



CORPORATE  
REVIEWS



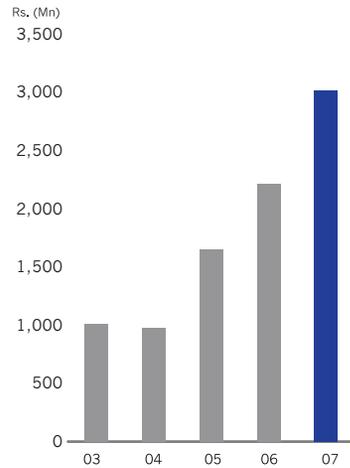


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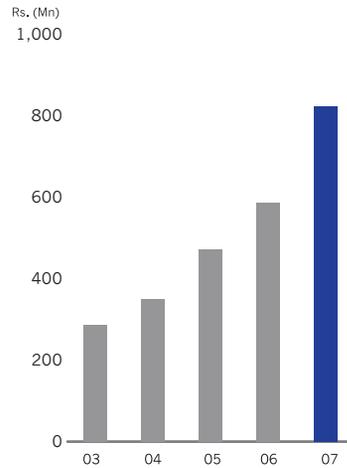
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# FINANCIAL HIGHLIGHTS

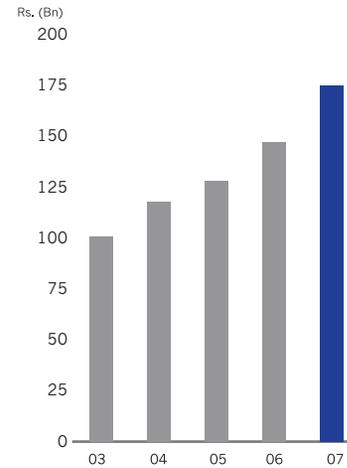
Net Profit After Taxation



Gross Dividends



Deposits



	2007 Rs.000	2006 Rs.000	% Change
<b>Results for the year</b>			
Income	<b>29,864,606</b>	21,493,695	+ 38.95
Net profit before income tax	<b>4,334,754</b>	3,019,450	+ 43.56
Income tax on profits	<b>1,312,298</b>	798,961	+ 64.25
Net profit after taxation	<b>3,022,456</b>	2,220,489	+ 36.12
Gross dividends	<b>824,353</b>	588,824	+ 40.00
Profit available after appropriation	<b>2,198,103</b>	1,631,665	+ 34.72
<b>At the year end</b>			
Shareholders' funds (Capital and Reserves)	<b>18,419,030</b>	12,929,808	+ 42.45
Deposits from customers	<b>175,659,573</b>	147,557,455	+ 19.04
Advances to customers including Leasing and Bills of Exchange	<b>163,626,068</b>	136,344,065	+ 20.01
Total Assets	<b>232,906,348</b>	196,070,349	+ 18.79



	2007	2006	% Change
<b>Information per ordinary share</b>			
Earnings(Rs.)	<b>*12.83</b>	9.43	+ 36.12
Dividends(Rs.)	<b>3.50</b>	5.00	- 30.00
Dividend Yield (%)	<b>2.86</b>	3.21	- 11.00
Net Asset Value (Rs.)	<b>*78.20</b>	54.90	+ 42.45
Market Value (Rs.) - Voting	<b>122.50</b>	155.75	- 21.35
Market Value (Rs.) - Non Voting	<b>53.25</b>	70.00	- 23.93
<b>Ratios</b>			
Return on average shareholders' funds (%)	<b>19.28</b>	18.37	+ 4.94
Price earning (Times)	<b>9.55</b>	16.52	- 42.22
Dividend cover (Times)	<b>3.67</b>	3.77	- 2.77
<b>Capital Adequacy ratios</b>			
Tier 1 (%)	<b>10.32</b>	10.23	+ 0.88
Tier 1 & 2 (%)	<b>12.08</b>	11.32	+ 6.71

\* On 29th March 2007 the Bank issued 1:1 bonus shares (one ordinary share for each ordinary share outstanding as at 31st December 2006) resulting in dilution of EPS and Net Asset Value. Accordingly the EPS and Net Asset Value for the comparative period has been restated.

**Profit Before tax Rs. 4,335 Mn**

**44%**

Increase over 2006

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**Profit After tax Rs. 3,022 Mn**

**36%**

Increase over 2006

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**Gross NPA Ratio 5.9**

**16%**

Improvement over 2006

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**Provision Cover**

**76%**

**Market Capitalization Rs. 23,193 Mn**

**57%**

Increase over 2006

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**Gross Dividends**

**40%**

Increase over 2006

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**Return on Average Assets 1.4%**

**15%**

Increase over 2006

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**Customer Centres**

**167**

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For the year ended 31st December 2007

	Medium Term Goals	Performance				
		2007	2006	2005	2004	2003
Return on average assets (%)	Over 1.5%	1.4%	1.2%	1.0%	0.7%	0.8%
Return on average shareholders' funds	Over 20%	19.3%	18.4%	16.3%	12.2%	15.2%
Cost/Net income ratio (1)	60%	64.26%	66.11%	62.3%	70.4%	63.2%
Dividend per share (Rs.)	3.0	*3.5	5.0	4.0	3.5	4.0
<b>Capital Adequacy</b>						
Tier 1 Capital ratio	9.00%	10.32%	10.23%	10.87%	9.83%	8.06%
Total Capital ratio	12.50%	12.08%	11.32%	11.55%	11.26%	11.47%

( 1 ) Operating expenses as a percentage of net income.

Operating expenses consist of staff costs, premises costs, financial VAT and establishment expenses and other overhead expenses.

Net income consists of net interest income, foreign exchange income, commission income, dividend income and other income.

\* HNB declared a 1:1 Bonus in March 2007, hence 2007 dividend per share is Rs. 7.00 compared to undiluted basis.



# CHAIRMAN'S MESSAGE

It is my pleasure to welcome you to the thirty-ninth annual general meeting of Hatton National Bank and present the Annual Report, which gives a comprehensive review of the Bank's activities during the year 2007.

Your Bank's performance was in accordance with expectations and projections made at the beginning of 2007. The Bank chartered a carefully planned course to accomplish its goals whilst being sensitive to the changing environment in the country, namely the potential threats related to the security and political environment and also the opportunities available despite these challenges. The availability of large resources coupled with our inherent strengths enabled us to cushion the negative effects and record extremely satisfactory results for the year 2007. The bottom line profit figures should have shown a further improvement had we received at least 50% of the total

## To our stakeholders

Once again, we commence the year with the financial sector facing a situation of unpredictable developments with regard to economic policy and prospects, a particularly disquieting scenario considering the lack of focus by the leadership on barriers hindering private sector participation in the country's development and public investment.

value of the immovable assets that were taken over by the Government about one and half years ago on account of a large and fully provided Non Performing Advance.

In view of these encouraging results despite increasingly complex conditions, the Board recommends a final dividend of Rs. 3.50 per ordinary share. Dividend payment for 2007 will be Rs. 824.3 Mn, reflecting a growth of 40% over 2006. More information on the performance indicators are detailed in the CEO's Review of Operations and in the Statement of Accounts in the Financial Reports section.

Although the government has given every indication of encouraging and promoting the rural economy, probably due to its focus on the security situation in the country, we did not experience any major development projects outside

the urban areas. Numerous proposals in the previous year's fiscal budget, where incentives were accorded to those who invested outside the Western province, in our view, did not materialise to match the targeted forecasts. With our strong network particularly in far away village areas, if the policy of migration and investment to rural provinces was implemented as planned we could have shown improved growth in our long established customer centres in such areas.

### Global economic influences

As mentioned in my comments last year, the Asian economy sustained its signs of rapid vibrancy, as emerging economies, especially India and China, continued their consistent growth rates. The far-reaching economic reforms witnessed in India with public and private sector participation are a clear path for our country too to follow. If our monetary authorities and political leadership take cognizance of the rapid economic growth taking place in India and follow that route by encouraging joint private/public sector participation particularly in sectors such as infrastructure, education and health, I have no doubt Sri Lanka too will see much more sustainable economic progress in the medium term.

Developed economies, however, displayed the converse, suffering from an unstable and adverse political and security environment, particularly in the US and UK. These economies, especially the two mentioned, would have progressed better if circumstances did not force them to divert attention to other external matters surrounding peace in the Middle East and involvement in Iraq. With certain parts of the economy weakening, these countries were forced to pursue an unsteady balancing act.

2008 will see further instability, particularly with the political activities foreseen in the US, challenges to the US by the Chavez regime in oil rich Venezuela and impending

changes in the presidency, as well as the currently governing Labour party in Britain being effectively challenged by Conservatives, an aspect that was not visible during the Tony Blair period. However, economic development in India and China as well as the comparably weaker economies of Bangladesh, Malaysia and Thailand prove to be good examples for Sri Lanka to emulate for the development of the economy, despite obstacles.

### Sri Lanka's economic performance

The country posted a growth of 6.4% at the end of 2007, slower than last year's 7.4%. This growth however could still be considered admirable and showcases the country's resilience despite grappling with rising oil prices, spiralling cost of living and an escalating war in the North and East which occasionally spilled into the commercial capital of Colombo. The commendable growth rate was fuelled by healthy performances in the industry and services sectors, with an impressive recovery seen in the agriculture sector. There have been increased exports in both rubber and tea which benefited from favourable weather conditions and high global demand, definitive contributory factors in gaining a higher growth rate.

Sri Lanka was adversely affected by rising oil prices resulting in continued inflationary trends, exacerbated due to relatively indecisive monetary policies, whereas countries like India and China and the smaller economies, although facing similar oil shocks, managed to ride the storm without affecting growth levels or posing inflationary situations. Inflation point to point measured at 18.8% in the New Colombo Consumers' Price Index, with the annual inflation average sitting officially at 15.8%. Increase in milk powder, petroleum and wheat prices contributed immensely to the spiralling rise in inflation especially in the second quarter of the year.

Cumulative exports increased by 12.5% over the year, while cumulative imports saw a modest increase of 10.2%, resulting in a trade deficit of US \$ 3,560 Mn. The balance of payments recorded a surplus of US \$ 531 Mn, with gross official reserves standing at US \$ 3,063 Mn. The appreciation of the Rupee against the dollar following the international bond issue did see further inflows. The depreciation of the Sri Lanka Rupee against the US Dollar was admirably limited to a mere 1%. The Central Bank's intentions of restricting demand pressures on the economy by curbing the infusion of new money injected into the economy, we observe, is an exercise that has been managed marginally well.

Net Credit to the Government from the banking system saw a substantial decline due to a streamlined repayment structure made by the government. Credit to public corporations, particularly to the Ceylon Petroleum Corporation, also saw a decline; a trend destined to continue through 2008 as well, due to the expected infusion of the Iranian Credit Facility into CPC. There has also been a decrease in domestic credit which is believed to facilitate a growth decline in money supply and will fuel demand-driven inflationary pressure. In response to the tight monetary stance adopted in 2006, credit to the private sector gradually decelerated to 19.3%.

India as well China are positively encouraging private sector investment and contribution within their economies, although similar incentives are not being granted to the private sector to gain their involvement and support into the broader macro-developmental picture in Sri Lanka. This is a short-sighted strategy, as I strongly believe that the private and corporate sectors can contribute significantly to the country's wealth and should be brought in to become strategic partners in the Government's plans for economic progress.

### **Influences within the Sri Lankan banking sector**

Once again, we commence the year with the financial sector facing a situation of unpredictable developments with regard to economic policy and prospects, a particularly disquieting scenario considering the lack of focus by the leadership on barriers hindering private sector participation in the country's development and public investment. Particularly sectors like education, health and infrastructure require substantial investments as well as astute and prudent planning. However, what we currently observe is a diversion of attention to issues which are for short-term survival as against long-term benefits to the community.

Nevertheless, HNB will continue its efforts to contribute towards national development, especially in uplifting the rural economy through our extensive branch network. As a fully private owned commercial bank, we are aware of our strengths, especially our penetrative branch network, some of which are the oldest in the country. We do realise that our competitors too have similar reach in these areas but our established track record and our strong relationship with the rural population through strategic products and services designed and developed especially for this segment, have given us a competitive edge. We hope to further strengthen our delivery units with added input and technology, while also infusing the synergies of similar organisations to provide common services.

Inflationary trends will undoubtedly affect our customer lending portfolio as we do realise the spiralling cost of living factor is proving to be one of the most challenging obstacles facing us in the coming year. We have however been incisive, and cushioned any anticipated shocks to the customer lending portfolio through general provisions in the portfolio, in accordance with monetary regulations and our internal policy. This is further mitigated with the strengthening of our recovery processes by decentralising

responsibilities connected to these activities. We also foresee further potential for infrastructure investment, especially in housing, within the southern and eastern provinces and have geared our customer centre network to be ready for such opportunities.

One of the constraints in strengthening our middle level outstation customers, who are not equipped with extensive resources available in the corporate sector in Colombo, is their inability to carry on business with banks. This segment has the additional challenge of facing delayed payment for services and supplies provided, particularly from government authorities, a factor which serves to delay repayments to the Bank, compelling us to not encourage further borrowings. This we believe is a major hindrance to the development of small and medium entrepreneurs from a banking point of view. Nevertheless, we are aware of the strong and stable customers in almost every major city and adjacent areas and have made a concerted effort to assist them in creating employment, income and general development of those regional economies to reduce urban migration.

Our continued thrust in social responsibility has seen the focus on education and health being further strengthened. We extended our 100 library project established in rural schools by adding equipment, especially IT facilities to some of them, in order to develop IT literacy in difficult areas. One of our biggest projects this year was the establishment of a Cancer Counselling Center, a dire need in dealing with the trauma that surrounds both the victims and their families. Our customer centre network displays immense leadership in being a true corporate citizen, participating in numerous local projects and ensuring that the communities in which they operate are drawn into the Bank's stakeholder net. These efforts have been further fortified with the strategic location of our newer customer centres, where remote areas like Mahiyanganaya and

Angunakolapelassa have also been drawn into the regular banking process. This will be our continued policy in spreading our resources and pursuing opportunities within the rural sector in order to fuel economic growth.

The end of last year saw the Central Bank of Sri Lanka announcing a new mandatory Code for Corporate Governance for commercial banks. Such governance guidelines, we strongly believe, should be uniformly accepted and conformed to by all financial institutions in both private and state sectors, particularly on issues pertaining to independent directors, audit committees and publication of periodical accounts, which should be mandatory for government institutions as well. We also strongly recommend that independent directors in government institutions must be truly independent and should not be political appointees. These directors can be nominated by established independent bodies like the business chambers and instructed to report to those institutions in the event of irregularities. This will also deter and prevent malpractices and instigate better use of resources as the major share of Sri Lanka's banking business continues to be in the hands of the state. Efficiency and prudence in the state-controlled financial institutions will undoubtedly bring substantial benefits to the country's economy.

### **In conclusion**

We have repeatedly mentioned, in every annual report for the last 15 years, the hope and trust we have placed in our political leaders to resolve the ethnic issue permanently. The instability undoubtedly is taking a massive and irreparable toll on both economic activity and development. It is estimated that the volatility of the prolonged civil war is inhibiting the development of more than one third of the country. If the North and East can be networked for economic activity and development, I have no doubt that the benefits would be enormous. If the Eastern province is

free of terrorist activity as reported, then development can be spearheaded by the private sector with the necessary safeguards for institutions like ours to make medium to long-term investments in those areas.

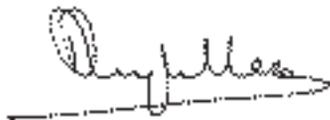
### **Appreciations**

My sincere appreciation to my fellow Directors for their unstinted co-operation over the year. They have been an immense source of support to me during the year, as have been the Management and staff, who worked tirelessly in ensuring commendable results we have posted, despite increasingly challenging circumstances.

The loyalty of our customers has been very encouraging despite intense competition. This situation has helped us maintain a competitive edge and gain business and market share over the year. I thank them for the confidence they continue to place in us.

I take this opportunity to thank His Excellency the President and Minister of Finance Mahinda Rajapakse and officials at his Ministry and the Governor of the Central Bank of Sri Lanka, Ajith Nivard Cabraal and his officials, for their guidance and continued support during 2007.

I would like to thank all stakeholders for the trust and confidence they continue to place in our Bank.



**Rienzie T Wijetilleke**

*Chairman*

*15th February 2008*



# CHIEF EXECUTIVE OFFICER'S REVIEW

It has proved to be an year where HNB has continued to substantiate its winning formula, meeting targeted forecasts and in many instances exceeding them, despite operating in one of the most challenging milieus experienced in recent times. Double digit inflation, volatile interest rates, less than desired levels of political stability, civil disturbances coupled with global oil prices seeing an undesirable heightening, all contributed towards a less than satisfying business operating environment. However, with the prudent, astute strategies employed in the past, HNB had the ability this year to ride the storm and continue its consistent growth paradigm, proving beyond doubt that the Bank has the long term vision to maintain its winning stance.

Deposits and advances saw significant growth trends posting above 19.0% and 21.0% respectively, while assets

The excitement is to keep "winning on the turns" during challenging times. It will be innovation, agility and the ability to offer value to our customers that will propel our quest to lead the industry.

also showed similar movements, showcasing 18.8% growth. Our concerted efforts in continuing the clean up process of the Bank's portfolio, (a process that continued reducing the curve for the third consecutive year), has resulted in Non Performing Advances sitting just under a commendable 6% this year. Our growth this year in After Tax Profits is 36.1% which, given the external environment, is highly creditable, especially in the light of inflation touching 20% during the latter part of the year.

## **Winning the customer over**

The emphasis this year has been not only on enhancing shareholder value and creating wealth but also in ensuring that the correct mix and balance is maintained in the key focus areas of customers, employees and the general community. Our customer penetration has reached impressive standards, which after 15 years of exceptional

growth and strategic planning, sees us present in most district within the country. We established 17 new centers this year, which is the highest number in a single year in the last ten years, with the interesting factor being that only five of that number are in the Western Province, emphasizing our focus of reaching beyond the urban sphere. The concentrated strategy to spur sustainable economic growth into the non-western province areas is in line with not only Sri Lanka's national development vision, Mahinda Chinthanaya, to avoid urban migration; but also to match the United Nations Millennium Development Goals, the axis on which the sustainable strategies of the Mahinda Chinthanaya are built on. This umbrella linkage combines corporate business with the rural economy, one of the primary concepts of Corporate Social Responsibility, amply exemplified in the Mahiyanganaya customer centre being established with the opportunity to fund a maize development project of one of our long standing customers. The linkage established now would enable some 20,000 small scale growers of Maize to have a purchasing point with the customer centre as the central link. However, it must be noted that while the momentum of the customer centre spread will continue, the expansion thrust will have a healthy mix of profit orientation and social responsibility.

Our ATM strength has seen an increase of 39 new ATMs established this year, again the largest increase in the 15 year history of the Bank since we first introduced ATMs, bringing our ATMs to a total of 184. With increasing customer convenience and accessibility being a primary facet in our customer reach strategy, we are targeting yet another 50 ATMs to be established next year, with added customer friendly features and more options and conveniences. Yet another initiative we commenced this year, is to migrate all our ATMs and POS machines towards EMV compliance, a move that has not yet been embarked upon and completed by the industry. Our partnership with

VISA was further enhanced this year with a soft launch of the VISA Debit Card which will be formally launched in 2008, giving customers further conveniences in terms of debit access.

Customer conveniences were, taken up a further notch with "our disabled friendly" initiative gathering more momentum. As a friendly bank to the physically challenged, we transformed 31 customer centres into disabled-friendly locations by the end of 2007. The branches were redesigned to ensure ramps, ATM accessibility and special low, dedicated counters were available for this segment of customer.

### **Our rapidly expanding global presence**

Our quest for overseas presence works on a two pronged reach strategy. Firstly to be established in countries with a strong Sri Lankan diaspora and secondly to identify countries which showcase opportunities and not necessarily those with a Sri Lankan expatriate presence. The former has seen us view the Middle East favourably due to its very high concentration of the Sri Lankan diaspora where HNB promoted business aggressively during the year. New partnerships have been established in the United Kingdom, Dubai, Abu Dhabi and Italy, while negotiations are underway for business initiatives in Oman, Qatar and Saudi Arabia. The business proposition in Qatar works on the interesting concept of joint liability banking where HNB is given the opportunity to work in partnership with the Doha Bank to cross sell each other's products and services, which works on a win-win situation for both partners, with an equitable revenue sharing model. This is a model that has been implemented by banks from India and the Philippines very successfully. HNB is probably the first Sri Lankan bank to work in Qatar using this formula. HNB also obtained regulatory approval from the Central Banks of Sri Lanka, the UAE and Oman, to establish our own branded exchange houses, which we hope will get off

the ground during 2008. The move is expected to increase the share of remittances flowing through official channels, another initiative that the government is trying to encourage Sri Lankan expatriates to use.

India is yet another country that HNB has been eyeing for the last several years: since first establishing our presence by way of a representative office in Chennai, and seeing the immense opportunity emerging in that country. However, stringent regulations in terms of full scale commercial banking still remain a challenge, urging us to pursue alternate lucrative options. We aim to penetrate into investment banking in India, initially covering the three states of Tamil Nadu, Kerala and Karnataka with prospects of Andhra Pradesh not being too far on the horizon. Joint venture investment banking operations in Tamil Nadu will combine HNB's corporate finance synergies and leverage on the distribution capabilities of our Indian joint venture partner who currently boasts of over 140 customer centres.

Bangladesh is yet another land of opportunity with its growing population of over 160 Mn. Definitely on our global expansion radar for 2008, we aim to penetrate this market, utilising our synergies to complement Bangladeshi financial services. One option we worked on during the year was bidding to resuscitate a failed bank, for which we are now one of the shortlisted candidates.

### **Domestic transformations**

One of our groundbreaking ventures this year was the initiative towards the establishment of the joint venture investment bank in Sri Lanka in partnership with DFCC Bank, with a capitalisation of Rs 500 Mn. Regulatory clearances were obtained from the necessary statutory and financial bodies in December 2007 with the transfer of assets and liabilities due for implementation in the first quarter of 2008. The new investment bank will house the

entire gamut of investment banking products and services, ranging from stock broking to fixed income securities and corporate finance/advisory services. This innovative strategy was initiated in order to combine the synergies of two corporate giants in Sri Lanka and to retain the abundance of talent available in corporate finance. The latter is not a strategy that can be employed easily by a commercial bank, due to various constraints especially in remuneration scales, but with this partnership can now be performed successfully. The venture has the foundation and trusses of a completely independent entity with its own distinctive brand, even though it is backed by two of Sri Lanka's largest corporate leaders.

### **Continuing IT enhancements**

The major deliverable in terms of enhancing technology platform within our operations and processes this year, was the selection of the new core banking application, with 2008 posing an even bigger challenge in the implementation process, but one we are sure to surmount very well. We have already signed up with Finacle, one of the world's best selling core banking systems, developed by Infosys of India; while in tandem, we are upgrading our entire communication and hardware infrastructure within the Bank. Our virtual branch is now being increasingly utilised by customers to whom the Internet is a vital tool in everyday dealings.

Our strategic tie ups with nearly all major players in the telecommunication industry for reload facilities will gather further momentum next year. Web based solutions, especially for speedy cash distribution will be a fundamental growth area for us in the future and one that we hope to fine tune in the next year.

During 2007, we upgraded our entire customer centre network of 167, to the latest web browser based platform offered by Moneygram International. This initiative now

enables a remittance beneficiary to walk into any of our centres and download /receive cash payout within minutes

### **Creating winning people**

Given that our team has proven to be a winning one, displaying team spirit that impels a knowledge driven culture garnished with innovation, motivation and dynamism, our 4,300 strong team has also shown great prowess in improving productivity, helping us to successfully maintain our competitive edge. However, one of the biggest challenges we have been faced with, within the last three years, has been the migration of skilled professionals, not only within the banking industry but across industries and world wide, due to high global demand. This we believe will exacerbate in the next few years; a threatening phenomenon that needs to be addressed with much urgency.

Some key initiatives have been introduced and implemented in terms of employment policy and HR framework over the last few years. The performance management system is now stabilised and functioning effectively. The concept of the variable pay strategy introduced for the executive cadre three years ago was taken to the next level this year, with the ESOP plan to be introduced for senior management aimed at driving performance and retaining the best in the organisation. As a further incentive (besides above par remuneration and benefits), senior management is now given the opportunity to participate in share ownership: a further reinforcement of commitment and allegiance to the organisation.

To minimise some of the effects of professional migration, some changes were implemented in our employment policy. Those who opt to take a hiatus, even for a period of four to five years, are given the option of returning to the Bank if they so desire. One of the bigger challenges however is the widening gap between the Bank's HR needs

and the availability of such skills in the country, which at present is posing a rapidly escalating problem. We have, over the year, instigated and conducted Management Trainee and Career Guidance programmes to encourage young people to look towards the banking industry as a lucrative career option.

The Staff Scholarship Fund is yet another persuasive feature we have introduced to retain and nurture our young achievers and is targeted at HNB employees' children. Education for university students who are a part of the Hatna family is funded by way of a limited number of scholarships. Once completing their degrees, these students are given an opportunity to qualify to join the Bank.

Rewards and recognition are also an integral feature in our HR strategy as we believe that individual and team brilliance in work and extracurricular activities must be encouraged and recognised.

### **CSR as a sustainable feature**

Our sustainability agenda this year has been focused primarily on education and health. While our sustainability report will present our projects in more detail, special mention must be made of our single largest healthcare project, which was the establishment of the Cancer Counseling Center in Maharagama at an initial investment of Rs 2 Mn, in partnership with the Cancer Hospital Maharagama. This is a much needed trauma counseling centre for cancer patients and their family members. It is intended that an initial batch of counselors will receive training from the Royal Marsden Hospital, UK and we look forward to further develop this project with the "buy in" of not only our Team, but customers and service providers as well. Our CSR efforts will receive greater focus and balance in 2008 with the formation of a CSR Trust which will institutionalize CSR at HNB.

## Focus on 2008 and beyond

Observing the trends at the close of 2007, inflation and the high level of domestic interest rates continue to be a threat to the country's development agenda. The recently abrogated Cease Fire Agreement (CFA) with the Liberation Tigers of Tamil Eelam (LTTE) gives cause for concern regarding the much desired prevalence of peace. The impact of inflation and cost of energy will certainly stress the domestic manufacturing and export oriented industries in terms of competitiveness viz-a-viz other emerging economies, while the absence of lasting peace will fuel emigration of much needed skilled and professional talent. Globally, as oil prices hover around the \$100 level and the US Economy slows down, we see unprecedented investment in the Middle East by sovereign coffers brimming with surpluses. Similarly, we see emerging economies such as Vietnam, Cambodia, parts of Africa and Bangladesh, attracting our exporting groups as competitive manufacturing bases. Cross border mobility of labour is envisaged to intensify further.

Against such a backdrop, HNB's focus will be three fold. Firstly, to identify mobility patterns and increase our share of inward remittances and business/personal financial needs of these customers, with user friendly, cost effective value for money offerings. Secondly, to work closely with our existing top tier corporate customers and add value as they diversify into overseas markets, which will also increase diversity in our own income and asset portfolios. Thirdly, to reinforce HNB's long term thrust: "We believe in Sri Lanka". As Sri Lanka's premier private sector commercial bank, we will continue stimulating economic growth and prosperity at the village and town level, which will retain wealth locally rather than follow a path of urban migration. After all, there is nothing special about doing well on a smooth slope. The excitement is to keep "Winning on the Turns" during challenging times. We also firmly believe that the margins enjoyed today are phenomenon

very much of the past. It will be innovation, agility and ability to offer value to customers that will propel our quest to lead the industry rather than be a part of the pack.

In 2008, we intend turning increasing attention to climate change and its impact on our business model. This is an area to which we have not been attentive enough in the past. Our intent is to develop a framework where we will consider the impact of climate change in our engagement with various stakeholders, be they customers, suppliers, communities we serve or our own HNB team. From the Bank's perspective we intend beginning by enhancing our awareness of climate change and what each of us as a citizen of the world and collectively as TEAM HNB, can do to minimize the adverse impact on our environment.

I would like to extend my appreciation to the Governor of the Central Bank of Sri Lanka and his staff for their support throughout the year. My deep gratitude to the Chairman and my fellow Board Directors for their encouragement, constructive input and guidance. Team HNB has been and will continue to be my motivation and I do thank them for their commitment, passion to perform and allegiance to our organization which are the three key ingredients which will drive us to realize our Vision.



**Rajendra Theagarajah**  
*Managing Director and CEO*

15th February 2008

# BOARD OF **DIRECTORS**



**CHAIRMAN****MR. RIENZIE T. WIJETILLEKE***F.C.I.B. (London), F.I.B. (Sri Lanka)*

Chairman since March 2004. He was Managing Director & Chief Executive Officer from July 1988 to December 2004 and counts over forty-seven years in Banking, including overseas assignments. He is Chairman of HNB Assurance PLC, HNB Stockbrokers (Pvt.) Ltd, HNB Securities Ltd, Sithma Development (Private) Ltd and Sunshine Holdings PLC; a Director of Nawaloka Hospitals PLC and Ceylon Biscuits Ltd. Former Chairman and Director of the Colombo Stock Exchange.

**DEPUTY CHAIRMAN****DR. V P VITTACHI***B.Com. (London), Ph.D.*

Director since 1988. He was the past Head of Sri Lanka Customs, past Chairman of several public corporations and past Governing Council Member of the Peradeniya and Moratuwa Universities. He is Chairman of Lanka Milk Foods (CWE) Ltd., and a Director of Stassen Group of Companies.

**MANAGING DIRECTOR/CHIEF EXECUTIVE OFFICER****MR. RAJENDRA THEAGARAJAH***F.C.M.A. (U.K.), F.C.A (Sri Lanka), M.B.A. (Cranfield)*

He was appointed Director/General Manager/Chief Executive Officer in December 2004. He was appointed Managing Director/Chief Executive Officer in December 2005. Member of the Corporate Management of HNB since 1997. He counts over 23 years in Banking, including overseas assignments. He is a Director of HNB Assurance PLC, HNB Securities Ltd, HNB Stockbrokers (Pvt.) Ltd, Sithma Development (Pvt.) Ltd, and Lanka Financial Services Bureau Ltd. He is a Board Member of the Asian Bankers Association.

**DIRECTOR****MR. D. H. S. JAYAWARDENA**

Director since 1988. He is the Chairman of Sri Lankan Airlines Ltd, the National Carrier; Aitken Spence PLC, Sri Lanka Insurance Corporation Ltd, Lanka Bell (Pvt) Ltd, Periceyl (Pvt) Ltd, Stassen Group of Companies, the Chairman and Chief Executive Officer of Distilleries Company of Sri Lanka Ltd, the Managing Director of Lanka Milk Foods (CWE) Ltd, Balangoda Plantations Ltd and Madulsima Plantations Ltd. He is a Director of Browns Beach Hotels Ltd and Lanka Hospitals Corporation PLC (Apollo Hospital, Colombo). He is also the Consul General for Denmark in Sri Lanka.

**DIRECTOR****MR. M.V. THEAGARAJAH***F.C.M.A., 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. OBEYSEKERE**

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

**DIRECTOR****MRS. PAMELA C. COORAY***LL.B.*

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

**DIRECTOR****MR. RATNESWARA SIVARATNAM**

Appointed Director in December 2004. He is a Director of Aitken Spence PLC, Acme Printing & Packaging PLC and Lanka Aluminium Industries Ltd. A past Chairman and Managing Director of Aitken Spence Group of Companies, past Chairman – Employers Federation of Ceylon, on the Steering Committee of the Airports and Port Development and past Executive Chairman of the Sri Lanka Export Development Board. He was past President – Association of Group Tour Agencies, Past Vice President – Ceylon Tourist Hotels Association and Travel Association of Sri Lanka, past Consul General for Finland in Sri Lanka and was an Executive Committee Member of the Ceylon Chamber of Commerce.

**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, Metecno (Pvt) Limited, Classic Teas (Pvt) Limited, Tea Small Holders Factories PLC, Green Farms (Pvt) Limited, Tokyo Cement PLC, Nestle Lanka PLC.

**BOARD SECRETARY****MS. INDRANI GOONESEKERA***ATTORNEY-AT-LAW & NOTARY PUBLIC*



**J M J Perera**

*F.C.I.B. (London)*

**Senior Deputy General Manager -  
Business Development  
& International**

**J D N Kekulawala**

*M.B.A. (Manchester),  
F.C.I.B.(London),F.C.A.(England & Wales)*

**Chief Financial Officer**

**R Theagarajah**

*M.B.A. (Cranfield), F.C.M.A.,  
F.C.A. (Sri Lanka)*

**Managing Director/  
Chief Executive Officer**

**Ms I Goonesekera**

*Attorney-at-Law & Notary Public*

**Deputy General Manager -  
Legal / Board Secretary**

**C P Abeywickrema**

*B.Com. (Special) Sri Lanka*

**Deputy General Manager -  
Personal Banking & Network  
Management**



**A Ratnasabapathy**

*F.P.M.A.*

**Assistant General Manager -  
Zone I**

**Ms D C Cooke**

*F.C.A.(Sri Lanka)*

**Deputy General Manager -  
Operations & Systems**

**U A C Obeyesekere**

*F.I.P.M. (Sri Lanka)*

**Deputy General Manager -  
Human Resources & Administration**

**P D Hennayake**

*M.B.A.(A.I.T.) Thailand, P.G Dip.(Eng.),  
B.Sc. Eng. (Hons) Moratuwa, C.Eng.,  
M.I.E. (Sri Lanka)*

**Assistant General Manager -  
Services**

**J R P M Paiva**

*B.A. (Hons) Ceylon*

**Deputy General Manager -  
Human Resources & Administration**



**R H Abayasekara**  
Assistant General Manager -  
International

**D Rodrigo**  
*M.B.A. (Cranfield), F.C.M.A., F.C.C.A.*  
Assistant General Manager -  
Risk & Compliance

**H N J Chandrasekera**  
Assistant General Manager -  
Zone III

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

**M Asokan**  
*F.C.A. [Sri Lanka], A.C.M.A., C.I.S.A. [USA],  
C.I.A. [USA]*  
Head of Internal Audit



**G Ramanan**  
*C.F.A., A.C.M.A.*  
Assistant General Manager -  
Investment Banking /  
Chief Executive Officer -  
HNB Securities Ltd.

