         |
| Certificates of deposit          | 5,576,315          | 5,439,817          | 5,576,315          | 5,439,817          |
|                                  | <b>191,971,116</b> | <b>167,182,907</b> | <b>191,863,192</b> | <b>167,103,382</b> |
| <b>Foreign Currency Deposits</b> |                    |                    |                    |                    |
| Current account deposits         | 794,003            | 1,191,309          | 794,003            | 1,191,309          |
| Savings deposits                 | 15,033,471         | 14,715,443         | 15,019,677         | 14,710,532         |
| Time deposits                    | 26,272,495         | 27,417,146         | 26,203,682         | 27,357,922         |
|                                  | <b>42,099,969</b>  | <b>43,323,898</b>  | <b>42,017,362</b>  | <b>43,259,763</b>  |
| <b>Total Deposits</b>            | <b>234,071,085</b> | <b>210,506,805</b> | <b>233,880,554</b> | <b>210,363,145</b> |
| Deposits from non-bank customers | 234,026,250        | 210,469,638        | 233,835,719        | 210,325,978        |
| Deposits from banks              | 29,238             | 24,533             | 29,238             | 24,533             |
| Deposits from finance companies  | 15,597             | 12,634             | 15,597             | 12,634             |
|                                  | <b>234,071,085</b> | <b>210,506,805</b> | <b>233,880,554</b> | <b>210,363,145</b> |

### 38 DIVIDENDS PAYABLE

| As at 31st December  | Bank           |                | Group          |                |
|--|----------------|----------------|----------------|----------------|
|  | 2010<br>Rs 000 | 2009<br>Rs 000 | 2010<br>Rs 000 | 2009<br>Rs 000 |
| Balance as at 1st January                                  | 215,607        | 127,303        | 215,607        | 127,303        |
| Final dividends declared in the prior year                 | 1,179,807      | 706,588        | 1,179,807      | 706,588        |
| Interim dividends declared during the year                 | 338,570        | 353,415        | 338,570        | 353,415        |
| Reversal of dividend declared in prior years [Note 38 (c)] | (175,712)      | -              | (175,712)      | -              |
| Dividends paid   | (1,508,713)    | (971,699)      | (1,508,713)    | (971,699)      |
| Unclaimed balance of Subsidiary acquired by Joint Venture  | -              | -              | 1,562          | -              |
| <b>Balance as at 31st December</b>                         | <b>49,558</b>  | <b>215,607</b> | <b>51,121</b>  | <b>215,607</b> |

#### 38 (a) Proposed Final Dividend

Board of Directors has recommended the payment of final dividend of Rs 5.50 per share for the year ended 31st December 2010 (2009 final - Rs 5.00 per share), which is to be approved at the Annual General Meeting to be held on 31st March 2011. In accordance with Sri Lanka Accounting Standard No 12 (Revised 2005), "Events after the Balance Sheet Date", this proposed final dividend has not been recognised as a liability as at 31st December 2010. Under the Inland Revenue Act No 10 of 2006, a withholding tax of 10% has been imposed on dividends declared. An interim dividend of Rs 1.50 per share (2009 - Rs 1.50) was paid for the shareholders on 24th November 2010. Final dividends proposed for the year 2010 amounts to Rs 1,309.122 Mn (2009 - Rs 1,179.807 Mn).

## NOTES TO THE FINANCIAL STATEMENTS

### 38 DIVIDENDS PAYABLE (Contd.)

#### 38 (b) Compliance with Section 56 and 57 of Companies Act No 7 of 2007

As required by Section 56 of the Companies Act No 07 of 2007, the Board of Directors of the Bank satisfied the solvency test in accordance with the section 57, prior to recommending the final dividend. A statement of solvency completed and duly signed by the directors on 18th February 2011 has been audited by Messrs KPMG Ford, Rhodes, Thornton & Co.

#### 38 (c) Reversal of Dividend Declared in Previous Years

The persons who invested in the ordinary shares (voting) of the Bank's capital, but not recognised and registered as shareholders of the Bank in the share register are not entitled to such shares. Title to any share/s will vest on a person only when such person's name is entered in the register as a holder of shares in the Bank. Thus no dividends were paid to unregistered share holders as such shareholders had no right to receive any dividends. In the event such investors are recognised as shareholders at any stage, then their shareholdings will be dated back to the date of the first investment and they will become entitled to all past dividends. However, the investors who disposed their shares while they were not registered as shareholders are therefore no longer entitled to any past dividends on such shares. Accordingly dividends accrued against such shareholders of Rs 175.712 Mn has been credited to retained earnings during the year and presented in the Statement of Changes in Equity.

### 39 BORROWINGS

| As at 31st December           | Bank              |                  | Group             |                  |
|-------------------------------|-------------------|------------------|-------------------|------------------|
|                               | 2010<br>Rs 000    | 2009<br>Rs 000   | 2010<br>Rs 000    | 2009<br>Rs 000   |
| Refinance borrowings          | 6,314,639         | 6,169,445        | 6,314,639         | 6,169,445        |
| Borrowings from foreign banks | 4,494,901         | 2,133,264        | 4,474,029         | 2,132,453        |
| Other borrowings              | 1,014             | 7,419            | 14,830            | 11,542           |
|                               | <b>10,810,554</b> | <b>8,310,128</b> | <b>10,803,498</b> | <b>8,313,440</b> |

### 40 SUBORDINATED DEBENTURES

|   |                  |                  |                  |                  |
|---|------------------|------------------|------------------|------------------|
| Balance as at 1st January   | 2,673,192        | 2,754,851        | 2,653,192        | 3,734,851        |
| Interest capitalised *  | 51,101           | 45,968           | 51,101           | 45,968           |
| Debentures redeemed **  | -                | (127,627)        | -                | (1,127,627)      |
| Debentures of the Bank held by Subsidiary acquired through Joint Venture*** | -                | -                | (6,750)          | -                |
| <b>Balance as at 31st December</b>  | <b>2,724,293</b> | <b>2,673,192</b> | <b>2,697,543</b> | <b>2,653,192</b> |

\* Interest payable on zero coupon debentures have been added to the debenture value.

\*\* On 10th September 2009 Rs 127.6 Mn worth of debentures were redeemed by the Bank, while on 15th December 2009 Rs 1 Bn worth of debentures were redeemed by Sithma Development (Pvt) Ltd.

\*\*\* Lanka Ventures PLC, a Subsidiary of Acuity Partners (Pvt) Ltd the Joint Venture holds Rs 13.5 Mn debentures of the Bank. 50% of this is recognised being the shareholding of the Bank in the Joint Venture.

HNB Assurance PLC, a Subsidiary of the Bank holds 200,000 debentures amounting to Rs 20 Mn.

#### 40 (a) Terms and Conditions of Unsecured, Subordinated, Redeemable Debentures issued are as follows

##### 40 (a) i Year of Issuance

2002

Number of debentures of Rs 100 each 1,132,240

Six types of debentures were included in the above issue, with fixed or floating interest rate options as follows.

| Redemption period           | 10 Years              |
|-----------------------------|-----------------------|
| Fixed p.a.                  | 14.20%                |
| Effective annual yield p.a. | 14.70%                |
| Floating p.a.               | 6 months net TB+1.25% |
| Redeemable on               | 10th September 2012   |
| Amount (Rs 000)             | 113,224               |

The floating rate is based on the six month treasury bill net rate with a cap of 17% p.a. and a floor of 12% p.a. These debentures are listed on the Colombo Stock Exchange.

## 40 SUBORDINATED DEBENTURES (Contd.)

### 40 (a) ii Year of Issuance 2006

Number of debentures of Rs 100 each 11,200,000

Five types of debentures were included in the above issue, with fixed or floating interest rate options as follows.

| Redemption Period           | 6 Year                  | 7 Year                  | 8 Year                  | 15 Year         | 18 Year         |
|-----------------------------|-------------------------|-------------------------|-------------------------|-----------------|-----------------|
| Fixed p.a.                  |                         |                         |                         | 11.00%          | 11.25%          |
| Effective annual yield p.a. |                         |                         |                         | 11.00%          | 11.00%          |
| Floating p.a.               | 6 months net TB + 2.25% | 6 months net TB + 2.25% | 6 months net TB + 2.25% |                 |                 |
| Redeemable on               | 31st March 2012         | 31st March 2013         | 31st March 2014         | 31st March 2021 | 31st March 2024 |
| Amount (Rs 000)             | 262,500                 | 250,000                 | 300,000                 | 176,657         | 332,209         |

The above floating rate is based on the six month treasury bill net rate with a cap of 16% p.a. and a floor of 8% p.a. These debentures are listed on the Colombo Stock Exchange.

### 40 (a) iii Year of Issuance 2007

Number of debentures of Rs 100 each 12,000,000

Two types of debentures were included in the above issue with fixed rates.

| Redemption Period           | 10 years       | 15 years       |
|-----------------------------|----------------|----------------|
| Fixed p.a.                  | 16.00%         | 16.75%         |
| Effective annual yield p.a. | 16.00%         | 16.75%         |
| Redeemable on               | 31st July 2017 | 31st July 2022 |
| Amount (Rs 000)             | 500,000        | 700,000        |

These debentures are listed on the Colombo Stock Exchange.

### 40 (a) iv Year of Issuance 2008

Number of debentures of Rs 100 each 897,045

Five types of debentures were included in the above issue with fixed or floating interest rate options. However only the 5 year debentures were issued with the following characteristics.

| Redemption period           | 5 year                |
|-----------------------------|-----------------------|
| Fixed p.a.                  |                       |
| Effective annual yield p.a. |                       |
| Floating p.a.               | 1 year net TB + 1.00% |
| Redeemable on               | 4th June 2013         |
| Amount (Rs 000)             | 89,705                |

These debentures are pending listing on the Colombo Stock Exchange.

**40(a)v** The above debentures will, in the event of the winding of the Bank, be subordinated to the claims of depositors and all other creditors of the Bank.

The Bank has not had any defaults of principal, interest or other breaches with respect to its subordinated liabilities during 2010 and 2009.

## 41 INSURANCE PROVISION-LIFE

The insurance provision - life balance represents the life fund of the Subsidiary HNB Assurance PLC, which is carrying out life and general insurance business. This balance represents the amounts attributable to life policy holders included in the Group's net assets. The valuation of the insurance provision - life as at 31st December 2010 was made by Mr M Poopalanathan, AIA, of Messrs Actuarial and Management Consultants (Pvt) Ltd for and on behalf of HNB Assurance PLC. The life fund stands at Rs 2,385.2 Mn as at 31st December 2010 (2009 - Rs 1,853.5 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 31st January 2011.

## NOTES TO THE FINANCIAL STATEMENTS

### 42 INSURANCE PROVISION - GENERAL

Insurance provision general represents the following which are included in the financial statements of HNB Assurance PLC, Subsidiary of the Bank, as required by the Statement of Recommended Practice of the Institute of Chartered Accountants of Sri Lanka (ICASL) and in accordance with the regulation of Insurance Industry Act No 43 of 2000.

| As at 31st December                      | Group          |                | Group          |                |
|--|----------------|----------------|----------------|----------------|
|  | 2010<br>Rs 000 | 2010<br>Rs 000 | 2009<br>Rs 000 | 2009<br>Rs 000 |
| Unearned premium                         |                |                |                |                |
| Gross                                    |                | 748,856        |                | 626,056        |
| Reinsurance                              |                | (196,675)      |                | (202,352)      |
| Net                                      |                | 552,181        |                | 423,704        |
| Deferred acquisition expenses            |                | (12,392)       |                | (4,644)        |
| Unexpired risk reserve                   |                | 12,641         |                | 9,244          |
|  |                | 552,430        |                | 428,304        |
| Claims outstanding - Gross               | 154,176        |                | 151,825        |                |
| Claims incurred but not reported - Gross | 24,052         | 178,228        | 19,235         | 171,060        |
| <b>Total</b>                             |                | <b>730,658</b> |                | <b>599,364</b> |

### 43 DEFERRED TAX LIABILITIES

| As at 31st December                    | Bank           |                | Group          |                |
|--|----------------|----------------|----------------|----------------|
|  | 2010<br>Rs 000 | 2009<br>Rs 000 | 2010<br>Rs 000 | 2009<br>Rs 000 |
| Deferred tax liabilities [Note 43 (a)] | 890,602        | 967,604        | 891,530        | 968,494        |
| Deferred tax assets [Note 43 (b)]      | (154,718)      | (28,351)       | (157,154)      | (30,128)       |
|  | 735,884        | 939,253        | 734,376        | 938,366        |

#### 43 (a) Deferred Tax Liabilities

|   | Bank                              |                         |                                   |                         | Group                             |                         |                                   |                         |
|---|-----------------------------------|-------------------------|-----------------------------------|-------------------------|-----------------------------------|-------------------------|-----------------------------------|-------------------------|
|   | 2010                              |                         | 2009                              |                         | 2010                              |                         | 2009                              |                         |
|   | Temporary<br>Difference<br>Rs 000 | Tax<br>Effect<br>Rs 000 | Temporary<br>Difference<br>Rs 000 | Tax<br>Effect<br>Rs 000 | Temporary<br>Difference<br>Rs 000 | Tax<br>Effect<br>Rs 000 | Temporary<br>Difference<br>Rs 000 | Tax<br>Effect<br>Rs 000 |
| Balance as at 1st January   | 2,764,583                         | 967,604                 | 2,582,693                         | 903,942                 | 2,768,345                         | 968,494                 | 2,588,134                         | 905,420                 |
| Impact on rate change reversed to<br>Income Statement [Note 43 (c)]                               | -                                 | (177,861)               | -                                 | -                       | -                                 | (177,898)               | -                                 | -                       |
| Impact on rate change to equity   | -                                 | (15,661)                | -                                 | -                       | -                                 | (15,661)                | -                                 | -                       |
| Deferred tax liabilities attributable<br>to revaluation surplus<br>charged to equity              | (8,029)                           | (2,248)                 | (8,029)                           | (2,810)                 | (8,029)                           | (2,248)                 | (8,029)                           | (2,810)                 |
| Adjustment to deferred tax on<br>additional investment in<br>Subsidiary through the Joint Venture | -                                 | -                       | -                                 | -                       | 657                               | 185                     | -                                 | -                       |
| Originating during the year   | 424,173                           | 118,768                 | 189,919                           | 66,472                  | 423,779                           | 118,658                 | 188,240                           | 65,884                  |
|   | 3,180,727                         | 890,602                 | 2,764,583                         | 967,604                 | 3,184,752                         | 891,530                 | 2,768,345                         | 968,494                 |

#### Deferred Tax Liability Charged Directly to Equity

According to Sri Lanka Accounting Standard No 14 (Revised 2005) "Income Taxes", deferred tax shall be charged or credited directly to equity if the tax relates to items that are credited or charged, in the same or in a different period, directly to equity.

Accordingly, the deferred tax liability arising on revaluation of property, plant and equipment of Rs 17,547 Mn was charged directly to revaluation reserve in the Statement of Changes in Equity in 2007. Reversals of Rs 2.248 Mn per annum (2009 - Rs 2.810 Mn) have been made to the revaluation reserve in the Statement of Changes in Equity from deferred tax liability. The reversal of deferred tax liability to revaluation reserve results from the excess depreciation resulting from the revaluation of property, plant and equipment that took place in 2007.

No deferred tax liability has been recognised for Sithma Development (Pvt) Ltd, in view of the tax holiday enjoyed by the company. The details have been given in Note 20 (i).

### 43 DEFERRED TAX LIABILITIES (Contd.)

#### 43 (b) Deferred Tax Asset

|   | Bank                 |            |                      |            | Group                |            |                      |            |
|---|----------------------|------------|----------------------|------------|----------------------|------------|----------------------|------------|
|   | 2010                 |            | 2009                 |            | 2010                 |            | 2009                 |            |
|   | Temporary Difference | Tax Effect | Temporary Difference | Tax Effect | Temporary Difference | Tax Effect | Temporary Difference | Tax Effect |
|   | Rs 000               | Rs 000     | Rs 000               | Rs 000     | Rs 000               | Rs 000     | Rs 000               | Rs 000     |
| Balance as at 1st January   | 81,003               | 28,351     | 90,114               | 31,540     | 86,078               | 30,128     | 93,587               | 32,756     |
| Opening balance adjustment  | -                    | -          | -                    | -          | (446)                | (156)      | -                    | -          |
| Impact on rate change reversed to Income Statement [Note 43 (c)]  | -                    | (5,670)    | -                    | -          | -                    | (5,853)    | -                    | -          |
| Deferred tax asset recognised / (reversed) on general provisions [Note 43 (d)]                              | 471,560              | 132,037    | (9,111)              | (3,189)    | 471,560              | 132,037    | (9,111)              | (3,189)    |
| Adjustment to deferred tax on additional investment in Subsidiary through the Joint Venture                 | -                    | -          | -                    | -          | 454                  | 127        | -                    | -          |
| Deferred tax asset recognised / (reversed) on deductible temporary differences other than general provision | -                    | -          | -                    | -          | 3,110                | 871        | 5,071                | 1,775      |
| Deferred tax on disposal of DNH Financial (Pvt) Ltd (former HNB Stockbrokers (Pvt) Ltd)                     | -                    | -          | -                    | -          | -                    | -          | (3,469)              | (1,214)    |
|   | 552,563              | 154,718    | 81,003               | 28,351     | 560,756              | 157,154    | 86,078               | 30,128     |

#### 43 (c) Impact Due to Corporate Income Tax Rate Change

The corporate income tax rate would be reduced to 28% commencing from year of assessment 2011/12 as per the budget proposals for 2011 announced by the Finance Minister, which is considered to be substantially enacted pending legislation in 2011. Accordingly, deferred tax asset and liability have been computed based on 28% and Rs 172.191 Mn in the Bank and Rs 172.045 Mn in the Group have been reversed to Income Statement as disclosed in Note 20 (b) - Deferred Tax Expense.

#### 43 (d) Deductible Temporary Difference - General Provision - Bank

During the year the Central Bank of Sri Lanka issued amended guidelines on general provision requirement for performing and overdue / special mention loans and advances as explained in Note 4.8.3 (b) which require the banks to maintain general provision at 0.5% commencing from 1st January 2012. The banks shall reduce the general provision requirement of 1% to 0.5% at a rate of 0.1% per quarter commencing from 1st October 2010.

The general provision requirement as at 31st December 2010 was 0.9%. Accordingly, 0.4% of the general provision will reverse during 2011. The Bank has recognised a deferred tax asset amounting to Rs 146.444 Mn arising due to the said reversal.

In management's view the Bank's NPA ratio as at Balance Sheet date is an indicator of deferred tax asset which could be recovered in the future periods in respect of the deductible temporary difference arising from this balance general provision of 0.5%. Recognition of deferred tax asset relating to temporary differences arising from balance general provision of 0.5% as at Balance Sheet date was limited to Bank's NPA ratio of 4.51% (2009 - 6.15%). Deferred tax asset recognised during the year of Rs 132.037 Mn is the deferred tax asset recognised during the year net of reversal of deferred tax asset.

### 44 OTHER LIABILITIES

| As at 31st December   | Bank       |            | Group      |            |
|---|------------|------------|------------|------------|
|   | 2010       | 2009       | 2010       | 2009       |
|   | Rs 000     | Rs 000     | Rs 000     | Rs 000     |
| Cheques sent on clearing  | 2,191,687  | 1,709,760  | 2,191,687  | 1,709,760  |
| Accrued expenditure and interest  | 14,474,729 | 14,652,430 | 14,594,661 | 14,746,243 |
| Items in transit  | 5,782      | 7,871      | 5,782      | 7,871      |
| Margins   | 1,162,309  | 905,455    | 1,162,309  | 905,455    |
| Refundable deposits and advances*   | -          | -          | 489,442    | 191,323    |
| Balance held o/a of Pension Fund  | 2,207,605  | 2,053,398  | 2,207,605  | 2,053,398  |
| Balance held o/a of Widows' / Widowers' and Orphans' Pension Fund (WW&OP) | 41,047     | 467,970    | 41,047     | 467,970    |
| Balance held o/a of Employees' Provident Fund (EPF)                       | 110,365    | 24,813     | 110,365    | 24,813     |
| Provision for retiring benefits   | -          | -          | 33,776     | 22,878     |
| Payable to vendors for lease equipments                                   | 640,469    | 181,703    | 640,469    | 181,703    |
| Other creditors   | 1,029,850  | 973,037    | 1,843,910  | 1,634,317  |
|   | 21,863,843 | 20,976,437 | 23,321,053 | 21,945,731 |

\*Refundable deposits and advances include the advances taken from customers on account of the apartments in the Residential Apartments Complex which is developed by Sithma Development (Pvt) Ltd.



## NOTES TO THE FINANCIAL STATEMENTS

### 45 EMPLOYEE RETIREMENT BENEFITS

#### 45 (a) Pension Fund

An actuarial valuation of the Pension Fund was carried out as at 31st December 2010 by Mr M Poopalanathan, AIA, Messrs Actuarial and Management Consultants (Pvt) Ltd, a firm of professional actuaries. The valuation method used by the actuaries to value the Fund is the "Projected Unit Credit Method", the method recommended by the Sri Lanka Accounting Standard No 16 (Revised 2006) "Employee Benefits".

Accordingly, the Bank contributes on the following basis for the employees to the Pension Fund:

Pensionable Employees - 24.34%

Employees who opted for the Optional Scheme - 23%

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.

#### 45 (a) i Amounts Recognised in the Balance Sheet are as follows

| As at 31st December   | 2010<br>Rs 000 | 2009<br>Rs 000 |
|---|----------------|----------------|
| Present value of unfunded obligation                        | -              | -              |
| Present value of funded obligation                          | 8,415,678      | 6,927,747      |
| Total present value of obligations                          | 8,415,678      | 6,927,747      |
| Fair value of plan assets                                   | (7,358,111)    | (5,977,832)    |
| Present value of net obligations                            | 1,057,567      | 949,915        |
| Less: Unrecognised net obligations                          | (1,057,567)    | (949,915)      |
| <b>Recognised liability for defined benefit obligations</b> | -              | -              |

The transitional liability to be recognised amounts to Rs 566.96 Mn.

#### 45 (a) ii Plan Assets Consist of the Following

| As at 31st December                   | 2010<br>Rs 000 | 2009<br>Rs 000 |
|---------------------------------------|----------------|----------------|
| Equity securities and debentures      | 402,302        | 347,001        |
| Government bond                       | 4,347,510      | 3,327,393      |
| Balance with Hatton National Bank PLC | 2,207,605      | 2,053,398      |
| Fixed deposits                        | 255,936        | 250,040        |
| Interest receivable                   | 148,770        | -              |
| Tax payable                           | (4,012)        | -              |
|                                       | 7,358,111      | 5,977,832      |

#### 45 (a) iii Movement in the Present Value of Defined Benefit Obligations

|  | 2010<br>Rs 000   | 2009<br>Rs 000   |
|--|------------------|------------------|
| Liability for defined benefit obligations as at 1st January          | 6,927,747        | 6,496,902        |
| Actuarial (gains) / losses   | 741,662          | (371,379)        |
| Benefits paid by the plan  | (373,470)        | (260,270)        |
| Current service cost and interest cost                               | 1,119,739        | 1,062,494        |
| <b>Liability for defined benefit obligations as at 31st December</b> | <b>8,415,678</b> | <b>6,927,747</b> |

#### 45 (a) iv Movement in Plan Assets

|  |                  |                  |
|--|------------------|------------------|
| Fair value of plan assets brought forward            | 5,977,832        | 4,338,509        |
| Contributions paid into plan                         | 825,160          | 1,106,182        |
| Benefits paid by the plan                            | (373,470)        | (260,270)        |
| Actuarial gains                                      | 408,190          | 225,810          |
| Expected return on plan assets                       | 520,399          | 567,601          |
| <b>Fair value of plan assets as at 31st December</b> | <b>7,358,111</b> | <b>5,977,832</b> |

#### 45 (a) v Actuarial Assumptions

|  | 2010  | 2009   |
|--|-------|--------|
| Discount rate as at 31st December                | 9.75% | 10.50% |
| Expected return on plan assets as at 1st January | 8.38% | 11.50% |
| Future salary increases                          | 9.77% | 10.01% |
| Future pension increases                         | Nil   | Nil    |
| Increase in cost of living allowance             | 10%   | Nil    |

Assumptions regarding future mortality are based on 1967 - 70 mortality table and a (90) annuitants table (males and females) issued by the Institute of Actuaries.

The overall expected long term rate of return on assets is 8.38%.

The demographic assumptions underlying the valuation are retirement age (55 years), early withdrawals from service and retirement on medical grounds, death before and after retirement, etc.

#### 45 (a) vi Historical Information

| As at 31st December                             | 2009<br>Rs 000 | 2008<br>Rs 000   | 2007<br>Rs 000   |
|---|----------------|------------------|------------------|
| Present value of the defined benefit obligation | 6,927,747      | 6,496,902        | 5,275,079        |
| Fair value of plan assets                       | (5,977,832)    | (4,338,509)      | (3,857,705)      |
| <b>Deficit in the plan</b>                      | <b>949,915</b> | <b>2,158,393</b> | <b>1,417,374</b> |

#### 45 (b) Widows', Widowers' and Orphans' Pension Fund

The results of the actuarial valuation of the Widows', Widowers' and Orphans' Pension Scheme indicates that the actuarial present value of the promised benefit is Rs 261.4 Mn and that the fair value of the fund assets is Rs 555.5 Mn resulting in a past service surplus of Rs 294.1 Mn (2009 - Rs 289.9 Mn) in the Widows', Widowers' and Orphans' Pension Scheme as at 31st December 2010.