**P Sridharan**  
Assistant General Manager -  
Personal Financial Services &  
Business Development

**Ms L L C C Thambiah**  
Assistant General Manager -  
Zone II

## **B J Sinniah**

**Chief Manager - Risk & Compliance**

## **A P L Fernando**

*F.I.B. (SL), Dip. in Bank Mgmt.*

**Chief Manager - Credit Supervision & Recoveries**

## **R M P Ratnayake**

*M.B.A. [Southern Queensland - Aus.], P.G. Dip. Busi. & Fin. Admin. (I.C.A.S.L. & Cranfield), A.I.B. (SL), M.A.A.T.*

**Chief Manager - International Operations/Chief AML Officer**

## **V K A F Rajasekara**

*MPMA [UK], Higher Dip. in Busi. Admin. (Chennai)*

**Chief Manager -South Western Region**

## **A N J De Silva**

**Chief Manager - Business Development – Subsidiaries**

## **M K Nambiyarooran**

*M.B.A.(Sri J.), M.A. (Fin.Econ), F.C.M.A., F.S.C.M.A., F.I.B.(SL)*

**Chief Manager – Treasury**

## **K L Wijesooriya**

*LL.B (Sri Lanka)*

**Chief Manager – Remittances**

## **D St E Fernando**

**Chief Manager – Operations**

## **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 – Information Technology**

## **T Govinthadas**

*M.B.A. (Colombo), B.Sc. (Hons) (P.F.T.) (Cey.), A.C.I.B.(Lond.)*

**Chief Manager- Network Banking**

## **I H A Wickramasinghe**

*M.B.A. (Sri J.), A.M.I.E. (SL),M.C.I.M. (UK), M.S.L.I.M.*

**Chief Manager - Project Finance**

## **B K Wijeratne**

*B.Sc. (Physical Science) Colombo*

**Chief Manager – Leasing**

## **N U Jumat**

*A.I.B. (Sri Lanka)*

**Chief Manager - Trade Services**

## **P G Wilson**

*B.Sc. (Kelaniya), Dip. in I.T. (N.I.B.M.)*

**Chief Manager - IT Research & Development**

## **J U N Chandrasena**

*M.A. (Econ) Colombo, A.C.M.A.*

**Chief Manager – Planning**

## **R J Thambirajah**

**Chief Manager - Colombo Region**

## **I A Baduge**

*Dip.in Bank Mgmt., A.I.C.M.*

**Chief Manager - Corporate Banking**

## **R M P Dayawansa**

*M.B.A. (Sri J.), F.I.B. (SL), M.C.I.M. (UK), M.S.L.I.M.*

**Chief Manager - Greater Colombo Region**

## **S Sivalingam**

*A.C.I.B. (London)*

**Chief Manager - Procurement & Logistics**

## **T M A Mutaliph**

*A.I.B.(SL), Dip. in Bank Mgmt.*

**Chief Manager - Operational Risk**

**A Goonesekere***M.B.A. (Sri J.), A.C.A. (Sri Lanka), A.S.C.M.A.***Chief Accountant****N Premakumar****Senior Manager - Admin & Trade Services (City)****U N I Elapata***B.A. (Hons) - Univ. of Texas (Austin)***Senior Manager - Head Office Branch****Ms N M C P Wettasinha***Attorney-at-Law & Notary Public***Senior Manager – Legal****E C Alles***B. Sc. (Bangalore)***Senior Manager - Cinnamon Gardens****R B Warnakulasuriya***B.Com. (Special) Kelaniya, M.A.A.T, A.I.C.M.***Senior Manager - North Western Region****V Ratnasabapathy***A.C.I.B. (London)***Senior Manager - Credit Risk 2****D L V Chandrasekera****Senior Manager – Leasing****S Udayakumar***M.C.M.I. (Lond), M.S.L.I.M, Dip. in Busi.Mgmt & Admin (UK), Dip. in Sales Mgmt & Marketing (UK)***Senior Manager - Operational Risk [Zone II]****J T M Weeresinghe****Senior Manager - Credit Risk****Mr N Premarajah***Higher Dip. in Int. Busi. Mgmt - Chennai***Senior Manager - Consumer Banking & Housing Finance****Mrs 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****Mrs R Prabhakaran***A.I.B. (Sri Lanka)***Senior Manager - Treasury Operations****Mr A. G. Gomez****Senior Manager - Treasury****Mrs K. Balasubramaniam***LL.B [Sri Lanka]***Senior Manager - HR Management****Mr H. J. A. Ferdinando***A.I.B. [Sri Lanka]***Senior Manager - Centralized Operations****Mr L. S. C. L. R. Fernando***A.I.B [Sri Lanka]***Senior Manager - Central Region****B K Achan***M.Sc. (Bombay), B.Sc. (Hons) (Calcutta), C.A.I.I.B.(India)***Chief Representative Officer – Chennai****A B Shahid***M.B.A, B.Sc. (Univ. of Karachi), F.I.B. (Pakistan)***Chief Representative Officer - Karachi**

## RISK MANAGEMENT

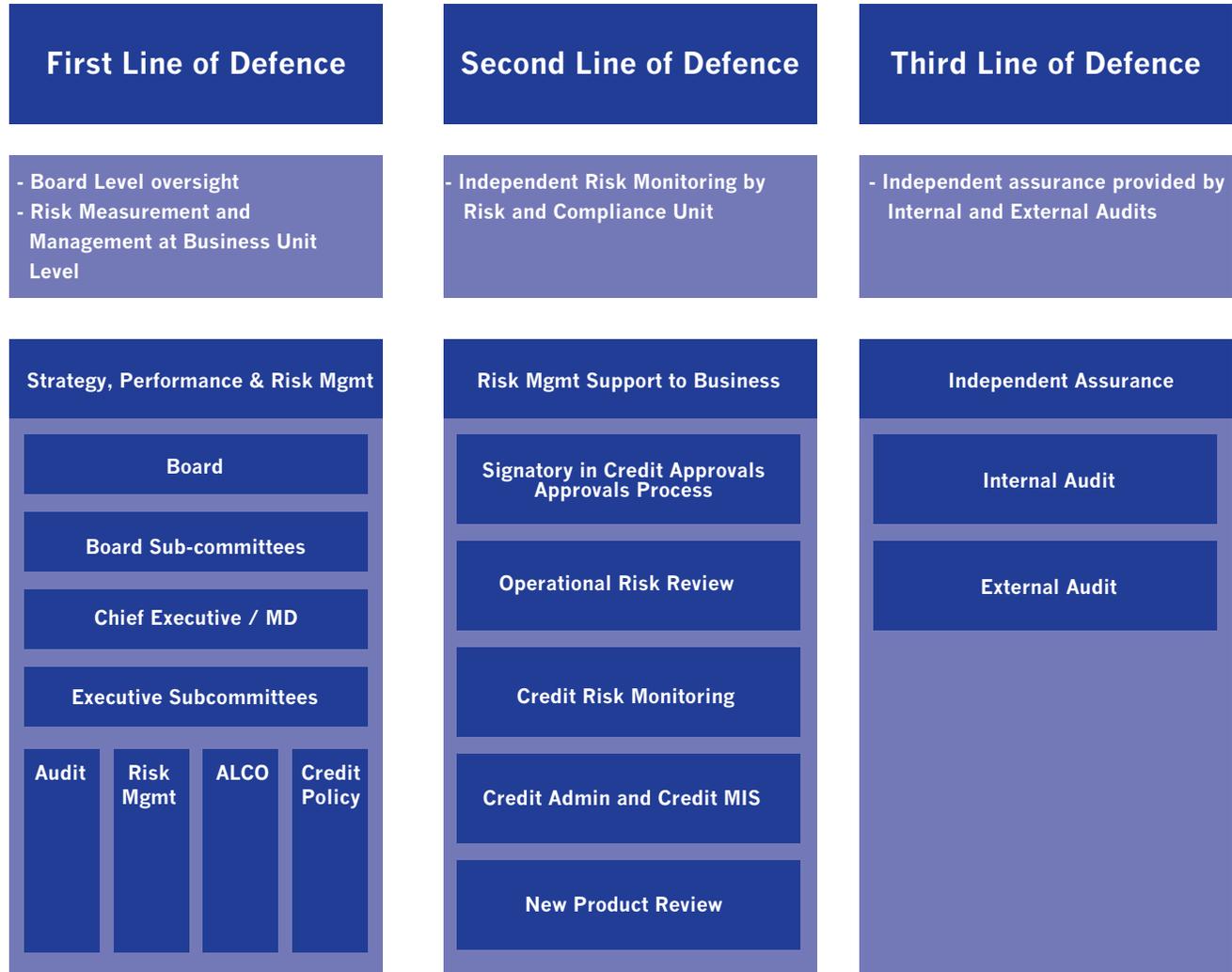
Effective management of risk is a key capability for a successful financial services provider and continues to be fundamental to HNB's Strategy. HNB views Risk Management as not just a compliance exercise, but as a business performance-enhancing and value-adding exercise. The single minded focus is to develop an organisation-wide 'Risk Awareness' culture in our Hatna Team members, to empower them to manage risk effectively to generate sustainable profits.

HNB manages risk within an established "three lines of defence" framework. The first line of defence comprises the business units managing the risk associated with their activities. The second line encompasses dedicated Risk and Compliance function, which is accountable for independent monitoring and oversight. The third line of defence relates to Internal Audit, independently reviewing, monitoring and testing businesses unit compliance with risk policies and procedures, and regularly assessing the overall effectiveness of risk management framework and assurance provided by the External Audit. Control is exercised through clearly defined delegation of authority, with clear communication and escalation channels throughout HNB.

The Risk Management Committee, the principal Risk Strategy and Risk Policy decision making body, is chaired by the MD/CEO and provides the Board with the assurance in the performance of the overall risk management framework and that Risk Management initiatives ensure balanced coverage of the Risk Charter. This committee is supported by the ALCO, Credit Policy, IT Steering Committee and CSR sub committees; each with a specialized focus.

HNB's Risk Management and Compliance Unit reports directly to the Managing Director/CEO and reports to the Board Audit Committee quarterly on its progress against planned initiatives outlined in the Risk Charter. Business Development and Risk Management business lines are clearly separated. In the last 3 years, the Risk Management Unit has expanded in scope and coverage to become an integral part of HNB's Governance Framework.

The three lines of defence and principal responsibilities that extend across HNB are as follows.



### Key Risk Management Initiatives implemented during 2007

- A Gap Analysis of HNB's Risk Management Practices against Best in Class Risk Management Practices was carried out by CRISIL, an Indian Consultancy firm based on our mandate to cover Credit, Market and Operational Risk areas. The recommendations have been studied in detail and an implementation roadmap is to be developed in 2008.
- An SME Scoring Model was also developed by CRISIL. This model is being further refined to acclimatise to local environment prior to launch in 2008.
- Completed 50% of the Credit Risk Assessment Modules training for the first batch of Credit Relationship Managers. This Program was developed by Omega USA, a global leader in Credit Training and was facilitated by the Risk Management Unit.

### Conformance against New Regulations introduced during the year (Table 1)

Minimum Standard Rules on KYC (issued by the Financial Intelligence Unit of the Central Bank, in May '07)	
New Customers - Natural Persons - Corporate Entities - Clubs, Societies, Charities, Associations and NGOs	Already Compliant
Existing Customers - Natural Persons - Corporate Entities - Clubs, Societies, Charities, Associations and NGOs	75% compliant by end Dec '07
Risk Profiling of all customers	Planned to commence from Jan '08
New Companies Act (effective from May '07)	
Registration of HNB under new Companies Act	Compliant
Registration of our customers (corporate entities)	On-going
Addressing customers failing the solvency test	Ongoing
Directors' Interest register	Compliant
Carry out Solvency test prior to recommending dividends	When required
Nominate a fair and reasonable price for the shares to be acquired	When required

## Progress achieved as against Risk Charter in 2007

Risk Factors and Risk Mitigation strategies	Actions taken during the year
<p><b>1. CREDIT RISK</b></p> <p><b>1.1 Portfolio Issues</b></p> <p>a) Review the effectiveness of credit risk strategies and monitor their ongoing review</p> <p>b) Review the adequacy of portfolio monitoring</p> <p>c) Review large and high risk accounts that could potentially have a material impact on future asset quality</p> <p><b>1.2 Policy Issues</b></p> <p>d) Review the effectiveness of credit risk policies and monitor their ongoing review</p> <p>e) Review delegated commitment authorities</p> <p>f) Mandated Head of Credit to decide on watch listed and high risk credits and refer findings for Committee review</p> <p>g) Policy to monitor single borrowers exposure and industry/country concentration</p>	<ul style="list-style-type: none"> <li>• Periodic review of existing product portfolios and risk review of new products prior to launch</li> <li>• Automation of network performance KPI to facilitate performance benchmarking and enhanced accountability at all levels</li> <li>• Industry Reports for Apparel and Tourism and its implications for HNB's Credit Portfolio</li> <li>• Client and Branch Reviews – 5 Large Branches comprising 209 SME Clients were reviewed and 9 Large Corporates were reviewed</li> <li>• Detailed analysis of additions during the year to NPA by action category(i.e. housekeeping issues, legal action, negotiation etc.) for follow up actioning</li> <li>• Miscellaneous Reports – Protection against Natural Disasters for Customers, Improving safeguards for lending against quoted company shares</li> <li>• Top 20 Local and Foreign Currency Loan Review</li> <li>• High Risk Accounts (Internally Risk Rated CCC and below) Customer Reviews</li> <li>• Review of quality and adequacy of Watchlisted Accounts across the network and developed policy and training module on identification and management of early alert accounts</li> </ul> <ul style="list-style-type: none"> <li>• Set up Credit Administration Unit reporting independently to Risk Management Unit, to support Credit Cell</li> <li>• Adequacy and effectiveness of Credit Policies evaluated in Monthly Meetings</li> <li>• Simplifying and Standardising Credit Documentation to enhance effectiveness</li> <li>• Amended Credit Approval Guidelines enhancing discretions across the network with improved centralised monitoring</li> <li>• Framework developed for identification and reporting of Watchlisted Exposures</li> <li>• Independent review of Watchlisted exposures for actioning by Branch / Relationship Managers</li> </ul>

Risk Factors and Risk Mitigation strategies	Actions taken during the year
<p><b>2 REGULATORY/COMPLIANCE RISK</b></p> <p>a) Review the adequacy and effectiveness of HNB's compliance management framework</p> <p>b) Review of compliance monitoring plans and results</p> <p>c) Review the major reports of regulators on the operations of HNB</p> <p>d) Oversee compliance by HNB with applicable laws, regulations and regulatory requirements that may impact HNB's risk management</p>	<ul style="list-style-type: none"> <li>• Adhered to CBSL Regulations and complied with filing of new electronic returns</li> <li>• Quarterly Report on adherence submitted to Audit Committee, Quarterly</li> <li>• Audit Management Letter and CBSL Inspection Report for 2007 followed through and actioned</li> <li>• New regulations introduced during the year – impact assessed and followed through in terms of policy, systems and guidelines (table 1) Specific training on Anti-Money Laundering and Combating of Financing of Terrorism. Excellent relationship maintained with regulators and law enforcement agencies</li> </ul>
<p><b>3 MARKET RISK</b></p> <p>a) Review HNB's market risk control framework and assess whether it is appropriately independent from the line of business and comprehensive</p> <p>b) Review appropriateness of Limit/Exposure position in light of prevailing market conditions</p> <p>c) Evaluate models to be used to measure risks and decide on risk appetite</p>	<ul style="list-style-type: none"> <li>• Set up a dedicated Treasury Middle Office, independently reporting to Risk Management in keeping with best practice with effect from 4th Qtr 2007</li> <li>• Focus is on covering Corporate Banking Positions with minimal trading on own account under the guidance of ALCO and Treasury Committee</li> <li>• Risk Review of planned new Treasury Products carried out</li> <li>• Revisiting existing models and review of appropriateness is being carried out with a view to introducing a new Treasury Trading System.</li> </ul>
<p><b>4 OPERATIONAL RISK</b></p> <p>a) Review the operational risk profile and operational risk strategy/appetite of HNB and monitor HNB's overall risk control framework</p> <p>b) Review the IT Risk Profile and Strategy based on the Risk Appetite of HNB</p> <p>c) Review Plan to make major modifications/enhancements to the System</p>	<ul style="list-style-type: none"> <li>• Developed Operational Risk Incidents reporting across the network and Operational Loss Database in line with BASEL 2 Criteria. Material Losses regularly analysed by cause and actions taken to improve systems and controls to prevent recurrence in the future</li> <li>• New circulars issued to provide guidelines on how to manage recurrent Operational Risk Issues</li> <li>• Decision to migrate to a new core-banking system taken after careful review of existing system capabilities. Risk Management is represented in IT Steering Committee selecting Finacle as the new core banking system. Data Clean up initiatives are being spearheaded to ensure significant improvement in data integrity ahead of Finacle System implementation.</li> </ul>
<p><b>5 LEGAL RISK</b></p> <p>a) Review litigation and any trends arising from litigation against HNB from a risk management perspective</p> <p>a) Review HNB's legal policies and practices from a risk management perspective</p>	<ul style="list-style-type: none"> <li>• Ongoing follow up. No additions during the year.</li> <li>• Ongoing review of legal documentation and Service Standards through internal customer surveys etc.</li> </ul>

Risk factors and Risk Mitigation strategies	Actions taken during the year
<p><b>6 LIQUIDITY</b></p> <p>a) Review the effectiveness of the risk management systems and policies adopted by the ALCO to manage structural interest rate risk</p> <p>b) Review new Balance Sheet Management policies</p>	<ul style="list-style-type: none"> <li>• Regular review of Asset and Liability Yield Analysis by product carried out this year to develop strategies to prevent/minimize deterioration in Net Interest Yields in an escalating interest rate scenario</li> <li>• Viability of Asset Securitisation is currently being reviewed for implementation</li> </ul>
<p><b>7 REPUTATION/STRATEGIC RISK</b></p> <p>a) Review strategic risks identified by the CFO</p> <p>b) Decide on risk appetite and/or those requiring escalation to the Board of Directors</p> <p>c) Review CSR/Sustainability Reporting policies and compliance with Bank's Risk Management Framework</p>	<ul style="list-style-type: none"> <li>• Reviewed as an integral part of the Strategic Planning and Budgeting process. Specific action plans developed for key risks (competitor strategies, regulatory changes etc.,) identified.</li> <li>• System in place to escalate all quantified risks above a threshold level to the Board Audit Committee on a regular basis</li> <li>• Sustainability Committee meets to discuss and action identified/approved CSR Projects</li> <li>• In the process of incorporating a CSR Trust with a specific scope.</li> </ul>

## Future

As part of the ongoing Strategic Review process, the Corporate Management had two offsite meetings in the year. An Environmental Analysis identified a number of foreseeable threats given the current economic/political scenario for which action plans were developed to mitigate the said risks identified.

### 1. Rising inflation and interest rates

#### Impact

Managing liquidity risk in a milieu of increasing interest rates poses numerous challenges including the difficulties faced in repricing assets, the deterioration in value of asset positions and in raising low cost demand and savings deposits. From the perspective of our borrowing customers, the inability to pass on the incremental cost to their customers results in profit margins being squeezed and consequently affects HNB's Asset Quality.

## Action plan

The ALCO Committee monitors Interest Rates and Net Interest Yields very closely and drives floating rate pricing on assets whenever possible. Frequent Value Additions to low cost deposit products are being pursued to ensure minimal deterioration in the Savings base. We are also reviewing the viability of asset securitisation of selective fixed rate portfolios to ensure greater yields, while improving liquidity and capital adequacy ratios in the process.

### 2. Conflict escalation in the North and East

#### Impact

HNB has a significant customer centre presence in the North and East which over the years has contributed significantly to deposit generation efforts and with consistently good asset quality. In addition to impacting business performance directly in these territories the indirect impact on the rest of the bank due to resultant slow/negative real GDP Growth can be significant.

### **Action Plan**

The Risk Committee took a decision to increase the Insurance coverage on the Pawning Portfolio in the North East and to manage Asset Growth within a planned target below Deposit growth across the bank. Greater focus on NPA Management, Risk Profiling and Watchlisting, with improved MIS to facilitate this exercise. HNB continues to lobby government through Private Sector industry groupings for peaceful resolution of the conflict and will renew focus on leveraging on attractive Regional/Global opportunities for selective growth.

### **3. Retaining experienced/qualified staff**

#### **Impact**

We have seen an escalation of key staff members pursuing remunerative job opportunities overseas in the banking industry. This could result in a weakening of skill-set in critical roles, resulting in a strain on achievement of business plans.

#### **Action Plan**

HNB conducted an independent employee survey last year and has been focused on implementation of action plans based on the findings. There is significant investment in Training and Development and a flexible performance management system to ensure high performers are recognized and rewarded. Succession Plans for key posts have been identified.

### **4. The emergence of alternative delivery channels**

#### **Impact**

Traditional branch banking is considerably threatened by the advent of technology induced banking, i.e. mobile phones, Internet etc. These channels are significantly more cost efficient.

#### **Action Plan**

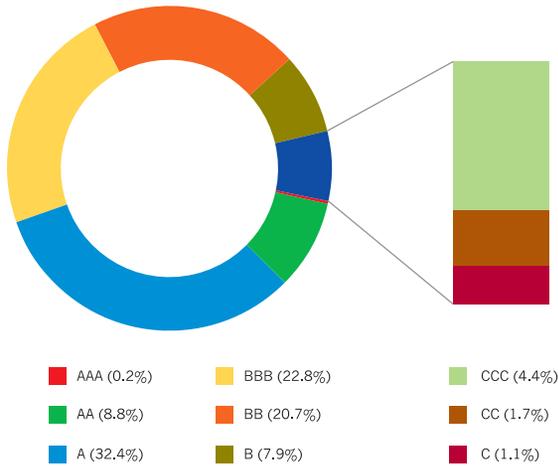
HNB aims to be a fore runner in driving technology induced banking to all segments of its customers from microfinance to large corporates. We are confident that with the successful implementation of the new Core Banking System this year, we would be equipped with the right platform to leverage the vast opportunities presented.

### **Winning strategies for 2008**

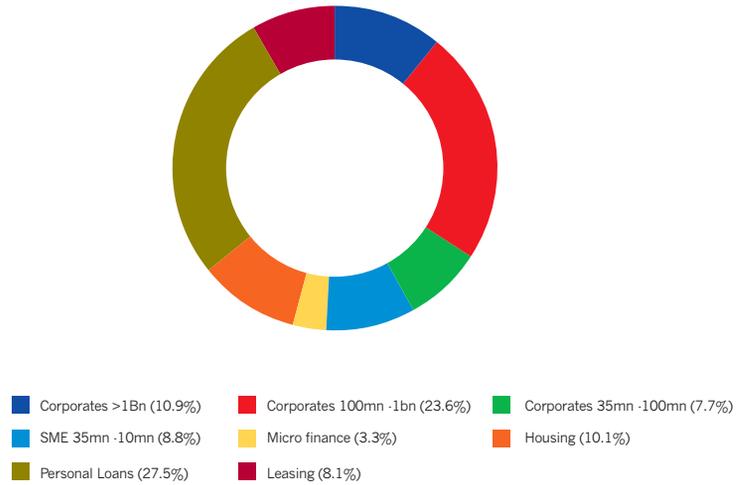
We are on track for BASEL 2 Standardised approach implementation in Jan. '08. We are confident that with the implementation of Finacle, our new Core Banking System we would be in a position to further refine the quality and integrity of our MIS. We are confident that with this roll out in 2008, our infrastructure, systems and processes will be more effectively streamlined, which in turn will significantly contribute towards improved decision making.

Looking beyond 2008, our priority over the medium term continues to be to gear ourselves for the BASEL 2 IRB Platform.

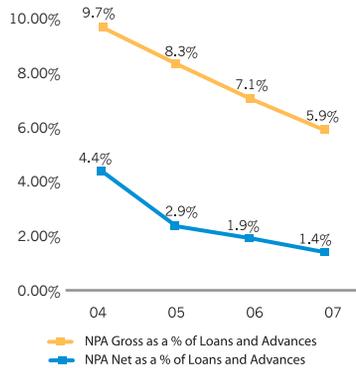
Portfolio Quality



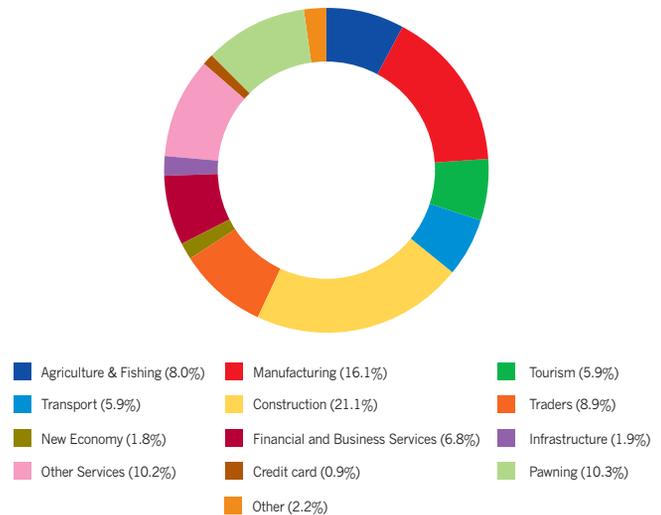
Exposure by Counterparties



Non Performing Advances (NPA)



Industrywise Exposure



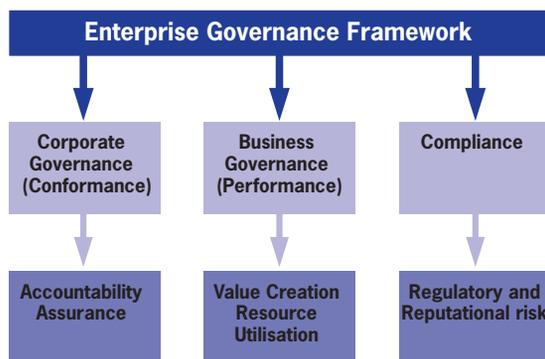
# ENTERPRISE GOVERNANCE AND COMPLIANCE

HNB has adopted an enterprise governance framework that covers both the corporate governance and business governance aspects of the organization. It encompasses governance structures that are strategically linked with performance management, enabling HNB to focus on the key areas that drive our business.

Enterprise Governance and Compliance constitute part of the entire accountability framework of HNB and require a balance between accountability and assurance (conformance) and value creation and resource allocation (performance).

Conformance includes Corporate Governance and covers issues such as Board structures and roles, executive remuneration, Risk Management, and audit function. Performance includes Business Governance and is focused on strategy and value creation, enabling the Board to

- Make strategic decisions;
- Understand its appetite for risk and the key drivers of performance; and
- identify key principles of decision making.



The Corporate Governance & Compliance process adopted by HNB to ensure conformance is disclosed below and the Business Governance practices adopted by the Board of HNB

which enables effective performance are discussed in the Management Discussion section of the Annual Report.

## Corporate Governance & Compliance

Corporate Governance is the process by which business operations of HNB are directed and controlled by the Board of Directors. The Corporate Governance structure lays down the distribution of responsibilities among different participants in the Bank such as the Board, Managers, Shareholders and other Stakeholders and spells out the principles and rules for making decisions on corporate affairs. This also provides the structure through which the Bank objectives are set and the means of attaining those objectives and monitoring performance, are defined.

Therefore, Corporate Governance encompasses our entire business operations and is not an isolated facet of Board Room or managerial obligations.

This is an evolving topic and comprises mostly qualitative judgemental aspects. Corporate Governance is a fundamental part of the culture and business practices at HNB. We have made an attempt to present the actual structures and processes in place in the simplest form possible for the users of this report, so that they could gain an understanding of the adequacy and effectiveness of the process.

The following disclosures below reflect HNB's level of compliance with the Code of Best Practice on Corporate Governance issued by the Institute of Chartered Accountants of Sri Lanka (ICASL) and the Code of Corporate Governance for Banks and Financial Institutions issued by the Central Bank of Sri Lanka (CBSL).

The structures in place and the compliance against the requirement and expectations and other initiatives, are given below under the following headings.

Corporate Governance Principle	Level of Compliance
<b>The Board of Directors</b>	
<b>Qualified and suitable Board of Directors</b>	<p>The Board consists of professionals in Banking, Accounting, Management, Law and Business Leaders. They possess the skill, experience and knowledge to set the directions and oversee the operations of the Bank. The profiles of the Directors are given on page 19 of the Corporate Reviews section of the Annual Report.</p>
<b>Meetings</b>	<p>Meetings of the Board are held at approximately monthly intervals with a minimum of twelve meetings held during the year to review the Bank's performance and to determine which strategies and business practices are aligned with stakeholders' expectations. Additional meetings are held whenever necessary.</p> <p>The number of meetings of the Board, Board appointed Sub Committees and individual attention by members are given on page 43 of Corporate Reviews section of the Annual Report.</p>
<b>Board Charter</b>	<p>The Board Charter defines the roles and responsibilities of the Board, Committees and those delegated to Management.</p> <p>The main responsibilities of the <b>Board</b> are</p> <p><b>Stakeholder Interests</b></p> <p>Serving in the interest of long term sustainable return for shareholders, also with regard to the interest of the other stakeholders, including customers, regulators, staff and communities; and building trust in HNB through consistent business performance, transparency and accountability.</p> <p><b>Strategy</b></p> <p>Providing strategic directions and formulating corporate strategic initiatives, while reviewing, approving and monitoring HNB's risk appetite</p> <p>The future strategic initiatives taken by the Board have been described in the Management Discussion section on pages 2 to 24 of the Annual Report.</p> <p><b>Business Performance</b></p> <p>Reviewing business results and monitoring budgetary controls.</p> <p><b>Integrity of external reporting</b></p> <p>Reviewing and monitoring the processes, controls and procedures which are in place to maintain the integrity of HNB's accounting and financial records and statements; and review and monitor reporting to shareholders and regulators including the provision of objective, comprehensive, factual and timely information to various stakeholders.</p> <p><b>Relationship with Stock Exchanges, Regulators and Continuous Disclosure</b></p> <p>Maintaining a direct, ongoing and healthy dialogue of communications with the SEC, CSE and other stock exchanges where HNB's securities are listed, ensuring that the market and our stakeholders are kept informed of developments.</p> <p><b>Risk Management and Compliance</b></p> <p>Monitoring and reviewing the risk management processes, HNB's risk profile and processes for compliance with prudential regulations and standards and other regulatory requirements.</p>

Corporate Governance Principle	Level of Compliance
<p><b>Board Charter (Contd)</b></p>	<p><b>Corporate Governance</b> Monitoring and reviewing corporate governance framework of HNB.</p> <p><b>Corporate Social Responsibility</b> Setting standards and monitoring compliance with our social responsibility policies and practices; considering the social, ethical and environmental implications of our business activities.</p> <p><b>Board performance and composition</b> Determining the size and composition of the Board and based on the recommendations of the Nominations Committee, making recommendations to the shareholders on the appointment and removal of directors and monitoring Board processes and performance.</p> <p><b>Executive review, succession planning and culture</b> Approving key executive appointments, monitoring and reviewing executive succession planning; reviewing and monitoring the performance of the CEO and CFO, monitoring and influencing HNB's culture, reputation and ethical standards. Audit - recommending to shareholders the appointment of the External Auditor based on the review process conducted by the Audit Committee.</p> <p>The following responsibilities have been delegated to Corporate Management.</p> <p><b>Strategy</b> Developing and implementing Corporate strategies and making recommendations to the Board on significant strategic initiatives.</p> <p><b>Senior Management selection</b> Recommending senior management selection and appointments, performance evaluation and succession planning to the Board Remuneration Committee.</p> <p><b>Financial Performance</b> Developing the Annual Budget and management of day to day operations in line with the Board approved budgetary forecast.</p> <p><b>Risk Management</b> Developing and maintaining an effective risk management framework.</p>
<p><b>Independence of the Directors</b></p>	<p>An Independent director must be independent of management and free to exercise unfettered and independent judgment.</p> <p>The Board considers that the following non executive directors are also independent (as defined by the Guidelines issued by the Securities and Exchange Commission of Sri Lanka);</p> <p style="padding-left: 40px;">Mr Ratna Seevaratnam Mrs Pamela Cooray Mr Ranjeevan Seevaratnam</p>

Corporate Governance Principle	Level of Compliance
<b>Conflict of Interest</b>	<p>All Directors exercise their independent and objective judgment on issues of strategy, policy, resources and standards of conduct.</p> <p>The Board is conscious of its obligation to ensure that Directors avoid conflicts of interest (both real and apparent) between their duty to HNB and their other interests. The Board has adopted a procedure 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 must declare such interest and unless the Board resolves otherwise, does not participate in boardroom discussions or vote on matters in which there is a conflict.</p> <p>All credit evaluations and trading transactions with related parties are approved by all Directors, other than the director who has an interest, present in Sri Lanka</p> <p>All related party transactions are disclosed on pages 73 to 90 of the Financial Reports section of the Annual Report.</p>
<b>Company Secretary</b>	<p>All Directors have access to the Company Secretary, who is an Attorney-at-Law by profession. She is responsible for supporting and advising the Chairman and the Board on all corporate governance matters, Board procedures and compliance with applicable rules and regulations.</p>
<b>Dedication of adequate time and effort the Board and Board Committees</b>	<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 make decisions via circular resolution.</p> <p>The Board sub-committees include;</p> <ul style="list-style-type: none"> <li>- Nomination Committee</li> <li>- Audit Committee</li> <li>- Credit Committee</li> <li>- Procurement Committee</li> <li>- Human Resources/Remuneration Committee</li> <li>- Asset Disposal Committee</li> </ul>
<b>Training for new Directors</b>	<p>Directors undertake such professional development as they consider necessary in assisting them to carry out their duties as Directors.</p> <p>Presentations are made to the Board by the senior management of the Bank from time to time on industry related matters.</p>
<b>Access to independent professional advice</b>	<p>The procedures for Directors, in the furtherance of their duties, to seek advice at the Bank's expense is co-ordinated through the Company Secretary</p>
<b>Confidential Information</b>	<p>The Directors regard the confidentiality of customer information as highly important. HNB has a policy to prevent the disclosure of confidential customer information outside HNB or the use of that information for the financial gains of any other entity (including any entity where a director has an association).</p>

Corporate Governance Principle	Level of Compliance
<b>Chairman &amp; CEO</b>	
<b>Division of responsibilities of the Chairman &amp; MD/CEO</b>	The functions of the Chairman and MD/CEO are clearly separated in order to ensure a balance of power and authority, such that no individual has unfettered powers of decision.
<b>Presence of a strong non-executive element on the Board</b>	All nine Directors are non-executive with the exception of the MD/CEO.
<b>Chairman's Role</b>	
<b>Role of the Chairman</b>	<p>The Chairman of the Bank 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>- Providing effective leadership in formulating Board 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, including 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 Company Secretary and conducting Board meetings.</li> </ul>
<b>Financial Acumen</b>	
<b>Availability of sufficient financial acumen and knowledge</b>	The MD/CEO is a fellow member of the Institute of Chartered Accountants of Sri Lanka and a fellow member of the Chartered Institute of Management Accountants – UK. 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 of England & Wales. These members of the Board have the ability to offer guidance on matters of finance to the Board.
<b>Appointment to the Board</b>	
<b>Nomination Committee</b>	<p>The Nomination Committee of the Bank comprises the following five Directors including the CEO.</p> <p>Mr R T Wijetillake – non executive director                      Mr D H S Jayawardena - non executive director                      Mr M V Theagarajah - non executive director                      Mr R K Obeyesekere - non executive director                      Mr R Theagarajah - executive director</p> <p>The composition of the Board is subject to continuous review by the Nomination Committee and one of the responsibilities of the Nomination Committee is identifying, evaluating and recommending candidates for suitable positions to ensure succession planning within the Bank, for the approval of the Board.</p>

Corporate Governance Principle	Level of Compliance
	<p>All new appointments as well as continuing directorships, are reviewed by the Nomination Committee. Directors are required to report any substantial change in their professional responsibilities, occupation of business associations to the Nomination Committee, which will examine the facts and circumstances and make recommendations to the Board.</p> <p>The annual self assessment and declaration submitted to the Central Bank of Sri Lanka, formerly clears each member as a 'fit and proper' person to hold a position of a Director.</p>
<b>Disclosure of details of new Directors to shareholders</b>	Details of new Directors are disclosed to the shareholders on their appointment. Prior notice on appointment of new Directors is given to the Director of Bank Supervision.
<b>Re-election</b>	
<b>Re-election of Directors</b>	According to the Articles of Association of the Bank, each Director other than the Managing Director/CEO and any nominee Director, retires by rotation once every three years and is required to stand for re-election by the shareholders at the Annual General Meeting. The Nomination Committee will consider their independence at that time and the proposed re-election of Directors is subject to prior review by the full Board.
<b>Appraisal of Board Performance</b>	
<b>Appraisal of Board Performance</b>	The performance of the Board and its committees is evaluated by the Chairman annually to ensure that the Board functions effectively and efficiently. The Board has taken steps to formally document this evaluation process, during the year.
<b>Appraisal of the CEO</b>	
<b>Appraisal of the MD/CEO</b>	The performance of the MD/CEO is reviewed every year by the full Board against financial and non financial targets which are in line with the short, medium and long term objectives of the Bank.
<b>DIRECTORS' REMUNERATION</b>	
<b>Remuneration Committee</b>	<p>The Remuneration Committee comprises the following three non-executive Directors. The CEO attends meetings on invitation.</p> <p>Mr R T Wijetillake – Non executive director  Mr R K Obeyesekere - Non executive director  Mrs P C Cooray - Executive director</p> <p>The Remuneration Committee is responsible for assisting the Board with regard to the remuneration policy for non-executive Directors and for making all relevant disclosures.</p> <p>The Remuneration Committee determines and agrees with the Board, the broad policy framework for the remuneration of the CEO. The MD/CEO does not participate in such meetings other than by invitation Further, the Committee is also responsible for advising and assisting the MD/CEO on remuneration policy for the executive management team of the Bank</p>

Corporate Governance Principle	Level of Compliance
<b>Remuneration of the Directors</b>	The remuneration package of the MD/CEO is structured to link rewards to corporate and individual performance. Non-executive Directors receive a nominal fee as disclosed in this Annual Report.
<b>Disclosure of Remuneration</b>	<p>The details of the total remuneration of the Directors are disclosed on page 31 of the Financial Reports section of the Annual Report.</p> <p>The Compensation paid to the Board of Directors is disclosed in aggregate under the different categories required by the Sri Lanka Accounting Standard 30 "Related Party Disclosures" on pages 73 to 90 of the Financial Reports section of the Annual Report.</p>
<b>RELATIONS WITH SHAREHOLDERS</b>	
<b>Constructive use of the Annual General Meeting (AGM)</b>	The Board remains mindful of being accountable to the shareholders and the need for transparency at all levels, striving to maintain this value framework in all shareholder dealings and communications. The primary modes of communication between the Bank and the shareholders are the Annual Report and the AGM. Information is received by the shareholders prior to the AGM to give them an opportunity to exercise prerogative to raise any issues relating to their shareholdings and the business, either verbally or in writing prior to the AGM. The Board, which includes the Chairmen of the Audit, Remuneration and Nominations Committees, are present at the AGM to answer any questions.
<b>Circularization of Notice of the AGM</b>	The Annual Report, financial statements and the notice of the meeting are sent to shareholders at least 21 calendar days prior to the date of the AGM. The Bank proposes a separate resolution for each item of business, giving shareholders the opportunity to vote on each substantially different issue.
<b>Major transactions</b>	<p>During 2007 there were no major transactions which materially affected the Bank's net asset base.</p> <p>Transactions, if any, which materially affect the net assets of the Bank, will be disclosed in the annual/quarterly financial statements.</p>
<b>Web site of HNB</b>	The Web site <a href="http://www.hnb.net">www.hnb.net</a> provides information regarding new products launched, quarterly financial statements filed with the Colombo Stock Exchange, Annual Reports, Streamer of HNB shares traded and share price, and key corporate social responsibility initiatives taken by HNB.
<b>ACCOUNTABILITY AND AUDIT</b>	
<b>Financial Reporting Statutory and Regulatory Reporting</b>	<p>The Bank has reported a balanced and fair assessment of the Company's position and prospects for the year ended 31st December and at the end of each quarter.</p> <p>In the preparation of quarterly and annual financial statements, the Bank has strictly complied with the requirements of the Companies Act No 07 of 2007, the Banking Act No.30 of 1988 and amendments thereto, which are prepared and presented in conformity with Sri Lanka Accounting Standards. The Bank has complied with the reporting requirements prescribed by the regulatory authorities such as the Central Bank and the CSE. As the Bank's Global Depository Receipts (GDRs) are listed on the Luxemburg Stock Exchange, the Bank has also complied with all the reporting requirements of the Luxemburg Stock Exchange.</p>

Corporate Governance Principle	Level of Compliance
<b>Directors' report in the Annual Report</b>	The Directors' report is given on pages 4 to 8 of the Financial Reports section of the Annual Report.
<b>Statement of Directors' on their responsibility on the preparation and presentation of financial statements</b>	<p>The statement of Directors' responsibility for financial reporting is given on page 9 of the Financial Reports section of the Annual Report.</p> <p>The statement of the Chief Financial Officer confirming that the Financial Statements have been proposed in compliance with the requirement of the Companies Act No: 7 of 2007 is given on page 13 of the Financial Reports section of the Annual Report.</p>
<b>Statement of the External Auditors' on their reporting responsibilities</b>	The Auditor's Report given on page 11 of the Financial Reports section of the Annual Report includes the scope of responsibility and opinion on the financial statements.
<b>Management Report in the Annual Report</b>	The Management Discussion and Analysis is given on pages 2 to 24 of the Management Discussion section of the Annual Report.
<b>Declaration by the Board that the business is a going concern</b>	This is given in the Directors' Report on page 5 of the Financial Reports section of the Annual Report.
<b>Summoning an EGM to notify shareholders if net assets fall below one half of the shareholders' funds</b>	The likelihood of such an occurrence is remote. However, should the situation arise, an EGM will be called for and shareholders will be notified.
<b>Statement of Solvency and Auditors' report on the Statement of Solvency</b>	In accordance with Section 57 of the Companies Act No 7 of 2007, the Board has carried out a Solvency test prior to recommending the final dividends to the Board, which are to be approved by the Shareholders at the AGM. The Statement of Solvency has been duly signed by the Directors and the Auditors report on the Statement of Solvency has been obtained by the Board.
<b>Internal Control Maintaining a sound system of internal control and risk management</b>	<p>The Board is ultimately responsible for the Bank's systems of internal control and for reviewing their effectiveness. These systems manage the risk of the Bank's business and ensure that the financial information on which business decisions are made and which is published, is reliable and also ensures that the Bank's assets are safeguarded.</p> <p>The systems of internal control are designed to manage rather than eliminate the risk of failure to achieve business objectives; internal controls are aimed at providing reasonable and not absolute assurance against material misstatement or loss.</p> <p>The Board of Directors is satisfied with the effectiveness of the system of internal control.</p> <p>A detailed Risk Management Report is given on pages 24 to 31 of the Corporate Reviews section of the Annual Report.</p>
<b>Reviewing the effectiveness of the internal control system</b>	<p>The Internal Audit Division of the Bank carries out regular reviews on the internal control system. A control self assessment is also being used by HNB as a means to enhancing process discipline and internal control.</p> <p>The Audit Committee monitors and reviews the effectiveness of the Bank's internal audit function and the internal control system. The Audit Committee's report on the effectiveness of the internal control system is reviewed by the Board annually.</p>

Corporate Governance Principle	Level of Compliance
<b>Audit Committee and Auditors</b>	
<p><b>Composition and Terms &amp; Conditions of the Audit Committee</b></p>	<p>The Audit Committee of the Bank is comprised of three non-executive Directors, the majority of whom are independent; and meets regularly throughout the year. A new Chairman was appointed during the year. He is a Fellow member of the Institute of Chartered Accountants of Sri Lanka and the Institute of Chartered Accountants, England &amp; Wales. The Company Secretary functions as the Secretary to the Audit Committee. The CEO and CFO attend meetings by invitation.</p> <p>The role and responsibilities of the Audit Committee are set out in the Audit Committee Charter.</p> <p>The Committee reviews HNB's internal control and risk management systems with particular reference to internal controls over financial reporting.</p> <p>The Committee monitors the integrity of the HNB's financial statements and formal announcements relating to the HNB's financial performance by reviewing the presentation of such reports and significant financial judgments/estimates contained in them.</p> <p>The Audit Committee also reviews issues relating to breach of ethics, such matters as fraud, accounting issues, employee wrong-doing; regulatory violations and the arrangements by which the staff of the Bank may in confidence raise concerns about possible irregularities. The Committee also ensures that the procedures for the independent investigations of such matters are appropriate.</p> <p>The Audit Committee Charter specifies a set of terms of reference defining its scope of authority, which includes the review of internal and external audit process, the adequacy of internal controls, accounting policies and compliance with accounting standards.</p> <p>The Audit Committee reports to the Board annually on the effectiveness of internal/external audit processes and adequacy of the internal control system.</p> <p>The report of the Audit Committee of the Bank for the year 2007 is given on page 10 of the Financial Reports section of the Annual Report.</p>
<p><b>Review of external audit function and Relationship with External Auditor</b></p>	<p>The Audit Committee monitors and reviews the effectiveness of the Bank's Internal Audit function, 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 ethical guidance 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 a recommendation on the appointment, re-appointment or removal of the External Auditor in line with professional standards and regulatory requirements. HNB follows the practice of ensuring independence of the Auditor by rotation of the Audit Engagement partner every 5 years.</p>
<p><b>Review of Internal Audit function and relationship with Internal Auditor</b></p>	<p>The Audit Committee monitors and reviews the effectiveness of the Bank's Internal Audit function. The Head of Internal Audit reports to the Audit Committee. The Audit Committee is responsible for the appointment of Head of Internal Audit. The Audit Committee reviews and approves the Internal Audit plan and resource requirements. It reviews the important Internal Audit findings and follow-up procedures. The Committee is responsible for</p>

Corporate Governance Principle	Level of Compliance
<p><b>Appraisal of Audit Committee performance</b></p>	<p>ensuring that the Corporate Governance requirements as per the Securities Exchange Commission in respect of Internal Audit are complied with.</p> <p>The Internal Audit function is governed by the Internal Audit Charter which spells out the role, rights and responsibilities. The Internal Audit Charter is approved by the Audit Committee</p> <hr/> <p>The effectiveness of the Audit Committee is assessed by the following members of the Board annually and presented to the Board for approval.</p> <p>Mr Ratna Sivaratnam – Independent non executive director  Mr R T Wijethilleke – Non executive Chairman  Mr R Theagarajah – MD/CEO</p> <p>The Board has taken the initiative to include the External Auditor, Head of Internal Audit and the CFO in the assessment of the Audit Committee from next year and a final report comprising comments from all parties involved in the assessment process will be presented to the Board.</p>
<b>COMPLIANCE</b>	
<p><b>Regulatory Compliance</b></p>	<p>An independent risk &amp; compliance function is in place to ensure that the Bank complies with applicable law and regulations.</p> <p>The Compliance Reports signed by the MD/CEO and CFO are reviewed by the Audit Committee prior to publishing interim financial statements. The CFO is required to submit a report on whether the Bank is up to date in the settlement of statutory payments.</p>
<b>CONTROLLED ENTITIES</b>	
<p><b>Monitoring of Controlled Entities</b></p>	<p>The activity of every company in the Group is overseen by its own Board of Directors.</p> <p>Directors of each of the controlled entities are provided with corporate governance guidelines, which have been approved by the main Board of the Bank. The corporate governance guidelines set out the specific roles, duties and responsibilities of the Directors of controlled entities. Such guidelines set out the key expectations that the Board would have from the Boards of controlled entities. The guidelines have been specifically tailored to the different entities, depending on the nature of business and its activities.</p> <p>The Board of HNB's confidence in the activities of a controlled entity Boards is achieved through high quality controlled entity Boards committed to Group objectives.</p> <p>There is a standing invitation to all of HNB's directors to attend any board meeting of a controlled entity through consultation with the Chairman. Such visits are undertaken to develop a broader understanding of the Group's total business operations.</p>
<p><b>RISK MANAGEMENT</b></p>	<p>HNB functions within a well defined Risk Management framework. Disclosure of the description of the Risk management frame work, which includes the policies and procedures adopted by HNB are disclosed on pages 24 to 31 of the Corporate Reviews section of the Annual Report</p>

Corporate Governance Principle	Level of Compliance
<b>HUMAN CAPITAL</b>	Disclosure of the description of HR policies and practices adopted by HNB, including the performance evaluation process, career development and work/life balance is on Pages 20 to 27 of Sustainability Report section of the Annual Report
<b>OTHER CORPORATE GOVERNANCE INITIATIVES</b>	
<b>Corporate Governance Culture</b>	With a view of embedding into our culture the highest standards of integrity and professionalism, and of instilling in our employees an appreciation of our core values and shared responsibilities; we provide them with opportunities and tools required to accomplish their goals, by offering continuing education at different levels. Orientation is provided to all new managers as well as to new employees. Management training is provided to all existing managers on a need to have basis. We strive to develop our talent and help our managers reach their potential through executive development programs, regular assessment and feedback.
<b>Corporate Social Responsibility ("CSR")</b>	In keeping with our core value of serving the community in which we live and work, the Bank has embarked on several ventures, details of which are discussed on pages 34 to 39 in the Sustainability Report section of the Annual Report which was compiled based on the Global Reporting Initiative (GRI) guidelines. The Bank has set up a Sustainability Committee, which has three sub-committees addressing the social responsibility issues relating to our key stakeholders, namely <ul style="list-style-type: none"> <li>- Customer Service and Investor Group</li> <li>- Employee Liaison Group</li> <li>- Environmental and Community Advisory Group</li> </ul> HNB's CSR Report, presented within the Sustainability Reporting Guidelines, is included in this Annual report from pages 2 to 58 of the Sustainability Report section and has been reviewed by an independent Assurance Provider

**Our proactive assessment of compliance with Codes of Corporate Governance issued by the Securities & Exchange Commission of Sri Lanka, and the Central Bank of Sri Lanka**

We have proactively assessed our level of compliance with the following codes as at the end of this year in order to take the necessary future initiatives to ensure compliance by next year.

- Voluntary Code of Corporate Governance, a joint initiative of ICASL and the Securities & Exchange Commission of Sri Lanka, becomes effective from 1 April 2008; and
- Mandatory Code of Corporate Governance for Licensed Banks in Sri Lanka issued by the CBSL, which will become effective from 1 January 2008.

Deviations, if any, will be disclosed in the 2008 Annual Report.

## MEETINGS

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

	<b>Board Meetings</b>	<b>Audit Committee</b>	<b>Nomination Committee</b>	<b>Remuneration Committee</b>
<b>Total number of meetings in 2007</b>	<b>13</b>	<b>05</b>	<b>01</b>	<b>01</b>
Mr Rienzie T Wijetilleke	13	-	01	01
Dr V P Vittachi	12	-	-	-
Mr R Theagarajah	13	<i>Note (e)</i>	01	<i>Note (e)</i>
Mr D H S Jayawardena	13	05	01	-
Mr M V Theagarajah	08	-	01	-
Mr R K Obeyesekere	10	-	01	01
Mrs P C Cooray	13	05	-	01
Mr R Sivaratnam	07	<i>Note (b)</i>	-	-
Mr D R Ghazalli	<i>Note (a)</i>	-	-	-
Mr R Seevaratnam	08	04	-	-

	<b>Credit</b>	<b>Asset Disposal</b>	<b>Procurement Committee</b>
<b>Total number of papers approved in 2007</b>	<b>367</b>	<b>04</b>	<b>28</b>
Mr Rienzie T Wijetilleke	322	04	27
Dr V P Vittachi	06	-	-
Mr R Theagarajah	312 ( <i>Note c</i> )	04	28
Mr D H S Jayawardena	05	-	-
Mr M V Theagarajah	124	-	13
Mr R K Obeyesekere	120	04	28
Mrs P C Cooray	209	04	-
Mr R Sivaratnam	86	04	23
Mr D R Ghazalli	01	-	-
Mr R Seevaratnam	115	-	09 ( <i>Note d</i> )

*Note a* - Mr D R Ghazalli resigned w.e.f 29.3.2007 and Mr R Seevaratnam was appointed as a director w.e.f 29.3.2007.

*Note b* - Mr R Sivaratnam resigned w.e.f 3.5.2007 and Mr Ranjeevan Seevaratnam was appointed to the committee as Chairman w.e.f 3.5.2007.

*Note c* - Total credit papers approved by Mr R Theagarajah were 312 while a further 52 papers were approved by Mr J M J Perera (as Alternate Director to Mr Theagarajah during his absence)

*Note d* - While Mr R Seevaratnam is not a regular member of this committee, he was co-opted as a member of the Procurement Committee and approved 9 papers during the absence of another regular committee member

*Note e* - Mr R Theagarajah attended all audit committee and remuneration committee meetings by invitation.

# CORPORATE INFORMATION

## NAME OF COMPANY

HATTON NATIONAL BANK PLC

## LEGAL FORM

A listed public company incorporated in Sri Lanka in March 1970, with limited liability

## COMPANY REGISTRATION NO.

PQ 82

## STOCK EXCHANGE LISTING

The Ordinary Shares and the Unsecured Subordinated Redeemable Debentures of the Company are listed on the Colombo Stock Exchange in Sri Lanka

Global Depository Receipts of the Company 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 Hatnbk Ce, 2166 Haynfx Ce

Swift : Bic Code – HBLILKLX

Email : moreinfo@hnb.net

Web: www.hnb.net

## BOARD OF DIRECTORS

Mr. Rienzie T. Wijetilleke (Chairman)  
Dr. V.P. Vittachi (Deputy Chairman)  
Mr R Theagarajah (Managing Director/CEO)  
Mr. D.H.S. Jayawardena  
Mr. M.V. Theagarajah  
Mr. R.K. Obeyesekere  
Mrs P C Cooray  
Mr Ratneswara Sivaratnam  
Mr. Ranjeevan Seevaratnam

## BOARD SECRETARY

Ms. Indrani Goonesekera  
Attorney-at-Law & Notary Public

## AUDIT COMMITTEE

Mr Ranjeevan Seevaratnam (Chairman)  
Mr. D.H.S Jayawardena  
Mrs P C Cooray

## AUDITORS

KPMG Ford, Rhodes, Thornton & Co.,  
Chartered Accountants  
No. 32A, Sir Mohamed Macan Markar Mawatha,  
Colombo 3, SRI LANKA.

## CREDIT RATINGS

The Bank has been assigned the AA- national credit rating for implied long term unsecured senior debt, by Fitch Ratings Lanka Limited

## ASSOCIATE COMPANIES

Brown's Engineering (Pvt) Ltd. 32.63%  
Construction & Engineering

Lanka Ventures Ltd. 20.07%  
Venture Capital

## SUBSIDIARY COMPANIES

Sithma Development (Pvt) Limited 100.00%  
Property Development

HNB Securities Ltd 100.00%  
Dealing in Government Debt Securities

HNB Stockbrokers (Pvt) Ltd 100.00%  
Stock Broking

HNB Assurance Limited 59.986%  
Insurance

## INVESTOR INFORMATION

Institutional Investors, Stock Brokers and Security Analysts requiring financial information should contact the Chief Financial Officer 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@sltnet.lk

Correspondents throughout the world







**SUSTAINABILITY**  
**REPORTING**





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Dear Stakeholder

Each stakeholder segment is integral to our existence and it is these stakeholders who are responsible for creating the winning organisation we have built up today. Ours is a bank whose history spans 119 years and in that period, we have ensured that our relationship with stakeholders is long term and sustainable, constructed on the axis of a winning partnership. Being a bank which revolves on the primary feature of service, we have always practiced the axiom denoted by the word 'sustainability'; that of 'meeting the needs of the present generation without compromising the ability of future generations to meet their own needs' and formulated our organisational vision, mission, objectives, values and ethics on this sustainability ethos.

The transformation from our genesis to the winning bank we have proven to be, has been from one of creating wealth for our shareholders, to encompassing the complete landscape of sustainability, to focusing more on the socio economic aspects of environmental and social change, within the macro picture of sustainable development. We have, in this journey, striven not only to ensure a viable and sustainable business, but also to ensure that our stakeholders, who include our customers, valued business partners, our team, the community and the nation, will be complete partners and buy into our sustainability culture. By using a systematic approach and by imbuing it with the added features of more transparency, accountability and sincerity of action, we are ensuring that the impact we have on our stakeholders is positive and advantageous, while being economically, socially and environmentally sustainable.

## ABOUT OUR REPORT

### Scope

Our 3rd Sustainability Report primarily covers the operations of HNB for the year ended 31 December 2007, consistent with our reporting in 2006. We continue our disclosures on HNB's non-financial performance in the key areas of Sustainability Strategy, Stakeholder Engagement, Customer Focus, Inspiring our People, Contribution to our Community, Protecting our Environment and Working with our Suppliers.

In each section of the Report we talk about actions we have taken to respond to the interests and expectations of our stakeholders.

### Selection of Topics

Most topics in this Report are based upon the structured engagement with our stakeholders on what they feel is of importance to form an opinion on our sustainability behaviour. The feedback we received on our 2006 Report has also been incorporated, where relevant, in this year's Report.

The Global Reporting Initiative ("GRI") G3 remains our foundation framework, to ensure we cover relevant topics, identified by a broad range of stakeholders, which are generic to Sustainability reporting. This report is at an A+ level. We also use GRI supplements for the financial services sector, the Social (2002) and Environmental (2005) supplements.

The guidelines comprise several sections, of which the two most important are the reporting principles and sustainability indicators.

### Reporting process

We have no overall information system in place for sustainability comparable to the system used for obtaining financial information for the Annual Report. Nevertheless, wherever possible we used corporate information systems for gathering data.

Although we are confident of the overall reliability of the data reported, we recognise that some of it is subject to a degree of uncertainty due to limitations associated with measuring, calculating or estimating.

At the end of the process, the business unit heads approved the data used in the sections on their respective units. The financial and non financial information included in this Report has been reviewed by M/s KPMG Ford Rhodes Thornton & Co (KPMG), who have provided an Independent Assurance Statement on the key performance indicators and other information included, in accordance with the International Standard on Assurance Engagement ISAE 3000 and Sri Lanka Auditing Practice Statement (SLAPS 3), applicable to Review Engagements. The Independent Assurance Statement is on pages 44 and 45.

### Forward looking Statements

This Report contains forward looking statements with respect to HNB's financial condition, operational results and business, and some of the plans and objectives with respect to these items. By their nature, forward looking statements involve risk and uncertainty because these relate to events, and depend on circumstances, that will occur in the future. There are a number of factors that could cause actual results and developments to differ materially from those expressed or implied by these forward looking statements.

### Disclaimer

This Report is not intended as a solicitation, invitation, offer or inducement to engage in any investment activity, to make or refrain from making any investment or from exercising or not exercising any rights in connection with any investments, or to enter or refrain from entering into any agreement. The Report is made for the purpose of investor and customer relations and to give details of HNB's commitment to sustainability to existing stakeholders. Nothing in this document is intended to extend HNB's existing obligations to its clients or shareholders.



THE CEO SAYS,

## Beyond The Numbers

Achieving  
Credibility  
Through  
Non Financial  
Corporate  
Reporting

Sustainability is central to HNB's business strategy and hence is an integral part of our Annual Report. Only by integrating and embedding sustainability into our core business can we achieve our ambition – to meet the needs of HNB while retaining and building the trust of our stakeholders, today and in the future. As we present the third Sustainability Report, we also look at this as a unique way in which to engage our stakeholders and communicate our contribution to Global efforts towards greater corporate accountability.

As Sri Lanka faces several challenges in charting its development road map, we as a responsible private sector organization can help in many ways. Our Sustainability initiatives focus on village level education, health and self employment/entrepreneurial opportunities in rural/semi urban communities, through our micro finance solutions which embrace the philosophy of financial inclusion. This, together with financing infrastructure development, creating economic prosperity in local communities and arresting urban migration, are examples to how HNB can contribute towards nation building.

As a Financial Institution, we have adopted an approach to sustainability which combines Risk Management, the foundation of any successful business, with market based opportunities, to enhance our overall business performance. We consider the Sustainability Report as a risk management tool which will contribute towards creating a sustainable economic platform which anticipates and manages risks better.

Sustainability for me includes all aspects of a viable business, be it financial, economic, social, environmental as well as Governance issues. Developing a strong governance culture within HNB is an important ingredient to success and we welcome the new Mandatory Code on Corporate Governance for Banks recently introduced by the Central Bank of Sri Lanka to which we made our contribution by way of comments and practical suggestions to the Exposure Draft (which was made available to banks and other stakeholders for comments). Combating corruption is another aspect which all of us must embrace and set an example by leading the way from the top.

Looking forward, 2008 would be a year where we turn increased focus on climate change. We intend formulating a structured framework where we consider the impact of climate change on all our engagement with various stakeholder groups and steadily build on our internal capacity to understand and disseminate knowledge of this subject both among our own employees and our customers, suppliers and investors.

Looking back on 2007, I am pleased to report that we made good progress in a number of important areas and will share these details with you in this Report. We are honoured to have received recognition in the form of prestigious corporate social responsibility awards. Although there are many challenges ahead of us, this acknowledgement from our stakeholders confirms that we are heading in the right direction. This report has been prepared based on Global Reporting Initiative G3 Guidelines and reflects stakeholder feedback on our 2006 Report. We continue our disclosures on HNB's non financial performance in the key areas of stakeholder engagement, customer service, workplace practices, community investment and protecting the environment. Compiling the story of such a sizable and diverse organisation such as ours is indeed a formidable challenge and we do not pretend to have captured every aspect of our focus and approach to sustainability. If we have missed something important, we would certainly like to know about it. I do hope that you will enjoy reading this Report and look forward to your constructive feedback so that we can continuously improve the quality of our service levels, product portfolios and augment the sustainable business model of your Bank. An investor feedback form is appended for your ease of use. Your feedback is important to us.



**Rajendra Theagarajah**  
*Managing Director and CEO*

*15th February 2008*

## OUR SUSTAINABILITY STRATEGY

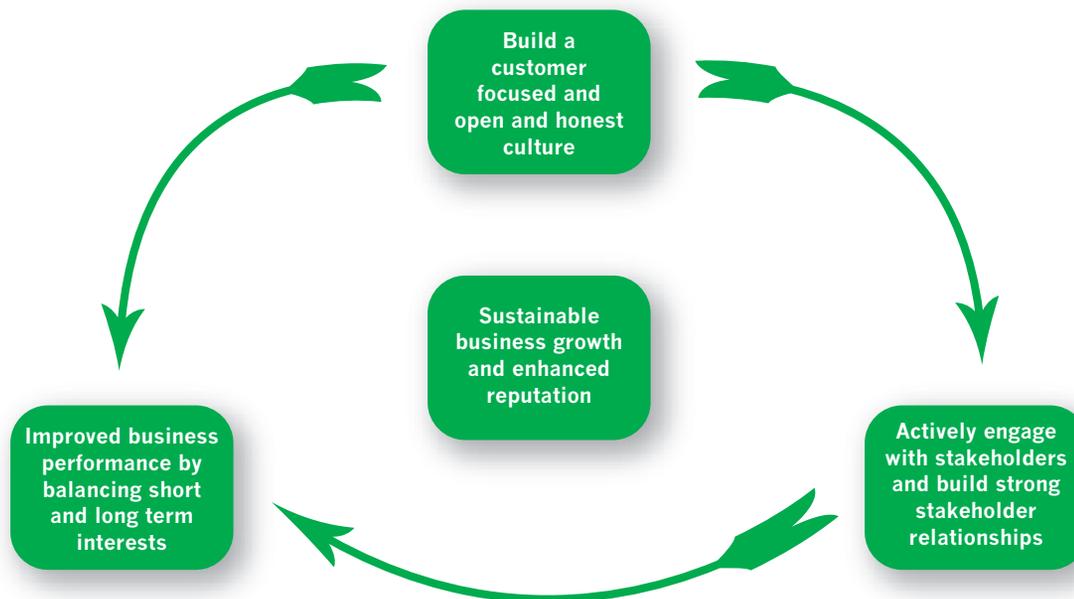
Our Sustainability strategy, which supports HNB's overall business strategy, provides a framework for us to develop our priorities and action plans to respond to the risks and opportunities presented by sustainability trends and challenges.

The key elements of our Sustainability strategy are to enhance business performance, build an open and honest culture and engage actively with stakeholders. We aim to achieve this by focusing on six areas;

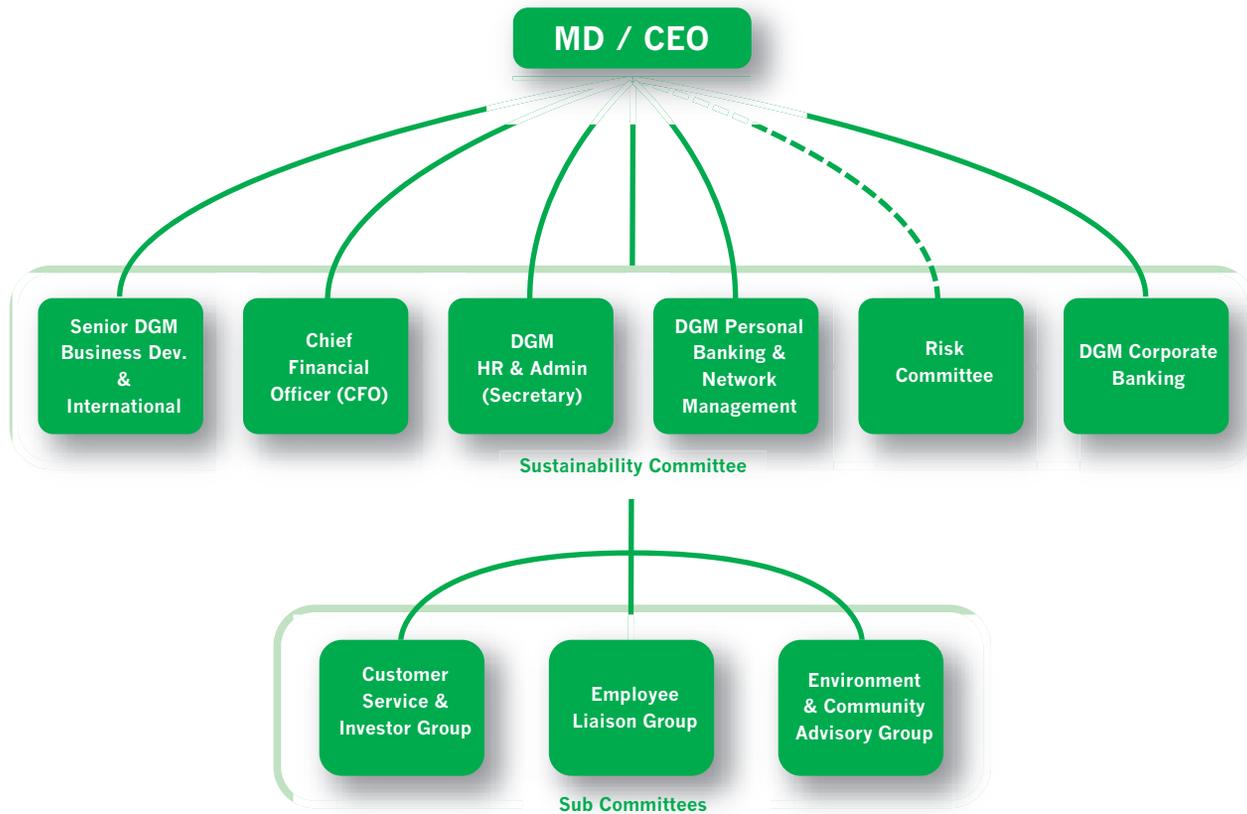
- Customer focus with product innovation and service excellence
- Inspiring and encouraging our people
- Connecting with our communities
- Creating value for our shareholders
- Working with our suppliers
- Minimising our impact on the environment

We are working to integrate environmental and social considerations into day to day business decision making and operational practices, which will add value to our business by reducing risk, improving operational efficiency and enhancing service excellence, as well as creating a great place to work.