No contribution is made by the Bank and the members contribution during the period amounted to Rs 53 Mn.

## NOTES TO THE FINANCIAL STATEMENTS

### 46 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.

| As at 31st December                                    | 2010      |                  | 2009      |                  |
|--|-----------|------------------|-----------|------------------|
|  | Rs 000    | Rs 000           | Rs 000    | Rs 000           |
| <b>Voting ordinary shares</b>                          |           |                  |           |                  |
| As at 1st January                                      |           |                  |           |                  |
| 189,520,615 (2009 - 189.3 Mn) voting ordinary shares   | 2,903,480 |                  | 2,881,387 |                  |
| Issue of shares under ESOP                             |           |                  |           |                  |
| 1,754,991 (2009 - 0.191 Mn) voting ordinary shares     | 209,650   |                  | 22,093    |                  |
| As at 31st December                                    |           |                  |           |                  |
| 191,275,606 (2009 - 189.5 Mn) voting ordinary shares   |           | 3,113,130        |           | 2,903,480        |
| <b>Non-voting ordinary shares</b>                      |           |                  |           |                  |
| As at 1st January                                      |           |                  |           |                  |
| 46,249,532 (2009 - 46.2 Mn) non-voting ordinary shares | 2,180,604 |                  | 2,178,003 |                  |
| Issue of shares under ESOP                             |           |                  |           |                  |
| 443,884 (2009 - 0.049 Mn) non-voting ordinary shares   | 24,816    |                  | 2,601     |                  |
| As at 31st December                                    |           |                  |           |                  |
| 46,693,416 (2009 - 46.2 Mn) non-voting ordinary shares |           | 2,205,420        |           | 2,180,604        |
| <b>Stated Capital as at 31st December</b>              |           | <b>5,318,550</b> |           | <b>5,084,084</b> |

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.

Voting and non-voting shares included under stated capital consist of share premium on shares issued of Rs 988 Mn and Rs 1,716 Mn respectively.

Expenses relating to the above share issue amounting to Rs 2.542 Mn has been charged to Income Statement as disclosed in Note 15 - Operating Expenses.

#### 46 (a) Employee Share Ownership Plan

Employee Share Ownership Plan was introduced in 2005 where shares were offered to the executive employees of the Bank.

No shares were allotted under the Employee Share Ownership Plan in 2009 and the loan outstanding as at 31st December 2010 amounts to Rs 197.284 Mn. The amount released to the employees who left the service in 2010 is Rs 105.78 Mn.

## 46 (b) Employee Share Option Plan

### 46 (b) i Allocation - 2008

| Type of share | Number of options brought forward | Number of options expired | Number of options exercised | Number of options remaining | Allotment price<br>Rs | Weighted average share price<br>Rs |
|---------------|-----------------------------------|---------------------------|-----------------------------|-----------------------------|-----------------------|------------------------------------|
| Voting*       | 1,963,198                         | Nil                       | 1,620,059                   | 343,139                     | 115.54                | 290.85                             |
| Non voting*   | 476,143                           | Nil                       | 410,960                     | 65,183                      | 52.51                 | 181.61                             |

\* These options were allocated on 28th March 2008 and the retention period ended on 27th March 2009.

The remaining contractual life of the above share options is 2 years and 2 months.

### 46 (b) ii Allocation - 2010

| Type of share | Number of options allocated | Number of options expired | Number of options exercised | Number of options remaining | Allotment price<br>Rs | Weighted average share price<br>Rs |
|---------------|-----------------------------|---------------------------|-----------------------------|-----------------------------|-----------------------|------------------------------------|
| Voting*       | 2,366,458                   | Nil                       | 134,932                     | 2,231,526                   | 166.51                | 290.85                             |
| Non voting*   | 577,367                     | Nil                       | 32,924                      | 544,443                     | 98.31                 | 181.61                             |

\* These options were allocated on 20th April 2010 and the retention period will end on 19th April 2011.

The remaining contractual life of the above share options is 4 years and 3 months.

No financial assistance is granted to the employees in order to purchase shares.

The share options received at a particular grant can be exercised only after one year from the grant date. However if an employee retires during the year in which he or she has been granted the options, may exercise the options prior to retirement.

The outstanding options can be exercised within four years from the end of retention period or at retirement, resignation or death whichever occurs first.

## NOTES TO THE FINANCIAL STATEMENTS

### 47 COMMITMENTS AND CONTINGENCIES - BANK AND GROUP

In the normal course of business, the Bank makes various commitments and incurs certain contingent liabilities with legal recourse to its customers and would be party to litigation due to its operations. No material losses are anticipated as a result of these transactions.

#### 47 (a) Capital Commitments

Capital expenditure approved by the Board of Directors for which provision has not been made in the accounts amounts to approximately Rs 347 Mn.

| As at 31st December             | Bank           |                | Group          |                |
|---------------------------------|----------------|----------------|----------------|----------------|
|                                 | 2010<br>Rs 000 | 2009<br>Rs 000 | 2010<br>Rs 000 | 2009<br>Rs 000 |
| Approved and contracted for     | 297,780        | 250,958        | 495,780        | 250,958        |
| Approved and not contracted for | 49,163         | -              | 49,163         | -              |
|                                 | <b>346,943</b> | 250,958        | <b>544,943</b> | 250,958        |

Share of capital commitments of Joint Venture amounted to Rs 198 Mn as at 31st December 2010.

#### 47 (b) Future Monthly Commitments on Operating Leases - Bank

| As at 31st December | Bank           |                | Group          |                |
|---------------------|----------------|----------------|----------------|----------------|
|                     | 2010<br>Rs 000 | 2009<br>Rs 000 | 2010<br>Rs 000 | 2009<br>Rs 000 |
| 0 - 1 year          | -              | -              | 17,721         | 15,994         |
| 1 - 5 years         | 10,391         | 6,960          | 20,742         | 14,572         |
| 6 - 10 years        | 7,233          | 17,591         | 7,233          | 17,591         |
| 11 - 15 years       | 304            | 798            | 304            | 798            |
| 16 - 20 years       | 15             | 278            | 15             | 278            |
|                     | <b>17,943</b>  | 25,627         | <b>46,015</b>  | 49,233         |

#### 47 (c) Irrevocable Commitments - Bank

Commitments as at Balance Sheet date that cannot be revoked at the discretion of the Bank without the risk of incurring significant penalty or expense amounted to Rs 42.511 Mn (2009 - Rs 29.750 Mn).

#### 47 (d) Contingent Liabilities

| As at 31st December                 | 2010<br>Rs 000     | 2009<br>Rs 000 |
|-------------------------------------|--------------------|----------------|
| Acceptances                         | 6,487,793          | 4,040,195      |
| Documentary credits                 | 14,290,864         | 9,505,450      |
| Guarantees                          | 28,220,189         | 20,244,879     |
| Bills for collection                | 5,842,576          | 6,062,584      |
| Interest rate swap                  | 394                | 2,940          |
|                                     | <b>54,841,816</b>  | 39,856,048     |
| Forward exchange contracts          | 69,328,734         | 23,171,172     |
| <b>Total - Bank</b>                 | <b>124,170,550</b> | 63,027,220     |
| Contingent liabilities Subsidiaries | -                  | 12,480         |
| <b>Total Contingencies - Group</b>  | <b>124,170,550</b> | 63,039,700     |

Unrecognised pension fund deficit amounted to Rs 1,057 Mn as at 31st December 2010.

Contingent liabilities of Joint Venture as at 31st December 2010 was nil.

## **47 COMMITMENTS AND CONTINGENCIES - BANK AND GROUP (Contd.)**

### **47 (e) Litigation against the Bank**

- i HC (Civil) case No. 277/2007 MR a claim for damages for dishonour of Bank draft due to a technical issue and for closure of current account.

Based on the above information available on the current status of the above case, the Bank is not in a position to quantify the potential financial impact if any, as at the Balance Sheet date. Further, the Bank confirms that there is no case (including the LT cases) which is not disclosed above which would have a material impact on the financial position of the Bank.

### **47 (f) Tax assessments against the Bank**

The following tax assessments are outstanding, against which the Bank has duly appealed.

- i VAT on financial services for 2003 and 2004, taxes amounting to Rs 207 Mn, on Assessment Nos. VATFS/06/0312/06, VATFS/U6/0401/01, VATFS/J6/0402/02, VATFS/U6/0403/03, VATFS/U6/0404/04 and VATFS/U6/0405/05. (Pursuant to the determination made by the Board of Review on the appeal made for VAT on financial services, the Bank filed a case in the court of appeal - CA No. 01/2010 - BRA/VAT - 06).
- ii PAYE taxes amounting to Rs 407 Mn. on Assessments Nos.8018210, 8202714, & 8364152 for the years 2003, 2004 & 2005 respectively.
- iii VAT on financial services for 2006 taxes amounting to Rs 437.7Mn, on Assessments Nos. VATFS/BFSU/2009/110 to VATFS/BFSU/2009/113.
- iv VAT on financial services for 2007 taxes amounting to Rs 1,330.6 Mn, on Assessments Nos. VATFS/BFSU/2009/131 to VATFS/BFSU/2009/142.
- v VAT on financial services for 2008 taxes amounting to Rs 1,825.3 Mn, on Assessments Nos. VATFS/BFSU/2009/251 to VATFS/BFSU/2009/262.
- vi VAT for the year 2005 taxes amounting to Rs 10.5 Mn, on Assessments Nos. 8865223 and 8865224.
- vii VAT for the year 2009 taxes amounting to Rs 11.8 Mn, on Assessment No.8882823.

The Bank is of the view that the above assessments will not have any material impact on the Financial Statements.

## NOTES TO THE FINANCIAL STATEMENTS

### 48 RELATED PARTY DISCLOSURES

The Bank carries out transactions in the ordinary course of its business with parties who are defined as related parties in Sri Lanka Accounting Standard 30 (Revised 2005) "Related Party Disclosures", the details of which 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.

#### 48 (a) Parent and Ultimate Controlling Party

The Bank does not have an identifiable parent of its own.

#### 48 (b) Transactions with Key Management Personnel (KMP)

According to Sri Lanka Accounting Standard 30 (Revised 2005) "Related Party Disclosures", Key Management Personnel are those having authority and responsibility for planning, directing and controlling the activities of the entity. Accordingly, the Directors of the Bank (including executive and non-executive Directors) and their immediate family members have been classified as KMP of the Bank.

Immediate family member is defined as spouse or dependent. Dependent is defined as anyone who depends on the respective Director for more than 50% of his / her financial needs.

As the Bank is the ultimate parent of its Subsidiaries listed out in Note 32, and the Board of Directors of the Bank have the authority and responsibility for planning, directing and controlling the activities of the Group, the Directors of the Bank and their immediate family members have been identified as the KMP of the Group.

Therefore, officers who are only directors of the Subsidiaries and not of the Bank have been classified as KMP of that respective Subsidiary only.

#### 48 (b) i Compensation to KMP

|  | Bank   | Group  |
|--|--------|--------|
| Short term employment benefits (Rs 000)      | 74,544 | 74,774 |
| Post employment benefits (Rs 000)            | 7,435  | 7,435  |
|  | 81,979 | 82,209 |
| Benefits under Employee Share Option Plan    |        |        |
| Voting (No of shares)                        |        |        |
| - Exercised                                  | 38,083 | 38,083 |
| - Remaining*                                 | 36,329 | 36,329 |
| Non-voting (No of shares)                    |        |        |
| - Exercised                                  | 9,293  | 9,293  |
| - Remaining*                                 | 8,865  | 8,865  |
| Benefits under Employee Share Ownership Plan |        |        |
| Non-voting (No of shares)                    | 53,179 | 53,179 |

\* Shares allotted in 2010 based on the results achieved for the year 2009.

In addition to their salaries, Bank also provides non cash benefits to KMP and contributes to a post employment defined benefit plan on behalf of the Executive Director.

#### 48 (b) ii Credit Card Facilities to KMP

As at 31st December 2010

|   | Limit  | Outstanding Balance |
|---|--------|---------------------|
|   | Rs 000 | Rs 000              |
| Mr Rienzie T. Wijetilleke (Chairman)              | 500    | 152                 |
| Mr Rajendra Theagarajah (Managing Director / CEO) | 500    | 308                 |
| Mr D H S Jayawardena *                            | 10,500 | 189                 |
| Mr M V Theagarajah                                | 500    | 12                  |
| Mr R K Obeyesekere                                | 500    | 29                  |
| Ms Pamela C. Cooray                               | 500    | 1                   |
| Mr Ranjeevan Seevaratnam                          | 350    | -                   |
| Mr N G Wickremeratne**                            | 900    | 269                 |
| Ms M A R C Cooray                                 | 500    | -                   |

\* Rs 500,000/= clean and the balance is secured by cash deposits.

\*\* Cash cover available for the total limit.



## 48 RELATED PARTY DISCLOSURES (Contd.)

### 48 (b) Transactions with Key Management Personnel (KMP) (Contd.)

#### 48 (b) iii Facilities Granted to KMP

| Name of Director                     | As at 31st December 2010  |  | Security                |
|--------------------------------------|---------------------------|--|-------------------------|
|                                      | Aggregate Limit<br>Rs 000 | Amount of Accommodation<br>Outstanding<br>Rs 000 |                         |
| Mr Rienzie T. Wijetilleke (Chairman) | 2,380                     | 2,038  | Cash deposit            |
| Mr M V Theagarajah                   | 4,600                     | -  | Cash deposit            |
| Mr Ranjeevan Seevaratnam             | 1,500                     | -  | -                       |
| Mr N G Wickremeratne                 | 180                       | -  | Shares and Cash Deposit |
| Ms Pamela C. Cooray                  | 6,000                     | -  | -                       |

No losses have been recorded against loan balances outstanding during the period with KMP and no specific provisions have been made for loan losses on balances with KMP and their immediate family members as at the Balance Sheet date.

#### 48 (b) iv Deposits held by KMP with the Bank

As at Balance Sheet date the aggregate deposits (including Treasury Bills and Repos) held by the KMP with the Bank are as follows:

|           |         |
|-----------|---------|
| SLRs '000 | 173,028 |
| USD '000  | 203     |
| GBP '000  | 18      |
| Euro '000 | 1       |
| AUD '000  | 28      |
| CAD '000  | 13      |

#### 48 (c) Transactions with / between Subsidiaries

Details of the Subsidiaries are given in Note 32.

#### 48 (c) i HNB Assurance PLC

HNB Assurance PLC ("Assurance"), is a Subsidiary of the Bank.

The details of the transactions with the Bank are as follows:

(a) Assurance held deposits and current accounts with the Bank amounting to Rs 155.16 Mn as at 31st December 2010 (2009 - Rs 122.35 Mn). The Company also held debentures of the Bank amounting to Rs 20.0 Mn as at 31st December 2010 (2009 - Rs 20.0 Mn).

(b) A summary of transactions of Assurance with the Group are given below:

| Transaction Type                   | HNB<br>Rs 000 | SITHMA<br>Rs 000 |
|------------------------------------|---------------|------------------|
| Premium received                   | 23,462        | 5,853            |
| Claims incurred                    | 7,099         | 4,464            |
| Interest received                  | 9,244         | -                |
| Office rent and electricity paid   | 16,756        | -                |
| Other administrative expenses paid | 69,074        | -                |
| Dividend paid                      | 33,742        | -                |

## NOTES TO THE FINANCIAL STATEMENTS

### 48 RELATED PARTY DISCLOSURES (Contd.)

#### 48 (c) Transactions with / between Subsidiaries (Contd.)

##### 48 (c) ii Sithma Development (Pvt) Ltd

Sithma Development (Pvt) Ltd ("Sithma") is a wholly owned Subsidiary of the Bank.

(a) The details of its borrowing transactions with the Bank are as follows:

| Type of Facility | Rate of Interest  | As at 31st December 2010 |                       | Security  |
|------------------|---|--------------------------|-----------------------|---|
|                  |   | Limit<br>Rs 000          | Outstanding<br>Rs 000 |   |
| Overdraft        | 2% above the one year *WATB. to be reviewed every 6 months.   | 900,000                  | 409,562               | Registered primary floating mortgage for Rs 3,000 Mn over land and building at No 479, T B Jayah Mw, Colombo 10.  |
| Term Loan        | 1.5% above the 6 month treasury bill rate (gross). To be reviewed every 6 months (24 months grace period) | 2,000,000                | 1,774,960             | A primary mortgage bond for Rs 3,000 Mn over immovable property at No 479, T B Jayah Mw, Colombo 10. (Standing concurrent to existing primary concurrent mortgage bond) |
|                  | Interest payable  |                          | 10,687                |   |

\*WATB - Weighted Average Treasury Bill rate

(b) A summary of other transactions of Sithma with the Group are given below:

| Transaction Type            | HNB     | HNB                 |
|-----------------------------|---------|---------------------|
|                             | Rs 000  | ASSURANCE<br>Rs 000 |
| Lease rental received       | 617,917 | -                   |
| Refundable deposit received | 500,000 | -                   |
| Insurance premium paid      | -       | 5,853               |
| Claims received             | -       | 4,464               |
| Overdraft interest paid     | 62,592  | -                   |
| Term loan interest paid     | 218,308 | -                   |
| Ground rent paid            | 3,811   | -                   |

##### 48 (c) iii Majan Exchange LLC

Majan Exchange LLC (Majan) is a 40% owned Subsidiary of the Bank.

Majan maintains a current account with the Bank and the balance as at 31st December 2010 amounted to Rs 20.8 Mn (2009 - Rs 389,000). Value of the outstanding guarantees issued by the Bank to Majan Exchange LLC as at 31st December 2010 amounted to Rs 2.2 Mn.

The Bank has paid an advance payment to Majan to the value of Rs 11.9 Mn during the year (2009 - 12.3 Mn).

##### 48 (c) iv Commercial Interlink Services Inc (o/a of Delma Exchange Canada)

Commercial Interlink Services Inc (o/a of Delma Exchange Canada) is a wholly owned Subsidiary of the Bank.

The Company maintains a current account with the Bank and the balance as at 31st December 2010 amounted to Rs 36,709/- (2009 - Rs 421,000). The total amount due from Commercial Interlink Services Inc as at 31st December 2010 is Rs 18.9 Mn for which 100% provision has been made by the Bank.

The company has ceased operations in 1st October 2010 and the Bank has made a full provision of Rs 10.063 Mn against its investments in the company.

## **48 RELATED PARTY DISCLOSURES (Contd.)**

### **48 (d) Transactions with Associates**

#### **48 (d) i Lanka Ventures PLC**

The Bank sold its equity stake of 20.07% in Lanka Ventures PLC to Acuity Partners (Pvt) Ltd, Joint Venture of HNB and DFCC Bank on 18th January 2010 [Note 48 (e)]. Accordingly as explained in Note 30, Lanka Ventures PLC ceased to be an Associate of the Bank.

#### **48 (d) ii Delma Exchange**

Delma Exchange is a 20% owned Associate of the Bank.

Delma Exchange maintains current accounts with the Bank and the balance as at 31st December 2010 amounted to Rs 35.4 Mn (2009 - Rs 9.8 Mn). Value of the outstanding guarantees issued by the Bank to Delma Exchange as at 31st December 2010 amounted to Rs 78.54 Mn. During the year receivable from Delma Exchange amounting to Rs 12.171 Mn was transferred to investment. There was no change in the Bank's interest in the Associate subsequent to this investment.

#### **48 (d) iii Splendor Media (Pvt) Ltd**

Splendor Media (Pvt) Ltd is a 25% owned Associate of Sithma, a fully owned Subsidiary of the Bank.

The Bank and Sithma have paid Rs 41 Mn (2009 - Rs 24.78 Mn) and Rs 1.01 Mn (2009 - 0.44Mn) respectively to Splendor Media (Pvt) Ltd as commission against advertising channeled through that company.

### **48 (e) Transactions with Joint Venture - Acuity Partners (Pvt) Ltd**

During the year Bank increased its capital contribution (direct / through conversion of loans) to Acuity Partners (Pvt) Ltd the Joint Venture between DFCC Bank and HNB by Rs 405 Mn. Bank's shareholding in Acuity Partners (Pvt) Ltd remained at 50% subsequent to this investment.

Acuity Partners (Pvt) Ltd has a current account with the Bank with a balance of Rs 14.3 Mn (2009 - Rs 192,455) as at 31st December 2010 and has paid bank charges of Rs 497,136. (2009 - Rs 130,000). Further the Company had paid to the Bank Rs 21.5 Mn as loan interest during the year ended 31st December 2010.

Bank sold its equity stakes in Lanka Ventures PLC (20.07%) and Acuity Securities Limited (49.99%) to Acuity Partners (Pvt) Ltd on 18th January 2010 and 30th September 2010 respectively. Both Lanka Ventures PLC (79.58%) and Acuity Securities Limited (100%) were Subsidiaries of Acuity Partners (Pvt) Ltd as at 31st December 2010.

Total profit earned by the Bank from these transactions amounted to Rs 149.29 Mn which is disclosed in Note 14 - Other Income under "Capital gain from sale of Associate company" and "Capital gain from sale of investment securities".

### **48 (f) Transactions with Other Related Entities**

Other Related Entities are those which are controlled or significantly influenced, directly or indirectly by KMP of the Bank. Significant influence is presumed to be established if a KMP of the Bank has more than 20% shareholding in an entity, unless otherwise rebutted by the respective KMP. Further, significant influence is also established if in the view of a KMP, he / she has the ability to influence the operating and financial policies of an entity even in the absence of 20% shareholding.

The transactions of the Bank with other related entities are disclosed in Note 48 (f) i, ii and iii.

## NOTES TO THE FINANCIAL STATEMENTS

### 48 Related Party Transactions (Contd.)

#### 48 (f) i Lending Transactions with Other Related Entities by the Bank

| Company                               | Name of Director<br>(Relationship)                           | Nature of Transaction               | Aggregate Amount of Accommodation<br>as at 31st December 2010 |                        | Security  |
|---------------------------------------|--|-------------------------------------|---|------------------------|---|
|                                       |  |                                     | Limit<br>(Rs Mn)  | Outstanding<br>(Rs Mn) |   |
| Stassen Exports (Pvt) Ltd             | Mr D H S Jayawardena<br>(Chairman / Shareholder)             | Overdraft I                         | 2,948.50  | 158.41                 | Quoted company shares   |
|                                       |  | Overdraft II                        | 300.00  | 241.23                 |   |
|                                       | Mr R K Obeyesekere<br>(Director / Shareholder)               | Letters of Credit                   | 265.00  | 35.19                  |   |
|                                       |  | Letters of Guarantee                | 100.00  | 47.95                  |   |
|                                       |  | Forex Forward Contracts             | 172.50  | 33.30                  |   |
|                                       |  | Negotiation of<br>Documentary Bills | 500.00  | 25.01                  |   |
|                                       | <b>Total</b>   |                                     | <b>4,286.00</b>   | <b>541.09</b>          |   |
| Stassen International<br>(Pvt) Ltd    | Mr D H S Jayawardena<br>(Managing Director)                  | Overdraft                           | 100.00  | -                      | Quoted company shares   |
|                                       |  | Letters of Credit                   | 150.00  | 63.38                  |   |
|                                       | Mr R K Obeyesekere<br>(Director)                             | Letters of Guarantee                | 125.00  | 61.11                  |   |
|                                       |  | Negotiation of<br>Documentary Bills | 500.00  | 76.78                  |   |
|                                       | <b>Total</b>   |                                     | <b>875.00</b>   | <b>201.27</b>          |   |
| Milford Exports (Ceylon)<br>(Pvt) Ltd | Mr D H S Jayawardena<br>(Managing Director /<br>Shareholder) | Overdraft                           | 10.00   | -                      | Quoted company shares   |
|                                       |  | Letters of Credit                   | 50.00   | -                      |   |
|                                       | Mr R K Obeyesekere<br>(Director / Shareholder)               | Letters of Guarantee                | 40.00   | 10.00                  |   |
|                                       |  | Negotiation of Doc Bills            | 200.00  | -                      |   |
|                                       | <b>Total</b>   |                                     | <b>300.00</b>   | <b>10.00</b>           |   |
| Madulsima Plantations PLC             | Mr D H S Jayawardena<br>(Chairman)                           | Overdraft I                         | 50.00   | 37.30                  | Immovable property<br>(leasehold),<br>Quoted company                                  |
|                                       |  | Overdraft II                        | 70.00   |                        |   |
|                                       | Mr R K Obeyesekere<br>(Director)                             | Standby Overdraft                   | 33.00   | 1.25                   | shares,<br>Stock in trade   |
|                                       |  | Letters of Guarantee                | 1.25  |                        |   |
|                                       |  | Term Loan I                         | 11.66   | 11.66                  | Cash deposit  |
|                                       |  | Term Loan II                        | 4.34  | 4.34                   |   |
|                                       |  | Letters of Guarantee                | 1.00  | -                      |   |
|                                       | <b>Total</b>   |                                     | <b>171.25</b>   | <b>54.55</b>           |   |
| Ceylon Garden Coir (Pvt) Ltd          | Mr D H S Jayawardena<br>(Managing Director)                  | Letters of Credit                   | 10.00   | -                      | Quoted company shares   |
|                                       |  | <b>Total</b>                        | <b>10.00</b>  | -                      |   |
| Stassen Natural Foods<br>(Pvt) Ltd    | Mr D H S Jayawardena<br>(Managing Director)                  | Letters of Credit                   | 50.00   | 0.65                   | Quoted company shares   |
|                                       |  | Letter of Guarantee                 | 15.00   | 15.00                  |   |
|                                       | Mr R K Obeyesekere<br>(Director)                             | Negotiation of<br>Documentary Bills | 200.00  | 10.18                  |   |
|                                       |  | Overdraft                           | 10.00   | -                      |   |
|                                       | <b>Total</b>   |                                     | <b>275.00</b>   | <b>25.83</b>           |   |
| Browns Beach Hotels PLC               | Mr D H S Jayawardena<br>(Chairman)                           | Letters of Guarantee                | 0.25  | 0.25                   | Cash deposits   |
|                                       |  | <b>Total</b>                        | <b>0.25</b>   | <b>0.25</b>            |   |
| Lanka Milk Foods<br>(CWE) PLC         | Mr D H S Jayawardena<br>(Chairman)                           | Overdraft                           | 900.00  | 133.52                 | Quoted company<br>shares, immovable<br>property (leasehold),<br>and plant & machinery |
|                                       |  | Letters of Credit                   | (900.00)  | -                      |   |
|                                       | Mr R K Obeyesekere<br>(Director)                             | Letters of Guarantee I              | (70)  | 96.65                  |   |
|                                       |  | Letter of Guarantee II              | 30.00   |                        |   |
| <b>Total</b>                          |  | <b>930.00</b>                       | <b>230.17</b>   |                        |   |
| Lanka Dairies (Pvt) Ltd               | Mr D H S Jayawardena<br>(Managing Director)                  | Overdraft                           | 200.00  | 152.77                 | Quoted company shares   |
|                                       |  | Letter of Credit                    | 100.00  | 17.02                  |   |
|                                       | Mr R K Obeyesekere<br>(Director)                             | <b>Total</b>                        | <b>300.00</b>   | <b>169.79</b>          |   |

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

#### 48 Related Party Transactions (Contd.)

##### 48 (f) i Lending Transactions with Other Related Entities by the Bank (Contd.)

| Company                                  | Name of Director<br>(Relationship)                                     | Nature of Transaction    | Aggregate Amount of Accommodation<br>as at 31st December 2010 |                        | Security  |
|--|--|--------------------------|---|------------------------|---|
|  |  |                          | Limit<br>(Rs Mn)  | Outstanding<br>(Rs Mn) |   |
| Ambewela Products<br>(Pvt) Ltd           | Mr D H S Jayawardena<br>(Chairman)<br>Mr R K Obeyesekere<br>(Director) | Overdraft                | 10.00   | 9.87                   | Quoted company shares                                     |
|  |  | Letters of Credit        | 50.00   | 13.03                  |   |
|  |  | <b>Total</b>             | <b>60.00</b>  | <b>22.90</b>           |   |
| Ambewela Livestock<br>Company Ltd        | Mr D H S Jayawardena<br>(Chairman)<br>Mr R K Obeyesekere<br>(Director) | Overdraft                | 50.00   | 4.91                   | Quoted company shares                                     |
|  |  | Letters of Credit        | 10.00   | -                      |   |
|  |  | <b>Total</b>             | <b>60.00</b>  | <b>4.91</b>            |   |
| Pattipola Livestock<br>Company Ltd       | Mr D H S Jayawardena<br>(Chairman)<br>Mr R K Obeyesekere<br>(Director) | Overdraft                | 50.00   | 8.22                   | Quoted company shares                                     |
|  |  | Letters of Credit        | 10.00   | -                      |   |
|  |  | <b>Total</b>             | <b>60.00</b>  | <b>8.22</b>            |   |
| Distilleries Company<br>of Sri Lanka PLC | Mr D H S Jayawardena<br>(Chairman)<br>Mr R K Obeyesekere<br>(Director) | Standby Overdraft        | 1,220.00  | 1,202.64               | Quoted company shares<br>cash margins                     |
|  |  | Letters of Credit        | 400.00  | 233.07                 |   |
|  |  | Letters of Guarantee     | 3.12  | 3.12                   |   |
|  |  | <b>Total</b>             | <b>1,623.12</b>   | <b>1,438.83</b>        |   |
| Periceyl (Pvt) Ltd                       | Mr D H S Jayawardena<br>(Chairman)<br>Mr R K Obeyesekere<br>(Director) | Letters of Credit        | 25.00   | -                      | Quoted company shares<br>cash margins                     |
|  |  | Standby Overdraft        | (25.00)   | 11.91                  |   |
|  |  | Letters of Guarantee     | 1.80  | 1.80                   |   |
|  |  | <b>Total</b>             | <b>26.80</b>  | <b>13.71</b>           |   |
| Balangoda Plantations PLC                | Mr D H S Jayawardena<br>(Chairman)<br>Mr R K Obeyesekere<br>(Director) | Overdraft                | 45.00   | -                      | Immovable property<br>(leasehold)                         |
|  |  | <b>Total</b>             | <b>45.00</b>  | -                      |   |
| Texpro Industries Ltd                    | Mr D H S Jayawardena<br>(Chairman)                                     | Overdraft                | 21.53   | 20.92                  | Cash deposit<br><br>Immovable property                    |
|  |  | Bank Guarantee           | 0.22  | 0.22                   |   |
|  |  | <b>Total</b>             | <b>21.75</b>  | <b>21.14</b>           |   |
|  |  | Overdraft US\$ Mn        | 0.15  | 0.13                   |   |
|  |  | Letter of Credit US\$ Mn | 1.60  | 0.83                   |   |
|  |  | Export Loans US\$ Mn     | (1.60)  | 0.54                   |   |
|  |  | Bill Purchase US\$ Mn    | (0.30)  | 0.22                   |   |
|  |  | Term Loans US\$ Mn       | 0.03  | 0.03                   |   |
|  |  | <b>Total US\$ Mn</b>     | <b>1.78</b>   | <b>1.75</b>            |   |
| Indo Lanka Exports (Pvt) Ltd             | Mr. D H S Jayawardena<br>(Chairman)                                    | Letters of Credit        | * 100.00  | -                      | Quoted company shares<br>*(limits not established<br>yet) |
|  |  | Overdraft                | * 40.00   | -                      |   |
|  |  | Letters of Guarantee     | * 30.00   | -                      |   |
|  |  | <b>Total</b>             | <b>170.00</b>   | -                      |   |
| Aitken Spence PLC                        | Mr. D H S Jayawardena<br>(Chairman)                                    | Term Loan                | 100.00  | 100.00                 | Negative pledge   |
|  |  | <b>Total</b>             | <b>100.00</b>   | <b>100.00</b>          |   |

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

## NOTES TO THE FINANCIAL STATEMENTS

### 48 Related Party Transactions (Contd.)

#### 48 (f) i Lending Transactions with Other Related Entities by the Bank (Contd.)

| Company                                     | Name of Director<br>(Relationship)   | Nature of Transaction               | Aggregate Amount of Accommodation<br>as at 31st December 2010 |                        | Security   |
|---|--|-------------------------------------|---|------------------------|--|
|   |  |                                     | Limit<br>(Rs Mn)  | Outstanding<br>(Rs Mn) |  |
| Elpitiya Plantations PLC                    | Subsidiary of Aitken<br>Spence Plantation<br>Management Ltd  | Overdraft / Short term<br>loan      | 50.00   | 32.52                  | Immovable property<br>(leased hold)  |
|   |  | Commercial Paper                    |   |                        | Stock in trade   |
|   |  | Money Mkt Loan /<br>overdraft       | 75.00   | 75.00                  | Cash margins   |
|   |  | Standby overdraft                   | (75.00)   | -                      | Corporate guarantee  |
|   |  | Revolving Loan /<br>overdraft       | 10.00   | -                      |  |
|   |  | Term Loan                           | 1.50  | 1.50                   |  |
|   |  | Term Loan                           | 0.68  | 0.68                   |  |
|   |  | Term Loan                           | 25.00   | 25.00                  |  |
|   |  | Term Loan                           | 1.66  | 1.66                   |  |
|   |  | Bank Guarantee                      | 5.50  | -                      |  |
|   |  | E-friends Loan                      | 4.53  | 4.53                   |  |
|   |  | Overdraft                           | 30.00   | -                      |  |
|   |  | Overdraft                           | 9.00  | -                      |  |
|   |  | Lease                               | 6.97  | 6.97                   |  |
| <b>Total</b>                                |  | <b>219.84</b>                       | <b>147.86</b>   |                        |  |
| A E N Palm Oil<br>Processing (Pvt) Ltd      | Associate of Aitken Spence<br>Plantation Management<br>Ltd   | Term Loan                           | 21.55   | 21.55                  | Corporate guarantee  |
|   |  | Short Term Export Loan              | 33.00   | -                      | Stocks & assignment<br>of book debts, Deposit<br>of irrevocable export<br>letters of credit,<br>Documentary bills drawn<br>on buyers |
|   |  | Negotiation of<br>Documentary Bills | (33.00)   | -                      | Letter of hypothecation<br>over bills / indemnity  |
|   |  | <b>Total</b>                        | <b>54.55</b>  | <b>21.55</b>           |  |
| Aitken Spence Hotel<br>Holdings PLC         | Mr D H S Jayawardena<br>(Chairman)   | Term Loan                           | 460.44  | 460.44                 | Corporate guarantee  |
|   |  | Overdraft                           | 20.00   | -                      |  |
|   |  | <b>Total</b>                        | <b>480.44</b>   | <b>460.44</b>          |  |
| Aitken Spence Resources<br>(Pvt) Ltd        | Subsidiary of Aitken<br>Spence PLC in<br>which<br>Mr D H S Jayawardena<br>is the Chairman                | Letters of Guarantee                | 0.75  | 0.75                   | Corporate guarantee  |
|   |  | <b>Total</b>                        | <b>0.75</b>   | <b>0.75</b>            |  |
| Aitken Spence Hotel<br>Management (Pvt) Ltd | Subsidiary of Aitken<br>Spence Hotel Holdings<br>PLC in which<br>Mr D H S Jayawardena<br>is the Chairman | Overdraft                           | 10.00   | -                      | Corporate guarantee  |
|   |  | <b>Total</b>                        | <b>10.00</b>  | -                      |  |
| Neptune Ayurvedic<br>Village (Pvt) Ltd      | Subsidiary of Aitken<br>Spence Hotel Holdings<br>PLC in which<br>Mr D H S Jayawardena<br>is the Chairman | Overdraft                           | 10.00   | -                      | Corporate guarantee  |
|   |  | <b>Total</b>                        | <b>10.00</b>  | -                      |  |
| Hethersett Hotels Ltd                       | Subsidiary of Aitken<br>Spence Hotel Holdings<br>PLC in which<br>Mr D H S Jayawardena<br>is the Chairman | Overdraft                           | 15.00   | -                      | Corporate guarantee  |
|   |  | <b>Total</b>                        | <b>15.00</b>  | -                      |  |

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

## 48 Related Party Transactions (Contd.)

### 48 (f) i Lending Transactions with Other Related Entities by the Bank (Contd.)

| Company                                   | Name of Director<br>(Relationship)   | Nature of Transaction   | Aggregate Amount of Accommodation<br>as at 31st December 2010   |  | Security  |
|---|--|---|---|--|---|
|   |  |   | Limit<br>(Rs Mn)  | Outstanding<br>(Rs Mn)   |   |
| Ace Containers (Pvt) Ltd                  | Subsidiaries of Aitken   | Overdraft* / money  | 100.00  | 63.25  | Corporate guarantee   |
| Ace Distriparks (Pvt) Ltd                 | Spence PLC in which  | market loan   |   |  | Corporate guarantee   |
| Ace Container Repair<br>(Pvt) Ltd         | Mr D H S Jayawardena<br>is the Chairman  | Letters of Guarantee*   | (100.00)  | 19.36  | * Interchangeable Limit<br>within 6 companies   |
| <b>Total</b>                              |  |   | <b>100.00</b>   | <b>82.61</b>   |   |
| Ace Freight Management<br>(Pvt) Ltd       |  |   |   |  |   |
| Ace Haulage (Pvt) Ltd                     |  |   |   |  |   |
| Ace Container Terminal<br>(Pvt) Ltd       |  |   |   |  |   |
| Aitken Spence<br>Garments Ltd             | Subsidiary of Aitken<br>Spence PLC in which<br>Mr D H S Jayawardena<br>is the Chairman                   | Letters of Credit US\$ Mn<br>Short Term<br>Export Loan US \$ Mn<br>Overdrafts US\$ Mn<br>Overdrafts US\$ Mn<br><b>Total US\$ Mn</b><br>Overdraft<br>Letters of Guarantee<br><b>Total</b>  | 1.50<br>(1.50)<br>0.15<br>0.10<br><b>1.75</b><br>(25.00)<br>2.00<br><b>2.00</b>                           | 0.29<br>0.46<br>0.02<br><b>0.77</b><br>-<br>0.70<br><b>0.70</b>                      | Documents to title<br>to goods, stock and<br>book debts / corporate<br>guarantee, mortgage<br>over immovable<br>property / movable<br>machinery<br>Indemnity                              |
| Cowie Investments<br>(Pvt) Ltd            | Subsidiary of Aitken<br>Spence Hotel Holdings<br>PLC<br>which<br>Mr D H S Jayawardena<br>is the Chairman | Term Loan US\$ Mn<br>Overdraft US\$ Mn<br>Term Loan US\$ Mn<br><b>Total US\$ Mn</b>   | 0.47<br>2.00<br>4.00<br><b>6.47</b>   | 0.47<br>0.14<br>4.00<br><b>4.61</b>  | Leashold rights to the<br>Island of Meedhapparu   |
| Ace Power Embilipitiya<br>(Pvt) Ltd       | Subsidiary of Aitken<br>Spence PLC in<br>which<br>Mr D H S Jayawardena<br>is the Chairman                | Overdraft<br>Syndicated Overdraft<br><b>Total</b><br>Overdraft US\$ Mn<br>Overdraft US\$ Mn<br>Letter of Credit US \$<br>Term Loan US\$ Mn<br>Term Loan US\$ Mn<br>Term Loan US\$ Mn<br>Term Loan US\$ Mn<br><b>Total US\$ Mn</b> | 200.00<br>(350.00)<br><b>200.00</b><br>0.62<br>2.63<br>0.5<br>0.11<br>0.46<br>0.57<br>2.43<br><b>7.32</b> | 0.05<br>-<br><b>0.05</b><br>3.75<br>-<br>0.11<br>0.46<br>0.57<br>2.43<br><b>7.32</b> | -<br>Leasehold land, building<br>& fixtures<br>Bookdebts & stock /<br>shares over Company /<br>Assignment of project<br>document / fixtures<br>Documents of title<br>Duly accpeted drafts |
| Elpitiya Lifestyle<br>Solutions (Pvt) Ltd | Subsidiary of<br>Elpitiya Plantation PLC   | Overdraft<br><b>Total</b>   | 4.00<br><b>4.00</b>   | 3.88<br><b>3.88</b>  | Demand promisory note<br>/ leasehold land<br>Factory, building &<br>machinery   |
| ADS Resorts (Pvt) Ltd                     | Subsidiary of Aitken<br>Spence Hotel<br>International Ltd  | Term Loan US\$ Mn<br><b>Total US\$ Mn</b>   | 1.94<br><b>1.94</b>   | 1.94<br><b>1.94</b>  | Project assets at<br>Lohifushi in Maldives  |
| Unique Resorts (Pvt) Ltd                  | Subsidiary of Aitken<br>Spence Hotel<br>International Ltd  | Term Loan US\$ Mn<br>Term Loan US\$ Mn<br><b>Total US\$ Mn</b>  | 12.76<br>4.00<br><b>16.76</b>   | 12.76<br>4.00<br><b>16.76</b>  | Project assets at<br>Vaadhoo Island Resort in<br>Maldives   |
| Kandalama Hotels Ltd                      | Subsidiary of Aitken<br>Spence Hotel Holdings<br>PLC which<br>Mr D H S Jayawardena<br>is the Chairman    | Overdraft<br><b>Total</b>   | 20.00<br><b>20.00</b>   | -<br>-   | Corporate guarantee   |

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



## NOTES TO THE FINANCIAL STATEMENTS

### 48 Related Party Transactions (Contd.)

#### 48 (f) i Lending Transactions with Other Related Entities by the Bank (Contd.)

| Company   | Name of Director<br>(Relationship)   | Nature of Transaction  | Aggregate Amount of Accommodation<br>as at 31st December 2010 |                        | Security  |
|---|--|--|---|------------------------|---|
|   |  |  | Limit<br>(Rs Mn)  | Outstanding<br>(Rs Mn) |   |
| Golden Sun Resorts (Pvt) Ltd<br>(Ramada Resort) | Subsidiary of Aitken   | Overdraft  | 10.00   | -                      | Corporate guarantee   |
|   | Spence Hotel Holdings PLC  | Term Loan  | 10.00   | 10.00                  | Immovable property  |
|   | which  | Term Loan  | 8.31  | 8.31                   |   |
|   | Mr D H S Jayawardena<br>is the Chairman  | <b>Total</b>   | <b>28.31</b>  | <b>18.31</b>           |   |
| Acuity Stockbrokers<br>(Pvt) Ltd                | Subsidiary of the Joint<br>Venture "Acuity"  | Overdraft  | 130.00  | -                      | -   |
|   |  | <b>Total</b>   | <b>130.00</b>   | -                      | -   |
| Acuity Securities Limited                       | Subsidiary of the Joint<br>Venture "Acuity"  | Overdraft  | 100.00  | -                      | -   |
|   |  | <b>Total</b>   | <b>100.00</b>   | -                      | -   |
| Falcon Commodities<br>(Pvt) Ltd                 | On the date the<br>accommodation<br>was granted, Mr D H<br>S Jayawardena had<br>significant influence<br>[through the shareholding<br>of Stassen Exports<br>(Pvt) Ltd] in Falcon<br>Commodities (Pvt) Ltd,<br>which was since disposed | Overdraft / Import Bills<br>Overdraft<br>(Habib Bank AG Zurich<br>Ltd) | -   | -                      | *Total outstanding as<br>at 31st December 2009<br>was Rs 326.4 Mn and<br>the Bank had made a<br>provision Rs 248.12 Mn<br>for the unsecured net<br>exposure as at that date.<br>The loan outstanding<br>was written off against<br>the above provision<br>of Rs 248.1 Mn, after<br>recovering Rs 78.3 Mn<br>from the cash deposits<br>held by the Bank. |

#### 48 (f) ii Other Business Transactions with Other Related Entities by the Bank

| Company                                     | Name of Director<br>(Relationship)   | Nature of Transaction                            | Amount<br>(Rs Mn) |
|---|--|--|-------------------|
| Madulsima Plantation PLC                    | Mr D H S Jayawardena<br>(Chairman)<br>Mr R K Obeyesekere<br>(Director)   | Lease of holiday bungalow at Bogawantalawa       | 2.28              |
| Lanka Bell (Pvt) Ltd                        | Mr D H S Jayawardena<br>(Chairman)   | Telecommunication charges<br>Merchant commission | 25.26<br>0.08     |
| Lanka Financial Services<br>Bureau Ltd      | Mr Rajendra Theagarajah<br>(Chairman)  | Subscription paid                                | 3.98              |
| Aitken Spence PLC                           | Mr D H S Jayawardena<br>(Chairman)   | Interest on repurchase agreements<br>Air tickets | 0.01<br>0.01      |
| Aitken Spence Hotel<br>Management (Pvt) Ltd | Subsidiary of<br>Aitken Spence Hotel Holdings PLC<br>in which company<br>Mr D H S Jayawardena<br>is the Chairman | Merchant commission                              | 0.02              |
| Balangoda Plantations PLC                   | Mr D H S Jayawardena<br>(Chairman)<br>Mr R K Obeyesekere<br>(Director)   | Repurchase agreements                            | 194.40            |
|   |  | Interest on repurchase agreements                | 6.34              |

**48 Related Party Transactions (Contd.)**
**48 (f) ii Other Business Transactions with Other Related Entities by the Bank (Contd.)**

| Company   | Name of Director<br>(Relationship)  | Nature of Transaction                             | Amount<br>(Rs Mn) |
|---|---|---|-------------------|
| Bell Vantage (Pvt) Ltd                          | Mr D H S Jayawardena<br>(Chairman)  | Payment for telephone systems                     | 0.01              |
| Browns Beach Hotels PLC                         | Mr D H S Jayawardena<br>(Chairman)<br>Mr M V Theagarajah<br>(Director / Shareholder)            | Repurchase agreements                             | 68.00             |
|   |   | Interest on repurchase agreements                 | 2.96              |
|   |   | Merchant commission                               | 0.85              |
| Stassen Exports (Pvt) Ltd                       | Mr D H S Jayawardena<br>(Chairman / Shareholder)<br>Mr R K Obeyesekere<br>(Director)            | Forward contract                                  | 336.80            |
|   |   | Interest on repurchase agreements                 | 0.49              |
| Stassen International (Pvt) Ltd                 | Mr D H S Jayawardena<br>(Managing Director)<br>Mr R K Obeyesekere<br>(Director)                 | Interest on repurchase agreements                 | 0.98              |
| Sri Lanka Insurance<br>Corporation Ltd          | Significant shareholder<br>of the Bank (according to CBSL<br>direction)                         | Repayment of excess insurance claims received     | 3.19              |
|   |   | Insurance premium paid                            | 4.83              |
|   |   | Claims lodged                                     | 0.52              |
|   |   | Merchant commission earned                        | 1.30              |
| Hatton National Bank<br>Retirement Pension Fund | Mr Rajendra Theagarajah<br>(Trustee)  | Investment in term deposits                       | 255.94            |
|   |   | Investment in HNB debentures                      | 53.65             |
|   |   | Interest received on HNB debentures               | 4.04              |
|   |   | Balance held by the Bank<br>on behalf of the fund | 2,207.61          |
|   |   | Interest paid                                     | 164.24            |
|   |   | Contributions made in 2010                        | 882.82            |
| Hatton National Bank<br>Employee Provident Fund | Mr Rajendra Theagarajah<br>(Trustee)  | Investment in term deposits                       | 1,811.44          |
|   |   | Investment in Repos                               | 2,177.59          |
|   |   | Balance held by the Bank on behalf of the fund    | 110.37            |
|   |   | Investment in HNB shares                          |                   |
|   |   | - Voting  | 2.08              |
|   |   | - Non-voting                                      | 8.73              |
|   |   | Contribution made in 2010                         | 339.48            |
|   |   | Interest paid                                     | 3.78              |
| Dividends paid                                  | 2.45  |   |                   |
| Widows', Widowers' and<br>Orphans' Pension Fund | Mr Rajendra Theagarajah<br>(Trustee)  | Balance held by the Bank on behalf of the fund    | 41.05             |
|   |   | Interest paid                                     | 7.21              |
| Acuity Securities Limited                       | Subsidiary of the<br>Joint Venture "Acuity"   | Interest received                                 | 0.10              |
|   |   | Commission received                               | 0.60              |
|   |   | Current account balance as at year end            | 12.29             |
| Acuity Stockbrokers<br>(Pvt) Ltd                | Subsidiary of the<br>Joint Venture "Acuity"   | Bank charges received                             | 0.07              |
|   |   | Interest received                                 | 3.35              |
|   |   | Commission paid                                   | 26.80             |
|   |   | Current account balance as at year end            | 39.94             |
| Lanka Ventures PLC                              | Subsidiary of Acuity Partners<br>(Pvt) Ltd in which<br>Mr Rajendra Theagarajah is a<br>Director | Interest paid                                     | 1.24              |
|   |   | Bank charges received                             | 0.05              |
|   |   | Current account balance as at year end            | 4.21              |
|   |   | Debentures  | 13.50             |

## NOTES TO THE FINANCIAL STATEMENTS

### 48 Related Party Transactions (Contd.)

#### 48 (f) ii Other Business Transactions with Other Related Entities by the Bank (Contd.)

| Company                 | Name of Director<br>(Relationship)   | Nature of Transaction | Amount<br>(Rs Mn) |
|-------------------------|--|-----------------------|-------------------|
| Namal Acuity Value Fund | A fund managed by National Asset Management Ltd (NAMAL), a Subsidiary of Milford Holdings (Pvt) Ltd in which Mr D H S Jayawardena is the Managing Director / Mr R K Obeyesekere is a Director. | Investment in units   | 150.00            |