Sustainability, in our view, needs to be further integrated into the financial reporting process, and the influence of sustainable development data in our corporate management objectives and management information systems must be increased. This will give the right balance of short- and long-term scoping needed for both corporate strategy setting and presenting a complete picture of HNB to our stakeholders, including analysts and investors.



## Sustainability Stewardship



### Duties of Sustainability Committee:

- Oversee progress in economic, business, employee, community and environmental projects
- Act as the think tank in developing the Sustainability Agenda
- Proactively evaluate all decisions that would have an impact on the reputation, ethics and values of the Bank
- Set standards for policies and guidelines in meeting Sustainability principles
- Ensure conformance with all sustainability guidelines
- Identify and manage areas of non-compliance within the Sustainability guidelines

Total investment disbursed on sustainability projects that encompass Community and Environmental Relations this year is Rs. 18.6 Million

### Sustainability Framework

Headed by the MD/CEO, the Sustainability structure demonstrates the Bank's complete commitment to ensuring that sustainability is integrated into our business processes. A dedicated committee sets out the goals, direction, framework and sustainability platform focus, while three subcommittees set out the project focus, investment and approvals in the areas of Customer/Investor, Employee Liaison and Environment/Community. With the Sustainability Committee driving direction and giving leadership, the sustainability reporting is now under the focused platforms of:

- Investor Relations** – creating wealth for shareholders, contributing to the larger economic picture and setting benchmarks for the industry
- Employee Relations** – creating two way relationships that inculcate team spirit within the Hatna Family concept
- Supplier Relations** – focus on long lasting partnerships on qualitative platforms
- Customer Relations** – ensuring that service excellence remains a fundamental in the delivery of superlative products and services
- Community Relations** – creating sustainable communities through education, entrepreneurial assistance and health
- Environmental Relations** – ensuring a sustainable planet through conservation and preservation of the environment by introducing best practices

### Incorporation of CSR Trust

Firmly believing that business and community growth are interlinked, we have striven to achieve a balanced mix of projects which result in sustainable long term benefits to society, while also supporting emergency relief. We have taken the initiatives to set up a CSR Trust in 2008, initially based on funding from HNB, which we intend expanding with contributions from our stakeholders. With the formation of our CSR Trust, our Sustainability initiatives will be developed based on structured policies and focus.

### Risk Management and Enterprise Governance

HNB has undertaken significant work to improve our Risk Management and Governance systems, as strong governance is crucial for our success. Our approaches to Risk Management and Corporate Governance have been described in the Corporate Reviews section of the Annual Report.

### Stakeholder Engagement

Stakeholder engagement is increasingly recognised as creating value. It contributes to risk management, organisational resilience, learning and innovation and helps identify opportunities to create products and improve performance. Therefore, we value the opportunity to engage in dialogue with key stakeholders.

We consider ongoing, open dialogue and relationships of trust, integrity and respect, as the markers of successful stakeholder engagement. Last year we introduced an Investor feedback form, seeking stakeholder views about our Sustainability Report. A wide spectrum of stakeholders are interested in our Report. Feedback gives us useful information to improve the content, readability and usefulness of the Report. The diversity of our stakeholders' interest presents a challenge.

Stakeholder forums structured around the themes Customers, Investors, Community, People and Environment held during this

year, provided our stakeholders with an opportunity to understand and influence our business priorities.

Our aim is to offer our CUSTOMERS clear and tangible reasons why they should deal with us. This means making banking as convenient and simple as possible, providing trusted and responsible financial advice, solutions and services. We held a series of Customer get-togethers, across our wide customer centre network, which were attended by our Chief Executive Officer along with the Corporate Management Team. These gatherings gave us an opportunity to understand the emerging needs of customers, and gave us insights into service areas which need further improvement, the level of customer satisfaction, and enabled us to better assess our brand loyalty. We held product launches where customers were invited to provide their feedback on the product features and be educated about our product innovation.

We aim to attract and retain the very best PEOPLE at HNB by creating a vibrant and high-performing culture. We listen to the feedback of our people and provide programs and opportunities to ensure they feel a sense of purpose and personal connection to their work and career with us. Through "SEARCH", (Skills, Enhancement And Results from Creative Human – Resources) an intranet site created to encourage innovative ideas and feed back from our people, we provide opportunities for our people to share their contributions with the Bank, and be recognised and rewarded for the best suggestions. The Grievance Committee is another platform where our people can air their grievances at a confidential forum.

We aim to deliver superior SHAREHOLDER returns over the long term, balancing our short- and long-term objectives and to be responsible for the social and environmental issues inherent in our business decisions and operations. Our Investor Relations Team is responsible for HNB's two way financial and strategy communications with analysts, existing and potential shareholders – both retail and institutional, and with rating agencies. We provide information to shareholders through a

range of publications, including Annual Reports and results presentations. We engage with our shareholders through our Annual General Meeting (AGM). Shareholders are encouraged to attend the AGM and ask questions from the Board of Directors and Senior Management.

Our COMMUNITY investment strategy aims to enhance the social and economic well being of the communities where we live and work. The heart of our approach involves developing innovative programs and partnerships with clear aims and results. We use our wide customer centre network to understand the needs of our community in various parts of our country, and develop focused projects to address these needs. We also volunteer our support to community projects initiated by other reputed organisations.

We are committed to operating in a way that advances sustainability and reduces our ENVIRONMENTAL impact. We identify projects based on our internal assessment of environmental initiatives and also partner projects with other organizations who share our objective to protect our environment.

## HNB's contribution to the national economy

Our involvement in the economy began at our inception, when the Bank was set up to cater to the vibrant plantation industry. We have, since then, merged to become a primary contributor to most aspects of the national economy; inculcating a savings culture among the people, fuelling industrial growth, encouraging official remittances of foreign exchange, uplifting and sustaining the rural economy through our pioneering micro finance programme; partnering over one million people in the country towards better economic status.

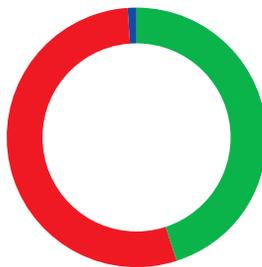
HNB is a proven winner, with both global and local peers heralding our industry leadership, entrepreneurial spirit, community empathy and excellent teamwork which have paved the way for our exponential growth and a contribution to the national economy which has developed both the industry and the nation, as a whole.



### Bank's Contribution to the Economy in 2007

	Rs'000
Bank's expenditure	24,168,693
Of this, amount spent on wages / salaries etc	3,657,111.82
Bank's contribution to taxes	2,306,885

Government Tax



- Income Tax - 45%
- VAT - 54%
- Debit Tax / Stamp Duty - 1%



## CUSTOMER FOCUS WITH PRODUCT INNOVATION AND SERVICE EXCELLENCE

We have always believed in building, nurturing and strengthening long term relationships; an equation in which our customers remain a fundamental catalyst in ensuring the sustainability of our business. Their discerning habits and constant insistence on product innovation and service excellence has seen the Bank work judiciously towards meeting a constantly raised internal bar. This has given the Bank the impetus to emulate global processes, systems and best practices, ensuring that our customers avail themselves of the best in the banking world. This attitude has also seen the Bank continue to remain a pioneer in some areas and a trailblazing winner in others. At the same time, it is pertinent to note that HNB's customer profile extends the gamut of large conglomerates to micro entrepreneurs, to high networth customers, to rural individuals; an extensive but pervasive customer portfolio that embeds our philosophy of being a strong and reliable partner who will nurture and create empowering milieus for all to win, succeed and prosper.

# CUSTOMER RELATIONS

## AT A GLANCE

- **Special Savings - Big Bonus Account upto 100% bonus**
- **Internet Based Money2Home Remittance Product**
- **Tri-Lingual Internet Banking Service via mobile phones**

## Service Excellence

Service is an intangible aspect of our customer rationale, but one that remains a primary challenge in getting the mix right to ensure our customers remain with us and new customers are attracted to partner with us. Service is also a constantly evolving facet, where standards and benchmarks are continually increased and paradigms do not remain the same for long. This poses a considerable challenge but one that the Bank undertakes with focus and determination.

**The HNB Service Standards Manual:** The HNB Service Standards Manual (detailing the minimum service standards) was distributed to all our team members during the year. This will assist in enhancing the service oriented culture within the Bank which we believe in turn will enhance customer service excellence.

**Customer Delight Committee:** In order to further integrate customer service excellence into our ethos and culture, a Customer Delight Committee consisting of Senior Level Officers was established towards the latter part of this year. Its objectives are to observe and recommend improvements to the Bank's customer service features. This includes looking at independent incidents that may involve customer service areas and proposing solutions and assessing the overall customer service culture, with a view to producing winning enhancements. The Committee will present a report to the MD/CEO on a quarterly basis and will make recommendations which will be further evaluated and implemented, where appropriate.

**Customer Interaction:** Hands-on customer interaction has become integral to our customer service ethos and as in past years, customer events were organized to interact with corporate and senior management which some 1,600 customers attended. Teams headed by the CEO attended 08 customer get-togethers during the year in provincial towns; these functions gave the various customer segments the opportunity to express their views on service and products offered by the Bank. We use these customer opinions to identify customer needs and better our service.

**Customer Satisfaction Survey:** Based on the findings and analysis of the external customer satisfaction survey conducted by TNS Lanka (Pvt) Limited last year, the Bank began working on some of the areas that required attention. A Workshop was conducted for Regional Managers by a team from TNS Lanka (Pvt) Ltd., and a plan of action formulated. This plan is being implemented at the branches through the Regional Heads, in order to rectify the shortcomings highlighted in the survey. Some of the issues that are being addressed in the plan are further elaborated in the table overleaf.



Weakness reported in 2006	Corrective steps taken in 2007
Delay in Credit Delivery Processes	A special workshop was held during the year for Regional Heads to discuss the findings of the Customer Satisfaction Survey followed by special training programmes for Credit Officers at branches as well as at the Training Centre on all aspects of credit including the delivery process.
Response/Delivery times not up to expectations <ul style="list-style-type: none"> <li>• Issue of cheque books</li> <li>• Issue of Cashline Cards</li> <li>• Dispatch of Current Account Statements</li> </ul>	Cashline Cards and the PIN numbers are now delivered to the customers immediately after the account is opened at all our Globus Branches. Dispatch of current accounts statements has also been expedited as a result of centralization of this operation.
Unattractive interest rates for savings	A special savings account called Big Bonus Account was introduced during the year offering (additional) Bonus interest up to 100% of the normal interest to eligible savings account holders.
Professionalism of Customer Centre Staff not up to expectations	Continuous training of staff at the customer centre as well as at the Training Centre to enhance their professional standards.
Inadequacies in the Delivery/Distribution process including ATMS	41 new ATMs were installed during the year and about 130 more ATMs were upgraded to enhance daily cash withdrawal limit from Rs.20,000/= to Rs.40,000/=. The number of ATMs with an enhanced cash withdrawal limit was thus increased to 184 as at end of the year.
Business hours need to be extended	Weekend Banking Service is provided through 40 customer centres located through out the country. In addition, Holiday Banking was also introduced during the year through these 40 centres to enable customers to access our services on Non-Mercantile Bank Holidays as well.
Inadequate Parking Facility	A reasonably adequate parking facility has been provided at 16 of the 17 new Customer Centres opened during the year and the Kirullapone, Pinnawela, Aluthgama and Athurugiriya branches re-located during the year.

### Complaints Handling

Our complaint handling process which is implemented under the aegis of the Financial Ombudsman through a dedicated Complaints Handling Unit, saw 80 customer complaints handled effectively this year. We look upon customer complaints as a learning experience and always strive to resolve issues effectively and efficiently to meet customer expectations.

The customer complaints reported in our 2006 Sustainability Report and the status of promises made, have been summarized in the table above.

### Physical Inclusion - ensuring an enabling environment

The initiative begun last year to upgrade our Customer centres for easy access of the physically challenged customers, received further impetus this year. 17 more Customer centres were made physically enabling, bringing the total of such Customer centres to 31 as at end of the year. ATM machines at 13 more branches have also been rendered wheelchair accessible for differently able customers, bringing the total number of such ATMs to 22 as at end of 2007, while amenities at 4 customer service centers were also made disabled-friendly.

We continue to improve access to our branches and facilities as we refurbish old and open new Customer centres.



### Customer Reach - Network Penetration

We strongly believe that visibility and penetration is imperative to ensure that customers in any part of the country are given the opportunity to enjoy the long-term winning partnerships we encourage. With customer service being the pivotal factor, we continue to expand into new areas in the country that may sometimes be deemed difficult, but with the support of our able and committed team, we have ensured that customers have access to our banking services country-wide.

- Weekend Banking has been further streamlined and the number of Customer Service Centres opening for weekend business increased from 15 to 40 as at end of 2007. Selected inward remittance payments are also being extended to customers under weekend banking at present.
- Holiday Banking has also been launched with the opening of selected customer centres on non-mercantile bank holidays to help our customers in the mercantile sector have access to banking services on such holidays.
- Our Call Centre at the Card Centre provides 24 hour Information Service where card holders and merchants can obtain assistance/information at any time.

17 New Customer Service Centres were opened during the year with 12 established outside the Western Province including one at Mahiyangana. Most of these new Customer Service Centres are located in small towns such as Angunakolapelessa, Samanthurai, Hettipola, Wariyapola, Digana, Passara and Godakawella, in order to reach out to the rural community

### Technology as a tool

Technology continues to be a primary driver in achieving winning customer service levels and while our Core Banking System was implemented to improve operational efficiency and customer service, the following were also launched to add to our IT platform and ultimately ensure a faster, more efficient service from the Bank.

#### ATM Network

The number of ATMs increased from 145 in 2006 to 184 as at end of 2007, with nearly all Customer Service Centres having the facility of ATMs on site. Cash withdrawal limit per day has been enhanced to Rs.40,000 at 184 ATMs which increased the maximum daily pay out to customers by 100%. The ATM network was further upgraded to accept both Master and Visa debit and credit cards and to allow ATM cash withdrawal by any local or foreign debit and credit card holders.

#### Cultural Inclusion - Internet Banking

The cultural diversity of our communities enriches us all. Diversity of our customer base provides us with both a responsibility and an opportunity. The Bank launched the first trilingual (Sinhalese, Tamil & English) Internet banking service in Sri Lanka, HNB Mobile Banking where customers are able to use Internet Banking via the mobile phone using GPRS 3G connectivity. Logging in to the HNB Virtual Branch using GPRS from anywhere in the world has proven to be very convenient to our web savvy customers.

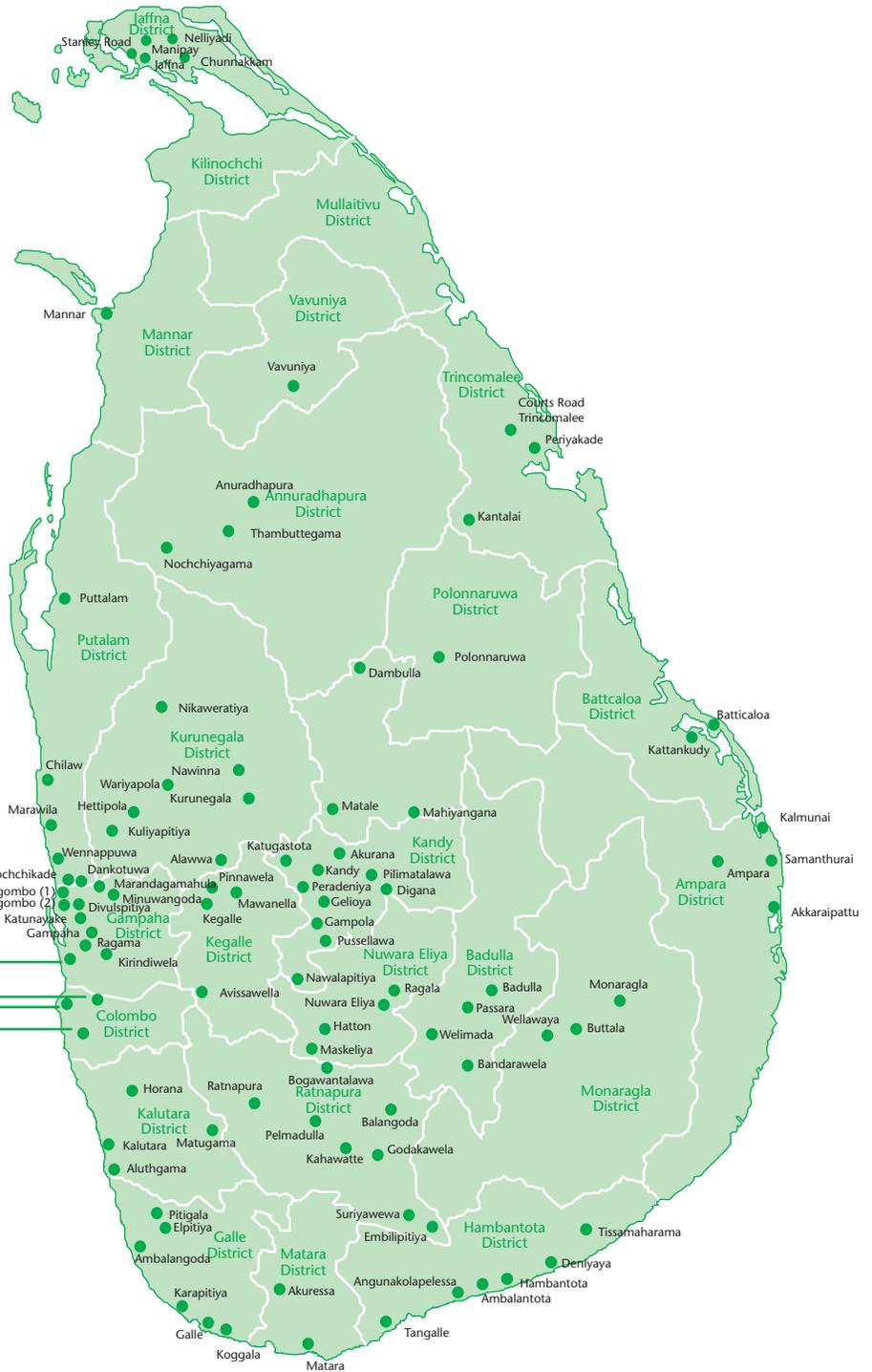
● HNB Customer Services Centres

- |                       |                              |
|-----------------------|------------------------------|
| Colombo               | Kotahena                     |
| Aluthkade             | Main Branch                  |
| Airport               | Maligawatte                  |
| Asha Central Hospital | Maradana                     |
| Apollo Hospitals      | Mt. Lavinia                  |
| Bambalapitiya         | Kaldemulla                   |
| Boralesgamuwa         | Mutwal                       |
| Borella               | Narahenpita                  |
| City Office           | Nawala                       |
| Cinnamon Gardens      | Nawaloka Hospital            |
| Dehiwela              | Nawam Mawatha                |
| Dematogoda            | Overseas School of Colombo   |
| Emirates              | Panchikawatte                |
| Grandpass             | Pettah (1)                   |
| Greenpath             | Pettah (2)                   |
| Gunasinghepura        | Ports Authority              |
| Head Office Branch    | Ratmalana Kaldemulla         |
| Hultsdorp             | Sea Street                   |
| IWMI - Pelawatte      | Sri Jayawardenapura Hospital |
| Jampettah Street      | Sri Lankan Airlines          |
| Kirullapone           | Thimbirigasyaya              |
| Kotte                 | Wellawatte                   |
| Kollupitiya           |                              |

- |            |
|------------|
| Ekala      |
| Ja-Ela     |
| Wattala    |
| Kandana    |
| Seeduwa    |
| Nittambuwa |
| Mirigama   |

- |             |
|-------------|
| Biyagama    |
| Delgoda     |
| Kaduwelluwa |
| Hanwelluwa  |

- |               |
|---------------|
| Mirihana      |
| Kadawatha     |
| Kiribathgoda  |
| Kottawa       |
| Maharagama    |
| Moratuwa      |
| Moratumulla   |
| Homagama      |
| Padukka       |
| Nugegoda      |
| Panadura      |
| Piliyandala   |
| Talangama     |
| Malabe        |
| Thalawatugoda |
| Athurugiriya  |
| Wijerama      |



Total number of customers at Dec 2007	10,370
Total number of new connections during 2007	5,179
Growth over last year	100%

### SMS Banking

Corporate banking customers now benefit from SMS alerts that signal market movements every morning, with any unusual activity also triggering an SMS during the course of the day. Scope was also expanded with partnership agreements with TIGO and Sri Lanka Telecom Mobitel dealer networks, enabling customers to reload their connections through SMS banking.

Total number of Customers at 2007	2,336
Total new connections as at 2007	1,237
Growth over last year	112%

### Enhancement of Remittance System

Given our emphasis and success pertaining to foreign remittances, we constantly look towards product developments and value additions that would give Sri Lankan expatriates the impetus to remit foreign currency through official channels. A key product introduced this year is Money2Home, also known as CashXPress, in which beneficiaries receive remittances online real time to any HNB account. A special Internet based international banking facility, Money2Home enables Sri Lankan migrant workers in the Middle East to make instant remittances directly to the credit of any account at any of our 167 Customer Service Centres through selected Exchange

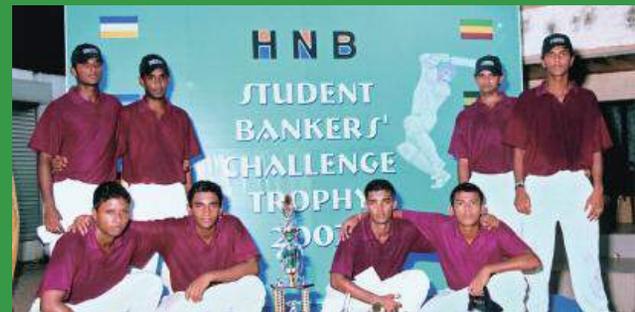
Houses in the Middle East. This facility also enables instant transfer of funds from these Exchange Houses for over-the-counter-payments to the nominated beneficiaries at any of our Customer Service Centers, enhancing service delivery by web and enabling all our 167 Customer centres to pay out Moneygram remittances. The typical download/ payout time is less than 60 seconds.

### Nurturing Student Bankers

Having conducted numerous programmes in the past for the Student Bankers' Association, which was formed in 2001 as a result of our intervention to promote a savings culture among students via our Singithi accounts. This year we sponsored the Student Bankers' Conferences in Galle, Tissamaharama, Colombo, Kurunegala and Kandy. These are landmark events which saw 110 schools and about 750 students come together to share experiences and learn more about banking and finance. The event was one that created more than just friendships, fostering camaraderie and the finding of common goals among young, aspiring youth who developed an understanding of the outside world.

### HNB Pathum Vimana

Probably one of the longest running unique rewards programmes that presents customers with the opportunity of winning high ticket items as prizes, HNB Pathum Vimana broke new ground this year with the launch of an exciting TV Game Show which draws 22 account holders to compete on national





TV. In addition, prize stakes were also increased with cash, luxury cars, houses and gold coins on offer.

### HNB Pathum Udanaya 2007

The pioneering scheme in Sri Lanka offering prizes for foreign currency savings, Pathum Udanaya was relaunched this year with an increased prize stake of Rs 30 million. Using unique communication tools, which included TV, radio and Internet channels to promote the scheme in the Middle East, USA and Europe, HNB Pathum Udanaya ensures that our expatriate customers may avail themselves of rewards and benefits for their foreign exchange earnings.

### Customer Safety and Security

HNB follows stringent guidelines on safety regulations at all our locations based island wide. All branches have been specifically designed with safety a priority and equipped with appropriate fire fighting devices and other safety equipment. Fire drills form a part of the Training & Development calendar with all employees thoroughly conversant and able to cope in the case of emergencies.

Specially trained armed security guards are also in attendance during business hours at all branches and customer service centres are provided with 24 hour security.

CCTV cameras are installed at all on-site ATMs with SMS Alerts giving customers the added benefit of instant information on credit card transactions. This is a free service to all 100,000 or so card holders extended by the Bank. Firewalls, passwords,

PIN numbers and internal information access control are also in place to ensure exceptional IT security.

Funds lying in credit in dormant or deceased accounts are especially protected with the segregation of such accounts and stringent restrictions placed on the reactivation process. The account mandates are secured in the vaults of the Bank in the custody of the Branch Manager.

Our staff fully understand the importance of confidentiality of customer data and we have taken all steps to protect it.

## Responsible Lending

### Micro Entrepreneurs developed

Our flagship pioneering micro finance programme, Gami Pubuduwa is not only positioned as one of the most successful micro finance programmes but also as one that ensures economic sustainability among the more economically challenged segments of the community. Empowering rural entrepreneurs to have confidence in their own skills and talents, Gami Pubuduwa provides the economic and technical impetus to ensure sustainability of these ventures. In pursuit of the Bank's objective of strengthening credit distribution channels to rural farmers and micro entrepreneurs, field staff coming under the Gami Pubuduwa Units and agricultural officers were increased to 113, disbursing funds through 106 Gami Pubuduwa microfinance units to nearly 5,000 micro entrepreneurs and benefiting 15,000 families.

In addition, under the Micro Insurance Scheme launched in 2006 jointly with HNB Assurance Ltd., where 50% of the premium is paid by the Bank, 1,336 micro entrepreneurs now come under a life and liability cover compared with 467 covered as at end of 2006.

### Financial literacy

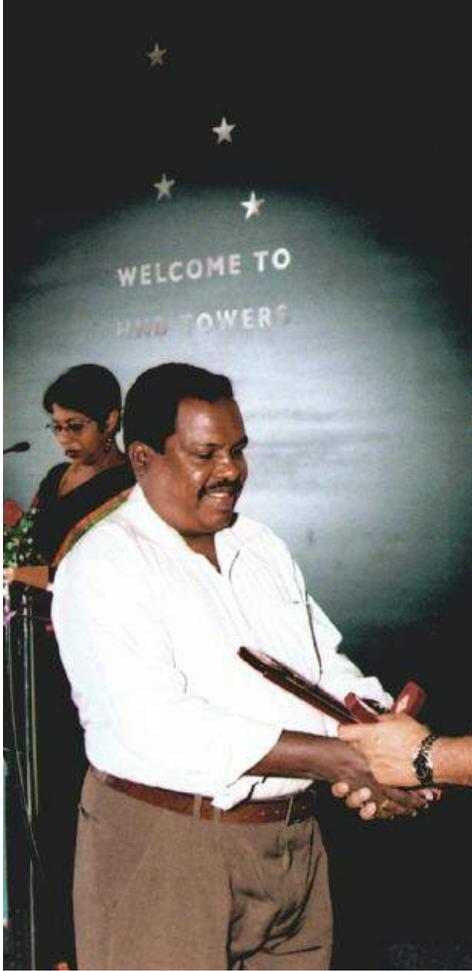
Improving financial literacy in our community is a core social responsibility for HNB and essential to the long term success of our business. The large range and complexity of financial products and services can make choosing the right product challenging. HNB continues to create opportunities for identified customer segments to have up to date access to information, the latest banking trends and upgrade their knowledge and awareness on banking products and best practices. The Bank spurred the following to meet these objectives:

- 12 farmers from agricultural parts of the country were given a conducted educational tour of India
- 5 Special Customer Awareness Programs on cultivation techniques and agricultural and production methods were conducted by outstation branches with the assistance of the relevant Government Departments/Institutions, for the benefit of 280 customers (farmers and rice millers)
- The Corporate and Treasury Divisions issue daily bulletins on the latest developments in foreign exchange and the money market for our corporate clientele
- HNB was the Official Banker for Construct Exhibition 2007, organized by the National Construction Association, with over 40,000 visitors benefiting from the “awareness” on Home Loans created by the Bank through this Exhibition
- Customers are given opportunities to meet the corporate management and senior officers at Head Office, away from office hours, through customer get together events which were organized by eight outstation branches for 1,600 customers

### Customers as our winning partners in 2008

The following initiatives are being proposed to continue strengthening and building on the winning relationships we have nurtured with our customers.

- The distribution network is to be further expanded with the establishing of over ten new Customer Service Centres, primarily in the outstation areas. The network will be further enhanced with new technology-based delivery channels to take banking to the customer’s doorstep.
- A Payment Portal for credit card based bill payments to enable customers to pay various utility bills and other similar payments with any locally issued credit card, by logging into the Bank’s Web Portal.
- Introduce E-Savings to enable existing Internet Banking Customers to apply on line for deposit accounts.
- Formal launch of a Debit Card which will also function as an ATM card, allowing customers to pay for purchases at the point of sale, directly from their account.
- Introduction of Bill Payments and Fund Transfers through the ATM network.
- SMS Alert Service which now covers credit card transactions, will be extended to cover cash withdrawals from ATMs as well.



## INSPIRING AND ENGAGING OUR PEOPLE

Ours is an enviable team – 4,200 people powered and driven by commitment, motivation, dynamism and inspiration. Aligned to the Bank’s vision to be inspired, the teamwork and commitment that the Hatna Team possesses has today transformed our culture into a holistic ownership of that vision via the conduits implemented by the Human Resource Management Strategy which fashions the HR role and model that has ensured a winning strategy for our team. Ours is a people based culture – transparent, participatory and interactive and aligned to the business end objectives unconditionally. The accolades won from both our local and global industry peers in the past and during this year are all testament to great team spirit, innovation and creativity displayed by our team – feats that cannot be achieved without complete co-operation and togetherness. This is fuelled by the multi-skilled professionally geared people who are multi-disciplined not only in industry knowledge but also in extracurricular activities that infuse numerous dimensions into individual personalities, the work environment and work ethic. We firmly believe that our winning culture is driven, stimulated and sustained by a unique winning team, which we will strive to constantly energize, encourage and invigorate, to reach greater heights.

# EMPLOYEE RELATIONS

## AT A GLANCE

- **Revalidation of the Balanced Scorecard at the Strategic Review Workshop headed by CEO**
- **Training Management System implemented in 2007**

## Recruitment process

HNB is now acknowledged as a preferred employer in the financial services industry and being an equal opportunity employer where recruitment, promotion, rewards and remuneration are transparent and built on meritocracy, our winning reputation has ensured that we attract and retain some of the best in the country and beyond. While professionalism, sound values and integrity, holistic knowledge and a desire to continuously steep oneself in a knowledge driven culture remain the primary focus for all recruits, executives are nurtured and cultivated to thrive in an internal succession plan to ensure career progression within the Bank. We do try, as mentioned earlier, to recruit team members from all parts of the country so that our team members continue to live in their own neighbourhoods and communities, giving them a healthier work life balance and also allowing the Bank to have a better comprehension of the communities around them.

All members of the Hatna Team are expected to abide by the Code of Ethics of the Bank, which imbues the core values of:

- Treasure professional and personal integrity at all times
- Demonstrate mutual respect in all interactions
- Be passionate about whatever you do
- Be committed to be customer centric, with the courage to change, challenge and be different
- Demonstrate unity in diversity



Recruitment is based on a manpower plan that's dependent on the evolutionary factors that involve the industry and external environment including IT, projected growth, work volumes and expansion. Driven by the HR division, the processes will be conducted in co-ordination with the Heads of Department and Customer centre Managers.

## Introduction to Hatna Family

The Vision, Mission and values of our Bank are cascaded to all new recruits. Our employees actions need to exhibit our three corporate behaviours: customer intimacy, internal business processes and integrity

A Code of Ethics is issued with the letter of appointment to ensure that new recruits understand and are willing to abide by the ethics and values expected of them by the Bank.

## Informing our employees

We strive to develop an open communication culture with our employees, especially when planning organizational changes. We aim to explain the business rationale for changes, clarify how we plan to implement it and of course outline what the change means to the employees involved, both from a team and individual perspective.



## Cultural change and people management

Transforming our culture remains a key priority, with our Corporate Principles at the heart of how we do business. All parts of business see cultural transformation as integral to delivering on our strategy, to reducing risk and as a top business priority. Involving our people in building the right type of culture for the Bank has been pivotal to this process from the outset. A major driver to our strategy is to have a compelling vision that our people can commit to and believe in. In 2007, we continued to focus on organizational culture development.

All our businesses are striving to build a “constructive culture” – one in which people work together to achieve performance growth and work quality, with honest and open communication. While there is more to be done, our focus is now firmly on the future.

## Performance Management

Performance continues to be imperative in measuring achievement level. Work quality, timely delivery, cost effectiveness and meeting objectives are some of the criteria pertaining to the performance management initiative. The Management and Executive cadre have goals set through an on line system based on the Balanced Scorecard, with quarterly appraisals, performance tracking and final evaluations ascertaining measurable goals achieved during the year. The process is linked to remuneration and rewards including increments, bonuses and promotions. Qualitative assessment and performance on specific competencies are appraised for some staff categories. Performance reviews are accompanied by appraisal reviews to ensure that strengths and weaknesses are assessed, discussed and future career paths mapped out for personal development.