#### 48 (f) iii Business Transactions with Other Related Entities by the Group

| Company                                | Name of Director<br>(Relationship)   | Nature of Transaction  | Amount<br>(Rs Mn)               |
|--|--|--|---------------------------------|
| <b>Sithma Development (Pvt) Ltd</b>    |  |  |                                 |
| Acuity Securities Ltd                  | Mr Rajendra Theagarajah<br>(Chairman)  | Lease rentals received   | 0.34                            |
| Lanka Bell (Pvt) Ltd                   | Mr D H S Jayawardena<br>(Chairman)   | Telecommunication charges  | 0.06                            |
| <b>HNB Assurance PLC</b>               |  |  |                                 |
| Acuity Stockbrokers (Pvt) Ltd          | Mr Rajendra Theagarajah<br>(Chairman)  | Insurance premium received<br>Claims paid  | 1.31<br>0.27                    |
| Acuity Securities Limited              | Mr Rajendra Theagarajah<br>(Chairman)  | Insurance premium received<br>Claims paid<br>Interest received<br>Investments (Repo) | 0.35<br>0.36<br>13.54<br>145.38 |
| Acuity Partners (Pvt) Ltd              | Mr Rajendra Theagarajah<br>(Director)  | Insurance premium received   | 0.98                            |
| Sri Lanka Insurance Corporation Ltd    | Significant shareholder<br>of the Bank (according to CBSL<br>direction)              | Co insurance premium<br>Co insurance claims  | 0.69<br>-                       |
| Colours of Courage Trust Guarantee Ltd | Mr Rajendra Theagarajah<br>(Director)  | Sponsorship provided   | 0.11                            |
| Stassen Exports (Pvt) Ltd              | Mr D H S Jayawardena<br>(Chairman / Shareholder)<br>Mr R K Obeyesekere<br>(Director) | Insurance premium received<br>Claims paid  | 11.92<br>9.77                   |
| Stassen International (Pvt) Ltd        | Mr D H S Jayawardena<br>(Managing Director)<br>Mr R K Obeyesekere<br>(Director)      | Insurance premium received   | 1.32                            |
| Stassen Natural Foods (Pvt) Ltd        | Mr D H S Jayawardena<br>(Managing Director)<br>Mr R K Obeyesekere<br>(Director)      | Insurance premium received   | 0.21                            |
| Ceylon Garden Coir (Pvt) Ltd           | Mr D H S Jayawardena<br>(Managing Director)<br>Mr R K Obeyesekere<br>(Director)      | Insurance premium received   | 0.07                            |

#### 48 Related Party Transactions (Contd.)

##### 48 (f) iii Business Transactions with Other Related Entities by the Group (Contd.)

| Company                                  | Name of Director<br>(Relationship)  | Nature of Transaction   | Amount<br>(Rs Mn)    |
|--|---|---|----------------------|
| Milford Exports (Ceylon)<br>(Pvt) Ltd    | Mr D H S Jayawardena<br>(Managing Director / Shareholder)<br>Mr R K Obeyesekere<br>(Director / Shareholder) | Insurance premium received  | 0.04                 |
| Milford Developers<br>(Pvt) Ltd          | Mr D H S Jayawardena<br>(Managing Director)<br>Mr R K Obeyesekere<br>(Director)                             | Insurance premium received  | 0.46                 |
| Aitken Spence Garments Ltd               | Subsidiary of Aitken Spence PLC<br>in which company<br>Mr D H S Jayawardena<br>is the Chairman              | Insurance premium received  | 0.36                 |
| Aitken Spence Cargo (Pvt)Ltd             | Subsidiary of<br>Aitken Spence PLC<br>in which company<br>Mr D H S Jayawardena<br>is the Chairman           | Insurance premium received  | 0.22                 |
| Elpitiya Plantations PLC                 | Subsidiary of Aitken<br>Spence Plantation<br>Management Ltd   | Insurance premium received<br>Claims paid                                   | 0.20<br>0.01         |
| Ambewela Products<br>(Pvt) Ltd           | Mr D H S Jayawardena<br>(Chairman)  | Claims paid   | 0.01                 |
| Beruwela Distillery (Pvt) Ltd            | Mr D H S Jayawardena<br>(Director)<br>Mr R K Obeyesekere<br>(Director)                                      | Claims paid   | 0.39                 |
| Distilleries Company<br>of Sri Lanka PLC | Mr D H S Jayawardena<br>(Chairman)<br>Mr R K Obeyesekere<br>(Director)                                      | Insurance premium received<br>Claims paid                                   | 0.21<br>2.76         |
| Lanka Bell (Pvt) Ltd                     | Mr D H S Jayawardena<br>(Chairman)  | Insurance premium received<br>Claims paid<br>Telecommunication charges paid | 0.04<br>1.27<br>0.06 |
| Periceyl (Pvt) Ltd                       | Mr D H S Jayawardena<br>(Chairman)<br>Mr. R K Obeyesekere<br>(Director)                                     | Insurance premium received<br>Claims paid                                   | 0.33<br>1.52         |
| Texpro Industries Ltd                    | Mr D H S Jayawardena<br>(Chairman)  | Insurance premium received  | 0.61                 |
| Lanka Milk Foods (CWE) PLC               | Mr D H S Jayawardena<br>(Chairman)<br>Mr. R K Obeyesekere<br>(Director)                                     | Insurance premium received<br>Claims paid                                   | 0.38<br>1.15         |
| Lanka Diaries (Pvt) Ltd                  | Mr D H S Jayawardena<br>(Chairman)<br>Mr. R K Obeyesekere<br>(Director)                                     | Insurance premium received  | 0.01                 |

## NOTES TO THE FINANCIAL STATEMENTS

### 48 Related Party Transactions (Contd.)

#### 48 (f) iii Business Transactions with Other Related Entities by the Group (Contd.)

| Company                   | Name of Director<br>(Relationship)   | Nature of Transaction      | Amount<br>(Rs Mn) |
|---------------------------|--|----------------------------|-------------------|
| Hethersett Hotels Ltd     | Subsidiary of Aitken Spence Hotel Holdings PLC in which Mr D H S Jayawardena is the Chairman | Insurance premium received | 0.06              |
| Ace Distriparks (Pvt) Ltd | Subsidiary of Aitken Spence PLC in which Mr D H S Jayawardena is the Chairman                | Insurance premium received | 0.05              |
| Ace Containers (Pvt) Ltd  | Subsidiary of Aitken Spence PLC in which Mr D H S Jayawardena is the Chairman                | Insurance premium received | 0.02              |

### 49 MATURITY ANALYSIS

#### 49 (a) Bank

An analysis of the total assets and liabilities of the Bank as at 31st December, based on the remaining period at the Balance Sheet date to the respective contractual maturity dates, is given below:

|  | Up to<br>3 Months<br>Rs 000 | 3 to 12<br>Months<br>Rs 000 | 1 to 3<br>Years<br>Rs 000 | 3 to 5<br>Years<br>Rs 000 | More Than<br>5 Years<br>Rs 000 | Total<br>2010<br>Rs 000 |
|--|-----------------------------|-----------------------------|---------------------------|---------------------------|--------------------------------|-------------------------|
| <b>Interest earning assets</b>               |                             |                             |                           |                           |                                |                         |
| Cash and short term funds                    | 12,084,793                  | -                           | -                         | -                         | -                              | 12,084,793              |
| Securities purchased under resale agreements | 1,185,831                   | -                           | -                         | -                         | -                              | 1,185,831               |
| Commercial papers                            | 158,963                     | -                           | -                         | -                         | -                              | 158,963                 |
| Investment securities-Bonds & Debentures     | 26,470,539                  | 18,875,315                  | 9,792,790                 | 2,508,325                 | 489,000                        | 58,135,969              |
| Bills of exchange                            | 1,401,130                   | -                           | -                         | -                         | -                              | 1,401,130               |
| Loans and advances                           | 76,798,052                  | 32,264,499                  | 19,303,741                | 28,721,567                | 30,945,992                     | 188,033,851             |
| Lease receivable                             | 1,239,343                   | 3,391,149                   | 6,322,272                 | 2,494,489                 | -                              | 13,447,253              |
|  | 119,338,651                 | 54,530,963                  | 35,418,803                | 33,724,381                | 31,434,992                     | 274,447,790             |
| <b>Non interest earning assets</b>           |                             |                             |                           |                           |                                |                         |
| Cash and short term funds                    | 5,920,847                   | -                           | -                         | -                         | -                              | 5,920,847               |
| Statutory deposit with CBSL                  | 12,491,644                  | -                           | -                         | -                         | -                              | 12,491,644              |
| Dealing securities - Shares                  | 576,280                     | -                           | -                         | -                         | -                              | 576,280                 |
| Investments - Quoted                         | -                           | -                           | -                         | -                         | 1,061,399                      | 1,061,399               |
| Investments - Unquoted                       | -                           | 180,000                     | 180,000                   | -                         | 27,956                         | 387,956                 |
| Investment in Associate companies            | -                           | -                           | -                         | -                         | 83,651                         | 83,651                  |
| Investments in Joint Venture companies       | -                           | -                           | -                         | -                         | 655,000                        | 655,000                 |
| Investment in Subsidiary companies           | -                           | -                           | -                         | -                         | 2,179,086                      | 2,179,086               |
| Intangible assets                            | -                           | -                           | -                         | -                         | 577,015                        | 577,015                 |
| Investment properties                        | -                           | -                           | -                         | -                         | 353,563                        | 353,563                 |
| Property, plant and equipment                | -                           | -                           | -                         | -                         | 7,473,947                      | 7,473,947               |
| Other assets                                 | 6,918,774                   | 254,140                     | 32,402                    | -                         | 500,000                        | 7,705,316               |
|  | 25,907,545                  | 434,140                     | 212,402                   | -                         | 12,911,617                     | 39,465,704              |
| <b>Total assets</b>                          | 145,246,196                 | 54,965,103                  | 35,631,205                | 33,724,381                | 44,346,609                     | 313,913,494             |
| <b>Percentage 31st December 2010</b>         | <b>46.27</b>                | <b>17.51</b>                | <b>11.35</b>              | <b>10.74</b>              | <b>14.13</b>                   | <b>100</b>              |
| Percentage 31st December 2009                | 48.37                       | 16.94                       | 16.44                     | 5.24                      | 13.00                          | 100                     |

## 49 MATURITY ANALYSIS (Contd.)

### 49 (a) Bank (Contd.)

|  | Up to<br>3 Months<br>Rs 000 | 3 to 12<br>Months<br>Rs 000 | 1 to 3<br>Years<br>Rs 000 | 3 to 5<br>Years<br>Rs 000 | More Than<br>5 Years<br>Rs 000 | Total<br>2010<br>Rs 000 |
|--|-----------------------------|-----------------------------|---------------------------|---------------------------|--------------------------------|-------------------------|
| <b>Interest bearing liabilities</b>              |                             |                             |                           |                           |                                |                         |
| Deposits from customers                          | 151,385,917                 | 42,476,244                  | 10,244,033                | 3,723,232                 | 1,233,551                      | 209,062,977             |
| Borrowings - Refinance                           | 607,147                     | 705,898                     | 2,287,915                 | 1,164,811                 | 1,548,868                      | 6,314,639               |
| Borrowings - Foreign Banks                       | 4,494,901                   | -                           | -                         | -                         | -                              | 4,494,901               |
| Other borrowings                                 | 507                         | 507                         | -                         | -                         | -                              | 1,014                   |
| Repo agreements                                  | 4,895,086                   | 7,056,641                   | -                         | -                         | -                              | 11,951,727              |
| Subordinated debentures                          | -                           | -                           | 715,429                   | 300,000                   | 1,708,864                      | 2,724,293               |
|  | 161,383,558                 | 50,239,290                  | 13,247,377                | 5,188,043                 | 4,491,283                      | 234,549,551             |
| <b>Non interest bearing liabilities</b>          |                             |                             |                           |                           |                                |                         |
| Deposits from customers                          | 25,008,108                  | -                           | -                         | -                         | -                              | 25,008,108              |
| Dividend payable                                 | 49,558                      | -                           | -                         | -                         | -                              | 49,558                  |
| Bills payable                                    | 1,305,161                   | -                           | -                         | -                         | -                              | 1,305,161               |
| Current tax liability                            | -                           | 3,127,622                   | -                         | -                         | -                              | 3,127,622               |
| Deferred tax liability                           | -                           | -                           | -                         | -                         | 735,884                        | 735,884                 |
| Other liabilities                                | 14,275,307                  | -                           | -                         | 7,588,536                 | -                              | 21,863,843              |
| Shareholders' funds                              | -                           | -                           | -                         | -                         | 27,273,767                     | 27,273,767              |
|  | 40,638,134                  | 3,127,622                   | -                         | 7,588,536                 | 28,009,651                     | 79,363,943              |
| <b>Total Liabilities and shareholders' funds</b> | <b>202,021,692</b>          | <b>53,366,912</b>           | <b>13,247,377</b>         | <b>12,776,579</b>         | <b>32,500,934</b>              | <b>313,913,494</b>      |
| <b>Percentage 31st December 2010</b>             | <b>64.36</b>                | <b>17.00</b>                | <b>4.22</b>               | <b>4.07</b>               | <b>10.35</b>                   | <b>100</b>              |
| Percentage 31st December 2009                    | 61.11                       | 18.51                       | 3.80                      | 4.02                      | 12.56                          | 100                     |

\* Upto 3 months deposits include the Bank's Savings Deposit Base of Rs 99.0 billion (2009 - Rs 80.8 billion).

### 49 (b) Group

|  | Up to<br>3 Months<br>Rs 000 | 3 to 12<br>Months<br>Rs 000 | 1 to 3<br>Years<br>Rs 000 | 3 to 5<br>Years<br>Rs 000 | More Than<br>5 Years<br>Rs 000 | Total<br>2010<br>Rs 000 |
|--|-----------------------------|-----------------------------|---------------------------|---------------------------|--------------------------------|-------------------------|
| <b>Interest earning assets</b>               |                             |                             |                           |                           |                                |                         |
| Cash and short term funds                    | 12,259,065                  | 183,928                     | 122,000                   | 75,000                    | -                              | 12,639,993              |
| Statutory deposit with Central Bank of Oman  | 14,408                      | -                           | -                         | -                         | -                              | 14,408                  |
| Securities purchased under resale agreements | 2,653,447                   | 60,144                      | -                         | -                         | -                              | 2,713,591               |
| Government of Sri Lanka treasury bills       | 223,193                     | 753,254                     | -                         | -                         | -                              | 976,447                 |
| Commercial papers                            | 158,962                     | 53,083                      | -                         | -                         | -                              | 212,045                 |
| Investment securities - Bonds and debentures | 26,814,762                  | 19,373,590                  | 10,849,582                | 2,905,176                 | 501,500                        | 60,444,610              |
| Bills of exchange                            | 1,401,130                   | -                           | -                         | -                         | -                              | 1,401,130               |
| Loans and advances                           | 76,792,272                  | 31,784,596                  | 18,848,557                | 28,225,964                | 30,331,345                     | 185,982,734             |
| Lease receivable                             | 1,239,343                   | 3,391,149                   | 6,322,272                 | 2,494,489                 | -                              | 13,447,253              |
|  | 121,556,582                 | 55,599,744                  | 36,142,411                | 33,700,629                | 30,832,845                     | 277,832,211             |
| <b>Non interest earning assets</b>           |                             |                             |                           |                           |                                |                         |
| Cash and short term funds                    | 5,866,518                   | -                           | -                         | -                         | -                              | 5,866,518               |
| Statutory deposit with CBSL                  | 12,491,644                  | -                           | -                         | -                         | -                              | 12,491,644              |
| Dealing securities                           | 750,416                     | -                           | -                         | -                         | -                              | 750,416                 |
| Investments - Quoted                         | 7,203                       | -                           | -                         | -                         | 1,061,979                      | 1,069,182               |
| Investments - Unquoted                       | -                           | 180,000                     | 234,813                   | -                         | 75,946                         | 490,759                 |

## NOTES TO THE FINANCIAL STATEMENTS

### 49 MATURITY ANALYSIS (Contd.)

#### 49 (b) Group (Contd.)

|  | Up to<br>3 Months<br>Rs 000 | 3 to 12<br>Months<br>Rs 000 | 1 to 3<br>Years<br>Rs 000 | 3 to 5<br>Years<br>Rs 000 | More Than<br>5 Years<br>Rs 000 | Total<br>2010<br>Rs 000 |
|--|-----------------------------|-----------------------------|---------------------------|---------------------------|--------------------------------|-------------------------|
| Investment in Associate companies                | -                           | -                           | -                         | -                         | 196,009                        | 196,009                 |
| Intangible assets                                | -                           | 1,974                       | -                         | -                         | 700,956                        | 702,930                 |
| Investment properties                            | -                           | -                           | -                         | -                         | 173,595                        | 173,595                 |
| Property, plant and equipment                    | -                           | 4,491                       | -                         | -                         | 14,531,287                     | 14,535,778              |
| Non current assets held for sale                 | -                           | 2,875                       | -                         | -                         | -                              | 2,875                   |
| Other assets                                     | 7,770,091                   | 1,210,334                   | 32,402                    | -                         | 133,264                        | 9,146,091               |
|  | 26,885,872                  | 1,399,674                   | 267,215                   | -                         | 16,873,036                     | 45,425,797              |
| <b>Total assets</b>                              | <b>148,442,454</b>          | <b>56,999,418</b>           | <b>36,409,626</b>         | <b>33,700,629</b>         | <b>47,705,885</b>              | <b>323,258,008</b>      |
| <b>Percentage - 31/12/2010</b>                   | <b>45.92</b>                | <b>17.63</b>                | <b>11.26</b>              | <b>10.43</b>              | <b>14.76</b>                   | <b>100</b>              |
| Percentage - 31/12/2009                          | 47.43                       | 17.23                       | 16.32                     | 5.37                      | 13.65                          | 100                     |
| <b>Interest bearing liabilities</b>              |                             |                             |                           |                           |                                |                         |
| Deposits from customers                          | 151,371,168                 | 42,380,181                  | 10,244,033                | 3,723,232                 | 1,233,551                      | 208,952,165             |
| Borrowings - money at call                       | -                           | -                           | -                         | -                         | -                              | -                       |
| Borrowings - refinance                           | 607,147                     | 705,898                     | 2,287,915                 | 1,164,811                 | 1,548,868                      | 6,314,639               |
| Borrowings - local banks                         | 13,816                      | -                           | -                         | -                         | -                              | 13,816                  |
| Borrowings - foreign banks                       | 4,475,043                   | -                           | -                         | -                         | -                              | 4,475,043               |
| Repo agreements                                  | 6,462,829                   | 7,060,284                   | -                         | -                         | -                              | 13,523,113              |
| Subordinated debentures                          | -                           | -                           | 696,179                   | 300,000                   | 1,701,364                      | 2,697,543               |
|  | 162,930,003                 | 50,146,363                  | 13,228,127                | 5,188,043                 | 4,483,783                      | 235,976,319             |
| <b>Non interest bearing liabilities</b>          |                             |                             |                           |                           |                                |                         |
| Deposits from customers                          | 24,928,389                  | -                           | -                         | -                         | -                              | 24,928,389              |
| Dividend payable                                 | 51,121                      | -                           | -                         | -                         | -                              | 51,121                  |
| Bills payable                                    | 1,305,161                   | -                           | -                         | -                         | -                              | 1,305,161               |
| Insurance provision - Life                       | -                           | -                           | -                         | -                         | 2,385,246                      | 2,385,246               |
| Insurance provision - General                    | -                           | 730,658                     | -                         | -                         | -                              | 730,658                 |
| Current tax liability                            | -                           | 3,258,984                   | -                         | -                         | -                              | 3,258,984               |
| Deferred tax liability                           | -                           | -                           | -                         | -                         | 734,376                        | 734,376                 |
| Other liabilities                                | 14,952,664                  | 741,000                     | -                         | 7,588,536                 | 38,853                         | 23,321,053              |
| Shareholders' funds                              | -                           | -                           | -                         | -                         | 30,566,701                     | 30,566,701              |
|  | 41,237,335                  | 4,730,642                   | -                         | 7,588,536                 | 33,725,176                     | 87,281,689              |
| <b>Total liabilities and shareholders' funds</b> | <b>204,167,338</b>          | <b>54,877,005</b>           | <b>13,228,127</b>         | <b>12,776,579</b>         | <b>38,208,959</b>              | <b>323,258,008</b>      |
| <b>Percentage - 31/12/2010</b>                   | <b>63.16</b>                | <b>16.98</b>                | <b>4.09</b>               | <b>3.95</b>               | <b>11.82</b>                   | <b>100</b>              |
| Percentage - 31/12/2009                          | 59.94                       | 18.14                       | 3.96                      | 3.88                      | 14.08                          | 100                     |



## 50 COMPARATIVE INFORMATION

The following comparative figures have been reclassified in the 2010 Financial Statements to maintain comparability of financial statements in order to provide a better presentation.

### 50 (a)

|  | As disclosed<br>Rs 000 | Bank<br>Reclassified<br>Rs 000 | Adjustment<br>Rs 000 | As disclosed<br>Rs 000 | Group<br>Reclassified<br>Rs 000 | Adjustment<br>Rs 000 |
|--|------------------------|--------------------------------|----------------------|------------------------|---------------------------------|----------------------|
| Income   | 39,374,436             | 39,357,864                     | 16,572               | 41,317,345             | 41,300,773                      | 16,572               |
| Foreign exchange profit                        | 919,782                | 903,210                        | 16,572               | 919,953                | 903,381                         | 16,572               |
| Premises, equipment and establishment expenses | 2,848,503              | 2,840,613                      | 7,890                | 2,648,960              | 2,641,070                       | 7,890                |
| Fee and commission expenses                    | 107,796                | 137,734                        | (29,938)             | 317,022                | 346,960                         | (29,938)             |
| Other expenses                                 | 4,841,000              | 4,802,380                      | 38,620               | 5,926,098              | 5,887,478                       | 38,620               |

**50 (a) i** Loss on FCBU revaluation of Rs 16.57 Mn and fee and commission expenses of Rs 29.94 Mn included under other expenses have been reclassified.

**50 (a) ii** Other expenses of Rs 7.89 Mn included under premises, equipment and establishment expenses have been reclassified.

### 50 (b)

|                           | As disclosed<br>Rs 000 | Bank<br>Reclassified<br>Rs 000 | Adjustment<br>Rs 000 | As disclosed<br>Rs 000 | Group<br>Reclassified<br>Rs 000 | Adjustment<br>Rs 000 |
|---------------------------|------------------------|--------------------------------|----------------------|------------------------|---------------------------------|----------------------|
| Fee and commission income | 2,309,235              | 2,331,278                      | (22,043)             | 2,355,467              | 2,377,510                       | (22,043)             |
| Other income              | 1,307,789              | 1,285,746                      | 22,043               | 3,009,624              | 2,987,581                       | 22,043               |

Fee and commission income of Rs 22.04 Mn included under other income have been reclassified.

### 50 (c)

|                           | As disclosed<br>Rs 000 | Bank<br>Reclassified<br>Rs 000 | Adjustment<br>Rs 000 | As disclosed<br>Rs 000 | Group<br>Reclassified<br>Rs 000 | Adjustment<br>Rs 000 |
|---------------------------|------------------------|--------------------------------|----------------------|------------------------|---------------------------------|----------------------|
| Cash and cash equivalents | 27,042,858             | 27,152,248                     | (109,390)            | 27,488,807             | 27,598,197                      | (109,390)            |
| Bills of exchange         | 1,476,044              | 1,447,490                      | 28,554               | 1,476,044              | 1,447,490                       | 28,554               |
| Loans and advances        | 159,184,398            | 159,247,361                    | (62,963)             | 156,391,674            | 156,560,522                     | (168,848)            |
| Other assets              | 7,333,833              | 6,886,678                      | 447,155              | 8,612,153              | 8,059,113                       | 553,040              |
| Other liabilities         | 21,008,833             | 20,976,437                     | 32,396               | 21,978,127             | 21,945,731                      | 32,396               |
| Borrowings                | 8,581,089              | 8,310,128                      | 270,961              | 8,584,401              | 8,313,440                       | 270,961              |

**50 (c) i** Cash and cash equivalents of Rs 109.39 Mn and loans and advances of Rs 34.40 Mn included under other assets have been reclassified.

**50 (c) ii** General provision of Rs 14.355 Mn and interest in suspense of Rs 14.199 Mn for bills of exchange included under loans and advances have been reclassified.

**50 (c) iii** Other liabilities of Rs 32.39 Mn included under other assets have been reclassified.

**50 (c) iv** Capital repayments of Rs 270.961 Mn made on the Balance Sheet date against borrowings classified under other assets have been reclassified.

**50 (c) v** Staff loan advances of Subsidiaries of Rs 105.889 Mn included under other assets have been reclassified.

Comparative information in the Cash Flow Statement has been amended based on the reclassified figures as disclosed above.

## NOTES TO THE FINANCIAL STATEMENTS

### 51 SEGMENT REPORTING

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.

| Business segments - Group                         | Banking     |              | Leasing     |           | **Dealing |           | Property  |           | Insurance |           | Eliminations |             | Consolidated<br>/Unallocated |              |
|---|-------------|--------------|-------------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|--------------|-------------|------------------------------|--------------|
|   | 2010        | 2009         | 2010        | 2009      | 2010      | 2009      | 2010      | 2009      | 2010      | 2009      | 2010         | 2009        | 2010                         | 2009         |
|   | 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       |
| Revenue from external customers :                 |             |              |             |           |           |           |           |           |           |           |              |             |                              |              |
| Interest  | 28,091,408  | 32,413,563   | -           | -         | 147,290   | 116,047   | -         | -         | 435,045   | 441,507   | 1,890,052    | 1,865,305   | 30,563,795                   | 34,836,422   |
| Exchange / premium                                | 1,015,987   | 903,210      | -           | -         | 3,711     | 265       | -         | -         | 1,868,746 | 1,537,309 | -            | -           | 2,888,444                    | 2,440,784    |
| Lease / brokerage                                 | -           | -            | 1,890,052   | 1,961,078 | 304,404   | 81,790    | -         | 12,000    | -         | -         | (1,890,052)  | (1,961,078) | 304,404                      | 93,790       |
| Commissions / rent                                | 2,787,882   | 2,272,323    | 7,751       | 3,966     | 15,407    | 7,136     | 97,495    | 100,112   | -         | -         | -            | 294         | 2,908,535                    | 2,383,831    |
| Other   | 1,486,507   | 1,485,765    | -           | -         | 124,468   | 42,003    | -         | -         | 8,689     | 3,873     | (180,177)    | 14,305      | 1,439,487                    | 1,545,946    |
| Total revenue from external customers             | 33,381,784  | 37,074,861   | 1,897,803   | 1,965,044 | 595,280   | 247,241   | 97,495    | 112,112   | 2,312,480 | 1,982,689 | (180,177)    | (81,174)    | 38,104,665                   | 41,300,773   |
| Inter-segment revenue                             | 302,034     | 317,958      | -           | -         | 11,585    | 1,538     | 618,037   | 615,609   | 44,968    | 55,364    | -            | -           | 976,624                      | 990,469      |
| Total revenue                                     | 33,683,818  | 37,392,819   | 1,897,803   | 1,965,044 | 606,865   | 248,779   | 715,532   | 727,721   | 2,357,448 | 2,038,053 | (180,177)    | (81,174)    | 39,081,289                   | 42,291,242   |
| Segment result                                    | 6,273,812   | 5,187,103    | 1,288,204   | 1,481,425 | 246,544   | 38,511    | 281,242   | 178,527   | 309,864   | 266,293   | (154,974)    | (89,657)    | 8,244,692                    | 7,062,202    |
| Unallocated expenses                              |             |              |             |           |           |           |           |           |           |           |              |             | (990,596)                    | (903,058)    |
| Profit from operations                            |             |              |             |           |           |           |           |           |           |           |              |             | 7,254,096                    | 6,159,144    |
| Income from Associates                            |             |              |             |           |           |           |           |           |           |           |              |             | (2,429)                      | 7,680        |
| Income tax expense                                |             |              |             |           |           |           |           |           |           |           |              |             | (2,364,839)                  | (1,613,464)  |
| Profit for the period                             |             |              |             |           |           |           |           |           |           |           |              |             | 4,886,828                    | 4,553,360    |
| Minority interests                                |             |              |             |           |           |           |           |           |           |           |              |             | (100,058)                    | (70,083)     |
| Profit attributable to equity holders of the Bank |             |              |             |           |           |           |           |           |           |           |              |             | 4,786,770                    | 4,483,277    |
| Segment assets                                    | 281,438,663 | 253,619,311  | 13,447,253  | 8,944,242 | 3,134,815 | 1,345,982 | 8,209,036 | 8,347,215 | 4,548,029 | 3,671,702 | (2,663,818)  | (2,917,800) | 308,113,978                  | 273,010,652  |
| Investment in Associates                          |             |              |             |           |           |           |           |           |           |           |              |             | 196,009                      | 226,129      |
| Unallocated assets                                |             |              |             |           |           |           |           |           |           |           |              |             | 14,948,021                   | 13,970,989   |
| Total assets                                      |             |              |             |           |           |           |           |           |           |           |              |             | 323,258,008                  | 287,207,770  |
| Segment liabilities                               | 247,415,567 | 222,392,033  | 13,447,253  | 8,944,242 | 2,122,282 | 962,719   | 3,479,387 | 3,788,244 | 3,531,689 | 2,840,851 | (2,537,207)  | (2,992,535) | 267,458,971                  | 235,935,554  |
| Unallocated liabilities                           |             |              |             |           |           |           |           |           |           |           |              |             | 25,232,336                   | 24,498,608   |
| Total liabilities                                 |             |              |             |           |           |           |           |           |           |           |              |             | 292,691,307                  | 260,434,162  |
| Cash flows from operating activities              | (6,068,453) | 35,419,533   | (4,520,676) | 2,640,209 | 141,456   | 15,282    | 592,170   | 55,354    | 789,197   | 759,098   | (1,472,408)  | 1,497,450   | (10,538,714)                 | 40,386,926   |
| Cash flows from investing activities              | (3,047,844) | (25,928,465) | -           | -         | (396,200) | 25,791    | (451)     | (796)     | (745,694) | (734,363) | 1,242,213    | (293,855)   | (2,947,976)                  | (26,931,688) |
| Cash flows from financing activities              | 4,490,365   | (8,280,981)  | -           | -         | 317,625   | -         | (225,040) | -         | (56,250)  | (47,906)  | (131,696)    | (1,088,303) | 4,395,004                    | (9,417,190)  |
| Capital expenditure                               | 1,052,402   | 1,181,806    | 474         | 315       | 10,319    | 39,012    | 451       | 796       | 44,944    | 69,013    | 30,691       | (57)        | 1,139,281                    | 1,290,885    |
| Depreciation                                      | 660,701     | 583,350      | 1,103       | 1,023     | 13,975    | 11,693    | 110,485   | 110,414   | 30,355    | 26,933    | (6,020)      | (6,120)     | 810,599                      | 727,293      |
| Amortisation                                      | 168,711     | 165,420      | 50          | 1,216     | 1,394     | 1,013     | 79        | 79        | 9,983     | 8,279     | (220)        | (242)       | 179,997                      | 175,765      |

\*\*Stock broking, Securities dealings, Remittances and Foreign currency related services.

## 52 EVENTS OCCURRING AFTER THE BALANCE SHEET DATE

There are no events occurring after the Balance Sheet date which require adjustments to or disclosure in the Financial Statements, other than those disclosed below:

### 52 (a) Proposed Dividends

Refer Note No 38 (a)

### 52 (b) Sub-division of Shares - without a Change to the Stated Capital

Board of Directors has recommended that the ordinary shares (voting and non-voting) of the Bank be increased by sub-dividing the existing shares on the basis of one ordinary voting share for every existing two ordinary voting shares and one ordinary non-voting share for every existing two ordinary non-voting shares without making any changes to the Bank's Stated Capital, which is to be approved at the annual general meeting to be held on 31st March 2011.

The basic and diluted Earnings per Share (EPS) disclosed in the Income Statement and in Note 21 to these financial statements has not been adjusted for the said sub-division of shares. If the sub-division of shares is considered for the EPS computation, the adjusted EPS would be:

For the year ended 31st December

|                                 | 2010  |       |
|---------------------------------|-------|-------|
|                                 | Bank  | Group |
| Basic Earning per Share (Rs)    | 12.56 | 13.47 |
| Diluted Earnings per Share (Rs) | 12.50 | 13.41 |

Retrospective adjustments have not been made as the above sub-division of shares is yet to be approved at the annual general meeting to be held on 31st March 2011.

## 53 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 156 for the statement of the Directors' Responsibility for Financial Reporting.

# CAPITAL ADEQUACY

Capital adequacy is a measure of a bank's financial strength and its ability to withstand liquidity shocks during the course of its business activities. The financial crisis in 2008 clearly revealed the need for regulators and banks alike to review existing capital and liquidity requirements and to assess a bank's capability of absorbing losses in its daily course of business and during economic and market stress situations.

## RISK ASSESSMENT UNDER BASEL II

The primary objective of the Capital Adequacy Ratio (CAR) defined under Basel II is to protect a bank's depositors, whilst maintaining confidence and giving stability to the world banking system. The regulators attempt to accomplish this by setting the capital reserves a bank needs to hold in relation to the risk the bank exposes itself to through its business activities. Keeping in line with international standards, the Central Bank of Sri Lanka has supported these regulatory reforms by enhancing them in accordance with local funding and liquidity requirements. The capital adequacy of local banks is monitored by CBSL on a regular basis.

The Bank computes CAR as a ratio of its capital to its risk weighted assets. Calculations of the risk weightings defined under credit risk and market risk are based on the standardized approach whereas operational risk is computed by using the basic indicator approach. As the Basel II guidelines are phased in and more sophisticated risk measurement systems and models are implemented, banks will be in a position to move from the standardized methods to the more refined and robust requirements of the advanced approaches.

HNB's capital ratios of 10.99% and 12.64% remain comfortably above CBSL's current capital requirements of Tier 1 and Total Capital Ratios of 5% and 10% respectively.

## CHANGES AND IMPLICATIONS OF BASEL III

The latest package of reforms defined under Basel III contains several important changes for banks' capital structures. Recently endorsed at the G-20 Summit held in November 2010 in Seoul, the new standards were finalized in mid-December 2010.

### Summary of changes proposed under Basel III

- **Increase in capital requirements**

The minimum requirement for Tier 1 capital is to be raised from 4% to 6%, the focus shifting from tier 1 capital to "core tier 1" capital, the concentration being on common equity where tougher minimum standards have been set.

- **Introduction of a capital conservation buffer**

Banks will be required to maintain additional capital up to 2.5% that can be used to absorb losses during periods of financial and economic stress. Although banks are permitted to draw on the buffer during periods of stress, the closer their regulatory capital ratios approach the minimum requirement, the greater the constraints on the distribution of earnings.

- **Implementation of a countercyclical framework**

Capital between 0% – 2.5% of common equity or other fully loss absorbing capital to be introduced at the discretion of national regulators. The aim of the countercyclical buffer is to force banks to start building up an extra reserve when the economy is in boom and when supervisors see excessive credit in the system that could reverse in the form of loan losses during a slump.

- **New liquidity and funding standards**

The liquidity coverage ratio (LCR) and the net stable funding ratio (NSFR) are to be introduced to ensure that banks have sufficient high-quality liquid assets to withstand a stressed funding scenario.

- **Introduction of a leverage ratio**

The objective of this ratio is to put a floor on the build-up of leverage in the banking sector and to put additional safeguards in place by supplementing risk-based measures with a more straightforward absolute measure.

- **Revised framework for credit risk**

Revised measures have been introduced to better address counterparty credit worthiness.

In view of Basel III, it is imperative that banks begin to measure their readiness on the new measures of liquidity and leverage. HNB has reviewed the impact of this initiative and will continue to monitor regulatory developments in this area.

## CAPITAL BASE

As at 31st December

|  | 2010<br>(Rs Mn) | 2009<br>(Rs Mn) |
|--|-----------------|-----------------|
| <b>TIER 1</b>  |                 |                 |
| Voting ordinary shares   | 3,113           | 2,903           |
| Non-Voting ordinary shares   | 2,206           | 2,181           |
| Statutory reserve fund   | 1,510           | 1,260           |
| Published retained earnings  | 4,420           | 3,849           |
| General and other reserves   | 13,000          | 10,700          |
| Less: Deductions from Tier 1 capital (Note 1)                      | (1,591)         | (1,332)         |
| <b>Eligible Tier 1 Capital</b>                                     | <b>22,658</b>   | <b>19,561</b>   |
| <b>TIER II</b>   |                 |                 |
| 50% of approved asset revaluation reserves (Note 2)                | 1,042           | 1,042           |
| General provision for loan losses                                  | 1,451           | 1,317           |
| Approved subordinated term debt                                    | 2,303           | 2,455           |
| <b>Tier II Capital</b>   | <b>4,796</b>    | <b>4,814</b>    |
| Less: Deductions from Tier II capital (Note 1)                     | (1,394)         | (1,195)         |
| <b>Eligible Tier II capital</b>                                    | <b>3,402</b>    | <b>3,619</b>    |
| <b>Capital Base</b>  | <b>26,060</b>   | <b>23,180</b>   |
| <b>Risk Adjusted capital ratios</b>                                |                 |                 |
| Tier 1 ( Eligible Tier 1 capital / Total risk adjusted balances) * | 10.99           | 11.10           |
| Total (Capital base / Total risk adjusted balances) **             | 12.64           | 13.16           |

\* Statutory minimum 5%    \*\* Statutory minimum 10%

## RISK ADJUSTED ON - BALANCE SHEET EXPOSURE

| Rupees Million<br>As at 31st December                                   | Balance        |                | Risk<br>Weights<br>(%) | Risk Adjusted<br>Balance |                |
|---|----------------|----------------|------------------------|--------------------------|----------------|
|   | 2010           | 2009           |                        | 2010                     | 2009           |
| <b>Exposures</b>  |                |                |                        |                          |                |
| - To Central Government and CBSL  | 73,122         | 64,164         | -                      | -                        | -              |
| - To banks / foreign sovereigns   | 12,539         | 22,420         | 20 - 150               | 2,871                    | 4,682          |
| - To financial institutions   | 3,297          | 1,739          | 20 - 150               | 1,663                    | 891            |
| - To corporates   | 68,908         | 64,910         | 20 - 150               | 66,456                   | 62,997         |
| - To retail sector (excluding claims secured by residential properties) | 56,033         | 38,056         | 75 - 100               | 45,384                   | 30,466         |
| - Secured on residential property mortgages                             | 21,202         | 19,798         | 50 - 100               | 13,215                   | 10,333         |
| - Non performing advances   | 5,511          | 6,865          | 50 - 150               | 5,810                    | 7,433          |
| - Other exposures   | 3,861          | 3,431          | 20 - 150               | 3,861                    | 3,431          |
| - Cash and cash items in the process of collection                      | 7,911          | 6,707          | 0 - 20                 | 414                      | 327            |
| - Other assets  | 14,025         | 13,867         | 100                    | 14,025                   | 13,867         |
| <b>Total assets</b>   | <b>266,409</b> | <b>241,957</b> |                        | <b>153,699</b>           | <b>134,427</b> |

**RISK ADJUSTED OFF - BALANCE SHEET EXPOSURE**

| Rupees Million  | Amount of Off-Balance Sheet Items | Credit Conversion Factor (%) | Credit Equivalent Amount | Risk Weights (%) | Risk Adjusted Balance |               |
|---|-----------------------------------|------------------------------|--------------------------|------------------|-----------------------|---------------|
|   |                                   |                              |                          |                  | 2010                  | 2009          |
| <b>As At 31st December</b>  | <b>2010</b>                       |                              | <b>2010</b>              |                  | <b>2010</b>           | <b>2009</b>   |
| Financial guarantees, bank acceptances and other guarantees                                       | 9,216                             | 100                          | 9,216                    | 0-100            | 8,553                 | 6,421         |
| Performance related guarantees and warranties and stand by LCs related to particular transactions | 17,266                            | 50                           | 8,633                    | 0-100            | 8,633                 | 5,416         |
| Shipping guarantees, documentary letter of credit and trade related acceptances                   | 18,960                            | 20                           | 3,792                    | 0-100            | 3,792                 | 2,824         |
| Other commitments with an original maturity of  |                                   |                              |                          |                  |                       |               |
| < one year  | 10,949                            | 0-20                         | 16                       | 0-100            | 16                    | 25            |
| > one year  | 28                                | 50                           | 14                       | 0-100            | 14                    | 362           |
| Foreign exchange contracts  | 69,329                            | 2                            | 1,386                    | 0-100            | 1,386                 | 463           |
| Interest rate contracts   | 210                               | 7                            | 15                       | 0-100            | 15                    | 102           |
| <b>Total off- balance sheet exposures</b>   | <b>125,958</b>                    |                              | <b>23,072</b>            |                  | <b>22,409</b>         | <b>15,613</b> |

**CAPITAL CHARGE FOR MARKET RISK**

Rupees Million

| As at 31st December                                | Capital Charge |             | Risk Adjusted Balance |            |
|--|----------------|-------------|-----------------------|------------|
|  | 2010           | 2009        | 2010                  | 2009       |
| Interest rate                                      | 1.1            | -           | 11                    | -          |
| Equity   | 72.0           | 7.9         | 720                   | 79         |
| Foreign exchange and gold                          | 96.0           | 46.3        | 960                   | 463        |
| <b>Total risk adjusted balance for market risk</b> | <b>169.2</b>   | <b>54.2</b> | <b>1,692</b>          | <b>542</b> |

**CAPITAL CHARGE FOR OPERATIONAL RISK**

Rupees Million

| As at 31st December                                     | Capital Charge |                | Risk Adjusted Balance |               |
|---|----------------|----------------|-----------------------|---------------|
|   | 2010           | 2009           | 2010                  | 2009          |
| Average gross income                                    | 18,922.6       | 17,066.4       |                       |               |
| 15% of average gross income                             | 2,838.4        | 2,560.0        |                       |               |
| <b>Total risk adjusted balance for operational risk</b> | <b>2,838.4</b> | <b>2,560.0</b> | <b>28,384</b>         | <b>25,600</b> |

Total risk adjusted balances (credit risk, market risk, operational risk)

206,184      176,182

**NOTES**

(1) Deductions

|   | Tier I       |              | Tier II      |              |
|---|--------------|--------------|--------------|--------------|
|   | 2010         | 2009         | 2010         | 2009         |
| Additional investment in Sithma Development (Pvt) Ltd | 450          | 450          | 450          | 450          |
| Employee share option plan                            | 197          | 137          | -            | -            |
| Others  | 944          | 745          | 944          | 745          |
| <b>Total deductions</b>                               | <b>1,591</b> | <b>1,332</b> | <b>1,394</b> | <b>1,195</b> |

(2) Revaluation reserves approved by CBSL is Rs 2,084 Mn.

(3) The capital adequacy computation has been indicated for the Bank only.

# INCOME STATEMENT

## IN US DOLLARS

| For the year ended 31st December                           | Bank             |                  | Group            |                  |
|--|------------------|------------------|------------------|------------------|
|  | 2010<br>US\$ 000 | 2009<br>US\$ 000 | 2010<br>US\$ 000 | 2009<br>US\$ 000 |
| <b>INCOME</b>  | <b>320,714</b>   | <b>344,037</b>   | <b>343,456</b>   | <b>361,020</b>   |
| Interest income  | 272,651          | 302,625          | 275,486          | 304,514          |
| Less: interest expenses                                    | 132,527          | 175,172          | 133,194          | 177,281          |
| <b>Net interest income</b>                                 | <b>140,124</b>   | <b>127,453</b>   | <b>142,292</b>   | <b>127,233</b>   |
| Foreign exchange profit                                    | 9,157            | 7,895            | 9,142            | 7,897            |
| Fee and commission income                                  | 25,322           | 20,378           | 28,081           | 20,782           |
| Dividend income  | 1,891            | 1,900            | 1,794            | 1,712            |
| Other income   | 11,693           | 11,239           | 28,953           | 26,115           |
| <b>OPERATING INCOME</b>                                    | <b>188,187</b>   | <b>168,865</b>   | <b>210,262</b>   | <b>183,739</b>   |
| Less:  |                  |                  |                  |                  |
| <b>OPERATING EXPENSES</b>                                  |                  |                  |                  |                  |
| Personnel expenses   | 41,681           | 35,784           | 45,881           | 38,864           |
| Premises, equipment and establishment expenses             | 26,846           | 24,831           | 25,432           | 23,086           |
| Fee and commission expenses                                | 1,213            | 1,204            | 1,220            | 3,033            |
| Provision for employee retirement benefits                 | 7,957            | 7,130            | 8,056            | 7,197            |
| Provision for loan losses                                  | 4,338            | 6,191            | 4,338            | 6,191            |
| Diminution / (appreciation) in value of investments        | 72               | 18               | 10               | 18               |
| Impairment of Goodwill                                     | -                | -                | -                | 45               |
| Loans written off  | 2                | 2                | 2                | 2                |
| Other expenses   | 45,404           | 41,979           | 59,939           | 51,464           |
|  | <b>127,513</b>   | <b>117,139</b>   | <b>144,878</b>   | <b>129,900</b>   |
| <b>PROFIT FROM OPERATIONS</b>                              | <b>60,674</b>    | <b>51,726</b>    | <b>65,384</b>    | <b>53,839</b>    |
| Share of profit / (loss) of associates (net of income tax) | -                | -                | (22)             | 67               |
| <b>PROFIT BEFORE INCOME TAX</b>                            | <b>60,674</b>    | <b>51,726</b>    | <b>65,362</b>    | <b>53,906</b>    |
| Less: income tax expense                                   | 20,438           | 13,688           | 21,315           | 14,104           |
| <b>PROFIT FOR THE YEAR</b>                                 | <b>40,236</b>    | <b>38,038</b>    | <b>44,047</b>    | <b>39,802</b>    |
| Attributable to:   | -                | -                | -                | -                |
| Equity holders of the Bank                                 | 40,236           | 38,038           | 43,145           | 39,190           |
| Minority interest  | -                | -                | 902              | 612              |
| <b>PROFIT FOR THE YEAR</b>                                 | <b>40,236</b>    | <b>38,038</b>    | <b>44,047</b>    | <b>39,802</b>    |
| <b>BASIC EARNINGS PER SHARE (US\$)</b>                     | <b>0.17</b>      | <b>0.16</b>      | <b>0.18</b>      | <b>0.17</b>      |
| <b>DILUTED EARNINGS PER SHARE (US\$)</b>                   | <b>0.17</b>      | <b>0.16</b>      | <b>0.18</b>      | <b>0.17</b>      |
| <b>DIVIDEND PER SHARE (US\$)</b>                           | <b>*0.06</b>     | <b>0.06</b>      | <b>*0.06</b>     | <b>0.06</b>      |

Exchange rate of US\$ 1 was Rs 110.945 as at 31st December 2010 (Rs 114.40 as at 31st December 2009)

\*Calculated on interim dividend paid and final dividend proposed, which is to be approved at the Annual General Meeting.

The Income Statement given on this page is solely for the convenience of the shareholders, bankers, investors, customers and other users of Financial Statements and do not form part of the audited Financial Statements.



# BALANCE SHEET

## IN US DOLLARS

| As at 31st December  | Bank             |                  | Group            |                  |
|--|------------------|------------------|------------------|------------------|
|  | 2010<br>US\$ 000 | 2009<br>US\$ 000 | 2010<br>US\$ 000 | 2009<br>US\$ 000 |
| <b>ASSETS</b>  |                  |                  |                  |                  |
| Cash and cash equivalents                                      | 162,293          | 237,345          | 166,808          | 241,243          |
| Statutory deposit with Central Banks                           | 112,593          | 96,713           | 112,723          | 96,843           |
| Government treasury bills                                      | -                | -                | 8,801            | 2,673            |
| Dealing securities   | 13,137           | 345              | 22,572           | 6,012            |
| Securities purchased under re-sale agreements                  | 10,688           | 4,371            | 24,459           | 8,310            |
| Non-current assets held for sale                               | -                | -                | 26               | 25               |
| Bills of exchange  | 12,629           | 12,653           | 12,629           | 12,653           |
| Commercial papers  | 1,433            | 1,828            | 1,911            | 2,473            |
| Lease receivable within one year                               | 41,737           | 34,363           | 41,737           | 34,363           |
| Lease receivable after one year                                | 79,470           | 43,821           | 79,470           | 43,821           |
| Loans and advances   | 1,694,838        | 1,392,022        | 1,676,351        | 1,368,536        |
| Investments securities   | 529,128          | 471,676          | 543,068          | 488,179          |
| Investments in Associates                                      | 754              | 1,782            | 1,767            | 1,977            |
| Investments in Joint Venture                                   | 5,904            | 2,185            | -                | -                |
| Investments in Subsidiaries                                    | 19,641           | 19,050           | -                | -                |
| Investment properties  | 3,187            | 3,066            | 1,565            | 1,508            |
| Property, plant and equipment                                  | 67,366           | 62,758           | 131,018          | 125,288          |
| Intangible assets  | 5,201            | 5,902            | 6,335            | 6,206            |
| Other assets   | 69,452           | 60,198           | 82,438           | 70,447           |
| <b>Total Assets</b>  | <b>2,829,451</b> | <b>2,450,078</b> | <b>2,913,678</b> | <b>2,510,557</b> |
| <b>LIABILITIES</b>   |                  |                  |                  |                  |
| Deposits from customers  | 2,109,794        | 1,840,094        | 2,108,077        | 1,838,839        |
| Dividends payable  | 447              | 1,885            | 461              | 1,885            |
| Securities sold under re-purchase agreements                   | 107,727          | 75,918           | 121,890          | 82,285           |
| Borrowings   | 97,441           | 72,641           | 97,377           | 72,670           |
| Current tax liabilities  | 28,191           | 25,535           | 29,375           | 26,025           |
| Bills payable  | 11,764           | 10,150           | 11,764           | 10,150           |
| Subordinated debentures  | 24,555           | 23,367           | 24,314           | 23,192           |
| Insurance provision - Life                                     | -                | -                | 21,499           | 16,202           |
| Insurance provision - General                                  | -                | -                | 6,586            | 5,239            |
| Deferred tax liabilities                                       | 6,633            | 8,210            | 6,619            | 8,202            |
| Other liabilities  | 197,068          | 183,361          | 210,204          | 191,833          |
| <b>Total Liabilities</b>                                       | <b>2,583,619</b> | <b>2,241,161</b> | <b>2,638,166</b> | <b>2,276,522</b> |
| <b>EQUITY</b>  |                  |                  |                  |                  |
| Stated capital   | 47,939           | 44,441           | 47,939           | 44,441           |
| Statutory reserve fund   | 13,610           | 11,014           | 13,610           | 11,014           |
| Retained earnings  | 39,842           | 33,645           | 39,254           | 31,034           |
| Other reserves   | 144,441          | 119,817          | 169,404          | 144,051          |
| <b>Total equity attributable to equity holders of the Bank</b> | <b>245,832</b>   | <b>208,917</b>   | <b>270,207</b>   | <b>230,540</b>   |
| Minority interest  | -                | -                | 5,305            | 3,495            |
| <b>Total Equity</b>  | <b>245,832</b>   | <b>208,917</b>   | <b>275,512</b>   | <b>234,035</b>   |
| <b>Total Liabilities and Equity</b>                            | <b>2,829,451</b> | <b>2,450,078</b> | <b>2,913,678</b> | <b>2,510,557</b> |
| <b>Commitments and Contingencies</b>                           | <b>1,119,208</b> | <b>550,937</b>   | <b>1,119,208</b> | <b>551,046</b>   |

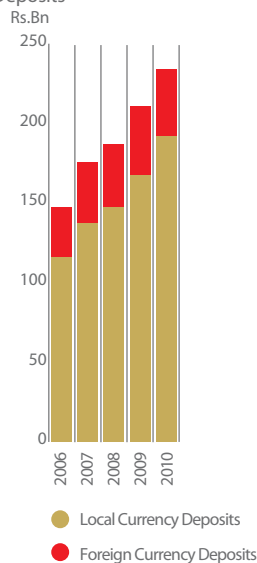
Exchange rate of US\$ 1 was Rs 110.945 as at 31st December 2010 (Rs 114.40 as at 31st December 2009)

The Balance Sheet given on this page is solely for the convenience of the shareholders, bankers, investors, customers and other users of Financial Statements and do not form part of the audited Financial Statements.