All others in the HNB Team are qualitatively appraised with appraisal interviews, self assessment and action plans worked on to bridge gaps in performance. If performance levels are below required standards, the HR Department initiates discussion to bridge gaps and work on improving performance.

Performance of trainees is tracked every two months, with probationers' performance tracked each month.

## Rewards and Recognition

We treat our people equitably and with fairness. This is reflected in how we reward and recognize achievement. Our reward and recognition policy acknowledges that recognizing achievements is essential to our ongoing success.

Our remuneration policy, which is administered by the HR Department, is centered on two key factors:

- Collective bargaining, which is enumerated in the Collective Agreements pertaining to clerical, allied and supervisory staff
- Base pay and performance related pay being the key factors in compensation for executive and managerial levels, based on market conditions and individual performance, worked on the Balanced Score Card

## Learning and Development

A predominant, influential and fundamental factor in the entirety of the Bank, Learning & Development is centric to our winning culture. With the annual Training Needs Analysis and Annual Training Plans forming the basis for continuous development, the HR department tries to ensure that training needs and training aspirations are matched according to the Bank's ultimate vision.

Learning & Development focusses on the broad areas of developing leadership, executive skills including IT and other speciality areas, self development, credit skills, international operations and trade related operations. The fully fledged modern training center spearheads most of the training agenda and has in fact infused On line training to bring in a more collective approach to learning and development. The e-learning system had more new features added this year, including learning via the Internet, and a comprehensive training management system has been included into the IT-enabling

learning culture we have developed . There was special focus on credit and international training, while specialized OMEGA credit training was imparted to selected Account Relationship Managers in our effort to constantly improve our customer service levels and increase prevalent benchmarks.

The HNB Training Center's state of the art facilities were shared with other corporates this year by insourcing services to selected companies and generating an income of Rs. 1.4 Million during the year. HNB also launched a fully automated library in December 2007.

### The Training Management System

Infusing a new dimension into our learning and development culture, the Training Management System implemented this year enables training needs analysis, nominations, training cost management and post training evaluations to be completed on line in minimum time and with considerable cost savings.

### Leadership Development

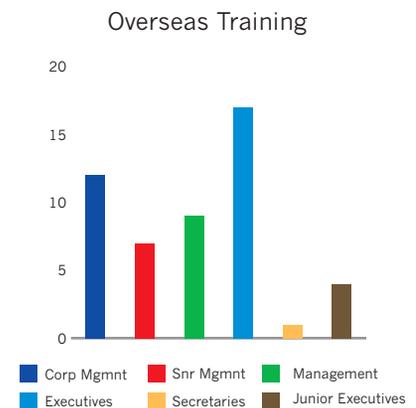
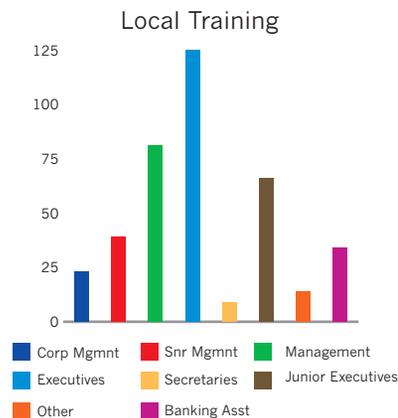
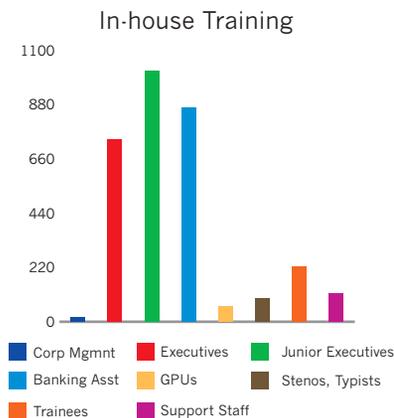
Leadership development is a priority focus for our business. To sustain and grow our business, we are investing in the development of our current and future leaders, Our leadership development philosophy is built on the understanding that

HNB is proud to have won a Silver Award at the National Best Quality Software Awards 2007 held under the aegis of the British Computer Society Sri Lanka Branch in the "In house" category

successful organizations do not wait for leaders to appear, but they identify leadership potential early and develop the individuals. The total cost of training for both local and overseas programmes, in respect of Leadership Courses, was approximately Rs. 8.7 Million for the year.

### Strategic Review Workshop

One of the most fundamental HR facets worked on this year was the revalidation and renewal of the Balanced Scorecard at the Strategic Review Workshop headed by CEO. Identifying critical success factors, the exercise focused essentially on encouraging multiple skills among our team, where training,



job rotation, diversity of talents and ability to integrate and create leaders was emphasized.

### Career and Succession Planning

A crucial facet in organizational growth, development and sustainability, career and succession planning is tracked through the robust Performance Management System which gives accurate feedback to the management of skills, professional ability and suitability of team members. Career and succession planning for Executives and Management is mapped by a staff committee headed by the CEO and top management, based on the following :

- Identification of key performance achievers projecting high value additions to the Bank, specifically at managerial level; who can be placed on the fast track
- Ensuring quick progression of individuals with potential, with leadership development and management training programmes and appropriate job assignments
- Meticulous tracking of on the job challenges to assess capability, implementation of work processes and achievements of objectives
- Training off the job, both internal and external
- Performance appraisals and one to one interviews

### Diversity

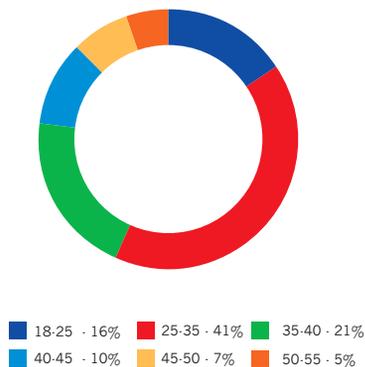
There is also a concerted recruitment drive from across the country, to meet our extensive Customer Centre expansion and to ensure that our team members, placed in various Customer centres, are sensitive to the nuances and subtle cultural differences prevalent in those areas, giving them the ability to interact better with our stakeholders.

### Employment of the differently able

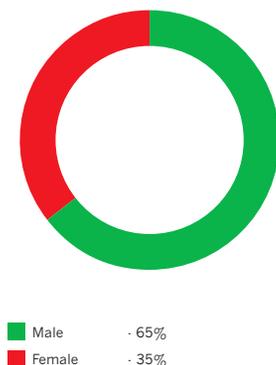
The Bank is one of the founder members of the "Employers network on disability" founded by the Employers Federation of Ceylon, together with the International Labour Organization (ILO). As a member we are committed to the Code of Good Practice on the employment of differently able people. As part of our commitment we have also been involved in arranging training programmes to prepare them for employment.

The recruitments we already made under this scheme have met our expectations and have given us great satisfaction. It is our intention to increase our recruitment of differently able people in 2008.

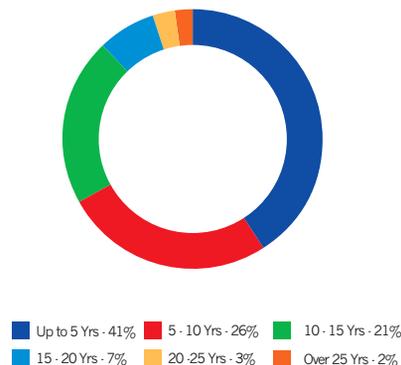
Age-wise Analysis of Employees



Gender-wise Analysis of Employees



Servicewise Analysis of Employees



### Employee Consultation and Feedback process

Strong proponents of open door style management, HNB executives and managers have an open discussion oriented relationship with the Hatna Team where ideas, suggestions and constructive criticism are welcomed, discussed and acted upon, as relevant. Cross functional committees work on areas pertaining to customer service, business development and general problem solving. Potential needs, grievances and changes required are discussed for greater effectiveness. The quarterly Hatna Mag, monthly HR newsletter and Marketing newsletter also ensure further value addition to the open communication process encouraged at the Bank.

### Industrial Relations

Industrial harmony is imperative for the smooth functioning of the Bank, given that our winning platform stems from the Hatna Team buying into our vision, mission, values and objectives. The Bank has continuous dialogue with the unions, with monthly interactive meetings between the HR Team and union officials being a key factor in problem solving and open discussion. Collective bargaining has led to an effective Collective Agreement, which is signed once in three years, wherein work practices including remuneration, benefits, processes and systems, are laid down in a suitable and agreed framework.

In agreement with Unions and as a result of the open and honest dialogue held between the management and unions, a comprehensive disciplinary code and grievance handling

procedure were worked on during the year. The Disciplinary Code includes the issues of suspension from duties, without pay and on half pay, process for disciplinary action, preliminary investigations, summary action and inquiry procedure. The objective of the Grievance Handling Procedures is to ensure that employees who have genuine grievances are given opportunities to make representation to the management for redress and at the same time, enabling management to look into the grievance, encourage industrial harmony and good industrial relations and ensure fair and consistent labour practices with transparency across the Bank.

### Instilling unity, harmony and camaraderie

Team culture and togetherness can only be nurtured through holistic team building which HNB encourages through the promotion of team sports and extracurricular activities including involvements in the arts, sports and other forms of recreation. In addition, family days, sports meets, festive and religious events and excursions are organised to give families and team members times of enjoyment. Excellence and achievement in sports, arts or any other extracurricular activity is rewarded and recognised. In fact, the Bank is proud to employ a large number of national and internationally recognised sportsmen and women.

In addition, the Bank lays emphasis on team welfare to ensure a more conducive and productive work environment which ensures a happy contented workforce. The initiatives



implemented throughout the Bank include a conducive working ambience with ergonomically designed lighting, furniture and fittings, appropriate sanitation facilities and clean drinking water, staff quarters, the facilities of holiday bungalows, comprehensive medical insurance cover, transport and accommodation facilities for those serving in difficult areas.

### **Caring for employees and their families**

The Bank, in addition to a host of benefits and schemes afforded to its staff, also has financially supported staff who have been afflicted with serious medical ailments beyond the scope of the normal medical scheme. In the year 2007 the Bank supported 09 such staff members.

We also initiated a scheme for employee's children where, on the demise of the employee, children's education is funded up to Advanced Level.

### **Working with communities**

We have intensified our sustainability training and awareness programs and communication efforts. Hatna Mag, the internal news letter, covers the sustainability efforts made by the Bank and encourages staff to incorporate sustainable development into their daily work.

Our people volunteer in a variety of ways, including team projects, individual interest and Bank led activities.

HNB joined with the City Branch of Sri Lanka Red Cross Society, at the enterprise of assisting the flood victims in Colombo, in May 2007 when many lowlands were submerged. HNB, with its dedicated volunteer team, offered its support at the appropriate time, in distributing food items to the flood victims.

### **Achievements of our people**

We encourage our people to balance their work and personal life. We list below and on the next page some of the achievements of our staff in sports, academic and other recognitions.

### **Achievements in the academic area**

Ms Saqena Samadh attached to our Thalangama branch emerged as the youngest ever person to have completed all levels of the Banking Exam conducted by the IBSL.

Mr Akalangka De Zoysa was ranked joint fifth in the world, based on his performance in paper P10 at TOPCIMA.



### Achievements in sports

Sport	Tournament Played	Achievement
Soccer	Inter Bank-Open	Champions
	Inter Bank-over 40 yrs	Champions
	Mercantile League	Champions
	Mercantile seven-a-side	Champions
Badminton	Mercantile Open Individual	Champions
	Mercantile men's A Division	Champions
	Mercantile ladies A Division	Champions
	Mercantile ladies B Division	Champions
Netball	Netball Nationals	Champions (for 12 consecutive years)
	Open Club Tournament	Champions
	Inter Bank Netball Tournament	Champions
Cricket	Inter Bank six-a-side	Champions
	Over 40 six-a-side	Champions
Hockey	Mercantile League (A Division)	Joint Champions with Commercial Bank
	Mercantile League (B Division)	Champions
	Mercantile Knock out (A Division)	Champions





## CREATING VALUE FOR OUR SHAREHOLDERS

Having set off last year on a winning platform, HNB this year has continued its progress within the industry, proving beyond doubt that the positive features and the undivided focus in creating wealth for shareholders while ensuring a sustainable milieu for all stakeholders, remain priorities, is the axis upon which our business revolves. Having won the prestigious Bracken Award for Bank of the Year in 2006 and Superbrand status among numerous other local and global accolades, HNB this year continued to display resilience in a rather challenging economic environment, using the winning strategies of stewardship, astute decision making and prudent risk management policies, which have held us in good stead this year to post noteworthy results.

Our penetrative reach through our extensive Customer centre network, intensified customer centric strategies, innovation and creativity at the forefront of an extensive product portfolio, and adherence to conformance and maintenance of standards through ISO, have all been fundamental to our success. HNB's winning strategies over the years include having the honour of being the first and only Sri Lankan bank, to date, to be listed internationally on the Luxembourg Stock Exchange, one of the first private commercial banks to introduce housing loans, the first to brand a product and the first private bank to introduce pawn broking services, customized credit cards and affinity cards.

# INVESTOR RELATIONS

## AT A GLANCE

- Growth in PAT well above CCPI
- Expansion of investment banking via joint ventures in Sri Lanka and India

### ICASL Annual Report Awards 2006

HNB emerged with an unprecedented three awards this year at the Institute of Chartered Accountants of Sri Lanka Annual Report Awards, being adjudged first runner up in the banking sector, winning the silver award for Corporate Social Responsibility Reporting and a bronze award for Corporate Governance disclosure.

### LMD 50 rankings

HNB retains its position on the LMD 50 Leaderboard 2006/7 in the results published in the LMD November 2007 issue, Sri Lanka's version of THE FORTUNE 500. HNB will continue to focus on increasing the bottom line through fee based activity, aggressively increasing customer reach and acquiring new businesses using alternate channels, such as technology. Our Asset allocation strategy will take into account diversification opportunities, and risk/reward benefits in increasing our non Sri Lankan exposure, including supporting strong Sri Lankan companies expanding overseas.

### LMD Most Respected Entities

HNB was again ranked among the most reputed entities in Sri Lanka for 2007 by LMD, for being an "Exceptional Banker", focusing on continuously delivering long-term, above average results in a sustainable manner, to the satisfaction of its stakeholders. As a public-quoted company, we provide opportunities to the investing community – both locally and

internationally – to savour the returns of a well managed business, built on solid fundamentals, delivering exceptional performance continuously. Absorbing turbulence in challenging times and responding effectively in the best interest of the stakeholders clearly demonstrates HNB's resilience and agility.

### Business Today Top 10 position

HNB was privileged to be recognised in the Business Today Top 10 Awards this year, organised by Business Today magazine, to recognise companies that have excellence in business. The relentless focus on business results which in turn directly contributes to societal development across the country has won us several accolades. The Business Today ranking, one of the most respected benchmarks for corporates in Sri Lanka, has honoured HNB on eight occasions during the past 11 years, which speaks volumes for the consistency in performance.



## GREATER ASPIRATIONS



**Q: How would you assess your performance, growth and general progress in the financial year under review?**  
**A:** In 2006, we developed a medium-term strategic plan and a new vision, mission and values – which signalled a new direction for the bank. Our performance in 2006 was in line with these expectations. Pre-tax profits grew by 63 per cent and post-tax profits passed the Rs. 2 billion mark for the first time in the bank's 60-year history. This was a testament to our strong performance in operating areas below inflation and a significant contribution to non-performing asset provision.

**Q: What have been your other achievements?**



merits and accomplishments in the same period?  
**A:** Being awarded the 'Bank of the Year' by the Singapore Business Week magazine (SIBW) was the highest honour, giving credence to the fact that we have achieved being acknowledged by our peers internationally as a leader in the Sri Lankan financial services industry. The three ratings awarded in two years from Fitch Ratings Lanka, a credit agency and the ACCA, Sustainability Reporting Award, and being recognised as one of the most powerful Sri Lankan brands by LMD are some of the diverse accolades – which underline the effectiveness of our sustainable business model. These awards serve to recognise the contribution made by the 'Main bank'

and impels us to strive for even greater heights.  
**Q: How has the economy in your estimate, fared in this period?**  
**A:** The year posed several challenges in the domestic environment, with escalation of violence in the north and east, and the impact of decreasing oil prices causing spiralling inflation and rising interest rates. Economic growth in 2006 was a commendable 7.4 per cent – thereby by agriculture, telecommunications and financial services – but continuing the trend of growth in 2007 and beyond has been tough, given that investors focus on drying up and uncertain prospects for peace both here. It is unfortunate that we ran the risk of being left behind



even by neighbouring countries, which are experiencing robust private-sector-driven economic growth.  
**Q: How has the market in which you operate responded to the macroeconomic climate?**  
**A:** The banking sector has been relatively robust, with the heavier inflows provided impacting on low-cost deposit generation. The constructive industry boom, coupled with that of global markets, resulted in banking sector ROA and ROCE rates improving over the previous year. Another positive development was seen in improving NPA ratios, driven by regular recovery in improved risk management.

Hatton National Bank is striving to reach fresh horizons with a new mission, vision and values.

However, rising interest rates – fuelled by inflation to reach the latter half of the year – resulted in lower following deposits, causing a slightly negative impact on capital adequacy and liquid asset ratios in the banking sector. The prevailing low situation will continue to cause greater operational intervention in the bond market, which will drive up arbitrage and interest rates, and indicate a fall in future business performance. Most insurance players will look for growth opportunities beyond Sri Lanka, to reinstate the growth momentum achieved in the last few years.

**Q: What factors, if any, could affect the performance of your company and/or the industry on the way forward?**



**A:** The resolution of the ethnic conflict must be our number-one priority. The Government must ensure all avenues for peace with renewed vigour and earnest intent. A decline of rising interest rates, share mergers and downturns, both pre-requisites for economic growth. In this context, controlling inflation is critical, as it is a driver influencing interest rates, exchange rates and – eventually – business confidence. HNB has demonstrated its business resilience to varying economic conditions in the past and has built up a combination of strategies to ensure that its sustainable growth momentum is continued. We believe that empowered people, precise digital systems and multi-class business strategies will be the key to our future. We continue to look

forward to the future, with confidence and optimism. Planned investment in a new core banking system, which will signal a new era in customer service and risk management, is an example of our preparation for the next phase of growth.

**Q: How much of a role has CSR played in your corporate ethic in 2006/07?**

**A:** HNB has a track record of providing sustainable value to the Sri Lankan economy. We possessed leading in the microfinance sector, directed in people habitats outside the banking sector. Over 10,000 rural entrepreneurs have benefited over the last 10 years from the 'Main Puhuduru' programme. The ashle-dura of



level to society in the form of employment, development of skills and skills, and foreign-exchange earnings have been significant. The 'Main Puhuduru' scheme – building 1000pin Shoolas for village schools – is another example of investing in the social fabric of our country, involving the needs of empowerment and welfare through ethical corporate citizenship. In 2006, we took sustainable initiatives to the next level by reporting on how activities impact stakeholder groups and identifying areas to add value to improving the quality of life. This has prompted a fresh look at initiatives such as waste recycling, empowerment of women, energy saving and responsible banking.



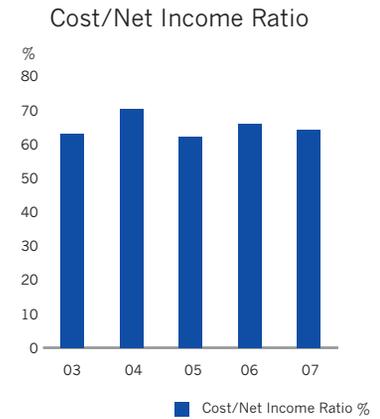
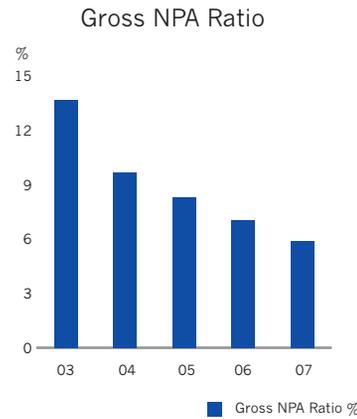
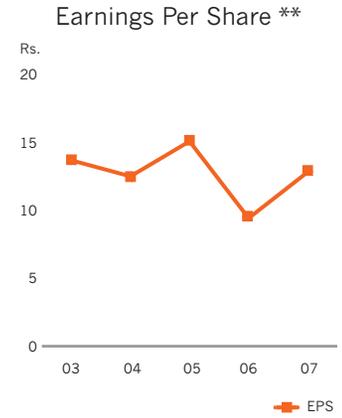
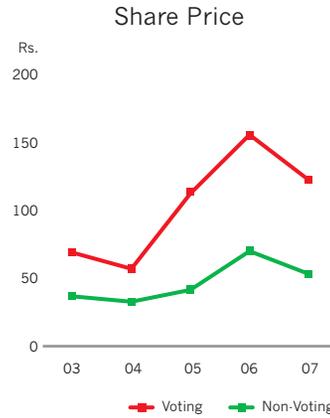
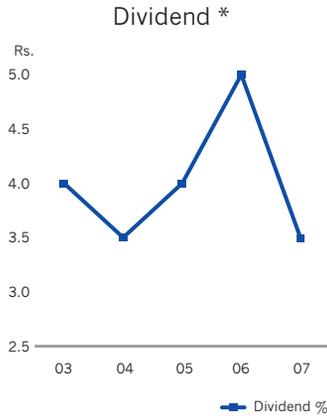
Rajendra Theagarajah  
Managing Director/CEO – Hatton National Bank

(HNB) Business Desk

## INDICATORS THAT DEPICT THE SUSTAINED GROWTH OF HNB

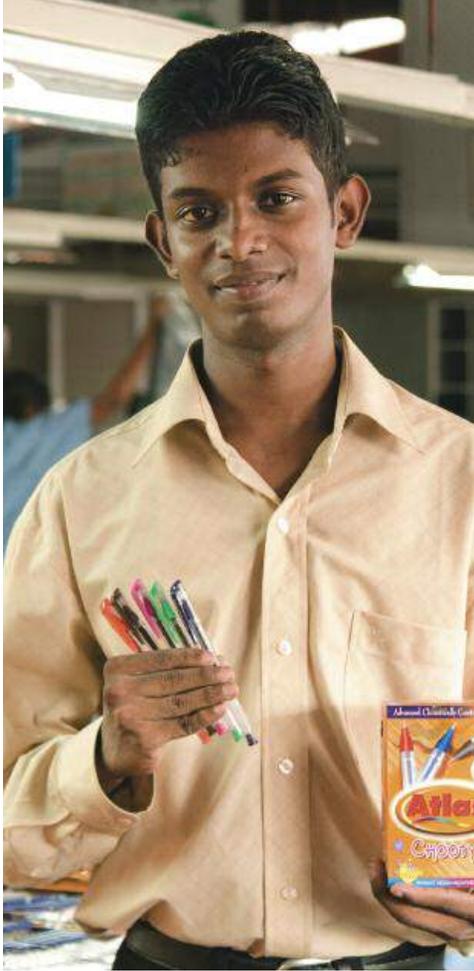
	2007	2006
EPS *	12.83	9.43
Dividend Yield (%) - Voting	2.86	3.21
Dividend Yield (%) - Non voting	6.57	7.14
Asset Growth (YOY%)	18.79	18.11
Holding Period Return - Voting (%)	61.80	42.89
Holding Period Return - Non Voting (%)	62.14	80.72
Operating Cost - Efficiency Ratio (%)	64.26	66.11
Share Price - Voting	122.50	155.75
Share Price - Non Voting	53.25	70.00
Dividends	35	50

\* In March 2007 the bank issued 1:1 bonus shares resulting in dilution of EPS. Accordingly 2006 & 2007 EPS for the Comparative Period has been restated.



\* 2007 dividend rate is 70% compared to undiluted basis.

\*\* On 29th March 2007 the Bank issued 1:1 bonus shares (one ordinary share for each ordinary share outstanding as at 31st December 2006) resulting in dilution of EPS. Accordingly the EPS for the comparative period has been restated.



## WORKING WITH OUR SUPPLIERS

By working with our suppliers to manage our direct and indirect social and environmental impacts, we believe we can reduce risk from our supply chain and make a positive difference to the communities in which we operate. Our responsible sourcing principles further underpin the sustainability of our business. Our relationships with our valued business partners are driven on a qualitative platform in which values, ethics, integrity, transparency in processes, value for money and cohesive but open dialogue, become the tenets for a winning partnership. That's why we are committed to fair contract and payment terms with our suppliers – in return we expect good service, at a good price, supplied in a responsible fashion.

# SUPPLIER RELATIONS

## AT A GLANCE

- Initiatives taken to develop a new Procurement policy in 2008, in line with our CSR philosophy

### Managing Supply Chain relationship

Working with our suppliers to create mutual value and to meet shared performance goals, is an important part of our procurement process. This starts with the selection process and is regular and ongoing. Managing supply chain does not only mean that we have the right to demand high ethical standards; it also implies our responsibility to treat our suppliers fairly.

### CSR in the Supplier Selection process

We operate a fair and equitable procurement selection process., which aims to clearly inform potential suppliers of our expectations, policies and requirements.

Suppliers are required to register with the Bank, while the Bank also encourages micro, small and medium organizations to apply.

The entire selection process remains completely transparent with each step documented and available for inspection at any time. Contract terms require suppliers to meet minimum regulatory requirements and conditions relevant to the purchase. Our current policy and practices concerning payment to suppliers is to agree to terms of payment during contract negotiation.

### Monitoring Supplier Performance

A Supplier Audit is conducted once goods are delivered to ensure that quality matches the price quoted. Prior to supply of goods, however, stringent verification procedures are implemented.

All systems are periodically reviewed and improved upon to ensure that quality standards are maintained or bettered. In the event the valued business partners do not achieve the stringent standards set by the Bank, they are encouraged to re-scrutinize their quality and standards and strive to meet our expectations.



## CONNECTING WITH OUR COMMUNITIES

Investing in communities is of great importance to HNB and we aim to contribute actively to the communities in which we operate. Our community investments complement our business activities and help communities to achieve higher levels of sustainability. The continued interaction and proactive relationship we have with our community has created a winning combination which ensures sustainable empowerment and development, not only for the communities around us, but also in creating stakeholder value.

# COMMUNITY RELATIONS

## AT A GLANCE

- Setting up of a Counseling Centre to manage trauma of cancer patients, at Cancer Hospital, Maharagama
- Upgrading the school libraries built by us with IT equipment

## Community Investment Strategy

HNB's community investment focus is on 'sustainable livelihoods' and it aims to provide people with the means and opportunity to sustain their lives and build their futures. Community investments require thorough and transparent assessment and decision making process which ensures fairness and applies the highest selection standards. HNB has identified three platforms - health, education and micro finance for Community investments, to support the sustainable livelihoods of our communities.

Projects and initiatives coming under these three platforms are all planned and developed based on the needs of the Communities to bridge whatever gaps exist, to ensure sustainability.

### Health

#### Cancer Counselling Center Maharagama – Rs. 2 Million

To fulfill the dire need of cancer patients visiting the single largest national institute for cancer in Sri Lanka, HNB funded and is currently operating and managing a Cancer Counselling Center for trauma counselling of patients and immediate family members. This project is conducted in collaboration with the Doctors at Maharagama Cancer Hospital who in turn are supported by the Royal Marsden Hospital, UK. Short training courses for doctors and nurses were also conducted at the London Counselling Center. HNB equipped the Center with all

facilities to create a conducive environment at the Counselling Center, and next year, hopes to set up a Fund to support patients in meeting the high cost of drugs for treatment.

We also aim to extend this programme to assist families whose sole breadwinner is afflicted with cancer, by compensating them for the loss of income during the critical period of illness. This proposed project enshrines the true values of good CSR, as we aim to encourage our other stakeholders, especially our customers, to participate actively on a volunteer basis. Our initial start up Fund will be Rs 5 million which we are confident will increase in the future, enabling us to extend our assistance to a larger number of people.

#### Anti Rabies and Animal Sterilisation Drive – investment Rs. 160,000

HNB partnered Embark and TAPA (Tsunami Animal People Alliance) to conduct an anti-rabies and sterilisation drive for dogs, in Colombo and the suburbs. The dogs were vaccinated for Rabies and sterilised to ensure a systematic depreciation of the stray dog population, both these issues posing health hazards to people living in and travelling into and around Colombo and the suburbs.



### **Improving Community Health – Investment Rs. 100,000**

Given that Sri Lanka has the fastest ageing population in the region, the provision of good community health services becomes a challenge for the state sector. Under the auspices of the SHARE Foundation, which funds nursing projects for the poor and needy in third world countries, HNB funded the work of two nursing sisters, attached to the Kotahena Community Center, who will respond to community health needs and promote good health care.

### **Breast Cancer Awareness Programme – Investment Rs. 325,400**

With the high incidence of breast cancer (a disease that can be controlled with early intervention) in Sri Lanka, HNB partnered the "Josephian Blues" in publishing communication materials in all three languages which included booklets, leaflets and referral notes to be distributed among 6000 women in the Badulla District, to ensure that timely preventable action is taken by the targeted population.

### **Improving the health of women and newborns – Investment Rs. 500,000**

Sri Lanka's health indicators are impressive compared to other countries in the region, with maternal mortality rates specifically being the lowest. In a bid to continue this positive trait which augurs well for future generations, HNB partnered the Sri Lanka College of Obstetricians & Gynaecologists in its efforts to construct a building that will be used for the prevention and

management of gynaecological cancers and malignant diseases and for training and development in new techniques and knowledge gathering.

### **Prevention of Dengue and Chikungunya – Investment Rs. 75,000**

HNB partnered the Colombo Municipal Council in conducting awareness programmes in Colombo and the suburbs for the prevention of the mosquito-borne diseases of Dengue and Chikungunya.

## **Education**

### **'Nana Pubuduwa' – 100 School Library Project – Investment Rs. 9 Million**

Initiated two years ago, the 100 school library project aimed to create an enabling learning culture among young people through school libraries which can be the catalyst in harnessing and spreading knowledge among the younger generation. Having now completed 114 libraries which are located in remote, underdeveloped areas in the country, HNB this year continued to add more facilities to them, presenting more books and relevant equipment and furniture to ensure that the children utilizing the services of the libraries will be further benefitted.

In addition, computer facilities will be provided to 50 of these schools to create an IT enabling environment for those students who would otherwise never have the opportunity to become IT savvy.



### Rewarding Young Achievers

With some of the children of Hatna Team members being academic high achievers, HNB began presenting scholarships to those who have excelled in competitive examinations conducted by the State. 15 scholarships of Rs 5,000 monthly for the first two years and Rs 7,500 monthly for the final two years were presented to those who had entered Sri Lankan universities, giving these young achievers assistance to continue their higher education and obtain a degree. The scholarship scheme is a continuous project on our sustainable education platform.

### Micro Finance

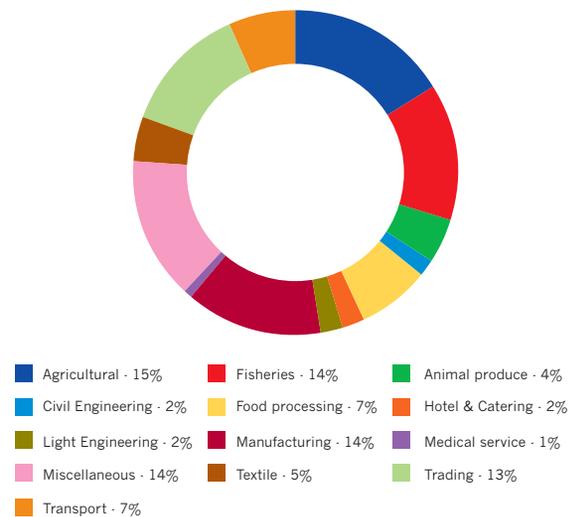
#### Micro Entrepreneurs – now sustainable

HNB this year concluded the nearly three year project partnered with one of the largest financial groups worldwide, the Savings Banks Foundation for International Co-operation(SBFIC). The SBFIC houses 670 savings banks and joint institutions worldwide and partnered HNB in assisting micro entrepreneurs establish entrepreneurial ventures after the Tsunami.

Total funding	Euro 5 Million
Directly financed	2,720 projects
New employment opportunities created	7,055
Families benefited	9,775 approx.

SECTOR	NO OF LOANS	PORTFOLIO
Agricultural	438	93,502,668
Fisheries	375	62,407,080
Animal produce	122	13,592,650
Civil Engineering	42	14,529,577
Food processing	194	45,825,937
Hotel & Catering	66	32,394,990
Light Engineering	58	18,534,641
Manufacturing	371	118,715,896
Medical service	20	11,860,900
Miscellaneous	384	134,542,753
Textile	128	39,160,190
Trading	344	114,915,233
Transport	178	51,364,505
Total	2,720	751,347,020

Sectorwise Distribution of Number of Loans



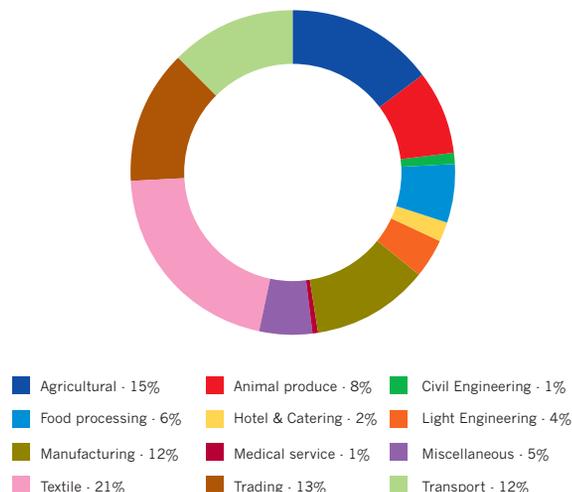
### Gami Pubuduwa

One of the most unique sustainable programmes conducted in Sri Lanka, Gami Pubuduwa completed 18 years in operation and has thus far touched the lives of hundreds of rural Sri Lankans based in agricultural areas. It was initially begun in 1973 as a rural village upliftment programme, which eventually metamorphosed into the flagship Gami Pubuduwa in 1989, in which poverty stricken villages were identified for progressive development, with their skills harnessed and used towards sustainable ventures which eventually saw the rural economy uplifted. Partnering the villagers with funding, skills and community development, building sustainable relationships between the bank and community, contributing towards micro sector sustainability through technical advice, assistance and financial solutions, HNB has ensured that villages coming under the purview of Gami Pubuduwa will continue to develop and sustain the ventures already established.

Total Number of projects completed	70,000
Total Financing of projects	Rs. 4.3 Billion
Existing portfolio caters to	14,434
NPA Rate maintained	lower than 5%

SECTOR	NO OF LOANS	PORTFOLIO
Agricultural	2,136	198,890,855
Animal produce	1,209	128,923,509
Civil Engineering	175	49,576,485
Food processing	835	141,403,418
Hotel & Catering	292	58,798,451
Light Engineering	552	94,366,583
Manufacturing	1,670	313,091,622
Medical service	81	18,133,207
Miscellaneous	757	91,279,490
Textile	3,027	384,117,950
Trading	1,904	296,054,021
Transport	1,796	275,151,569
Total	14,434	2,049,787,160

Sectorwise Distribution of Number of Loans



### **Rebuilding Pragathigama Village – Additional Investment of Rs. 692,814**

HNB completed the rebuilding of Pragathigama during the year and ceremonially handed over the homes to recipients. The homes were built on a project undertaken under the aegis of Shanthi Housing Loans, in order to empower the villagers of the remote and impoverished area of Padiyathalawa. The communication campaign associated with the project even sparked interest in the village from various parts of the country.

We recognise the initiative taken by Mr. Janath Tillekeratne to highlight the plight of this village and bring it to the attention of HNB.

### **Employee volunteering**

Our business encourages employees to become community service oriented by volunteering. We offer them flexibility and support and encourage them to look for innovative ways of getting involved in CSR. Engaging our staff to volunteer to benefit communities, encourages them to take greater pride in being part of HNB. We continue to encourage our employees to give of their time and energy to community investment programs.



### **Awareness campaigns**

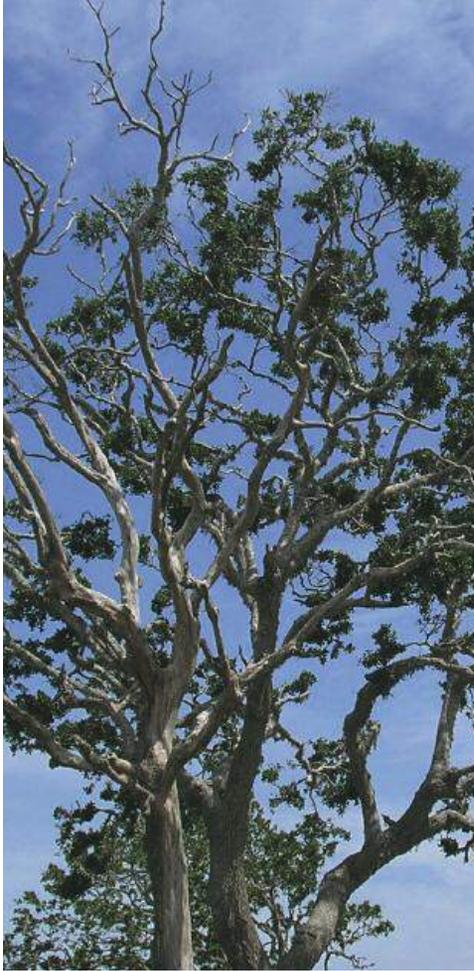
HNB along with 15 other Banks pledged its commitment to the Banks' Campaign to Crush Child Pornography on the Internet (B3CPI) which was launched in November 2007 on the initiative of Standard Chartered Bank, Sri Lanka to eradicate the problem of child pornography through concerted, cross industry action to cut off the funding of these websites.

### **Community Sponsorships**

#### **HNB ventures into Golf**

For the first time in its history, HNB commenced an association with Golf. In October of 2007, HNB sponsored one of the most prestigious golf tournaments in the annual calendar of the Royal Colombo Golf Club – The Millennium Trophy 2007. The RCGC, in return, entitled the tournament trophy the "HNB Millennium Trophy".





## MINIMISING OUR IMPACT ON THE ENVIRONMENT WE OPERATE IN

While most of our overall environmental impact is indirect, resulting from our financing and investment activities, we also have a direct impact on the environment through our day-to-day business operations. Widely accepted as a leader of industry, we consider that reducing the direct impact our operations have on the environment, is the first step we can take towards sustainability of our planet. We are working towards reducing waste and the more efficient use of resources.

The second step is reducing our indirect environmental impact by managing our products, services and our supply chain.

# ENVIRONMENTAL RELATIONS

## AT A GLANCE

- Initiatives to formulate a structured framework to consider the impact of climate change

## Energy Saving

A key challenge facing businesses globally is the increasing energy requirements. HNB's energy management approach begins within its Property Operations. As we have described in our 2006 Report, HNB Towers is considered one of the most energy efficient buildings in Colombo due to revolutionary technology incorporated into the building at the time of construction. Some of the initiatives implemented to reduce energy consumption were reported in 2006, and included;

- Variable air volume units which control the supply of air temperature and the rate of airflow, based on actual demand.
- A demand-controlled ventilation system comprising an energy saving feature which controls the amount of outdoor air supplied, based on carbon dioxide levels within the air conditioned space
- An intelligent microprocessor, which senses the daylight component to provide only the necessary levels of illumination, and
- The exterior of the building itself, which is equipped with energy efficient high pressure sodium vapor, metal halide and compact fluorescent lamps.

HNB continues to focus on managing energy consumption.



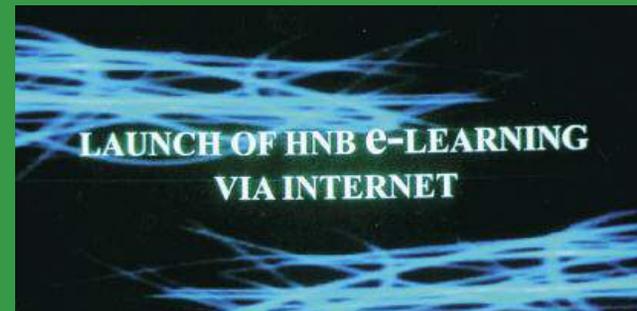
## Garbage and waste disposal

As a financial services provider we consider waste as a less relevant indicator as it is mainly the result of our employees consumption, and not from our business activities. The recycling project begun last year as an environmentally friendly practice, continues at HNB Tower with garbage bins placed systematically around the building to ensure a systematic process for garbage disposal. All rental clients too fall in line with this project which ensures that the collected garbage is recycled and supplied to manufacturers of paper and plastic as raw material.

## Use of paper

Paper continues to be the most significant single material input to our business. We use paper in the office and in the production of customer information documents. A4 paper use is a major component of our office based paper usage. Reducing the use of paper and recycling it, provide both an environmental and economic benefit, and some of the initiatives taken by us during the year are;

- We insist on double-sided printouts and photocopies wherever relevant
- Paper communication between the divisions/Customer centres of HNB has been replaced with on-line communication where possible, resulting in significant reduction in paper usage
- HNB's user friendly E-banking facilities have enhanced the size of the customer base that accesses our web site in



order to initiate and complete their day to day banking transactions electronically.

- We have converted selected staff training sessions into our E-learning process, which has resulted in reduced paper usage on training materials.

### Use of water

We have identified the need to reclaim water consumed at the HNB Tower, with a view to recycling its use.

### Clearing invasive species at Bundala – Investment Rs. 500,000

Together with the Wildlife and Nature Protection Society of Sri Lanka, as a team oriented effort, HNB helped clear a further five hectares of jungle which had been attacked by an invasive species of vegetation in Bundala. The Bundala wetlands are the only 'RAMSAR' site in Sri Lanka and lie in South Arid Zone of the country. This national park consists of lagoons, a reservoir and scrub jungle, which is home to numerous migrant birds, some of them from as far as Siberia; and a nesting ground for very rare sea turtles. The invasive species has habitat problems for the birds, animals, insects, amphibians and other beings within the Park. In the next phase of this project, we will create a sanctuary for the sustainability of the bird and insect life within the park. As a demonstration of our continued involvement, HNB has committed a further sum of Rs 500,000 to clear another 10 hectares.

### Facing climate change

Climate change is a global issue and we have been examining and addressing the impact of environmental issues on our business. Our response to climate change will be fourfold;

- Responsible lending
  - Supporting environmentally friendly projects, based on impact assessment carried out by us internally, or externally by independent parties.
  - Supporting local dairy, poultry farming and other agricultural food production projects, linking the supply chain and reducing the implications of transportation
  - Considering measures to increase awareness among our customers on the impact of climate change
- Increasing Awareness
  - Educating our employees on our climate change strategy and increasing awareness through our internal news letter Hatna-Mag and internal communication network Hatna-net.
- Assessing our Key Suppliers
  - In the future, our process for the assessment of key suppliers will include their approach to CSR and climate change.
- Participation in climate change initiatives
  - HNB functions as the major distributor for JBIC's E-Friends funding line which is a Government facilitated climate change initiative.

We also intend joining UN Global Compact, which is the world's largest global corporate citizenship initiative, and is a framework for businesses that are committed to aligning their operations and strategies with ten universally accepted principles which include the areas of human rights and the environment.

## 1. CUSTOMER RELATIONS

### **Complaints handling**

80 customer complaints were received and resolved effectively during the year

### **Physical inclusion**

17 Customer centres were made physically enabling during the year  
ATMs at 13 more branches have been rendered wheel chair accessibility

### **Customer Reach**

17 new customer centres were opened during the year

## 2. EMPLOYEE RELATIONS

### **Learning and development**

The In house, local and overseas training data are available on page 23

### **Diversity**

Age wise and Gender wise analysis of HNB staff are given on page 24  
Employee turnover at Senior/ Corporate management level  
Employee turnover at Senior/ Corporate management level - 2.18%

## 3. INVESTOR RELATIONS

The economic performance indicators of the Bank have been presented on pages 30 and 31

## 4. COMMUNITY RELATIONS

### **Investment in Health projects**

Details are given on pages 35 and 36

### **Investment in Education projects**

Details are given on 36

### **Sectorwise analysis of Micro Finance loans**

Details are given on pages 37 and 38

## 5. ENVIRONMENT RELATIONS

### **Investment in environment projects**

Details are given on page 42 of this Report



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## TO THE READERS OF THE SUSTAINABILITY REPORT 2007

### Introduction

We have been engaged by Hatton National Bank PLC (HNB) to review the Sustainability Report 2007 (further referred to as The Report). The Report, including the identification of material issues, is the responsibility of HNB's management. Our responsibility is to issue an assurance report on The Report.

### Context and scope

In The Report HNB describes its efforts and progress in relation to Sustainability. Our engagement was designed to provide the readers of The Report with:

- reasonable assurance on whether:
  - the data on financial performance, as specified on page 30 and 31 of The Report are properly derived from financial statements of HNB for the year ended 31 December 2007;
- limited assurance on whether:
  - the data on Key Performance Indicators for 2007 specified on page 43 are fairly stated;
  - the other information in The Report is fairly stated.

'Fairly stated' means that the reported information properly reflects the information contained in the underlying sources such that it is consistent with the source information. Reasonable assurance is a higher level of assurance than limited assurance, which is reflected in the nature and depth of the work performed

### Standards and criteria

We conducted our engagement in accordance with the Sri Lanka Auditing Practice Statement (SLAPS 3), applicable to review engagements, and the International Standard on Assurance Engagements (ISAE 3000): Assurance Engagements other than Audits or Reviews of Historical Financial Information, issued by the International Auditing and Assurance Standards Board. Amongst others, these standards require that:

- the assurance team members possess the specific knowledge, skills and professional competencies needed to understand and review the information in The Report;
- when providing limited assurance, which is a lower level than reasonable assurance, a negative form of conclusion is used.

There are no generally accepted standards for reporting sustainability performance. HNB applies its own internal sustainability reporting criteria, derived from Sustainability Reporting Guidelines of the Global Reporting Initiative and its stakeholder engagement process as detailed on page 9 of The Report.

### Considerations and limitations

Environmental and social performance data are subject to inherent limitations given their nature and the methods used for determining, calculating and estimating such data.

To obtain a thorough understanding of the financial results and financial position of HNB, the reader should consult HNB's audited financial statements for the year ended 31 December 2007, included in the Financial Reports from page 12 to 94.

**Work undertaken and conclusions**

We reviewed the reliability of the data on Key Performance Indicators for 2007 based on:

- visits to selected project sites and branches to review systems and data;

And reviews of:

- the systems used to generate, aggregate and report these data.
- the data reported by the relevant business units to corporate level;
- the data validation processes at corporate and business level;
- the data trends in discussions with management

Based on the above, the data for Key Performance Indicators for 2007, specified on page 43 do not appear to be unreliable.

**Financial data**

We have reconciled the data on financial performance reported on page 31 of The Report with the audited financial statements of HNB for the year ended 31 December 2007.

Based on the above, we conclude that the data on financial performance reported on page 31 are properly derived from the financial statements of HNB for the year ended 31 December 2007 for which the independent auditors issued an unqualified audit opinion dated 15 February, 2008 on page 11 of the Financial Reports.

**Other information**

We reviewed the other information in The Report, based on:

- an analysis of the systems and processes used to generate this information;
- review of internal documentation and sources;
- interviews with staff for the information;
- our knowledge and understanding of the sector and HNB's business.

Based on the above, the other information in The Report does not appear to be unfairly stated.

*Forst Rhodes Thornton & Co*

**CHARTERED ACCOUNTANTS**

Colombo

15 February 2008

FORST RHODES THORNTON & CO. Chartered Accountants  
 15, Bankers' Buildings, Colombo 02, Sri Lanka.  
 Members of the Institute of Chartered Accountants of Sri Lanka  
 (ICASA) and the Institute of Chartered Accountants in England  
 and Wales (ICAEW).

Mr. R. Fernando FCA  
 Mr. S. D. Fernando FCA  
 Mr. A. P. Samar FCA  
 Mr. S. Jayasinghe FCA  
 Mr. C. C. Jayasinghe FCA

Mr. R. Fernando FCA  
 Mr. S. D. Fernando FCA  
 Mr. A. P. Samar FCA  
 Mr. S. Jayasinghe FCA  
 Mr. C. C. Jayasinghe FCA

# The Global Reporting Initiatives (GRI) G3

The Global Reporting Initiative (GRI) provides a generally accepted framework for reporting on an organisation's economic, environmental and social performance. HNB has used the GRI Sustainability Reporting Guidelines (G3) in the development of our 2007 Sustainability Report. This index provides a comprehensive listing of the GRI indicators reported by HNB. We have also used the financial services sector supplements on social and environmental performance. This Index refers to information in our 2007 Sustainability Report, as well as the other sections of our 2007 Annual Report.

We have self assessed our report as an A+.

	2002 In Accordance	C	C+	B	B+	A	A+
<b>Mandatory</b>	Self declared						✓
<b>Optional</b>	Third party checked						
	GRI checked						

## GRI Index

### Profile

- Strategy and analysis
- Organisational profile
- Report parameters
- Governance, commitments and engagement

### Economic

- Economic performance
- Market presence
- Indirect economic impacts

### Environmental

- Materials
- Energy
- Water
- Biodiversity
- Emissions, effluents and waste
- Products and services

### Labour practices and decent work

- Employment
- Labour/management relations
- Occupational health and safety
- Training and education
- Diversity and equal opportunity

### Human rights

- Investment and procurement practices
- Non-discrimination
- Freedom of association and collective bargaining
- Child labour
- Forced and compulsory labour
- Security practices
- Indigenous rights

### Society

- Community
- Corruption
- Public policy
- Anti-competitive behaviour
- Compliance

### Product responsibility

- Customer health and safety
- Product and service labeling
- Marketing communication
- Customer privacy
- Compliance

### Legend

<b>Corporate Review Book</b>	<b>CR</b>
<b>Management Discussion Book</b>	<b>MD</b>
<b>Financial Reports Book</b>	<b>FR</b>
<b>Sustainability Report Book</b>	<b>SR</b>

## Profile

1. Strategy and analysis		Reference
1.1 Statement from the CEO and chairperson	<ul style="list-style-type: none"> <li>Chairman's report</li> <li>CEO's report</li> </ul>	CR
1.2 Description of key impacts, risks and opportunities	<ul style="list-style-type: none"> <li>Key challenges and opportunities</li> <li>Inspiring and engaging our people</li> <li>Improving financial literacy and inclusion</li> <li>Responsible lending</li> <li>Corporate responsibility highlights</li> <li>Governance</li> </ul>	CR & SR
2. Organisational profile		
2.1. Name of the reporting organization	<ul style="list-style-type: none"> <li>Hatton National Bank PLC</li> </ul>	
2.2 Primary brands, products and services	<ul style="list-style-type: none"> <li>Profile</li> </ul>	MD
2.3 Operational structure of the organization	<ul style="list-style-type: none"> <li>Profile</li> </ul>	CR & MD
2.4 Location of organization's headquarters	<ul style="list-style-type: none"> <li>HNB Towers , 479. T B Jayah Mawatha, Colombo 10.</li> </ul>	
2.5 Number and name of countries with operations	<ul style="list-style-type: none"> <li>N/A</li> </ul>	
2.6 Nature of ownership and legal form	<ul style="list-style-type: none"> <li>Corporate Information</li> </ul>	CR
2.7 Markets served	<ul style="list-style-type: none"> <li>Profile</li> </ul>	MD
2.8 Scale of the reporting organization	<ul style="list-style-type: none"> <li>Number of employees</li> <li>Profit and loss summary</li> <li>Ten year summary</li> <li>Twenty largest shareholders</li> <li>Breakdowns of operating income, cost-to-income and employees by country</li> </ul>	FR
2.9 Significant changes during the reporting period	<ul style="list-style-type: none"> <li>Changes during the year are given</li> </ul>	SR & CR
2.10 Awards received	<ul style="list-style-type: none"> <li>Recognition</li> </ul>	SR
3. Report parameters		
3.1 Reporting period	<ul style="list-style-type: none"> <li>1 January 2007 to 31 December 2007</li> </ul>	
3.2 Date of most recent previous report	<ul style="list-style-type: none"> <li>December 2006</li> </ul>	
3.3 Reporting cycle	<ul style="list-style-type: none"> <li>Annual</li> </ul>	
3.4 Contact point	<ul style="list-style-type: none"> <li>Contact details</li> </ul>	CR
3.5 Report Scope and Boundary	<ul style="list-style-type: none"> <li>About Our Report</li> </ul>	SR
3.6 Defining report content	<ul style="list-style-type: none"> <li>GRI 3</li> </ul>	SR
3.7 Boundary of report	<ul style="list-style-type: none"> <li>HNB's 2007 Sustainability Report covers the Bank's operations.</li> </ul>	SR

3.8	Limitations on scope/boundary	<ul style="list-style-type: none"> <li>About our report</li> <li>Key challenges and opportunities</li> </ul>	SR
3.9	Data measurement techniques	<ul style="list-style-type: none"> <li>Reporting Process</li> </ul>	SR
3.10	Restatements	<ul style="list-style-type: none"> <li>None</li> </ul>	
3.11	Significant changes	<ul style="list-style-type: none"> <li>No significant changes, but the initiatives taken by the Bank have been reported.</li> </ul>	SR
3.12	Location of content	<ul style="list-style-type: none"> <li>Will be uploaded on the HNB website</li> </ul>	
3.13	External assurance	<ul style="list-style-type: none"> <li>Independent Assurance Report</li> </ul>	SR
<b>4. Governance, commitments and engagement</b>			
4.1	Governance structure	<ul style="list-style-type: none"> <li>Corporate responsibility leadership</li> <li>Corporate Governance</li> </ul>	CR
4.2	Chair of the highest governance body	<ul style="list-style-type: none"> <li>Chairman's report</li> <li>Chairman's biography</li> </ul>	CR
4.3	Highest governance body	<ul style="list-style-type: none"> <li>HNB's organizational approach to corporate responsibility (diagram)</li> <li>Corporate Governance</li> </ul>	CR
4.4	Mechanisms for employees/share holders to provide recommendations/direction to the board	<ul style="list-style-type: none"> <li>Feedback form</li> <li>Access to directors</li> <li>Stakeholder engagement</li> </ul>	SR
4.5	Compensation and performance	<ul style="list-style-type: none"> <li>Corporate Responsibility Leadership</li> <li>Performance appraisal based on balance scorecard</li> </ul>	SR
4.6	Avoidance of conflicts of interest	<ul style="list-style-type: none"> <li>Conflict of interest</li> <li>Directors' Disclosure of Interest Policy and Policy for handling conflicts of interest</li> </ul>	CR
4.7	Expertise of governance body	<ul style="list-style-type: none"> <li>Board composition, selection and appointment</li> </ul>	CR
4.8	Mission and values statements	<ul style="list-style-type: none"> <li>Corporate Responsibility Leadership</li> <li>Values</li> <li>Corporate governance</li> </ul>	CR
4.9	Management of performance	<ul style="list-style-type: none"> <li>Corporate responsibility leadership</li> </ul>	CR & SR
4.10	Evaluating the performance	<ul style="list-style-type: none"> <li>Performance evaluations</li> <li>Corporate responsibility leadership</li> </ul>	SR
4.11	Precautionary approach	<ul style="list-style-type: none"> <li>Risk Management Framework</li> </ul>	CR
4.14	List of stakeholder groups	<ul style="list-style-type: none"> <li>Stakeholder Engagement</li> </ul>	SR
4.15	Identification and selection of stakeholders	<ul style="list-style-type: none"> <li>Stakeholder Engagement framework (PDF)</li> <li>GRI 3</li> </ul>	SR
4.16	Approaches to stakeholder engagement	<ul style="list-style-type: none"> <li>Stakeholder engagement</li> <li>GRI 3</li> </ul>	SR
4.17	Key issues and concerns of stakeholders	<ul style="list-style-type: none"> <li>Key challenges and opportunities</li> <li>Stakeholder relations</li> </ul>	SR

## Economic

Management approach		Reference
Disclosure of management approach		• Policy <b>SR</b>
Economic performance		
EC1 Economic value generated and distributed	• Value added statements	<b>MD</b>
EC2 Financial implications of climate change	• Initiatives taken by HNB	<b>SR</b>
EC3 Organization's defined benefit pension plan	• Description of the pension plan	<b>FR</b>
EC4 Financial assistance from government	• HNB does not receive any significant assistance from government	
Market Presence		
EC5 Entry-level wage-local minimum age (additional)	• Defined in the collective agreement and labour law	
EC9 Indirect Economic impacts (additional)	• Concessions for the community • Improving financial literacy and inclusion. • Taking the next step on responsible lending. • Indigenous employment, mature-aged workers, women in management and disability advocacy • Supporting rural employment and access to financial services	<b>SR</b>

## Environment

Management approach		Reference
Disclosure of management approach	<ul style="list-style-type: none"> <li>Policy</li> </ul>	SR
Materials		
EN1 Material used by weight or volume	<ul style="list-style-type: none"> <li>Not available now</li> </ul>	
EN2 Percentage of materials used that are recycled input materials	<ul style="list-style-type: none"> <li>Initiatives taken by HNB have been reported, but the data are not available now</li> </ul>	SR
Energy		
EN3 Direct energy consumption by primary energy source	<ul style="list-style-type: none"> <li>Initiatives taken by HNB have been reported, but the data are not available now</li> </ul>	SR
EN4 Indirect energy consumption by primary source	<ul style="list-style-type: none"> <li>Initiatives taken by HNB have been reported, but the data are not available now</li> </ul>	SR
EN5 Energy saved due to conservation and efficiency improvements (Additional).	<ul style="list-style-type: none"> <li>Initiatives taken by HNB have been reported, but the data are not available now</li> </ul>	SR
EN6 Initiatives to provide energy-efficient or renewable energy based products and services, and reduction in energy requirements as a result of these initiatives (additional).	<ul style="list-style-type: none"> <li>Initiatives taken by HNB have been reported, but the data are not available now</li> </ul>	SR
EN7 Initiatives to reduce indirect energy consumption and reductions achieved (additional)	<ul style="list-style-type: none"> <li>Initiatives taken by HNB have been reported, but the data are not available now</li> </ul>	SR
Water		
EN8 Total water withdrawal by source.	<ul style="list-style-type: none"> <li>Key environmental indicators</li> <li>Initiatives taken by HNB have been reported, but the data are not available now</li> </ul>	SR
EN9 water sources affected significantly by withdrawal of water (additional)	<ul style="list-style-type: none"> <li>Not applicable to our organization</li> </ul>	
EN10 Percentage and total volume of water recycled and reused (additional)	<ul style="list-style-type: none"> <li>Collective agreement</li> </ul>	
Biodiversity		
EN11 Location and size of land owned, leased, managed in, or adjacent to, protected areas and areas of high biodiversity value outside protected areas.	<ul style="list-style-type: none"> <li>Not applicable to our organization</li> </ul>	
EN12 Description of significant impacts of activities, products, and services on biodiversity in protected areas and areas of high biodiversity value outside protected areas.	<ul style="list-style-type: none"> <li>Not applicable to our organization</li> </ul>	
EN13 Habitats protected or restored (additional).	<ul style="list-style-type: none"> <li>Not applicable to our organization</li> </ul>	
EN14 Strategies, current actions and future plans for managing impacts on biodiversity (additional)	<ul style="list-style-type: none"> <li>Not applicable to our organization</li> </ul>	
EN15 Number of IUCN Red List species and national conservation list species with habitats in areas affected by operation level of extinction risk (additional)	<ul style="list-style-type: none"> <li>Not applicable to our organization</li> </ul>	

<b>Emissions, effluents and Waste</b>		
EN16 Total direct and indirect greenhouse gas emissions by weight	<ul style="list-style-type: none"> <li>Not applicable to our organization at this stage</li> </ul>	
EN17 Other relevant indirect greenhouse gas emissions by weight.	<ul style="list-style-type: none"> <li>Not applicable to our organization at this stage</li> </ul>	
EN18 Initiatives to reduce emissions and reductions achieved (additional)	<ul style="list-style-type: none"> <li>Managing our environmental impact and supply chain</li> </ul>	<b>SR</b>
EN19 Emissions of ozone-depleting substances by weight	<ul style="list-style-type: none"> <li>Not applicable to our organization</li> </ul>	
EN20 NOx, SOx, and other significant air emissions by type and weight.	<ul style="list-style-type: none"> <li>Not applicable to our organization</li> </ul>	
EN21 Total water discharge by quality and destination.	<ul style="list-style-type: none"> <li>Initiatives taken by HNB have been reported, but the data are not available now</li> </ul>	<b>SR</b>
EN22 Total weight of waste by type and disposal method	<ul style="list-style-type: none"> <li>Initiatives taken by HNB have been reported, but the data are not available now</li> </ul>	<b>SR</b>
EN23 Total number and volume of significant spills	<ul style="list-style-type: none"> <li>Not applicable to our organization</li> </ul>	
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 (additional)	<ul style="list-style-type: none"> <li>Not applicable to our organization</li> </ul>	
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 (additional).	<ul style="list-style-type: none"> <li>Not applicable to our organization</li> </ul>	
<b>Products and Services</b>		
EN26 Initiatives to mitigate environmental impacts of products and services, and extent of impact mitigation.	<ul style="list-style-type: none"> <li>Social and environmental risks in Institutional lending</li> </ul>	<b>SR &amp; MD</b>
EN27 Percentage of products sold and their packaging materials that are reclaimed by category.	<ul style="list-style-type: none"> <li>Not applicable to our organization</li> </ul>	
<b>Compliance</b>		
EN28 Monetary value of significant fines and total number of non-monetary sanctions for non-compliance with environmental laws and regulations.	<ul style="list-style-type: none"> <li>No fines</li> </ul>	
<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 (additional).	<ul style="list-style-type: none"> <li>Initiatives taken by HNB have been reported, but the data are not available now</li> </ul>	<b>SR</b>
<b>Overall</b>		
EN30 Total environmental protection expenditures and investments by type (additional)	<ul style="list-style-type: none"> <li>Initiatives taken by HNB have been reported, but the data are not available now</li> </ul>	<b>SR</b>

## Labour practices and decent work

		Reference
Disclosure of management approach	<ul style="list-style-type: none"> <li>Policy</li> </ul>	SR
<b>Employment</b>		
LA1 Breakdown of total workforce.	<ul style="list-style-type: none"> <li>Inspiring and engaging our people</li> </ul>	SR
LA2 Employee turnover	<ul style="list-style-type: none"> <li>Staff turnover is monitored by the HR division regularly</li> </ul>	
LA3 Minimum benefits (additional)	<ul style="list-style-type: none"> <li>Defined in the collective agreement</li> </ul>	
<b>Labour /Management Relations</b>		
LA5 Notice period regarding operational changes	<ul style="list-style-type: none"> <li>Defined in the collective agreement, labour law and appointment letters</li> </ul>	
<b>Occupational Health &amp; Safety</b>		
LA6 Management – Worker health and safety committees (additional)	<ul style="list-style-type: none"> <li>Health, safety and wellbeing</li> </ul>	SR
LA7 Lost Time Injury Frequency Rate	<ul style="list-style-type: none"> <li>Health, safety and wellbeing</li> </ul>	SR
LA8 Serious communicable diseases	<ul style="list-style-type: none"> <li>Assistance is provided to employees with serious medical ailment beyond the normal medical scheme. During the year the Bank has supported 9 such staff members.</li> </ul>	SR
LA9 Health and safety in union agreements (additional)	<ul style="list-style-type: none"> <li>Collective Agreement</li> </ul>	SR
<b>Training and Education</b>		
LA10 Hours of training	<ul style="list-style-type: none"> <li>Learning and development</li> </ul>	SR
LA11 Employability and managing career endings (additional)	<ul style="list-style-type: none"> <li>Learning and development</li> </ul>	SR
<b>Diversity and Equal Opportunity</b>		
LA13 Employees according to diversity	<ul style="list-style-type: none"> <li>Diversity</li> <li>Equal opportunity</li> </ul>	SR
LA14 Basic salary of men and women	<ul style="list-style-type: none"> <li>No gender pay differential</li> </ul>	SR

## Human rights

		Reference
<b>Management approach</b>		
Disclosure of management approach	• Policy	SR
<b>Investment and procurement practices</b>		
HR1 Investments with HR clauses/screening	• Social and environmental risk in Institutional lending	SR & MD
HR2 Suppliers that underwent HR screening	• Supply chain	
HR3 Employee training on human rights (additional)	• Learning and development	SR
<b>Non discrimination</b>		
HR4 Incidents of discrimination	• None reported	
<b>Freedom of association and collective bargaining</b>		
HR5 FOA and collective bargaining	• Collective agreement	
<b>Child Labour</b>		
HR6 Child labour	• Governed by labour law in the country	
<b>Forced and Compulsory Labour</b>		
HR7 Forced or compulsory labour	• Governed by labour law in the country	
<b>Security Practices</b>		
HR8 Security personnel trained in human rights (additional)	• Security process is outsourced. But the security coordinator of the Bank is responsible for the overall security arrangement of the Bank and the internal security cadre.	
<b>Indigenous Rights</b>		
HR9 Rights of indigenous people (additional)	• Not applicable	

## Society

		Reference
<b>Management approach</b>		
Disclosure of management approach	<ul style="list-style-type: none"> <li>• Policy</li> <li>• Goals and performance</li> </ul>	<b>SR</b>
<b>Community</b>		
S01 Impacts of operations on communities	<ul style="list-style-type: none"> <li>• Initiatives taken by HNB</li> </ul>	<b>SR</b>
<b>Corruption</b>		
S02 Analysis for risks of corruption	<ul style="list-style-type: none"> <li>• Employee handbook</li> <li>• Internal training session</li> </ul>	
S03 Training in anti-corruption	<ul style="list-style-type: none"> <li>• Employee handbook</li> <li>• Internal training session</li> </ul>	
S04 Instances of corruption	<ul style="list-style-type: none"> <li>• None reported</li> </ul>	
<b>Public Policy</b>		
S05 Public policy development and lobbying	<ul style="list-style-type: none"> <li>• No significant involvement during the year</li> </ul>	
S06 Contributions to political parties or related institutions (additional)	<ul style="list-style-type: none"> <li>• No significant involvement during the year</li> </ul>	
<b>Anti Competitive Behavior</b>		
S07 Legal actions for anti-competitive, antitrust and monopoly practices (additional)	<ul style="list-style-type: none"> <li>• None reported during the year</li> </ul>	
<b>Compliance</b>		
S08 Monetary value of significant fines	<ul style="list-style-type: none"> <li>• None reported during the year</li> </ul>	

## Product Responsibility

		Reference
<b>Management approach</b>		
Disclosure of management approach	<ul style="list-style-type: none"> <li>• Policy</li> <li>• Goals and performance</li> </ul>	<b>SR</b>
<b>Customer Health &amp; safety</b>		
PR2 Non-compliance with regulations/codes (additional)	<ul style="list-style-type: none"> <li>• We are currently determining whether we have any incidences of this nature.</li> </ul>	
<b>Product and Service Labelling</b>		
PR3 Information required by procedures	<ul style="list-style-type: none"> <li>• Improving Financial Literacy and Inclusion</li> <li>• Responsible Lending</li> </ul>	<b>SR</b>
PR4 Non-compliance concerning labelling (additional)	<ul style="list-style-type: none"> <li>• We are currently determining whether we have any incidences of this nature</li> </ul>	
PR5 Customer satisfaction (additional)	<ul style="list-style-type: none"> <li>• Customer relations</li> </ul>	<b>SR</b>
<b>Marketing Communications</b>		
PR6 Adherence to laws, standards and codes	<ul style="list-style-type: none"> <li>• Simple and clear communication</li> </ul>	
PR7 Non-compliance concerning marketing (additional)	<ul style="list-style-type: none"> <li>• We are currently determining whether we have any incidences of this nature</li> </ul>	
<b>Customer Privacy</b>		
PR8 No of breaches of customer privacy (additional)	<ul style="list-style-type: none"> <li>• None reported during the year</li> </ul>	<b>SR</b>
<b>Compliance</b>		
PR9 Non-Compliance with laws/regulations	<ul style="list-style-type: none"> <li>• We are currently determining whether we have any incidences of this nature</li> </ul>	