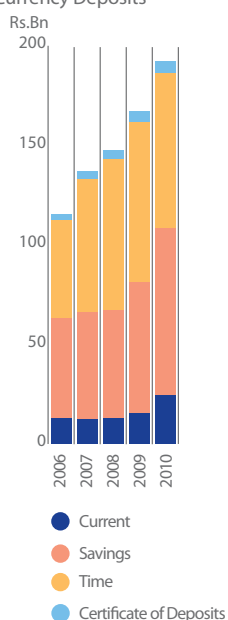
# ANALYSIS OF DEPOSITS

|                                       | 2006<br>Rs 000 | 2007<br>Rs 000 | 2008<br>Rs 000 | 2009<br>Rs 000 | 2010<br>Rs 000 |
|---------------------------------------|----------------|----------------|----------------|----------------|----------------|
| <b>Local currency deposits</b>        |                |                |                |                |                |
| Current                               | 12,635,473     | 12,482,701     | 12,748,863     | 15,090,759     | 24,214,105     |
| Savings                               | 50,697,086     | 53,565,590     | 54,544,453     | 66,080,330     | 83,981,743     |
| Time                                  | 48,869,303     | 66,836,282     | 75,828,902     | 80,572,001     | 78,198,953     |
| Certificate of Deposit                | 3,348,716      | 4,021,045      | 4,269,993      | 5,439,817      | 5,576,315      |
|                                       | 115,550,578    | 136,905,618    | 147,392,211    | 167,182,907    | 191,971,116    |
| <b>Foreign currency deposits</b>      |                |                |                |                |                |
| Current                               | 1,188,634      | 1,348,573      | 1,522,500      | 1,191,309      | 794,003        |
| Savings                               | 13,600,463     | 15,784,655     | 14,178,854     | 14,715,443     | 15,033,471     |
| Time                                  | 17,217,780     | 21,620,727     | 23,676,297     | 27,417,146     | 26,272,495     |
|                                       | 32,006,877     | 38,753,955     | 39,377,651     | 43,323,898     | 42,099,969     |
| <b>Total deposits</b>                 | 147,557,455    | 175,659,573    | 186,769,862    | 210,506,805    | 234,071,085    |
| Refinance                             | 3,582,587      | 5,749,624      | 6,424,054      | 6,169,445      | 6,314,639      |
| <b>Total deposits &amp; refinance</b> | 151,140,042    | 181,409,197    | 193,193,916    | 216,676,250    | 240,385,724    |

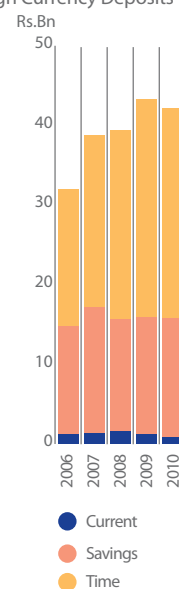
Analysis of Total Deposits



Analysis of Local Currency Deposits



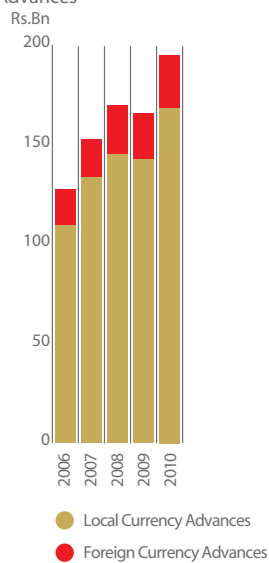
Analysis of Foreign Currency Deposits



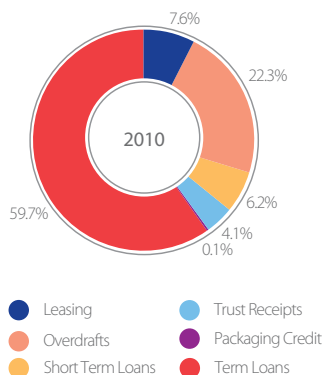
# ANALYSIS OF ADVANCES

|  | 2006<br>Rs 000     | 2007<br>Rs 000     | 2008<br>Rs 000     | 2009<br>Rs 000     | 2010<br>Rs 000     |
|--|--------------------|--------------------|--------------------|--------------------|--------------------|
| <b>Local Currency Advances (Gross)</b>   |                    |                    |                    |                    |                    |
| Overdrafts                               | 27,455,224         | 33,776,672         | 35,393,588         | 32,264,297         | 40,673,843         |
| Short term loans                         | 5,636,464          | 5,129,706          | 7,074,630          | 9,704,995          | 11,223,962         |
| Trust receipts                           | 6,876,898          | 7,097,272          | 7,642,331          | 6,347,877          | 7,461,863          |
| Packing credit                           | 618,787            | 763,188            | 375,633            | 252,283            | 211,285            |
| Term loans                               | 68,451,741         | 86,692,434         | 94,493,224         | 93,899,250         | 108,681,036        |
|  | 109,039,114        | 133,459,272        | 144,979,406        | 142,468,702        | 168,251,989        |
| <b>Leasing facilities</b>                |                    |                    |                    |                    |                    |
|  | 12,036,467         | 13,772,361         | 12,038,851         | 9,398,642          | 13,919,317         |
| <b>Total local currency advances</b>     | <b>121,075,581</b> | <b>147,231,633</b> | <b>157,018,257</b> | <b>151,867,344</b> | <b>182,171,306</b> |
| <b>Foreign currency advances (Gross)</b> |                    |                    |                    |                    |                    |
|  | 18,412,257         | 18,988,347         | 24,696,099         | 23,371,444         | 26,240,327         |
| <b>Total Advances</b>                    | <b>139,487,838</b> | <b>166,219,980</b> | <b>181,714,356</b> | <b>175,238,788</b> | <b>208,411,633</b> |

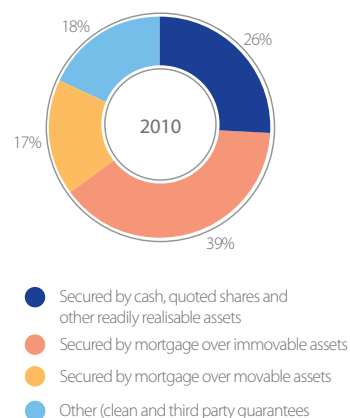
Analysis of Total Advances



Analysis of Advances by Type



Analysis of Advances by Security

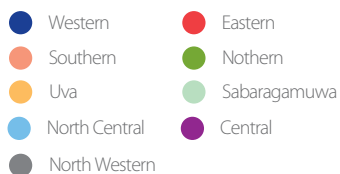
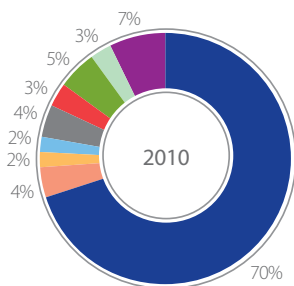


# PROVINCEWISE ANALYSIS OF DEPOSITS AND ADVANCES

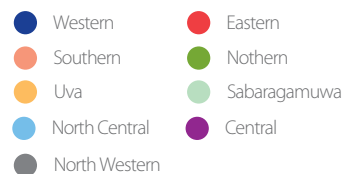
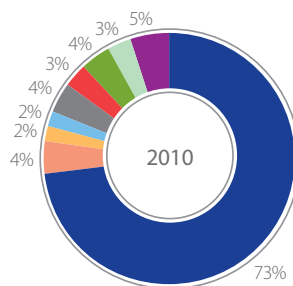
As at 31st December 2010

| Province      | No of Branches | Deposits (Rs Mn) | %   | Advances Including Leasing (Rs Mn) | %   | Deposit Utilisation % |
|---------------|----------------|------------------|-----|------------------------------------|-----|-----------------------|
| WESTERN       | 95             | 162,884          | 70  | 153,524                            | 73  | 94                    |
| SOUTHERN      | 17             | 8,957            | 4   | 8,569                              | 4   | 96                    |
| UVA           | 10             | 5,046            | 2   | 3,471                              | 2   | 69                    |
| NORTH CENTRAL | 7              | 4,153            | 2   | 3,893                              | 2   | 94                    |
| NORTH WESTERN | 16             | 9,926            | 4   | 8,404                              | 4   | 85                    |
| EASTERN       | 16             | 7,422            | 3   | 5,995                              | 3   | 81                    |
| NORTHERN      | 13             | 11,859           | 5   | 8,112                              | 4   | 68                    |
| SABARAGAMUWA  | 10             | 7,506            | 3   | 5,707                              | 3   | 76                    |
| CENTRAL       | 21             | 16,318           | 7   | 10,738                             | 5   | 66                    |
| TOTAL         | 205            | 234,071          | 100 | 208,412                            | 100 | 89                    |

Province-wise Deposits



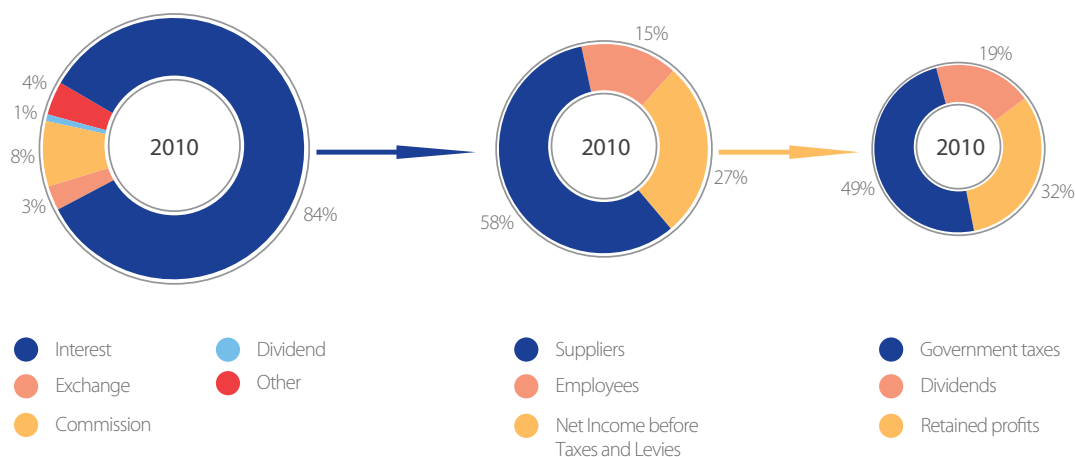
Province-wise Advances



# SOURCES AND UTILISATION OF INCOME

|  | 2006<br>Rs 000    | 2007<br>Rs 000    | 2008<br>Rs 000    | 2009<br>Rs 000    | 2010<br>Rs 000    |
|--|-------------------|-------------------|-------------------|-------------------|-------------------|
| <b>SOURCES OF INCOME</b>                                   |                   |                   |                   |                   |                   |
| Interest   | 18,451,961        | 26,250,038        | 32,431,158        | 34,620,276        | 30,249,230        |
| Exchange   | 772,825           | 1,114,313         | 1,166,979         | 903,210           | 1,015,987         |
| Commission   | 1,795,340         | 2,081,569         | 2,364,434         | 2,331,278         | 2,809,330         |
| Dividend   | 76,983            | 125,142           | 538,321           | 217,353           | 209,762           |
| Other  | 396,586           | 423,656           | 650,194           | 1,285,746         | 1,297,312         |
| <b>Total</b>   | <b>21,493,695</b> | <b>29,994,718</b> | <b>37,151,086</b> | <b>39,357,863</b> | <b>35,581,621</b> |
| <b>UTILISATION OF INCOME</b>                               |                   |                   |                   |                   |                   |
| <b>Employees</b>   |                   |                   |                   |                   |                   |
| Salaries and other payment to Staff                        | 3,164,917         | 3,657,112         | 4,348,690         | 4,909,419         | 5,507,101         |
| <b>Suppliers</b>   |                   |                   |                   |                   |                   |
| Interest Paid  | 9,797,449         | 15,189,698        | 19,751,667        | 20,039,646        | 14,703,256        |
| Other expenses   | 4,529,175         | 5,544,177         | 6,488,202         | 6,250,003         | 6,668,020         |
|  | 14,326,624        | 20,733,875        | 26,239,869        | 26,289,649        | 21,371,276        |
| Net Income before Government Taxes and Levies              | 4,002,154         | 5,603,731         | 6,562,527         | 8,158,795         | 8,703,244         |
| <b>Government</b>  |                   |                   |                   |                   |                   |
| Income Tax, SRL, NBT, VAT, Debit Tax, (Incl. Deferred Tax) | 1,781,665         | 2,581,275         | 3,343,547         | 3,807,143         | 4,239,277         |
| <b>ShareHolders</b>  |                   |                   |                   |                   |                   |
| Dividends  | 588,824           | 824,353           | 942,118           | 1,533,065         | 1,647,692         |
| Retained Profits   | 1,631,666         | 2,198,103         | 2,276,862         | 2,818,588         | 2,816,275         |
| <b>Total</b>   | <b>21,493,695</b> | <b>29,994,718</b> | <b>37,151,086</b> | <b>39,357,863</b> | <b>35,581,621</b> |

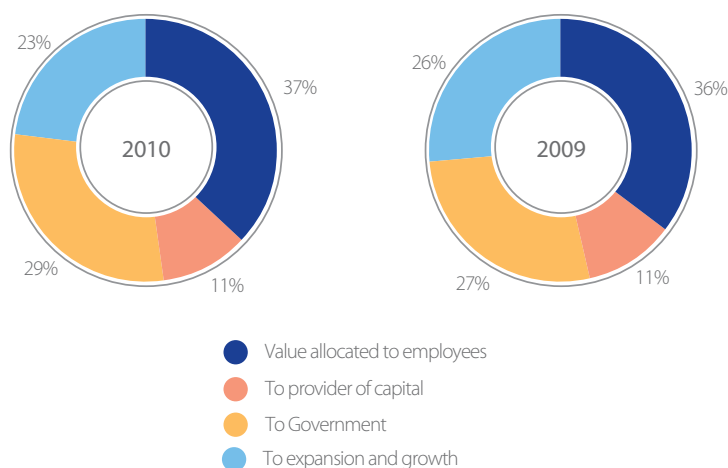
Sources and Utilisation of Income



# VALUE ADDED STATEMENT

|   | 2010<br>Rs 000 | %         | 2009<br>Rs 000 | %      |
|---|----------------|-----------|----------------|--------|
| <b>Value Added</b>                          |                |           |                |        |
| Income earned by providing banking services | 34,502,529     |           | 38,598,619     |        |
| Cost of services                            | 20,051,377     |           | 24,828,375     |        |
| Value added by banking services             | 14,451,152     |           | 13,770,244     |        |
| Non-banking income                          | 1,079,092      |           | 759,245        |        |
| Provision for fall in value of investments  | (8,025)        |           | (2,038)        |        |
| Provision for bad debts                     | (481,309)      |           | (708,227)      |        |
|   | 15,040,910     |           | 13,819,224     |        |
| <b>Value allocated to employees</b>         |                |           |                |        |
| Salaries, wages & other benefits            | 5,507,101      | 36.62     | 4,909,419      | 35.53  |
| <b>To providers of capital</b>              |                |           |                |        |
| Dividends to shareholders                   | 1,647,692      | 10.95     | 1,533,065      | 11.09  |
| <b>To Government</b>                        |                |           |                |        |
| Value Added Tax                             | 1,859,676      |           | 2,193,577      |        |
| Income Tax                                  | 2,452,944      |           | 1,496,206      |        |
| Debit tax                                   | 11,156         |           | 10,845         |        |
| Nation Building Tax                         | 50,786         |           | 36,691         |        |
| Stamp Duty                                  | 50,175         | 4,424,737 | 29.42          | 163    |
|   |                |           | 3,737,482      | 27.05  |
| <b>To expansion and growth</b>              |                |           |                |        |
| Retained income                             | 2,816,275      | 18.72     | 2,818,588      | 20.40  |
| Depreciation and Amortization               | 830,565        | 5.52      | 751,009        | 5.43   |
| Deferred Taxation                           | (185,460)      | (1.23)    | 69,661         | 0.50   |
|   | 15,040,910     | 100.00    | 13,819,224     | 100.00 |

Analysis of Value Addition



| For the three months ended                  | 2010             |                   |              |               | 2009             |                   |              |               |
|---|------------------|-------------------|--------------|---------------|------------------|-------------------|--------------|---------------|
|   | December<br>31st | September<br>30th | June<br>30th | March<br>31st | December<br>31st | September<br>30th | June<br>30th | March<br>31st |
| <b>Balance Sheet Data</b>                   |                  |                   |              |               |                  |                   |              |               |
| <b>(Rs Mn)</b>                              |                  |                   |              |               |                  |                   |              |               |
| Total assets                                | 313,913          | 295,368           | 286,240      | 281,901       | 280,289          | 268,639           | 266,971      | 260,969       |
| Loans, leases and bills                     | 210,067          | 190,876           | 180,245      | 174,595       | 177,229          | 180,471           | 174,829      | 178,040       |
| Deposits                                    | 234,071          | 221,384           | 216,529      | 214,611       | 210,507          | 203,934           | 201,366      | 193,338       |
| Shareholders' funds                         | 27,274           | 25,689            | 24,642       | 23,393        | 23,900           | 22,557            | 21,649       | 20,638        |
| Average assets                              | 304,641          | 290,804           | 284,071      | 281,095       | 274,464          | 267,805           | 263,970      | 258,840       |
| <b>Income Statement Data</b>                |                  |                   |              |               |                  |                   |              |               |
| <b>(Rs 000)</b>                             |                  |                   |              |               |                  |                   |              |               |
| Net interest income                         | 4,244,428        | 3,866,343         | 3,816,891    | 3,618,312     | 3,795,833        | 3,695,410         | 3,629,466    | 3,459,921     |
| Foreign exchange profit                     | 294,833          | 305,317           | 235,793      | 180,044       | 185,139          | 240,847           | 261,460      | 215,764       |
| Other income                                | 797,669          | 1,077,139         | 1,239,536    | 774,078       | 687,518          | 856,333           | 925,253      | 621,419       |
| Total revenue                               | 5,336,930        | 5,248,799         | 5,292,220    | 4,572,434     | 4,668,490        | 4,792,590         | 4,816,179    | 4,297,104     |
| Provision for loan losses (Net of recovery) | 42,394           | (36,574)          | (10,041)     | (49,380)      | 338,662          | (66,093)          | (166,447)    | (70,780)      |
| Non-interest expenses                       | (3,062,824)      | (3,688,019)       | (3,584,388)  | (3,330,100)   | (3,292,291)      | (3,246,588)       | (3,101,588)  | (3,051,719)   |
| Provision for income tax                    | (596,777)        | (572,259)         | (558,271)    | (540,177)     | (44,150)         | (572,375)         | (537,820)    | (411,522)     |
| Net profit after tax                        | 1,719,723        | 951,947           | 1,139,520    | 652,777       | 1,670,711        | 907,534           | 1,010,324    | 763,083       |
| <b>Ordinary Share Information</b>           |                  |                   |              |               |                  |                   |              |               |
| <b>Market Price per Share (Rs)</b>          |                  |                   |              |               |                  |                   |              |               |
|   | V                | NV                | V            | NV            | V                | NV                | V            | NV            |
| High  | 445.00           | 260.00            | 390.00       | 250.00        | 300.00           | 207.00            | 189.50       | 145.00        |
| Low   | 380.00           | 190.70            | 270.00       | 173.60        | 185.00           | 132.25            | 168.00       | 105.00        |
| Closing                                     | 399.90           | 214.60            | 386.10       | 239.90        | 281.00           | 190.25            | 188.25       | 140.00        |
| V - Voting NV - Non Voting                  |                  |                   |              |               |                  |                   |              |               |
| Book value per ordinary share (Rs)          | 114.61           |                   | 108.00       |               | 103.97           |                   | 99.14        |               |
|   |                  |                   |              |               |                  |                   | 101.37       |               |
|   |                  |                   |              |               |                  |                   | 95.77        |               |
|   |                  |                   |              |               |                  |                   | 91.92        |               |
|   |                  |                   |              |               |                  |                   |              | 87.62         |
| <b>Financial Measures</b>                   |                  |                   |              |               |                  |                   |              |               |
| <b>Profitability</b>                        |                  |                   |              |               |                  |                   |              |               |
| Return on average                           |                  |                   |              |               |                  |                   |              |               |
| Shareholders' equity (annualised) (%)       | 17.45            |                   | 14.89        |               | 14.93            |                   | 11.04        |               |
|   |                  |                   |              |               |                  |                   | 19.57        |               |
|   |                  |                   |              |               |                  |                   | 16.54        |               |
|   |                  |                   |              |               |                  |                   | 16.77        |               |
|   |                  |                   |              |               |                  |                   |              | 14.81         |
| <b>Productivity</b>                         |                  |                   |              |               |                  |                   |              |               |
| Non interest expenses to total revenue (%)  | 57.39            |                   | 70.26        |               | 67.73            |                   | 72.83        |               |
|   |                  |                   |              |               |                  |                   | 70.52        |               |
|   |                  |                   |              |               |                  |                   | 67.74        |               |
|   |                  |                   |              |               |                  |                   | 64.40        |               |
|   |                  |                   |              |               |                  |                   |              | 71.02         |
| <b>Capital</b>                              |                  |                   |              |               |                  |                   |              |               |
| <b>Risk Weighted Capital Ratios</b>         |                  |                   |              |               |                  |                   |              |               |
| Tier 1 (%)                                  | 10.99            |                   | 10.49        |               | 10.40            |                   | 10.50        |               |
| Total (Tier 1+2) (%)                        | 12.64            |                   | 12.25        |               | 12.31            |                   | 12.47        |               |
|   |                  |                   |              |               |                  |                   | 13.16        |               |
|   |                  |                   |              |               |                  |                   | 11.93        |               |
|   |                  |                   |              |               |                  |                   | 11.85        |               |
|   |                  |                   |              |               |                  |                   |              | 10.93         |
| <b>Asset Quality</b>                        |                  |                   |              |               |                  |                   |              |               |
| Gross NPA ratio (%)                         | 4.51             |                   | 5.94         |               | 6.48             |                   | 7.40         |               |
| Net NPA ratio (%)                           | 1.95             |                   | 3.09         |               | 3.30             |                   | 4.11         |               |
|   |                  |                   |              |               |                  |                   | 6.15         |               |
|   |                  |                   |              |               |                  |                   | 8.44         |               |
|   |                  |                   |              |               |                  |                   | 8.73         |               |
|   |                  |                   |              |               |                  |                   |              | 8.17          |
|   |                  |                   |              |               |                  |                   | 3.86         |               |
|   |                  |                   |              |               |                  |                   |              | 3.48          |



# TEN YEAR STATISTICAL SUMMARY

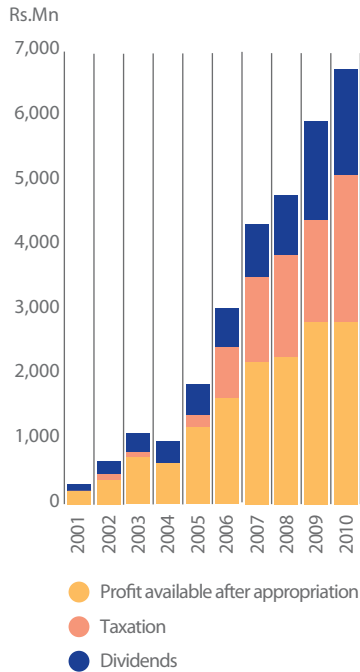
| Year ended 31st December (Rs Mn)  | 2001          | 2002           | 2003           | 2004           | 2005           | 2006           | 2007           | 2008           | 2009           | 2010           |
|---|---------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| <b>OPERATING RESULTS</b>  |               |                |                |                |                |                |                |                |                |                |
| Income  | 11,564        | 11,799         | 14,831         | 14,087         | 16,915         | 21,494         | 29,995         | 37,151         | 39,358         | 35,582         |
| Interest Income   | 9,336         | 9,399          | 11,537         | 11,469         | 14,130         | 18,452         | 26,250         | 32,431         | 34,620         | 30,249         |
| Interest Expense  | 7,201         | 6,258          | 6,909          | 5,962          | 7,281          | 9,797          | 15,190         | 19,752         | 20,040         | 14,703         |
| Exchange Income   | 516           | 382            | 506            | 662            | 646            | 773            | 1,114          | 1,167          | 903            | 1,016          |
| Other Income  | 1,712         | 2,018          | 2,788          | 1,956          | 2,139          | 2,269          | 2,630          | 3,553          | 3,834          | 4,316          |
| Operating Expenses  | 4,061         | 4,873          | 6,830          | 7,175          | 7,785          | 8,677          | 10,470         | 12,615         | 13,401         | 14,147         |
| Profit before Income Tax  | 301           | 669            | 1,092          | 950            | 1,850          | 3,019          | 4,335          | 4,785          | 5,918          | 6,731          |
| Income Tax on Profit  | (2)           | 80             | 83             | (26)           | 195            | 799            | 1,312          | 1,566          | 1,566          | 2,267          |
| Profit after Taxation   | 303           | 589            | 1,008          | 976            | 1,655          | 2,220          | 3,022          | 3,219          | 4,352          | 4,464          |
| <b>LIABILITIES AND SHAREHOLDERS' FUNDS</b>                                      |               |                |                |                |                |                |                |                |                |                |
| Customer Deposits   | 75,599        | 87,884         | 101,026        | 118,524        | 128,284        | 147,557        | 175,660        | 186,770        | 210,507        | 234,071        |
| Refinance Borrowings  | 1,565         | 1,659          | 1,764          | 2,066          | 2,712          | 3,583          | 5,750          | 6,424          | 6,169          | 6,315          |
| Other Liabilities   | 16,000        | 19,354         | 23,161         | 22,787         | 23,464         | 31,687         | 32,472         | 42,064         | 38,773         | 45,518         |
| Deferred Taxation   | 215           | 304            | 387            | 350            | 314            | 314            | 606            | 872            | 939            | 736            |
| <b>Shareholders' funds</b>  | <b>5,753</b>  | <b>6,235</b>   | <b>6,993</b>   | <b>9,052</b>   | <b>11,239</b>  | <b>12,930</b>  | <b>18,419</b>  | <b>20,581</b>  | <b>23,900</b>  | <b>27,274</b>  |
| <b>Total</b>  | <b>99,132</b> | <b>115,436</b> | <b>133,331</b> | <b>152,780</b> | <b>166,012</b> | <b>196,070</b> | <b>232,906</b> | <b>256,711</b> | <b>280,289</b> | <b>313,913</b> |
| <b>ASSETS</b>   |               |                |                |                |                |                |                |                |                |                |
| Bills of Exchange   | 3,153         | 2,690          | 2,412          | 2,077          | 2,027          | 1,911          | 2,069          | 2,187          | 1,447          | 1,401          |
| Loans and Advances (Net)  | 50,473        | 62,152         | 75,326         | 88,594         | 101,609        | 119,997        | 144,985        | 161,073        | 159,247        | 188,034        |
| Lease Rentals Receivable  | 2,898         | 4,032          | 5,085          | 6,838          | 8,864          | 11,552         | 13,289         | 11,547         | 8,944          | 13,447         |
| Cash, Short Term Funds and Statutory<br>Deposits with Central Bank of Sri Lanka | 17,377        | 21,479         | 21,119         | 25,013         | 24,400         | 30,200         | 32,565         | 35,149         | 38,216         | 30,497         |
| Property, Plant & Equipment   | 2,509         | 2,781          | 3,414          | 3,387          | 3,059          | 2,908          | 6,083          | 6,866          | 7,180          | 7,474          |
| Other Assets  | 22,722        | 22,302         | 25,975         | 26,870         | 26,053         | 29,502         | 33,915         | 39,888         | 65,254         | 73,060         |
| <b>Total</b>  | <b>99,132</b> | <b>115,436</b> | <b>133,331</b> | <b>152,780</b> | <b>166,012</b> | <b>196,070</b> | <b>232,906</b> | <b>256,711</b> | <b>280,289</b> | <b>313,913</b> |
| <b>RATIOS</b>   |               |                |                |                |                |                |                |                |                |                |
| Return on Average Shareholders' Funds (%)                                       | 5             | 10             | 15             | 12             | 16             | 18             | 19             | 17             | 20             | 17             |
| Income Growth (%)   | 20            | 2              | 26             | (5)            | 20             | 27             | 40             | 24             | 6              | (10)           |
| Return on Average Assets (%)  | 0.3           | 0.6            | 0.8            | 0.7            | 1.0            | 1.2            | 1.4            | 1.3            | 1.6            | 1.5            |
| Dividend Cover (times)  | 3.1           | 2.8            | 3.5            | 2.8            | 3.5            | 3.8            | 3.7            | 3.4            | 2.8            | 2.7            |
| Advance to Deposits & Refinance (%)   | 73            | 78             | 81             | 81             | 86             | 88             | 88             | 90             | 78             | 84             |
| Property, Plant & Equipment to Shareholders Funds (%)                           | 44            | 45             | 49             | 37             | 27             | 22             | 33             | 33             | 30             | 27             |
| Total Assets to Shareholders Funds (Times)                                      | 17            | 19             | 19             | 17             | 15             | 15             | 13             | 12             | 12             | 12             |
| <b>(As specified in the Banking Act No. 30 of 1988)</b>                         |               |                |                |                |                |                |                |                |                |                |
| Capital Funds to Liabilities including<br>Contingent Liabilities (%)            | 1.2           | 1.2            | 1.0            | 1.0            | 1.0            | 1.0            | 1.3            | 1.2            | 1.1            | 1.1            |
| Liquid Assets to Liabilities (%)  | 28            | 32             | 27             | 25             | 24             | 22             | 22             | 22             | 29             | 24             |
| <b>SHARE INFORMATION</b>  |               |                |                |                |                |                |                |                |                |                |
| Market Value per Share (Rs)   |               |                |                |                |                |                |                |                |                |                |
| - Voting  | 52.00         | 79.00          | 69.00          | 57.00          | 112.50         | 155.75         | 122.50         | 69.75          | 170.25         | 399.90         |
| - Non Voting  | 36.00         | 47.00          | 36.75          | 32.75          | 41.50          | 70.00          | 53.25          | 32.00          | 104.75         | 214.60         |
| Earnings per Share (Rs)   | 4.66          | 8.24           | 14.10          | 9.75           | 14.05          | 18.86          | 12.83          | 13.67          | 18.47          | 18.84          |
| Earnings per Share (Adjusted) (Rs) *  | 1.28          | 2.49           | 4.26           | 4.12           | 6.98           | 9.37           | 12.76          | 13.58          | 18.37          | 18.84          |
| Price Earnings Ratio  | 11.16         | 9.59           | 4.89           | 5.84           | 8.01           | 8.26           | 9.55           | 5.10           | 9.22           | 21.23          |
| Net Assets per Share (Adjusted) (Rs) **   | 24.42         | 26.47          | 29.69          | 38.43          | 47.71          | 54.89          | 78.19          | 87.37          | 101.46         | 115.78         |
| Dividend per share (Rs)   | 1.50          | 3.00           | 4.00           | 3.50           | 4.00           | 5.00           | 3.50           | 4.00           | 6.50           | 7.00           |
| Gross Dividends (Rs Mn)   | 98            | 215            | 286            | 350            | 471            | 589            | 824            | 942            | 1,533          | 1,648          |
| <b>OTHER INFORMATION</b>  |               |                |                |                |                |                |                |                |                |                |
| No. of Employees  | 4,137         | 4,280          | 4,203          | 4,180          | 4,259          | 4,287          | 4,334          | 4,395          | 4,302          | 4,352          |
| No. of Customer Centres   | 123           | 137            | 138            | 142            | 148            | 151            | 167            | 177            | 186            | 205            |
| No. of Student Banking Centres  | 122           | 144            | 151            | 152            | 152            | 152            | 152            | 152            | 153            | 159            |
| No. of other Financial Centres  | 110           | 110            | 110            | 110            | 113            | 113            | 114            | 114            | 115            | 121            |

\* Earnings per share has been adjusted for weighted average number of shares during the current year.

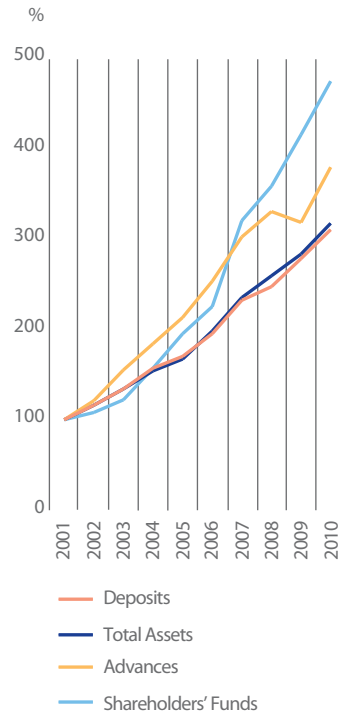
\*\* Net Assets per share has been computed for the current number of issued shares as at 31st December 2010.

# TEN YEAR GRAPHICAL REVIEW

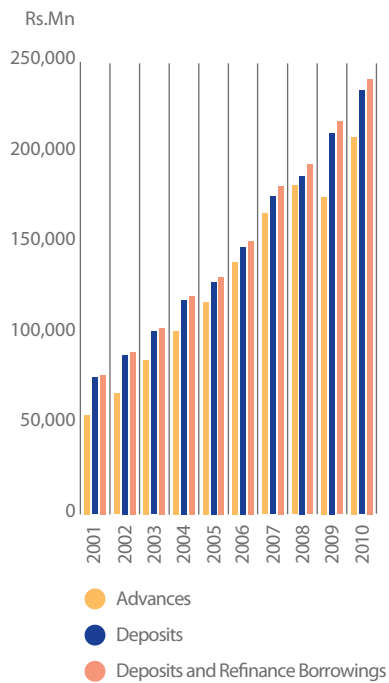
Distribution of Profits



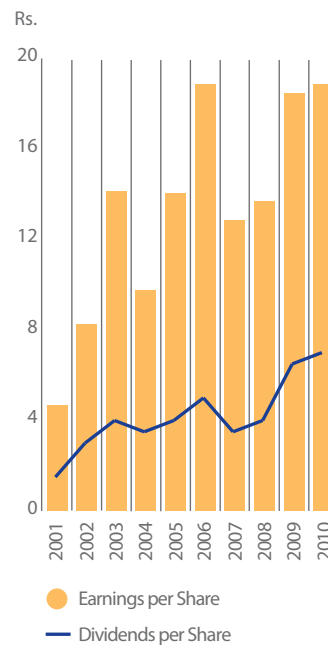
Balance Sheet Growth  
(Base year 2001)



Advances, Deposits and Re-Finance Borrowings



Earnings per Share and Dividends per Share



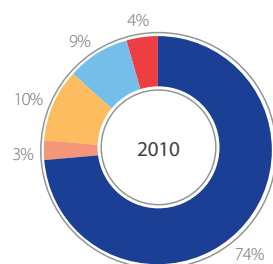
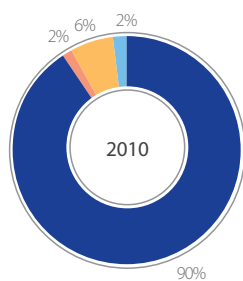
# SEGMENTAL ANALYSIS

## Business Segments

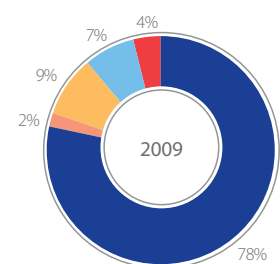
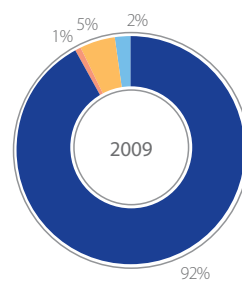
|                              | Banking           |                   | Leasing          |                  | Dealings*      |                | Property       |                | Insurance        |                  | Total             |                   |
|------------------------------|-------------------|-------------------|------------------|------------------|----------------|----------------|----------------|----------------|------------------|------------------|-------------------|-------------------|
|                              | 2010              | 2009              | 2010             | 2009             | 2010           | 2009           | 2010           | 2009           | 2010             | 2009             | 2010              | 2009              |
|                              | 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                     | 28,359,178        | 32,659,198        | -                | -                | 150,040        | 116,426        | -              | -              | 448,742          | 453,759          | 28,957,960        | 33,229,383        |
| Exchange                     | 1,015,987         | 903,210           | -                | -                | 3,711          | 265            | -              | -              | (5,489)          | (94)             | 1,014,209         | 903,381           |
| Lease, Premium and Brokering | -                 | -                 | 1,890,052        | 1,961,078        | 306,003        | 82,159         | -              | -              | 1,905,506        | 1,572,270        | 4,101,561         | 3,615,507         |
| Commissions and Rent         | 2,801,579         | 2,327,312         | 7,751            | 3,966            | 15,407         | 7,136          | 715,532        | 727,721        | -                | -                | 3,540,269         | 3,066,135         |
| Other                        | 1,507,074         | 1,503,099         | -                | -                | 131,704        | 42,793         | -              | -              | 8,689            | 12,118           | 1,647,467         | 1,558,010         |
| <b>Total Revenue</b>         | <b>33,683,818</b> | <b>37,392,819</b> | <b>1,897,803</b> | <b>1,965,044</b> | <b>606,865</b> | <b>248,779</b> | <b>715,532</b> | <b>727,721</b> | <b>2,357,448</b> | <b>2,038,053</b> | <b>39,261,466</b> | <b>42,372,416</b> |

\* Stock broking, Securities dealings, Remittances and Foreign currency related services

Segmental Analysis of Revenue



Segmental Analysis of Revenue



# SHARE AND DEBENTURE INFORMATION

## 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 2010 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 4,380 registered Voting Shareholders as at 31st December 2010 (2009 - 4,169) 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           | 2,741               | 881,015      | 0.64   | 39                  | 17,954       | 0.04   | 2,780               | 898,969      | 0.50   |
| 1,001 - 10,000      | 1,095               | 3,728,067    | 2.71   | 37                  | 132,744      | 0.32   | 1,132               | 3,860,811    | 2.16   |
| 10,001 - 100,000    | 366                 | 9,757,844    | 7.10   | 31                  | 1,160,273    | 2.79   | 397                 | 10,918,117   | 6.10   |
| 100,001 - 1,000,000 | 39                  | 9,208,106    | 6.70   | 11                  | 2,380,395    | 5.72   | 50                  | 11,588,501   | 6.47   |
| Over 1,000,000      | 11                  | 113,836,130  | 82.85  | 10                  | 37,940,136   | 91.13  | 21                  | 151,776,266  | 84.77  |
|                     | 4,252               | 137,411,162  | 100.00 | 128                 | 41,631,502   | 100.00 | 4,380               | 179,042,664  | 100.00 |

## ANALYSIS OF SHAREHOLDERS

### Resident / Non-Resident

|              | 31st December 2010 |              |        | 31st December 2009 |              |        |
|--------------|--------------------|--------------|--------|--------------------|--------------|--------|
|              | No of Shareholders | No of Shares | %      | No of Shareholders | No of Shares | %      |
| Resident     | 4,252              | 137,411,162  | 76.75  | 4,075              | 128,779,859  | 68.97  |
| Non-Resident | 128                | 41,631,502   | 23.25  | 94                 | 57,937,576   | 31.03  |
| Total        | 4,380              | 179,042,664  | 100.00 | 4,169              | 186,717,435  | 100.00 |

### Individuals / Institutions

|              | 31st December 2010 |              |        | 31st December 2009 |              |        |
|--------------|--------------------|--------------|--------|--------------------|--------------|--------|
|              | No of Shareholders | No of Shares | %      | No of Shareholders | No of Shares | %      |
| Individuals  | 4,086              | 27,304,716   | 15.25  | 3,923              | 18,866,761   | 10.10  |
| Institutions | 294                | 151,737,948  | 84.75  | 246                | 167,850,674  | 89.90  |
| Total        | 4,380              | 179,042,664  | 100.00 | 4,169              | 186,717,435  | 100.00 |

As at 31st December 2010 the average size of holding of ordinary shareholding was 40,877 voting shares. (31st December 2009 - 44,787 voting shares)

As per the rule No. 7.6 (iv) of Colombo Stock Exchange, percentage of public holding as at 31st December 2010 was 63 approximately.

## SHARE INFORMATION - NON VOTING

There were 11,536 registered Non Voting Shareholders as at 31st December 2010 (2009 - 11,252) 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           | 7,410               | 2,450,636    | 6.05   | 57                  | 24,124       | 0.39   | 7,467               | 2,474,760    | 5.30   |
| 1,001 - 10,000      | 3,561               | 9,770,106    | 24.11  | 49                  | 165,520      | 2.68   | 3,610               | 9,935,626    | 21.28  |
| 10,001 - 100,000    | 399                 | 9,938,570    | 24.53  | 17                  | 720,560      | 11.67  | 416                 | 10,659,130   | 22.83  |
| 100,001 - 1,000,000 | 34                  | 9,228,226    | 22.77  | 5                   | 1,006,200    | 16.30  | 39                  | 10,234,426   | 21.92  |
| Over 1,000,000      | 1                   | 9,133,274    | 22.54  | 3                   | 4,256,200    | 68.96  | 4                   | 13,389,474   | 28.67  |
|                     | 11,405              | 40,520,812   | 100.00 | 131                 | 6,172,604    | 100.00 | 11,536              | 46,693,416   | 100.00 |

## ANALYSIS OF SHAREHOLDERS

Resident / Non-Resident

|              | 31st December 2010 |              |        | 31st December 2009 |              |        |
|--------------|--------------------|--------------|--------|--------------------|--------------|--------|
|              | No of Shareholders | No of Shares | %      | No of Shareholders | No of Shares | %      |
| Resident     | 11,405             | 40,520,812   | 86.78  | 11,142             | 40,538,994   | 87.65  |
| Non-Resident | 131                | 6,172,604    | 13.22  | 110                | 5,710,538    | 12.35  |
| Total        | 11,536             | 46,693,416   | 100.00 | 11,252             | 46,249,532   | 100.00 |

Individuals / Institutions

|              | 31st December 2010 |              |        | 31st December 2009 |              |        |
|--------------|--------------------|--------------|--------|--------------------|--------------|--------|
|              | No of Shareholders | No of Shares | %      | No of Shareholders | No of Shares | %      |
| Individuals  | 11,249             | 21,385,974   | 45.80  | 11,032             | 24,182,823   | 52.29  |
| Institutions | 287                | 25,307,442   | 54.20  | 220                | 22,066,709   | 47.71  |
| Total        | 11,536             | 46,693,416   | 100.00 | 11,252             | 46,249,532   | 100.00 |

As at 31st December 2010 the average size of holding of ordinary shareholding was 4,048 non-voting shares.  
(31st December 2009 - 4,110 non-voting shares)

As per the rule No. 7.6 (iv) of Colombo Stock Exchange, percentage of public holding as at 31st December 2010 was 96 approximately.

## 3 SHARE TRADING

|                                | 2010     | 2009    |
|--------------------------------|----------|---------|
| <b>VOTING</b>                  |          |         |
| Number of transactions         | 8,997    | 3,984   |
| Number of shares traded (Mn)   | 95.5     | 35.1    |
| Rank (As per CSE)              | 41       | 33      |
| Value of shares traded (Rs Mn) | 27,130.9 | 5,635.5 |
| Rank (As per CSE)              | 2        | 4       |
| <b>NON VOTING</b>              |          |         |
| Number of transactions         | 11,745   | 14,138  |
| Number of shares traded (Mn)   | 19.4     | 26.3    |
| Value of shares traded (Rs Mn) | 3,538.0  | 1,859.9 |

## SHARE AND DEBENTURE INFORMATION

### 4 DIVIDENDS

|              | 2010                                   | 2009                       |
|--------------|--|----------------------------|
| Interim (Rs) | 1.50 Paid in November 2010             | 1.50 Paid in November 2009 |
| Final (Rs)   | 5.50 Proposed to be paid in April 2011 | 5.00 Paid in April 2010    |

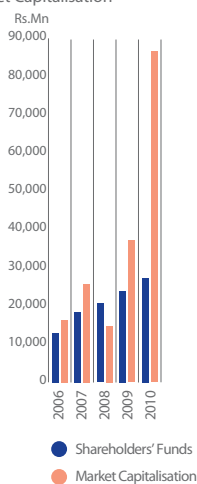
### 5 EARNINGS

|                              | 2010  | 2009  |
|------------------------------|-------|-------|
| Earnings per share (Rs)      | 18.84 | 18.47 |
| Price earnings ratio (Times) | 21.23 | 9.22  |

### 6 MARKET VALUE

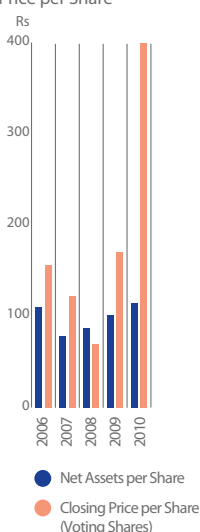
|               | Highest<br>Rs | Lowest<br>Rs | Year End<br>Rs |
|---------------|---------------|--------------|----------------|
| 2006 - Voting | 161.00        | 100.00       | 155.75         |
| - Non Voting  | 74.25         | 39.00        | 70.00          |
| 2007 - Voting | 225.00        | 90.00        | 122.50         |
| - Non Voting  | 120.00        | 35.00        | 53.25          |
| 2008 - Voting | 135.00        | 65.00        | 69.75          |
| - Non Voting  | 57.50         | 31.00        | 32.00          |
| 2009 - Voting | 175.00        | 68.00        | 170.25         |
| - Non Voting  | 107.00        | 32.00        | 104.75         |
| 2010 - Voting | 445.00        | 168.00       | 399.90         |
| - Non Voting  | 260.00        | 105.00       | 214.60         |

Shareholders' Funds and Market Capitalisation

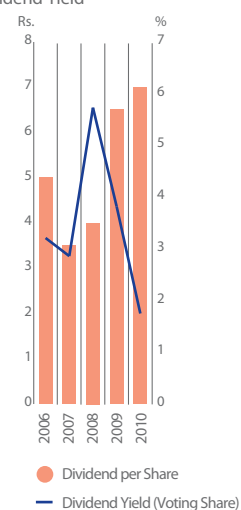


\*HNB Market Capitalisation includes both Voting and Non voting shares

Net Assets per Share and Closing Price per Share



Dividend per Share and Dividend Yield



### 7 MARKET CAPITALISATION AS AT 31ST DECEMBER

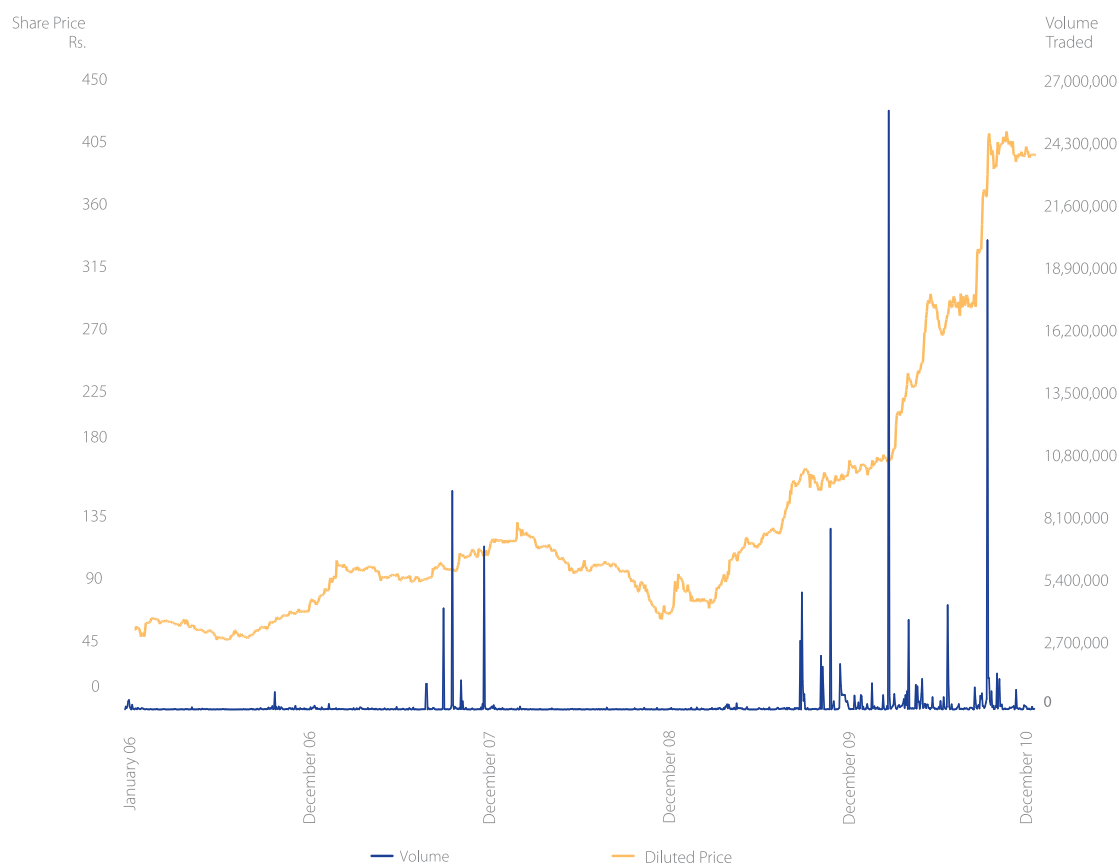
|      | Capital & Reserves<br>Rs Mn | HNB Market Capitalization<br>Rs Mn | CSE Market Capitalization<br>Rs Mn | HNB Market Capitalization as a % of CSE Market Capitalization | Market Capitalization Ranking |
|------|-----------------------------|------------------------------------|------------------------------------|---|-------------------------------|
| 2006 | 12,930                      | 16,361                             | 834,763                            | 1.95  | 10                            |
| 2007 | 18,419                      | 25,653                             | 820,652                            | 3.13  | 6                             |
| 2008 | 20,581                      | 14,684                             | 488,813                            | 3.00  | 7                             |
| 2009 | 23,900                      | 32,266                             | 1,092,138                          | 2.95  | 8                             |
| 2010 | 27,274                      | 76,491                             | 2,210,452                          | 3.46  | 7                             |