## Financial Services Sector Supplement Social Performance (November 2002)

		Reference
<b>Corporate Social Responsibility Management</b>		
CSR1 CSR Policy	<ul style="list-style-type: none"> <li>Our approach-Chairman and CEO reports</li> <li>Governance</li> </ul> External standards: <ul style="list-style-type: none"> <li>Global Reporting Initiative</li> <li>AA 100</li> <li>London Benchmarking Group</li> </ul>	<b>SR &amp; CR</b>
CSR2 CSR organization	<ul style="list-style-type: none"> <li>Governance</li> <li>Sustainability framework</li> </ul>	<b>SR</b>
CSR3 CSR audits	<ul style="list-style-type: none"> <li>External Assurance</li> <li>ISEA 3000 Standards</li> <li>Independent Assurance Report</li> </ul>	<b>SR</b>
CSR4 Management of sensitive issues	<ul style="list-style-type: none"> <li>Policies and practice, Human rights</li> <li>Stakeholder engagement, Public policy-making process, Political donations</li> <li>Key challenges and opportunities</li> <li>Workplace relations, communication and complaints. Our approach to jobs in India</li> <li>Social and environmental risks in Institutional lending</li> <li>Issue-specific training</li> </ul>	<b>SR</b>
CSR5 Non-compliance with law or code of conducts	<ul style="list-style-type: none"> <li>We are currently determining whether we have any incidents of this nature</li> </ul>	
CSR6 Stakeholder dialogue	<ul style="list-style-type: none"> <li>Stakeholder engagement</li> <li>Feedback form</li> </ul>	<b>SR</b>
<b>Internal Social Performance</b>		
INT1 Internal CSR Policy	<ul style="list-style-type: none"> <li>Sustainability Strategy</li> </ul>	<b>SR</b>
INT2 Staff turnover and job creations	<ul style="list-style-type: none"> <li>Employee relations</li> </ul>	<b>SR</b>
INT3 Employee satisfaction	<ul style="list-style-type: none"> <li>Employee relations</li> </ul>	<b>SR</b>
INT4 Senior management remuneration	<ul style="list-style-type: none"> <li>Performance appraisal based on balance scorecard</li> </ul>	<b>SR</b>
INT5 Bonuses fostering sustainable success (additional)	<ul style="list-style-type: none"> <li>Performance appraisal based on balance scorecard</li> </ul>	<b>SR</b>
INT6 Female-Male salary ratio	<ul style="list-style-type: none"> <li>Based on genderwise employee analysis</li> </ul>	<b>SR</b>
INT7 Employee profile	<ul style="list-style-type: none"> <li>Service-wise, age-wise and gender-wise</li> </ul>	<b>SR</b>
SOC1 Charitable Contributions	<ul style="list-style-type: none"> <li>Disclosed in the Directors Report</li> </ul>	<b>FR &amp; SR</b>
SOC2 Economic value added	<ul style="list-style-type: none"> <li>Ten year summary</li> </ul>	<b>FR</b>

<b>Performance of Suppliers</b>		
SUP1 Screening of major suppliers	<ul style="list-style-type: none"> <li>• Supply chain</li> <li>• Managing environmental impact and supply chain</li> </ul>	<b>SR</b>
SUP2 Supplier satisfaction		<b>SR</b>
<b>Retail Banking</b>		
RB1 Policy-socially relevant elements	<ul style="list-style-type: none"> <li>• Improving financial literacy and inclusion</li> <li>• Personal report</li> </ul>	<b>SR &amp; MD</b>
RB2 Lending profile	<ul style="list-style-type: none"> <li>• Business Banking Lending Profile</li> <li>• Small Business Lending Profile</li> </ul>	<b>MD</b>
RB3 Lending with high social benefit	<ul style="list-style-type: none"> <li>• Micro financing</li> <li>• Concessions for the community</li> <li>• Taking the next step in responsible lending</li> </ul>	<b>SR</b>

## Financial Services Sector Supplement Environmental Performance (March 2005)

		Reference
<b>Financial Services Sector Supplement: Environmental Performance</b>		
F1	Environmental policies	<ul style="list-style-type: none"> <li>Initiatives taken by the Bank have been disclosed. A structured approach to climate change is to be implemented in 2008</li> </ul> <b>SR</b>
F2	Assessing/screening environmental risks	<ul style="list-style-type: none"> <li>Initiatives taken by the Bank have been disclosed. A structured approach to climate change is to be implemented in 2008</li> </ul> <b>SR</b>
F3	Threshold at which assessments are applied	<ul style="list-style-type: none"> <li>Data are currently not available</li> </ul> <b>SR</b>
F4	Clients compliance with risk assessment	<ul style="list-style-type: none"> <li>Customer relations</li> <li>Responsible lending</li> </ul> <b>SR</b> <b>MD</b>
F5	Staff competency	<ul style="list-style-type: none"> <li>HR framework</li> <li>A different approach for better outcomes</li> <li>Performance management</li> </ul> <b>SR</b>
F6	Audits that include environmental risk systems	<ul style="list-style-type: none"> <li>A structured approach is to be implemented in 2008</li> </ul>
F7	Interactions regarding risks and opportunities	<ul style="list-style-type: none"> <li>Social and environmental risk in lending</li> <li>Supply chain</li> </ul> <b>SR</b>
F8	Companies that have been engaged	<ul style="list-style-type: none"> <li>Not currently available</li> </ul>
F9	Assets subjected environmental screening	<ul style="list-style-type: none"> <li>Not currently available</li> </ul>
F10	Voting policy on environmental issues	<ul style="list-style-type: none"> <li>Not currently available</li> </ul>
F11	Percentage of assets under management	<ul style="list-style-type: none"> <li>Not currently available</li> </ul>
F12	Environmental products and services	<ul style="list-style-type: none"> <li>Products and Services</li> </ul> <b>MD</b>
<b>Investment Banking</b>		
IB1	Investment policy-socially relevant elements	<ul style="list-style-type: none"> <li>Responsible lending</li> </ul> <b>SR</b>
IB2	Customer profile: global transaction structure	<ul style="list-style-type: none"> <li>Products and services - Responsible lending</li> </ul> <b>MD</b>

To request information or submit a comment/query to the Company, please complete the following and return this page to -

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Hatton National Bank Limited,  
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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

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No

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INVESTOR FEEDBACK FORM











**MANAGEMENT**  
DISCUSSION





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## Corporate Banking

Corporate Banking at HNB continues to be an integral facet of the bottom line contribution, although increasingly the Banking Industry has become competitive, with the market heralding more players, less opportunities and contracting margins. However, given the competitive circumstances, Corporate Banking performed beyond expectations, posting a growth of over 30%, which can be considered a remarkable achievement. In the latter part of 2006, there was consolidation and centralisation of the Corporate Banking function, which saw Credit Authorities and Relationship Managers coming under the purview of the Head Office. This proved to be a judicious strategy as the results were extraordinary this year. Customer service, the speedy delivery of financial solutions, coupled with flexibility, innovation and the pursuit of, new market opportunities, resulted in the portfolio increase.

With Corporate Banking essentially revolving on the axis of customer relationships, we continued to emphasise on quality rather than the quantitative aspect of our portfolio, to ensure that a sustainable bottom line was maintained. We have also remained prudent about the facilities extended, cautious about our customer quality and have managed risks effectively, using the numerous processes implemented by the Bank. Coupled with the centralisation of Corporate Banking functions, credit delivery has proven to be speedier and more efficient. Using the synergies within the banking group, including insurance, share trading and the healthy network of over 372 correspondent banks and overseas representative offices in the region, the value addition we can give our customers has proven to be a competitive advantage in attracting new customers and inspiring committed loyalty among existing customers.

The Project Division (which comes under the purview of the Corporate Banking Group), also continues to be pivotal in enhancing our growth curve, maintaining a diversified portfolio of which 45% comprises FCBU loans for local BOI projects and overseas investments. Offshore lending has been quite vibrant, with the Maldivian sector performing exceptionally well. While 2006 saw more emphasis on mini hydropower projects due to the availability of refinance under the World Bank's RERED Credit Line, this year we focused on the offshore leisure industry, which

has been a winning decision. Currently our project portfolio showcases 56% in the leisure sector, 14% in power and energy, 6% each in manufacturing, tea & real estate and the balance in communication, health, food and beverages. The total loans approved this year amounted to Rs. 4.3 Billion with the leisure sector, seeing 84.5% of that infused into projects in Sri Lanka and the Maldives.

HNB is the leading Bank in Sri Lanka in approving facilities under Contract A of the EIB Credit Line (available for Tsunami affected industries), extending facilities amounting to Rs. 2.5 Billion this year, while also approving Rs. 324 Million under the E-Friends II Credit Line, providing financial assistance to fund environmental solutions to industrial enterprises.

### **SME Unit**

As a strategic measure, the activities of the division were restructured during 2007 in order to give better focus to our end objectives. This strategy bore fruit with the SME division posting a healthy growth of 41.3%, a portfolio increase of Rs. 1.5 Billion from Rs. 1.06 Billion posted last year, in addition to a satisfactory NPA ratio of 5.7%.

During the year 2007, the Bank's SME Division actively participated in the refinance credit lines, committing to Rs. 569 Million, under SMILE I Rev Scheme and Rs. 247 Million, under EIB Contract – B, continuing its winning stance by maintaining the premier position as having had the most number of loans approved and disbursed.

For further penetration, the Bank participated in two road shows in Colombo and Hambanthota, organised by the SEDF Facility of the IFC, with a participation of over 4,000 visitors.

### **Winning Strategies for 2008**

Our strategy in corporate banking is on the long term viability of the business rather than a short term spurt, as our ethos is one of a winning partnership. We will continue to improve on the quality of our portfolio, where risk is minimized and account profitability is satisfactory. Credit quality will be the main focus

and this year will hopefully see us gaining wider exposure in foreign currency offshore banking.

In project finance, while the construction, power and energy and healthcare sectors seem to display good growth trends in the next few years, we will be pursuing opportunities, especially overseas, in which ever sectors or industries with prospects and prove to be likely winners.

In the year 2008, the Bank, whilst consolidating the current portfolio, intends to expand SME lending for clients whose requirements are between Rs. 10 and 40 Million.

Specific areas of focus will be:-

- Further diversification of FCBU by following our key Lankan Corporates overseas in quality opportunities including Hotel and Garment Manufacturing projects.
- Facilitation of vertical integration of our micro credit, SME and Corporate Banking borrowers by financing quality projects which link small scale suppliers using HNB's micro credit, with our larger Corporates who procure from this segment in the Agriculture, Dairy and Poultry farming sectors.
- Positioning ourselves as the preferred Local Partner for major Export Credit Agencies (ECAs) in syndicating large scale projects.
- Coordinating closely with the newly incorporated Investment Banking Joint Venture (with DFCC Bank), where our top end Corporate Customer will be offered greater value creation solutions.



## Personal Banking

The year proved to be a challenging one for personal banking, due to a volatile financial environment that saw inflation and interest rates spiral, both major challenges for personal banking. The entire banking environment proved to be highly competitive with deposit mobilisation being extremely challenging. However, having anticipated these challenges in the domestic economic environment, HNB infused numerous initiatives into its personal banking product and services portfolio to ensure that the bottom line maintained its winning stance, with all lines of business showing exceptional growth during the year.

### Deposit mobilisation

HNB continued its winning streak despite a very challenging and competitive external milieu, growing our deposit base to Rs. 137 Billion, with the term deposits contributing significantly to the overall figures with a growth percentage of 36%. Marketing communications and promotional campaigns were geared toward mobilising savings to counter the high interest rates offered on Term Deposits.

The overall Savings portrayed a growth of 5.7% by end 2007. The key contributor to Pathum Vimana, the largest ever Savings prize scheme of Rs. 100 Million on offer, saw over 11,000 customers rewarded. Given the intense market competitiveness, one of HNB's winning strategies was to introduce the HNB Big Bonus scheme during the second half of the year, giving customers the option of earning bonus interest or winning prizes through Pathum Vimana, which proved to be one of the significant positive facets in growing our deposit base.

The popular minor savings scheme, HNB Singithi, also displayed a growth of 12% with considerable emphasis given via the 152 school based student banking units. Incentives on deposits made, participating in Student/Manager Conferences in each region for interaction and exchange of ideas and a special promotion for World Thrift Day which extended into the month of October and targeted parents of new born babies who were rewarded with gold pendants, were value additions that assisted in the significant upward growth curve.

Term Deposits, our most successful portfolio this year, recorded a tremendous growth, surpassing our expectations.

### Network Expansion

Our stance of being a visible partner to people anywhere in the country, was further augmented with the expansion of our branch and ATM network. Customer service was a pivotal factor in this expansion process and continues to be the winning platform upon which the Bank is positioned. We also made a conscious effort to launch more branches to give accessibility to the disabled, for further mobility to our physically challenged customers.

Customer Centres opened	17
Number of new ATMs installed	39

### Credit Cards

While forecasts for 2007 saw the Card Centre set for itself an ambitious promotional drive on new issuance for the year; considering the general economic climate, prudent measures were implemented with 15,000 new cards being the target set and achieved for 2007. Increased activity and profitability however did increase with card usage displaying a growth of 29% during the year.

Merchant acquisition, the other key area of business however saw intense competition and contracting margins. But HNB's winning position continued and the Card Centre overcame the posed challenges to retain its leading status, with the Maldives arm of the business too showing steady improvement.

With HNB instigating more emphasis on delivering superior services through cutting edge technology, the Card Centre too strategically improved its IT systems, including the implementation of a Fraud Guard to reduce fraudulent usage of cards, modifying the back end system to the latest version.

### Leasing

Working through a very challenging year in a high interest regime, our leasing business managed to hold its own despite intense competition. Positioned towards a hassle free

economical alternative, HNB Leasing uses the strengths of the Bank to penetrate all parts of the country effectively. The year also saw specialised promotional campaigns that publicised value additions and benefits, coupled with innovative leasing packages and a concerted effort to create brand awareness for HNB Leasing.

The portfolio continued to grow, with an above average market growth of 15.0% during the year and new leases disbursed showcased at Rs. 6.68.Billion. The market rank as per the Leasing Association of Sri Lanka statistics as at 31st March 2007, places HNB Leasing as No: 1 among the banks, while holding No: 3 position in the overall market.

### Pawning

A significant contributor towards the Bank's bottom line, pawning has been a definite winner this year, showing exceptional growth. The winning stance was supported amply with a sustained and incisive communications strategy. The challenging growth target of Rs. 2.53 Billion was exceeded with an impressive net growth of Rs. 3.34 Billion at the end of 2007, which was achieved without any dilution of portfolio quality as convincingly demonstrated by the exceptionally low overall NPA ratio of 1.6% (NPA over 3 months only 0.17%) as at the end of the year.

Yet another facet of this winning performance of the pawning business is the substantial growth in gross interest income, which at the end of the year stood at Rs.2.992 Billion, a remarkable increase from the figure of Rs. 2.365 Billion recorded for 2006.

### Shanthi Home Loans

One of the first branded housing finance products launched by a commercial bank 12 years ago, Shanthi Home Loans have proved to be a winning feature in the personal banking portfolio. Having arrested the NPAs at below 3%, the loan portfolio grew by a tremendous 22.9%, resulting in significant disbursements during the year despite the challenges of a significant increase in interest rates.

This year, under the theme 'Build for them', Shanthi Home Loans gave the concept of home loans a new dimension by focusing on permanent homes for the children's future. The concept was a successful launch pad at the Construct 2007 exhibition organised by the National Construction Association of Sri Lanka for which HNB was nominated as the Official Banker. Added incentives to those visiting the exhibition were insurance cover and savings account benefits. The Home Loan Wipe Off Draw was also continued during this year, deleting up to a maximum of Rs. 2 Million on a Shanthi Home Loan in 2007.

Shanthi Home Loans also ventured overseas this year, entering a joint partnership with Currency Exchange Corporation Limited UK, where expatriates in the UK can obtain loans in any designated foreign currency or in Sri Lankan Rupees. The sponsorship of the UK Lanka Times Sri Lankan of the Year Awards in the UK was also helpful in expanding our presence and brand value.

We also introduced a tripartite agreement which assists second home investors and home buyers purchase luxury condominiums. The agreement provides long term loans to the buyer with the developer retaining the title deed until the loan is fully paid up. The majority of the leading property developers joined hands with HNB in providing this value added scheme.

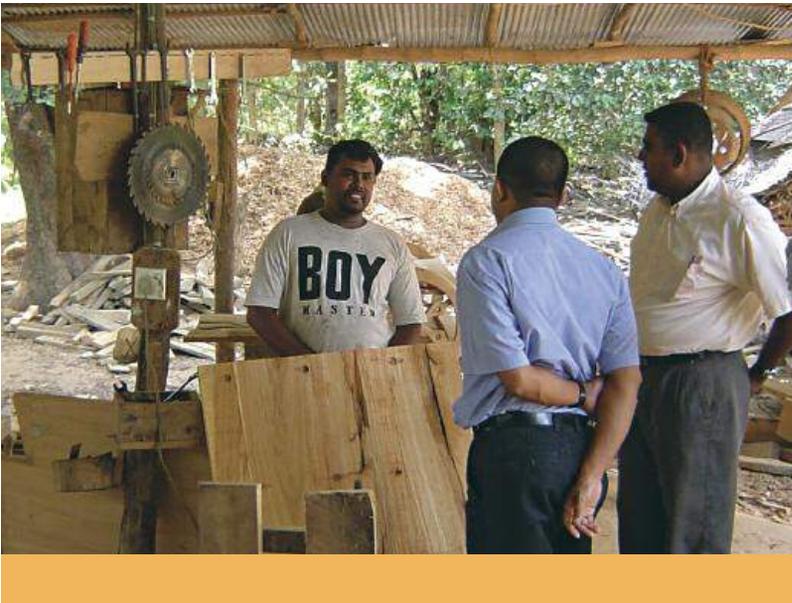
### HNB Personal Loans

Encompassing student graduation and vehicle loans, HNB Personal Loans had to contend with a rising interest regime but nevertheless held its own. HNB opted to take a cautious approach while providing priority for salaried A/Cs. The following developments took place during the year:

- Strategic alliances with Synergy School of Marketing for financial assistance for post graduate and professional studies and with Royal Institute of Colombo for student loans
- Vehicle loans to senior officials at Government institutions and professionals who are eligible to import vehicles under special concessions

### Winning strategies for 2008

- Increase ATMs by 36% to 250
- Increase New Customer Centres by 5% or more to 175
- Minor Savings
- Capture increased share of Deposits and Personal Financial Services from increasing pool of diaspora
- Decrease card fraud by franchising clip & pin implementation plan for cards.
- Grow Housing Finance Business by 20+%.



## Development Banking

### Financial Inclusion

During 2007, we continued to deliver banking services at an affordable cost to vast sections of the rural population. Providing access to banking and payment services to the entire population without discrimination was the prime objective of the bank.

This division mainly caters to the agriculture and micro financing sectors and HNB holds the distinction of being the first commercial bank in Sri Lanka to recruit qualified agricultural personnel to the banking stream to assist the rural agricultural enterprises and micro finance sectors.

Not only positioned as one of the most successful microfinance programmes, but also as a facet that fulfils sustainability aspects through economic sustainability, HNB's micro finance programme "Gami Pubuduwa" continued into its 19th year. The primary objective of this scheme is to establish a closer linkage between the Bank and the rural community, who were earlier treated as 'Non Bankable'. This scheme emphasises harnessing the inherent skills of the rural community, thereby assisting them to become self-reliant. Worked through 110 Gami Pubuduwa microfinance units and 117 dedicated field officers, the disbursement of Rs. 840 Million covers nearly 6000 micro entrepreneurs and benefits 18,000 families. The portfolio increase is at 13% compared to last year; up to Rs. 2.1 Billion with a collection ratio of over 95% and Rs. 1.2 Billion rural deposits successfully mobilised.

Financing of rural agricultural activities grew by 22 % during the year to Rs. 3.3 Billion, with disbursing loans amounting to Rs. 1.3 Billion approximately. Nearly 27 % of the total portfolio is for medium and long term agri projects covering tea, coconut and perennial crop development and most of these advances were backed by refinance schemes.

The Bank has been an active 'Participating Credit Institution' for almost all credit lines funded by the Asian Development Bank, the World Bank, the International Fund for Agricultural Development and the Japanese Bank for International

Cooperation as well as concessionary credit lines introduced by the Government of Sri Lanka from time to time.

The bank is involved in several refinance & non-refinance credit lines and provides a comprehensive package of financial services to develop the rural economy. In providing sustainable technical advice, the bank organised a farmer tour to India for 12 farmers in a bid to enhance their contribution towards developing Sri Lanka's rural agricultural sector. Further, the Bank also conducted several awareness programmes, which were specially designed and focused for the benefit of the rural community.

The German Savings Bank funded microfinance scheme to facilitate loans to entrepreneurs in tsunami affected areas was successfully completed having disbursed a total fund of Euro 5 Million.

The pioneering innovative micro insurance product launched jointly with HNB Assurance Ltd, continued to provide relief to borrowers in the microfinance sector. A significant growth of 54% during the year 2007 compared to the year 2006 was achieved.

### **Winning strategies for 2008**

Encourage Financial Inclusion through,

- Low cost delivery
- Wider risk management, awareness & solutions (Micro Insurance)
- Clearly identify linkage between microfinance & corporate for targeted industries
- Increase capacity building of customer segments



## International Operations

HNB's International operations have shown remarkable progress during the year, surpassing some of the more stringent targets set out at the beginning of the year.

In the field of inward remittances, HNB has consolidated its position as a major remittance handler and expanded its global network of remittance agency tie ups in Italy, the United Kingdom and Qatar, to provide customers with a wider opportunity to receive payments.

Our representatives are present in Bahrain, Kuwait and the United Arab Emirates and are providing the personalised services required for Sri Lankans employed in these regions. Their services include remittances as well as cross selling of all HNB's and its subsidiaries' products. Historically, Middle Eastern markets have been known for smaller individual remittances with substantial volumes into Sri Lanka. HNB's tie ups in European destinations have on the contrary provided larger quantifiable benefits, consequent to values of each transaction being considerably higher than from the Middle East.

HNB has been the dominant remittance partner for MoneyGram International in Sri Lanka, recording an increase of over 20% in the value of remittances handled during 2007 compared with the previous year. An award for the Best Collaboration of Signage Project from among the top eight agents in the Asia Pacific Region, was presented to HNB at a regional conference held in Shanghai.

Aggressive, well directed multi media awareness campaigns have been carried out in strategic markets to boost the momentum of harnessing deposits from Sri Lankan expatriates and from Sri Lankan migrants.

HNB pursued an ambitious growth target of US\$ 21 Million on the foreign currency base and successfully surpassed this milestone by 36% in spite of the sharp changes the local economy experienced during the same period.

During the year, HNB's in-house developed remittance software was commissioned among several remitting agencies overseas

which contributed to offering speedy and efficient delivery of remittances, providing the edge in a highly competitive market. The installation of software to automate back office operations in remittance handling also contributed to increase the efficiency level of delivery.

Performances in international trade finance operations have shown significant increases both in volume as well as income received. Our trade business was buoyant, especially with the increase in the volume of export business handled, totalling over 31% and the overall trade income received was up by 40%. Proactive co-operation between the International Division and the Corporate Banking Division enabled us work towards this achievement.

ISO 9001: 2000 Certification was awarded to us in April 2004 for the processing of trade transactions. The high standard of service provided for trade service operations on a continuing basis was reaffirmed with the re-certification in July this year for a further period of three years.

Our global network of well respected correspondents have continued to place their confidence in HNB and as a result we grew business volumes on the letters of guarantee segment recording a growth of 27% in remuneration.

### **Straight Through Processing**

Fine tuning of Straight Through Processing was successfully implemented for SWIFT outward message traffic and headway has been made on the same lines for SWIFT inward message traffic, which is expected to be concluded in early 2008.

### **Creation Of Swift Service Bureau Lanka Financial Services Bureau Ltd.**

HNB took the lead in creating a common service bureau for Sri Lankan SWIFT users, namely the Central Bank, commercial banks, Primary Dealers and the Colombo Stock Exchange, whereby a cost saving would be achieved through sharing a high powered single SWIFT connection to Sri Lanka among all SWIFT users, as against dedicated SWIFT connections for each bank/institution. This development is expected to enable the creation

of new Payments and Settlements Products to benefit all customers.

### **Winning Strategies For 2008**

We aim to continue our global penetration by venturing into new markets to support the Sri Lankan diaspora and also propose to use our web based system to complement the delivery of remittances, whereby an enhanced volume is envisaged. Our presence in Chennai and Karachi via representative offices will be further utilised to increase business opportunities, as will our expectations of having a representative office in the UAE in early 2008.

State of the art technology processes will be used to make further inroads in providing enhanced service quality to our Trade Finance customers in 2008.



## Treasury Operations

The year 2007 saw a lot of turmoil in both local and overseas financial markets. Locally the Sri Lankan Rupee weakened to an all time low of 113.60 against the U.S. dollar and overnight inter-bank call money rates peaked at around 55%. In spite of rising inflationary pressures, the Central Bank of Sri Lanka raised benchmark rates by only 0.50% during the year. The first-ever overseas debt sale by the Central Bank also increased volatility in local exchange and interest rates. Internationally, the Euro and the Swiss Franc reached all time highs while crude oil too continued its alarming upward trend approaching the psychological barrier of US\$ 100 per barrel. Most other major currencies and commodities rose to their respective highs for decades. The Treasury Division successfully managed to weather the turbulence in forex, money and commodity markets, through proactive and prudent trading and risk management strategies.

While the theme for the year was to pioneer financial innovation in the local market, adhering to the highest possible ethical and professional standards, the Treasury Division sustained its steady growth rates in profitability and retained and enhanced its well-established market share and image. During the year, the Treasury introduced a three-year U.S. Dollar Deposit and developed Rupee Options, Overnight Index Swaps and Gold Trading, to help customers manage their exposures to forex, money and commodity market fluctuations, effectively and efficiently.

The Treasury Division widened its dimensions on the customer service front, introducing SMS Alerts to be sent to consenting clients, in addition to the daily comprehensive and up-to-date news bulletin. The knowledge and expertise of staff members of the Dealing Room, were shared with others in the HNB Team at an in-house bourse game conducted solely using internal resources.

Currency notes trading also experienced a boost, as the Central Cash & Treasury Divisions collaborated for more effective disposal via local buyers.

### **Winning Strategies for 2008**

The year 2008 is envisaged to bring forth challenges due to turbulent macro environmental factors. Amidst recessions and stagflations that are expected to hit most economies, the Treasury Division would focus on maintaining its exchange and interest margins, by deploying stringent risk management strategies. Our strategies for the future would also focus on maximising customer satisfaction across all customer touch-points.

Fully launching Rupee Based Currency Options, Overnight Interest Rate Swaps, Gold Sales, as well as the continuous development of skills in order to keep our staff abreast of the latest developments in financial markets, top our agenda for 2008.



## Investment Banking

Corporate Finance activities were drastically curtailed in the Financial Year 2007 as market conditions for capital market transactions continued to deteriorate for much of the period under review on account of continued political uncertainties and the escalation of hostilities in our home market. The equity market was largely stagnant with both retail and institutional investors adopting a wait and see policy. Consequently there were no new IPOs during the period and the only notable equity transactions were a few strategic sales. Fiscal slippage by the Government and the resulting rise in interest rates across the yield curve, caused a decline in the corporate debt market and crowding out of productive private sector investment. Consequently, placement of fixed income securities was more difficult during the period under review. The loan syndication market, which had hitherto been largely immune to market conditions, was adversely affected for the first time as large project investments by corporates in the domestic market were significantly curtailed on account of the high interest rate environment and unfavourable economic conditions in general. As a result, the number of corporate finance transactions undertaken during the year was significantly below the level achieved in previous years.

### Advisory Services

- HNB and DFCC Bank were the joint advisors to a leading unlisted corporate for a financial restructuring and private equity placement.

### Loan Syndications

- HNB was the Lead Bank and Lead Arranger for a USD 14.5 Million, syndicated credit facility for a leading Maldivian corporate. Although substantially all the work was completed, closure of the transaction was postponed on account of unfavourable industry conditions.

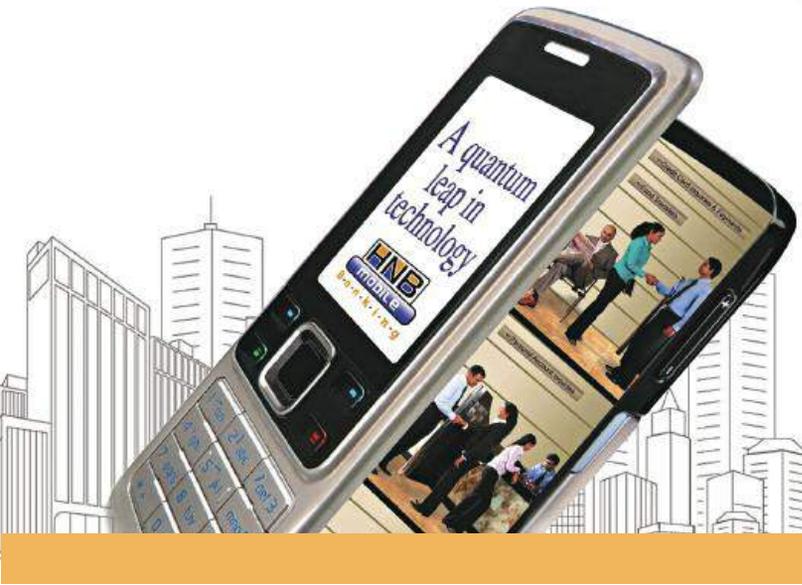
### Structured Finance

- HNB was the Manager and Arranger for asset backed financing for Rs. 500 Million through securitisation of lease receivables for a leading finance company.

The HNB Investment Banking Group has been mandated for a large debt capital raising assignment with a value exceeding USD 40 Million which we hope to finalise in the coming year and more capital market transactions currently being negotiated. HNB Investment Banking Group is confident of making a more significant contribution to the fee income earned by the Bank in Financial Year 2008, assuming that market conditions improve for capital market transactions. We are also in the process of diversifying our revenue streams by focusing on new markets and product offerings.

### Winning Strategies for 2008

- HNB proposes to set up a joint venture investment bank in partnership with DFCC Bank to offer full service investment banking services in Sri Lanka. It is envisaged that the joint venture will enable us to enhance our market share in Sri Lanka while realising significant synergies and cost savings. Currently we are in the process of obtaining all necessary regulatory approvals.
- HNB has entered into a Memorandum of Understanding (MOU) with a well established private sector bank based in South India to set up a joint venture investment banking operation focusing on the capital raising requirements of the vibrant South Indian market. The joint venture will enable us to further diversify our revenue streams. Regulatory approvals will be sought from the relevant authorities in Sri Lanka and India for the joint venture.



## Information Technology

Technology continues to be the axis upon which the bank's future progress, product development and winning stance are heavily dependent. In addition, the global banking environment demands technology development and enhancements to ensure that banking worldwide becomes speedy and efficient, giving customers the best value in terms of time and investment.

Our most significant achievement in IT this year was the selection of a Core Banking System to replace the existing solutions.

Yet another winning development was the launch of HNB Mobile Banking, a new product developed in-house and the first of its kind in the country by any bank. A trilingual product, HNB customers can use GPRS 3G connectivity off their mobile phones to log onto the HNB Virtual Branch from anywhere in the world to transact banking business.

The Bank also upgraded the technology used in the ATM Switch enabling outstation customers and even customers of other banks to withdraw cash on a VISA or Mastercard debit or credit card. Some ATM cards were reissued this year to streamline and standardise the cards issued. We also established a dedicated unit to handle ATM enquiries.

As mentioned last year, Money2Home was launched in 2007 giving Sri Lankan expatriates in the Middle East the option of remitting foreign exchange on line, real time, to any HNB account. The added benefit of an SMS alert sent to the beneficiary automatically is a further value addition to this product.

### Winning Strategies for 2008

The most significant strategy was the bank's bold and ambitious decision to convert the entire island wide branch network to a single platform. The strategy is expected to improve internal business processes, thereby providing our customers with product diversity, speedier delivery, and excellence in customer service.



## Marketing

The communication strategy for 2007 was developed to maintain the ideal mix of corporate image and brand building and proved to be a winning combination in maximising our communication objectives. Value delivery beyond the promotional dimension was acutely heeded to with each campaign launched in a timely manner so as to give maximum mileage to top-of-mind recall of the Corporate brand and the key sub brands.

### Corporate Communications

It has become important that HNB is projected as a premier winning Bank in Sri Lanka and into this concept, all aspects of the Bank's profile must be included. An umbrella branding strategy was conceptualised to bring each sub brand under the corporate brand. In the context of corporate and brand communication more focus was given to getting our customers interacting with our brand. This was achieved by focusing more on interactive media over traditional media and by conducting more event based activities for corporate and brand communication.

'HNB Power Zone', a new branch based promotional concept was developed in Nawam Mawatha as a pilot project offering deals on credit cards, leasing, home loans and savings products for limited periods. The concept was developed to get the non customers to interact with the brand for positive outcomes. Given its success, the concept will be used for seasonal promotions in the future as well. Built around an advertising campaign, HNB also conducted its regular Avurudu Ganu Denu during the Sinhala and Tamil New Year. For the first time more emphasis was given to the use of Web based media for corporate and brand communication, with customised messages.