\* 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         |
| 2001 | Bonus                              | 1:10  | 6,500,000          |
| 2004 | Rights (voting @ Rs 55/-)          | 2:5   | 22,000,000         |
| 2004 | Rights (non voting @ Rs 33/-)      | 2:5   | 6,600,000          |
| 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          |
|      | <b>Total</b>                       |       | <b>237,969,022</b> |

## 9 PRICE VOLUME CHART





## SHARE AND DEBENTURE INFORMATION

### 10. TWENTY MAJOR SHAREHOLDERS (VOTING) OF THE BANK AS AT 31ST DECEMBER 2010

| Name  | % on total capital | No. of Shares 2010 | No. of Shares 2009 |
|---|--------------------|--------------------|--------------------|
| 1. Sri Lanka Insurance Corporation Limited (Life fund)                          | 11.95              | 28,448,832         | 11,533,832         |
| 2. Employees Provident Fund   | 7.58               | 18,042,000         | 5,700,000          |
| 3. Milford Exports (Ceylon) Limited   | 6.46               | 15,373,050         | 15,373,050         |
| 4. Stassen Exports Limited  | 5.60               | 13,324,850         | 13,324,850         |
| 5. Brown and Company Limited  | 5.55               | 13,205,230         | 12,612,690         |
| 6. Mr. Sohli Edulji Captain   | 4.03               | 9,589,060          | -                  |
| 7. HSBC International Nominees Ltd - SSBT- Janus Overseas Fund                  | 3.98               | 9,473,600          | -                  |
| 8. Sonetto Holdings Limited   | 3.55               | 8,445,206          | 8,445,206          |
| 9. Distilleries Company of Sri Lanka Limited                                    | 2.51               | 5,961,708          | 5,961,708          |
| 10. National Savings Bank   | 2.34               | 5,578,200          | -                  |
| 11. HSBC International Nominees Ltd - Janus Aspen Series Overseas Port Fol      | 1.80               | 4,292,400          | -                  |
| 12. Standard Chartered Bank Singapore S/A HL Bank Singapore Bran.               | 1.69               | 4,013,800          | -                  |
| 13. HSBC International Nominees Ltd-BBH-GMOEMERGING Markets Fund                | 1.37               | 3,266,130          | -                  |
| 14. FI-CIBLUX S/A Batterymarch Global Emerging Market Fund                      | 1.11               | 2,648,000          | 2,648,000          |
| 15. Northern Trust Co S/A The Royal Bank of Scotland as Trustee                 | 0.79               | 1,875,000          | -                  |
| 16. Mr. Yonmerenne Simon Hewage Indra Kumar Silva                               | 0.75               | 1,781,600          | 1,000,000          |
| 17. BNY-CF Ruffer Investment Funds: CF Ruffer Pacific Fund                      | 0.66               | 1,564,500          | -                  |
| 18. The Ceylon Investment PLC A/c No.2  | 0.63               | 1,500,000          | 1,500,000          |
| 19. Deutsche Bank Trust Company Americas  | 0.55               | 1,311,500          | 35,329,400         |
| 20. HSBC International Nominees Ltd - SSBT- Deutsche Bank AG Singapore          | 0.44               | 1,050,000          | -                  |
| Sub total   | 63.34              | 150,744,666        |                    |
| * Unregistered Shares   | 5.14               | 12,232,942         |                    |
| Balance held by 4,360 voting shareholders<br>(Total voting shareholders- 4,380) | 11.89              | 28,297,998         |                    |
| Total voting shares   | 80.37              | 191,275,606        | 189,520,615        |
| Shares held by 11,536 Non-voting shareholders                                   | 19.63              | 46,693,416         | 46,249,532         |
| Total No. of Ordinary shares  | 100.00             | 237,969,022        | 235,770,147        |

\*An entity has been removed from the register of shareholders with effect from 19th August 2010 on a direction given by the CBSL in terms of Sec. 12(IC)(c) of the Banking Act.

11. TWENTY MAJOR SHAREHOLDERS (NON-VOTING) OF THE BANK AS AT 31ST DECEMBER 2010

| Name  | % on total capital | No. of Shares 2010 | No. of Shares 2009 |
|---|--------------------|--------------------|--------------------|
| 1. Legalinc Trustee Services (Pvt) Limited (HNBL ESOP Trust)                                | 3.84               | 9,133,274          | 9,133,274          |
| 2. Perching LLC S/A Averbach Grauson & Co.  | 0.79               | 1,873,100          | 2,168,100          |
| 3. Fast Gain International Ltd  | 0.51               | 1,213,000          | 1,397,000          |
| 4. HINL-JPMCB-Butterfield Trust (Bermuda) Limited   | 0.49               | 1,170,100          | -                  |
| 5. Employees Trust Fund Board   | 0.35               | 826,130            | -                  |
| 6. DFCC Bank A/c 1  | 0.34               | 797,600            | 797,600            |
| 7. National Savings Bank  | 0.27               | 650,000            | -                  |
| 8. Asian Alliance Insurance PLC - A/c 02 (Life Fund)  | 0.27               | 638,800            | 303,400            |
| 9. Deutsche Bank AG-National Equity Fund  | 0.19               | 442,400            | -                  |
| 10. Bank of Ceylon No.1 A/c   | 0.18               | 439,900            | -                  |
| 11. Deutsche Bank AG as Trustee for Namal Acuity Value Fund                                 | 0.17               | 413,300            | 489,800            |
| 12. Bank of Ceylon A/c Ceybank Century Growth Fund  | 0.17               | 408,700            | -                  |
| 13. Hatton National Bank PLC - A/c No.2   | 0.14               | 338,638            | 338,638            |
| 14. BNYM SA/NV-The Walter Fund  | 0.14               | 337,500            | -                  |
| 15. Union Assurance PLC/No.01A/C  | 0.13               | 297,900            | -                  |
| 16. Waldock Mackenzie Ltd/Mr.H M S Abdulhussein   | 0.12               | 290,200            | 300,200            |
| 17. Swiss Lloyd Limited   | 0.10               | 248,000            | -                  |
| 18. Mr.Dickowita Kankanamge Weeratunga & Mr.Dickowita Kankanamge Athula Kithsiri Weeratunga | 0.10               | 237,760            | 537,760            |
| 19. Saboor Chatoor (Pvt) Limited  | 0.09               | 225,000            | -                  |
| 20. Lanka Synthetic Fibre Co.Limited  | 0.09               | 220,000            | 220,000            |
| Sub total   | 8.48               | 20,201,302         |                    |
| Balance held by 11,516 Non-voting shareholders (Total Non-voting shareholders-11,536)       | 11.15              | 26,492,114         |                    |
| Total Non-voting shares   | 19.63              | 46,693,416         | 46,249,532         |
| Shares held by 4,380 voting shareholders  | 75.23              | 179,042,664        | 186,717,435        |
| Unregistered voting Shares  | 5.14               | 12,232,942         | 2,803,180          |
| Total voting shares   | 80.37              | 191,275,606        | 189,520,615        |
| Total No. of Ordinary shares  | 100.00             | 237,969,022        | 235,770,147        |

12. RELATED PARTY TRANSACTIONS EXCEEDING 10% OF THE EQUITY OR 5% OF THE TOTAL ASSETS OF THE BANK

The Bank carried out transactions in the ordinary course of business with the following parties and the aggregate monetary value of these transactions exceeded 10% of the share holders' equity of the Bank as at 31st December 2010.

Sithma Development (Pvt) Ltd

Stassen Exports (Pvt) Ltd\*

Hatton National Bank Retirement Pension Fund

Hatton National Bank Employee Provident Fund

The details of these transactions are given in Note 48 (C) ii (page 230), 48 (f) I (page 232) and 48 (f) ii (page 237) respectively.

\* For the above computation the credit limit granted to this company by the Bank of Rs 4,286 Mn was considered, although the outstanding as at the Balance Sheet date was Rs 541.09 Mn.

## SHARE AND DEBENTURE INFORMATION

### HNB DEBENTURES 2002

#### i) Market Value

12 months ended 31st December 2010

|                   |   |          |
|-------------------|---|----------|
| Highest price     | - | Rs 95.00 |
| Lowest price      | - | Rs 95.00 |
| Last traded price | - | Rs 95.00 |

#### ii) Interest Income

12 months ended 31st December

|  | 2010            |                                    | 2009            |                                    |
|--|-----------------|------------------------------------|-----------------|------------------------------------|
|  | Coupon Interest | Yield of comparable Govt. Security | Coupon Interest | Yield of comparable Govt. Security |
| 10 year Fixed Rate (14.20% p.a.)                 | 14.20           | 7.75                               | 14.20           | 17.33                              |
| 10 year Floating Rate (6 months TB +1.25% p.a.)* | 12.00           | 7.75                               | 13.25           | 17.33                              |

\* The floating rate debentures have a cap of 17.00% p.a. and a floor of 12.00% p.a.

The above rupee coupon interest rates are applicable for the next interest payment due on the 15th of February 2011.

### HNB DEBENTURES 2006

#### i) Market Value

12 months ended 31st December 2010

These debentures have not traded for the period ended 31st December 2010

#### ii) Interest Income

12 months ended 31st December

|   | 2010            |                                    | 2009            |                                    |
|---|-----------------|------------------------------------|-----------------|------------------------------------|
|   | Coupon Interest | Yield of comparable Govt. Security | Coupon Interest | Yield of comparable Govt. Security |
| 6 year Floating Rate (6 months TB + 2.25% p.a.) * | 9.63            | 7.61                               | 10.87           | 10.90                              |
| 7 year Floating Rate (6 months TB + 2.25% p.a.) * | 9.63            | 8.03                               | 10.87           | 10.90                              |
| 8 year Floating Rate (6 months TB + 2.25% p.a.) * | 9.63            | 8.81                               | 10.87           | 11.63                              |
| 15 year Fixed Rate (11.00% p.a.)                  | 11.00           | N/Q                                | 11.00           | N/Q                                |
| 18 year Fixed Rate (11.25% p.a.)                  | 11.25           | 9.49                               | 11.25           | 11.05                              |

\* The floating rate debentures have a cap of 16.00% p.a. and a floor of 8.00% p.a.

N/Q – Not quoted for the period ended 31st December

The above rupee coupon interest rates are applicable for the next interest payment due on the 30th of June 2011.

## HNB DEBENTURES 2007

### i) Market Value

12 months ended 31st December 2010

These debentures have not traded for the period ended 31st December 2010

### ii) Interest Income

12 months ended 31st December

|                                  | Coupon Interest | 2010 Yield of comparable Govt. Security | Coupon Interest | 2009 Yield of comparable Govt. Security |
|----------------------------------|-----------------|---|-----------------|---|
| 10 year Fixed Rate (16.00% p.a.) | 16.00           | N/Q                                     | 16.00           | 12.10                                   |
| 15 year Fixed Rate (16.75% p.a.) | 16.75           | N/Q                                     | 16.75           | N/Q                                     |

N/Q – Not quoted for the period ended 31st December

The above rupee coupon interest rates are applicable for the next interest payment due on the 30th of June 2011.

## HNB DEBENTURES 2008

### i) Market Value

12 months ended 31st December 2010

These debentures were not listed as at 31st December 2010

### ii) Interest Income

12 months ended 31st December

|   | Coupon Interest | 2010 Yield of comparable Govt. Security | Coupon Interest | 2009 Yield of comparable Govt. Security |
|---|-----------------|---|-----------------|---|
| Yield of comparable Govt. Security            |                 |   |                 |   |
| 5 year Floating Rate (1 year TB + 1.00% p.a.) | 10.27           | 8.07                                    | 13.93           | 10.46                                   |

The above rupee coupon interest rates are applicable for the next interest payment due on the 30th of June 2011.

### Ratios

|                                  | 2010  | 2009  |
|----------------------------------|-------|-------|
| Debenture to Equity Ratio (%)    | 10.00 | 11.20 |
| Debenture Interest Cover (times) | 19.60 | 16.27 |
| Liquid Asset Ratio (LAR)         | 23.55 | 29.22 |

# GLOSSARY

## A 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.

## AMORTISATION

The systematic allocation of the depreciable amount of an intangible asset over its useful life.

## 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.

## B BIS SURPLUS

The total Capital Adequacy in excess of the minimum stipulated by Basel International Standards and as modified to suit local requirements by the Central Bank of Sri Lanka.

## 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 and Reserve Fund set aside for specific purposes defined under the Banking Act, No 30 of 1988 and shall not be reduced or impaired without the approval of the Monetary Board.

## 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.

## 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.

## CONTINGENT LIABILITIES

Conditions or situations at the balance sheet date, the financial effect of which are to be determined by the future events which may or may not occur.

## COST INCOME RATIO

Operating expenses as a percentage of net 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.

## D 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.

## DEPRECIATION

The systematic allocation of the depreciable amount of an asset over its useful life.

## 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.

## 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.

## EFFECTIVE TAX RATE

Provision for taxation excluding deferred taxation divided by the profit before tax.

## 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.

## F FAIR VALUE

Fair value is the amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction.

## FOREIGN EXCHANGE INCOME

The realised gain recorded when assets or liabilities denominated in foreign currencies are translated into Sri Lankan Rupees on the balance sheet date at prevailing rates which differ from those rates in force at inception or on the previous balance sheet date. Foreign exchange income also arises from trading in foreign currencies.

## G GENERAL PROVISIONS

General provisions are established for leasing transactions, housing loans, pawning advances and others for anticipated losses on aggregate exposures where credit losses cannot yet be determined on an individual facility basis.

## 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.

## I IMPAIRMENT

This occurs when recoverable amount of an asset is less than its carrying amount.

## 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 SPREAD

This represents the difference between the average interest rate earned and the average interest rate paid on funds.

## **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 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.

## **LOAN LOSS PROVISION**

Please refer Provision for Bad and Doubtful Debts below.

## **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.

## **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-PERFORMING ADVANCES**

All loans are classified as non-performing when a payment is 90 days in arrears.

## **NON-PERFORMING ADVANCES COVER (NPA COVER)**

Cumulative loan provision as a percentage of total non-performing advances (net of interest in suspense).

## **NPA RATIO**

Total non-performing advances (net of interest in suspense) divided by total advances portfolio (net of interest in suspense).

## **O 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.

## **PRICE EARNINGS RATIO (P/E RATIO)**

Market price of an ordinary share divided by earnings per share (EPS).

## **PROVISION FOR BAD AND DOUBTFUL DEBTS**

A charge to income which is added to the allowance for loan losses. Specific provisions are established to reduce the book value of specific assets (primarily loans) to estimated realisable values.

## **R RETURN ON AVERAGE ASSETS (ROA)**

Net income 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 (ROE)**

Net income, 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.

## **REPURCHASE AGREEMENT**

This is a contract to sell and subsequently repurchase government securities at a given price on a specified future date.

## **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.

## **RISK-ADJUSTED 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.

## **RIGHTS ISSUE**

Issue of shares to the existing shareholders at an agreed price, generally lower than market price.

## **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.

## **SHARE PREMIUM**

Amount paid by a shareholder, over and above the par value of a share.

## **SHAREHOLDERS' FUNDS**

Shareholders' funds consist of stated capital plus capital and revenue reserves.

## **SUBSIDIARY**

A subsidiary is an entity, including an unincorporated entity such as a partnership, that is controlled by another entity (known as the parent).

## **SWAPS (CURRENCY)**

The simultaneous purchase of an amount of a currency for spot settlement and the sale of the same amount of the same currency for forward settlement. Alternatively a simultaneous spot sale and forward purchase of a currency.

## **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.

## **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.

# NOTICE OF MEETING

Notice is hereby given that the Forty Second (42nd) Annual General Meeting of the Hatton National Bank PLC is convened on Thursday the Thirty First (31st) of March 2011 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 Ordinary Business will be transacted.

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 2010, the Auditors' Report thereon.

To declare a final dividend of Rs 5.50 per share for the year 2010, to the shareholders as recommended by the Directors.

To re-elect Mr R K Obeyesekere who retires by rotation at the Annual General Meeting, a Director of the Bank in terms of Article 87 of the Articles of Association of the Bank.

To re-elect Mrs P C Cooray who retires by rotation at the Annual General Meeting, a Director of the Bank in terms of Article 87 of the Articles of Association of the Bank.

To re-appoint the Auditors for the ensuing year and to authorise the Directors to fix their remuneration.

To authorise the Directors to determine payments for the year 2011 for charitable and other purposes.

By Order Of The Board



INDRANI GOONESEKERA  
DGM (LEGAL) / BOARD SECRETARY

Colombo, Sri Lanka.  
18th February 2011

## 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 "HNB Towers", Level 19, No: 479, T.B. Jayah Mawatha, Colombo 10, not less than 48 hours before the time appointed for holding the meeting.



# 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 Theobald Wijetilleke or failing him Rajendra Theagarajah, or failing him Don Harold Stassen Jayawardena, or failing him Manickam Vallipuram Theagarajah, or failing him Rajpal Kumar Obeyesekere or failing him Pamela Christine Cooray, or failing her Ranjeevan Seevaratnam or failing him Nirmala Gihan Wickremeratne or failing him Mirihana Arachchige Rose Chandralatha Cooray, as \*my/our proxy, to represent \*me/us and to vote for \*me/us on \*my/our behalf on the resolutions (including the under mentioned) at the Forty Second (42nd) 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 31st day of March, 2011 at 10.00 in the forenoon and at any adjournment thereof and at every poll which may be taken in consequence thereof :

|   |           |  |
|---|-----------|--|
| To declare a dividend of Rs 5.50 per share  | In favour |  |
|   | Against   |  |
| To re-elect Mr R K Obeyesekere, a Director of the Bank  | In favour |  |
|   | Against   |  |
| To re-elect Mrs P C Cooray, a Director of the Bank  | In favour |  |
|   | Against   |  |
| To re-appoint Auditors for the ensuing year/authorise the Directors to fix their remuneration | In favour |  |
|   | Against   |  |
| To authorise the Directors to determine payments for charitable and other purposes            | In favour |  |
|   | Against   |  |

Mark your preference with " ✓ "

Signed this ..... day ..... 2011.

Signature/s .....

.....

Please provide the 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

\* Delete inappropriate words

#### 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 "HNB Towers", Level 19, No: 479, T B Jayah Mawatha, Colombo 10, not less than 48 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 Theobald Wijetilleke or failing him  
Rajendra Theagarajah or failing him Don Harold Stassen Jayawardena, or failing him Manickam Vallipuram Theagarajah, or failing him  
Rajpal Kumar Obeyesekere or failing him Pamela Christine Cooray, or failing her Ranjeevan Seevaratnam or failing him  
Nirmala Gihan Wickremeratne or failing him Mirihana Arachchige Rose Chandralatha Cooray, as \*my/our proxy, to represent \*me/us at  
the Forty Second (42nd) 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 31st day of March, 2011 at 10.00 in the forenoon and at any adjournment thereof :

Signed this ..... day ..... 2011.

Signature/s .....

.....

***Please provide the 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

\* Delete inappropriate words

### 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 "HNB Towers", Level 19, No: 479, T B Jayah Mawatha, Colombo 10, not less than 48 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 -

Senior Deputy General Manager - Strategy & Compliance,  
Hatton National Bank Limited,  
No. 479, T.B. Jayah Mawatha (Darley Road)  
Colombo 10.  
Sri Lanka

Email : nihalke@hnb.lk

Name : \_\_\_\_\_

Permanent Mailing Address : \_\_\_\_\_

Contact Numbers - (Tel) : \_\_\_\_\_  
Country Code Area Code Number

- (Fax) : \_\_\_\_\_  
Country Code Area Code Number

E-mail : \_\_\_\_\_

Name of Company : \_\_\_\_\_  
(If Applicable)

Designation : \_\_\_\_\_  
(If Applicable)

Company Address : \_\_\_\_\_  
(If Applicable)

Queries / Comments

Please tick (✓) the appropriate box

Would you like to receive soft copies of the HNB annual and interim reports via e-mail?

| Yes                      | No                       |
|--------------------------|--------------------------|
| <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"/> |
|--------------------------|--------------------------|



# 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.

Global Depository Receipts of the Bank are listed on the Luxembourg Stock Exchange.

## REGISTERED OFFICE

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 2664664, 2662772, 4764764  
Fax Nos 2662814, 2662832 International – 2446523  
Telex Nos 21259 Hatnbc Ce, 2166 Haynfx Ce  
Swift : Bic Code – HBLILKX  
e-mail : moreinfo@hnb.net  
Web : www.hnb.net

## CREDIT RATINGS

The Bank has been assigned AA-(lka) national credit rating for implied long term unsecured senior debt by Fitch Ratings Lanka Limited

## BOARD OF DIRECTORS

Mr Rienzie T. Wijetilleke (Chairman)  
Mr Rajendra Theagarajah (Managing Director / CEO)  
Mr D H S Jayawardena  
Mr M V Theagarajah  
Mr R K Obeyesekere  
Ms Pamela C. Cooray (Senior Director)  
Mr Ranjeevan Seevaratnam  
Mr N G Wickremeratne  
Ms M A R C Cooray

## BOARD SECRETARY

Ms Indrani Goonesekera  
Attorney-at-Law & Notary Public

## BOARD AUDIT COMMITTEE

Mr Ranjeevan Seevaratnam (Chairman)  
Mr D H S Jayawardena  
Ms Pamela C. Cooray  
Mr N G Wickremeratne

## BOARD NOMINATION COMMITTEE

Mr Rienzie T. Wijetilleke (Chairman)  
Mr D H S Jayawardena  
Mr M V Theagarajah  
Mr R K Obeyesekere

## BOARD REMUNERATION COMMITTEE

Ms Pamela C. Cooray (Chairperson)  
Mr Rienzie T. Wijetilleke  
Mr R K Obeyesekere  
Mr N G Wickremeratne

## BOARD INTEGRATED RISK MANAGEMENT COMMITTEE

Mr M V Theagarajah (Chairman)\*  
Mr Rienzie T. Wijetilleke\*  
Ms M A R C Cooray\*  
Mr Rajendra Theagarajah (Managing Director / CEO)\*\*  
Mr J D N Kekulawala – Senior DGM - Strategy & Compliance\*\*  
Mr D P N Rodrigo – DGM - Risk\*\*

\* Representatives of the Board

\*\* Representatives of the Management

## ASSOCIATE COMPANIES

**Delma Exchange** 20.00%  
Remittances and Foreign Currency Related Services

**Browns Engineering (Pvt) Ltd** 32.63%  
Construction and Engineering

## JOINT VENTURE COMPANIES

**Acuity Partners (Pvt) Ltd** 50.00%  
Financial Services

## SUBSIDIARY COMPANIES

**HNB Assurance PLC** 60.00%  
Insurance Services

**Sithma Development (Pvt) Ltd** 100.00%  
Property Development

**Majan Exchange LLC** 40.00%  
Remittances and Foreign Currency Related Services

**Commercial Interlink Services Inc** 100.00%  
(O/A of Delma Exchange Canada)  
Remittances and Foreign Currency Related Services

## AUDITORS

KPMG Ford, Rhodes, Thornton & Co.,  
Chartered Accountants  
No 32A, Sir Mohamed Macan Markar Mawatha,  
Colombo 3,  
Sri Lanka

## INVESTOR INFORMATION

Institutional Investors, Stock Brokers and Security Analysts requiring financial information should contact the Senior DGM - Strategy & Compliance at:  
"HNB Towers", Level 16,  
No 479, T B Jayah Mawatha (Darley Road),  
Colombo 10,  
Sri Lanka.

Telephone : 2662705, 2664705  
Fax : 2662815  
e-mail : nihalke@hnb.lk





**HNB**

[www.hnb.lk](http://www.hnb.lk)