The use of publicity and public relations was heightened to communicate the Bank's CSR initiatives conducted during the year. The key CSR communication covered reconstructing of branches to make them accessible to the disabled, the launch of the 100th school library under the HNB Nena Pubuduwa scheme, donation of houses and fishing equipment to the fishing village of Padiyatalawa to form HNB Pragathigama.

### Bracken Award for the Bank of the Year Sri Lanka

Highlighting the key values embraced by HNB, on winning the Bracken Award, a TV based advertising campaign dedicated to 'People Power' was developed, using three key levels of the management structure at HNB. This corporate communication campaign was aimed at communicating the key corporate values our employees embrace when doing business.

### Sponsorships

In line with one of the Bank's winning strategies of developing professionalism among the youth of the country, we actively partnered CIMA Sri Lanka through the sponsorship of CIMA Master Courses. In addition, the Bank also sponsored the UK Lanka Times Sri Lankan of the Year Awards in the UK as a promotional venture for Spathodea Residencies, as well as the HNB Millennium Trophy, a key golfing event at the Royal Colombo Golf Club.

### Pathum Vimana 2007

An improved prize structure with more options and chances of winning was the axis upon which Pathum Vimana 2007 was launched in January 2007. Positioned as the largest deposit draw in Sri Lanka, with over Rs. 100 Million in prizes which included Mercedes Benz & Suzuki Swift Cars (throughout the year); houses, gold coins and wristwatches. As a support campaign, winners were given publicity vis-a-vis their loyalty and savings habits over the years. The Pathum Vimana Road Shows, five in all, conducted around the island, gave the required promotional exposure to the new prize scheme, creating more awareness and opportunity for enhanced customer numbers.

The pioneering Pathum Vimana TV Game Show also launched this year on Rupavahini in November 2007, aimed to create added excitement, was successful in creating awareness of the scheme and enabled a number of customers to take part and win cash prizes of up to Rs. 100,000 on a weekly basis.

### Pathum Udanaya 2007

Re-launched with a total prize value of Rs. 30 Million, Pathum Udanaya is the first and only scheme currently prevalent in

Sri Lanka geared to offer prizes on foreign currency savings. The Super Draw prize included a luxury apartment in Colombo. The communication was aimed at building on the positioning of being the only draw to offer fabulous prizes on foreign currency savings.

### Credit Cards

Built around the theme 'Stay on track and win great prizes', the HNB Royalty Programme 2007 was built on a two pronged approach of enticing existing card holders to increase usage and in encouraging more customers to become card holders. A direct communication strategy with support from outdoor, print and electronic media campaigns, was successful in creating awareness about the extensive range of luxury prizes on offer, the frequency of the draws (mid and year end) and the value added benefits afforded to HNB cardholders.

In addition, to drive card usage up, a very successful promotion was carried out at Arpico Super Centres and other Arpico outlets, with extensive brand communication at site.

### HNB Leasing

The communication mix for leasing was two fold: conducting joint promotions with vehicle agents and creating top of the mind recall for HNB Leasing. The tag "It's more than just leasing", gave further emphasis to the value additions including a free credit card and life insurance cover. The entire communication rationale was directed towards positioning HNB Leasing as the most hassle free convenient service provider in Leasing

### HNB Shanthi Long Term Home Loans

Repositioned this year on the new platform of 'Build for them', communication was aimed towards differentiating the product from the competitors, with a more socially acceptable platform to promote housing finance, and the first phase targeted at the rental public focusing on building a permanent home for their child.

### **HNB Singithi**

Universal Children's Day and World Thrift Day were used as launch pads for customised promotions including a promotional drive at major hospitals islandwide, in a scheme for newborns and reactivating the existing 152 school savings units which had since inception seen over 500,000 jumbo tills distributed. The latter campaign used the iconic jumbo till as the centric promotional feature for the young saver.

### **HNB Gami Pubuduwa/Rural Credit**

A more one to one marketing approach was used in promoting HNB Gami Pubuduwa/Rural Credit, with high emphasis placed on seminars and special work shops in selected areas. These efforts were further augmented with a stall at the SME Road Show organised by the IFC and a special Indian study tour organised for local farmers.

### **HNB Pawning**

One of our most significant businesses over the year, HNB pawning used a gift based promotion with strong brand communication throughout the branches to differentiate HNB Pawning services from competition and gain higher visibility and brand recall.

### **Mobile Banking**

With the intention of attracting more usage for the HNB Virtual Branch – Internet banking service, Trilingual Mobile Phone Banking was introduced to customers, positioning HNB as an IT savvy bank that uses winning strategies through IT to infuse customer service excellence. The communication campaign was a simple, effective message intended to draw the customers to the Virtual Branch. It also aimed at creating awareness of the new convenience of Internet banking in all three languages for everyday transactions, through a mobile phone.

### **Winning Strategies for 2008**

Winning strategies, developed and well implemented, will greatly and directly impact on putting the bank in a winning position. In marketing communications, media planning and selecting media will be pursued with more strategic intent during 2008, with the intention of capitalising on the most appropriate media to address the target market. In order to maximise more on the best options in media buying with maximum value for money, we will build on the existing group synergies at the time of selecting and buying media. Brand communication and corporate communication will focus on developing more direct messages to drive our value proposition with high emphasis on tailor made messages to relate to our target audience. At a basic level our communication strategy will move away from one message to many, to many messages to one.

During the year more focus will be on pursuing brand building and thus creating markets through these winning brands. All our winning strategies will ultimately be focused on building top of the mind recall for HNB as the preferred partner in progress.



## Subsidiary Operations

### HNB Stockbrokers (Pvt) Ltd

Despite an excellent first quarter in 2007 that saw the ASPI achieve an all time high of 3016.4 points and turnover figures reach significant levels, the challenges continued for HNB Stockbrokers. The positive trend reversed from the second quarter as high interest rates and slowing corporate earnings stalled equity market momentum and emaciated market turnover. The ASPI recorded a negative growth of 3.5% for the year compared with a growth of more than 40% last year. Nevertheless, average market turnover levels showed a slight increase, backed by a few high value trades in 2007.

Despite the slowdown in the market, the Company was successful in maintaining a steady business flow throughout the year while sustaining profitability with a winning performance, evidence of the company's ability to remain profitable even in turbulent market conditions.

The average market share registered throughout the year, based on the market turnover, was 5%, while January 2007 showcased the highest percentage of 8%. The company's market share based on the number of transactions was 6.2%. The company continues to be ranked among the top four stockbroking companies in the country based on the number of transactions effected at the Colombo Stock Exchange.

The company recorded a turnover of Rs. 10.1 Billion with a pre tax profit amounting to Rs. 23.6 Million and a post tax profit of Rs. 17.2 Million from a total income of Rs. 93.4 Million. The highest brokerage income earned was in the first quarter ending 31st March 2007, which amounted to Rs. 40.6 Million. During the year the company paid an interim dividend of Rs. 7 Million which was a 19.4% distribution based on Share Capital of Rs. 36 Million. The company is planning to make a further distribution to its share holders for the financial year 2007.

The Research Department, an active contributor to the value additions provided by the Company, continues to publish regular industry and company research, strategy and economic reports, weekly reports, daily reports and daily valuations. In addition, a comprehensive report on banking sector strategy and an analysis of Budget 2008 were also published. Several

awareness programmes were conducted around the country in partnership with the Securities and Exchange Commission and the Colombo Stock Exchange.

### **Winning strategies for 2008**

We hope to continue to remain among the top winners in stockbroking in the next year as well, strengthening market share and growing retail and foreign business operations by reaching a wider clientele both in Sri Lanka and overseas. This will be the primary focus of our business in the upcoming year. The strategic alliance entered into between HNB and the DFCC Bank for the formation of an investment banking company will be a primary step towards meeting these objectives. The alliance will infuse vital synergies into our operations, amalgamating capital market business, corporate finance divisions and the other related entities of both institutions, including the stockbroking and primary dealership business. This will also enable the offer of a complete range of integrated investment banking services.

The alliance will thus ensure a winning performance throughout 2008 with an emphasis on new business and expansion plans being brought about through our branches in Kandy, Matara and Kurunegala. The new investment alliance will also see the streamlining of front and back office operations, supported by the highly qualified professional team who will contribute towards the cost efficiencies of this new venture.



## Subsidiary Operations HNB Securities Ltd

The year began with optimism as the Central Bank and the Secretary to the Treasury charted a road map to reduce inflation to a single digit. In tandem with this, it was envisaged that interest rates would be brought down to 10% too, using the one-year treasury-bill rate as the benchmark. However, the fiscal position deviated substantially from estimates made in the budget, resulting in unplanned increased borrowing by the government, which exerted considerable pressure on the local money market. Continued negative developments in the monetary aggregates, compounded by supply side pressure stemming from escalating oil prices, forced the Central Bank to increase the effective interest rates in the market from 12.77% at the beginning of the year to 21.30% by year-end, using the three months treasury-bill rate as the benchmark. Nevertheless, we at HNB Securities Ltd., skillfully managed the resultant exposure to interest rate risk and out-performed the market by using effective risk management techniques, suitable controls and discipline.

We were challenged the most during the post-\$500 Million bond issue period, as the local money market was inundated with excess liquidity, leading to an artificial decline in interest rates, which in turn re-activated the near-dormant bond market. We adopted a strategy of taking intra-day positions as against carrying a trading book, enabling us to capture the interest rate reduction without taking on the corresponding risk. The prudent yet astute stance adopted by the company enabled it to seize opportunities presented by the movements in the highly volatile overnight money market as well, by forecasting liquidity levels accurately and shifting the maturity profile accordingly.

The Company ended the year with a profit before tax of Rs. 85 Million and a post tax profit of Rs. 59 Million, compared to the loss of Rs. 18 Million incurred in 2006.

### Winning Strategies for 2008

We, at HNB Securities Ltd., will align ourselves with the new Joint Venture Investment Bank of which we will be an integral part in 2008, with the aspiration of reaping the benefits of a fully integrated investment banking operation. Further, we plan to cross-sell government securities to equity and share broking clients in the ensuing year.



## Subsidiary Operations HNB Assurance PLC

It has been a winning year for HNB Assurance despite a competitive and highly challenging market environment. The company showcased above average market growth of 30% with profitability displayed at Rs. 123.3 Million, a 35% growth over last year. We are also proud to have delivered a bonus issue of shares of 1:2, increasing our share capital to Rs. 375 Million. Although we are a relatively young company compared to other industry players, our share capital is among the highest. With our share price performing exceptionally well, we rank among the top ten shares in terms of returns to shareholders. We also received our first independent rating from Fitch Ratings Sri Lanka, with an Insurer Financial Strength Rating of 'A (Ika)' and a National Long Term Rating of 'A- (Ika)', only the second insurer in Sri Lanka to receive a Fitch Rating.

Both General and Life insurance recorded above average performance. Our motor insurance product was a significant contributor to the general insurance portfolio and our pioneering micro insurance product Sathkara in partnership with Sarvodaya, got off to a good start. Continuously innovating in order to maintain our winning position, we also introduced Prime - a group insurance cover for corporates and professional associations, Ran Aswanu - a unique insurance policy for seasonal income earners and Scholar - a policy targeted at international schools linked to their fee paying structure. We added renewal reminders via SMS for life and general policy holders and several enhancements to our web site. Our branch network now extends to 35 branches.

### Winning Strategies for 2008

Having increased our share capital to Rs. 375 Million this year, we are now committed to increasing it to Rs. 500 Million next year in line with proposed regulatory requirements. We will focus on increasing insurance business through HNB branches, while extending the distribution network to generate more business through agents and brokers. The opening of a new fully-fledged Customer Relations Centre in Colombo and the establishment of extension offices in selected HNB branches will infuse a superior level of customer service. We will use innovative communications and promotions to increase awareness of the HNB Assurance brand and products, while also pursuing strategic alliances with other financial institutions.



## Subsidiary Operations

### Sithma Development (Pvt) Ltd

For the first time in the history of this subsidiary, Sithma Development displayed a winning streak, recording a net profit of Rs. 9.9 Million. Prudent management of operational and maintenance costs and an overall increase in rental income saw operational profit increasing to Rs. 391.6 Million. However, the spiralling domestic interest rates during the year did adversely affect our bottom line.

HNB Towers completed 5 years of operation in October 2007 and remains the best and most sought after state-of-the-art office complex in the City.

Construction work on our real estate development project, “Spathodea Residencies”, a 48 luxury apartment project in Colombo 5, is progressing well. Despite the general decline in sales in the Housing Sector, pre sales of “Spathodea Residencies” are encouraging.

#### Winning Strategies for 2008

Our main focus during the year 2008 would be to continue to maintain and provide our tenants at HNB Towers with the highest standards of service. We will focus on improving the overall profitability which will be further augmented with the completion of the Apartment Project planned during the 4th quarter. We are also planning to re-structure the balance sheet to reduce the impact of volatile domestic interest rates.



## LANKA VENTURES PLC

### Associate Company Lanka Ventures PLC

The company continued to function in its characteristic paradigm of being a compact organisation targeting high value performance, with the flexibility to expand whenever the circumstances dictate. This astute approach gave us the desired winning results this year although the market we were operating in proved to be tougher than other years. To counteract the challenges, we reduced our exposure to the listed equity market, decreasing the impacts we may have been subjected to due to market volatility. As a result we were able to maintain somewhat improved results during the year, especially in the months from April to December 2007. Our pre-tax profitability stood at Rs. 62 Million at the end of December 2007 compared to last year's Rs. 60 Million, while our investment income and interest income were equally placed at around Rs. 40 Million. Our post-tax profit for the period was Rs. 55 Million compared to Rs. 36 Million last year which was adversely affected by an excessive tax charge of Rs. 24 Million.

Being in the unique position of having investments that incorporate equity or quasi equity features, while prospects of returns are higher, it is rare for results to meet expectations with cash flows and profits not matching appraisal stage expectations. Having realised this, we decided to concentrate on the two sectors of power generation and healthcare, infusing major investment into these which have shown a considerable growth trend. In healthcare, we partnered with a reputed private hospital in Colombo in its expansion project and further strengthened our joint venture partnerships with three well known developers in the power and energy sector. The long term focus at this point will be in these two sectors. This focus also spurred the incorporation of our subsidiary LVL Energy Fund (Pvt) Limited to consolidate all our investments in the power and energy sector.

#### Winning Strategies for 2008

Observing that the coming year will continue to be challenging with the business climate showcasing similar volatile trends compounded by the fact that the stock market has also continued to dive, we anticipate a year that may not showcase as much growth as this year. Our strategy will hedge on continuing to monitor the market and react accordingly, although power and energy and the healthcare sectors will be focused upon intently on a long term basis.



**Americas**

- Argentina
- Bahamas
- Bermuda
- Brazil
- Canada
- Chile
- Colombia
- Hawaii
- Mexico
- Peru
- Uruguay
- United States of America

**Middle East & Africa**

- Bahrain
- Botswana
- Egypt
- Ethiopia
- Ghana
- Iran
- Israel
- Jordan
- Kenya
- Kuwait
- Lebanon
- Libya
- Mauritius
- Oman
- Qatar
- Saudi Arabia
- Sierra Leone
- Somalia
- South Africa
- Sudan
- Swaziland
- United Arab Emirates
- Yemen
- Zambia
- Zimbabwe

**Europe**

- Austria
- Belgium
- Cyprus
- Czech Republic
- Denmark
- Finland
- France
- Germany
- Gibraltar
- Greece
- Hungary
- Ireland
- Italy
- Netherlands
- Norway
- Poland
- Portugal
- Romania
- Russian Federation
- Serbia & Montenegro
- Spain
- Sweden
- Switzerland
- Turkey
- United Kingdom

**Asia & Pacific**

- Australia
- Bangladesh
- China
- Fiji Islands
- Hong Kong
- India
- Indonesia
- Japan
- Korea
- Maldives Islands
- Malaysia
- Nepal
- New Zealand
- Pakistan
- Philippines
- Singapore
- Taiwan
- Thailand
- Uzbekistan
- Vietnam

**HNB Customer Centres to be opened during the 1st quarter of the year 2008**

- Haputale
- Thalawakele

**HNB Student Banking Centres – 152**

**HNB Gami Pubuduwa Banking Centres - 110**

Village Based – 23 Branch Based – 87

**HNB Mobile Banking Centres – 2**

Hotel Culture Club and Kandalama Hotel – Dambulla

**Overseas Representative Offices**

Chennai – India and Karachi - Pakistan

**NORTH WESTERN PROVINCE**

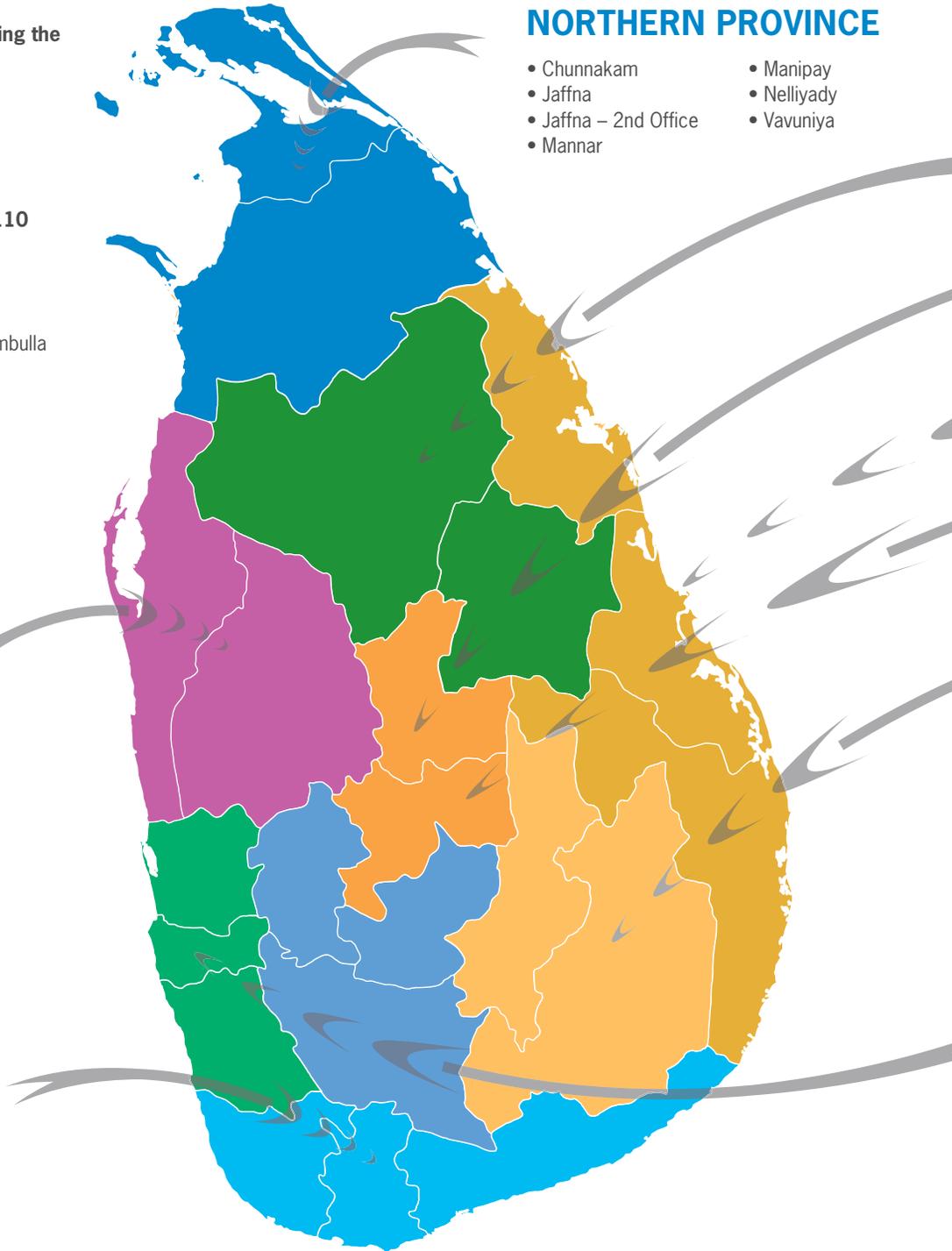
- Alawwa
- Chilaw
- Dankotuwa
- Hettipola
- Kuliyaipitiya
- Kurunegala
- Kochchikade
- Marawila
- Nikaweratiya
- Nawinne Ext-Kurunegala
- Puttalam
- Wennappuwa
- Wariyapola

**SOUTHERN PROVINCE**

- Angunakolapelassa
- Akuressa
- Ambalangoda
- Ambalantota
- Deniyaya
- Elpitiya
- Galle
- Karapitya
- Hambantota
- Koggala
- Matara
- Pitigala
- Suriyawewa
- Tangalle
- Tissamaharama

**NORTHERN PROVINCE**

- Chunnakam
- Jaffna
- Jaffna – 2nd Office
- Mannar
- Manipay
- Nellyyady
- Vavuniya



## NORTH CENTRAL PROVINCE

- Anuradhapura
- Nochchiyagama
- Polonnaruwa
- Thambuttegama

## CENTRAL PROVINCE

- Akurana
- Bogawantalawa
- Dambulla
- Digana
- Gampola
- Geli Oya
- Hatton
- Kandy
- Katugastota
- Maskeliya
- Matale
- Nawalapitiya
- Nuwara Eliya
- Peradeniya
- Pilimathalawa
- Pussellawa
- Ragala

## EASTERN PROVINCE

- Akkaraipattu
- Ampara
- Batticaloa
- Kalmunai
- Kantalai
- Kattankudy
- Sammanthurai
- Trincomalee
- Trincomalee – Courts Road

## SABARAGAMUWA PROVINCE

- Balangoda
- Embilipitiya
- Godakawela
- Kahawatte
- Kegalle
- Mawanella
- Pelmadulla
- Pinnawela
- Ratnapura

## UVA PROVINCE

- Badulla
- Bandarawela
- Buttala
- Moneragala
- Passara
- Welimada
- Wellawaya
- Mahiyanganaya

## WESTERN PROVINCE

- Airport Office
- Aluthgama
- Aluthkade
- Apollo Hospitals
- Asha Central Hospital
- Athurugiriya
- Avissawella
- Bambalapitiya
- Biyagama
- Boralesgamuwa
- Borella
- Cinnamon Gdns
- City Office
- Dehiwela
- Delgoda
- Dematagoda
- Divulapitiya
- Ekala
- Emirates
- Gampaha
- Grandpass
- Gunasinghepura
- Hanwella
- Head Office Branch
- Homagama
- Horana
- Hulftsdorp
- IWMI – Pelawatta
- Ja-ela
- Jampettah Street
- Kadawatha
- Kaduwela
- Kalutara
- Kandana
- Katunayake
- Kiribathgoda
- Kirindiwela
- Kirullapone
- Kollupitiya
- Kotahena
- Kottawa
- Kotte
- Maharagama
- Main Branch
- Malabe
- Maligawatte
- Maradana
- Marandagamulla
- Mathugama
- Minuwangoda
- Mirigama
- Mirihana
- Moratumulla
- Moratuwa
- Mt. Lavinia
- Mutwal
- Narahenpita
- Nawala
- Nawaloka Hospital
- Nawam Mawatha
- Negombo
- Negombo Extension Office
- Nittambuwa
- Nugegoda
- Overseas School of Colombo
- Padukka
- Panadura
- Panchikawatte
- Pettah
- Pettah – 3rd Office
- Piliyandala
- Ports Authority
- Ragama
- Ratmalana
- Sea Street
- Seeduwa
- Sri Jayawardenapura Hospital
- Sri Lankan Airlines Admn. Complex
- Talangama
- Thalawathugoda
- Thimbirigasyaya
- Wattala
- Wellawatte
- Wellawatte Extension Office
- Wijerama

# FINANCIAL REVIEW

The Year 2007 was one of the most challenging for the entire financial services industry in recent times. Interest rates were volatile and spiralling inflation, along with increased Government borrowing, made the industry extremely competitive. This along with the arduous business climate led to an overall decrease in industry profit margins.

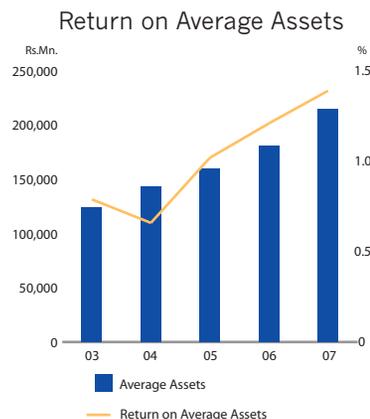
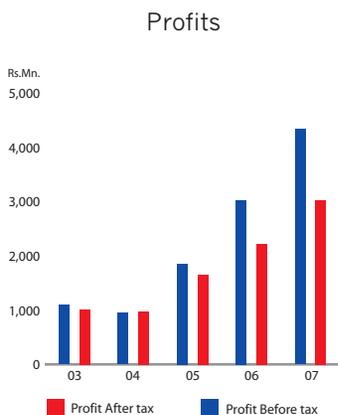
While the Bank had the daunting task on its hands of mobilising low cost deposits, and with interest rates moving up, we did not want to boost the balance sheet at the expense of profitability. Maintaining reasonable profit margins has been the biggest challenge and HNB had to continuously improve its efficiency, and therefore took a concerted decision, of not passing down every increase in rates to the customer.

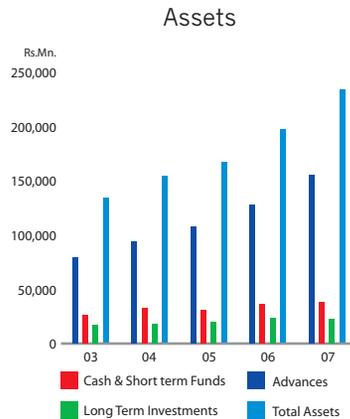
HNB's performance this year against the backdrop of constantly changing adverse scenarios has been commendable along with its nimbleness and the increased growth, a result of astute initiatives implemented in the past few years. Despite severe constraints, the Bank managed to exceed the target set last year of 20% year on

year growth in post-tax profit. All core areas of business have shown encouraging growth although such a positive performance may be very difficult to sustain in 2008, when interest rates and inflation are expected to remain high along with the impact of the abrogation of the Ceasefire Agreement expected to adversely affect the business climate in general.

## Profit for the Year

After its remarkable achievement of exceeding the Rs. 2.2 Billion mark last year, the Bank with a 36.1% year on year increase recorded its highest ever post tax profit this year of Rs. 3.0 Billion. This figure is even more impressive in the context of an unfavourable tax regime, in a very difficult year where periodically inflation rose above 20% and increased Government borrowing decreased domestic liquidity in the market. The true impact of the year on year growth in pre-tax profits of 43.6% is negated by taxation, accounting for Rs. 1.3 Billion this year in comparison with Rs. 0.8 Billion last year. Profit before tax was at a record Rs. 4.3 Billion compared with Rs. 3 Billion last year.





Financial Services Value Added Tax charge this year is a staggering Rs. 1.2 Billion compared to Rs. 1.0 Billion last year. We continue to reiterate that the taxation regime in place at present is not conducive to the growth of the Bank and stifles the entirety of the financial services industry.

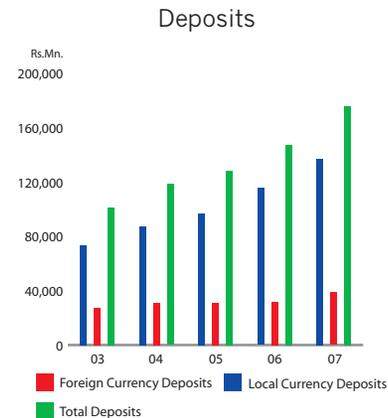
### Balance Sheet

One of the key drivers of our performance has been strong overall balance sheet growth during the past 12 months.

### Asset Growth

After coming close to the Rs. 200 Billion total asset value last year, an increase of 18.8% year on year was registered in 2007 leading to Total Assets reaching Rs. 233 Billion, one of the highest asset bases among Commercial Banks in Sri Lanka. A large component of HNB's assets represents lending to individuals, corporates, SMEs & other entities. This includes leasing, housing, pawning, credit card lending and loans for various business related activities.

The Total Loan portfolio increased by 21.3% year on year to reach Rs. 147.2 Billion from the previous year's Rs. 121.4 Billion. Demand for Overdraft facilities was high and total overdrafts were at Rs. 35.8 Billion, recording an increase of 23.4% over the Rs. 29.0 Billion last year.

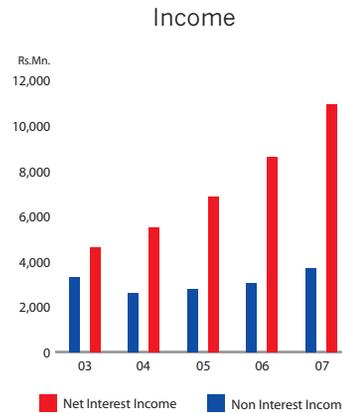
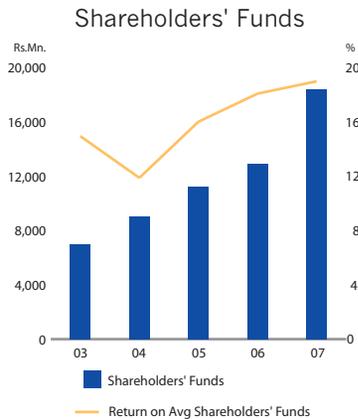


This year, the Bank's main retail products, Housing and Pawning posted an impressive 22.9% and 24.8% growth respectively. The Bank continued its policy of increasing its Housing Loan portfolio which reached Rs. 16.4 Billion this year from Rs. 13.4 Billion in 2006. The countrywide economic downturn led to many of the Bank's customers utilising its pawning facilities, which increased to Rs. 16.8 Billion from Rs. 13.4 Billion last year. Aggressive marketing but cautious evaluation led the Bank's leasing portfolio increasing by a moderate 15.0% this year to Rs. 13.3 Billion from Rs. 11.5 Billion in 2006, defending our market leadership among Commercial Banks in the sector.

Cash and short term funds rose by 33.0% to Rs. 24.3 Billion in comparison to the previous year's Rs. 18.3 Billion.

### Liability Growth

Personal, corporate & institutional deposits and other borrowings are the biggest items on the liability side of our balance sheet at Rs. 185.5 Billion. The Bank's Rupee Deposit Base showed a healthy growth of 18.5% year on year and stood at Rs. 136.9 Billion. In an ever increasing competitive environment for Deposits where the Government Treasury Bill rate moved up by 67%, a demonstration of the strength of the Bank's mobilization capabilities was manifested by the high confidence shown by depositors. However,



this year, even with the 17 newly opened customer centres and wide publicity being given to the 'Pathum Vimana' lottery scheme, mobilising low cost savings deposits proved to be a difficult task.

Demand deposits remained virtually unchanged at Rs. 12.5 Billion, while Savings Deposits recorded a year on year increase of 5.7% to reach Rs. 53.6 Billion. The main growth in this segment was from the popular 'Singithi' accounts which grew 12.3% from Rs. 4.2 Billion to Rs. 4.7 Billion. Given the higher interest rate scenario, 'time deposits' proved to be popular and a 36.8% growth was recorded with time deposits climbing to Rs. 66.8 Billion from the previous year's Rs. 48.9 Billion. This increase is significant in the context that both Government Treasury Bills and other commercial banks were offering very competitive interest rates.

NRFC, RFC and EFC accounts posted an increase of 17.2% over the previous year and were at an equivalent of Rs. 31.7 Billion. FCBU deposits grew by 42.0% to reach the equivalent of Rs. 7.0 Billion from Rs. 5.0 Billion last year.

### Shareholders' Funds

The Rs. 3.0 Billion after tax profit will result in the total shareholders' funds growing to Rs. 18.4 Billion. Free capital of the Bank increased from Rs. 6.0 Billion in 2006 to Rs. 7.4 Billion in 2007, which now stands at 40% of the shareholder's funds.

### Income

In 2007 the total interest income recorded a growth of 41.7% from Rs. 18.4 Billion in 2006 to Rs. 26.1 Billion in 2007 despite adverse economic conditions. This is complemented by the strong growth (16.9%) in interest earning assets and rise in the interest rates. Continued maintenance of high asset quality levels and above industry average collection ratios by the Bank also helped to contribute to the increase in the interest income.

Interest paid has increased by 55.0% during the period mainly due to the increase in interest rates and the shift in deposit mix towards high cost deposits, reflecting a strong 35.7% growth in Rupee fixed and certificate of deposits.

Net Interest income of Rs. 10.9 Billion in 2007, was Rs. 2.3 Billion or 26.5% higher than in 2006. This reflects continued solid growth

in interest earning assets of 16.9% partly off set by a marginal decline in the net interest margin.

Exchange gains accounted for 29.9% of the non interest income with a record growth of 44.2% to Rs. 1.1 Billion, which is the highest ever exchange profit recorded in the Bank's history. This was mainly due to the volatile exchange rates which at the beginning of the year saw the US dollar/SL Rupee at Rs. 107.70, climbing to Rs. 113.47 in September and then settling at Rs. 108.71 at the year end. The stabilisation at the year end was mainly due to the successful US\$ 500 Million Government Bond Issue.

Fee and commission income which contributed to over 55% of other operating income recorded a growth of 15.9% to surpass Rs. 2 Billion. Increase in the trade finance volumes and expansion in credit card operations generated a healthy fee and commission income for the bank during 2007.

Other income was recorded at Rs. 405.9 Million compared to the 2006 figure of Rs. 396.6 Million, displaying only a marginal increase of Rs. 9.3 Million which was mainly due to a loss of liquidation of a long term overseas investment and also the scaling down of equity trading in stock exchange.

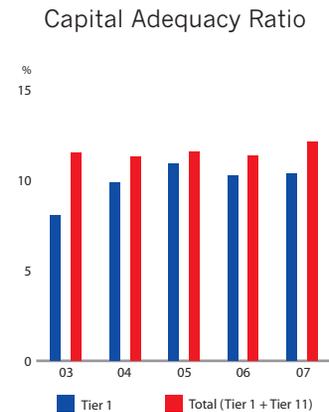
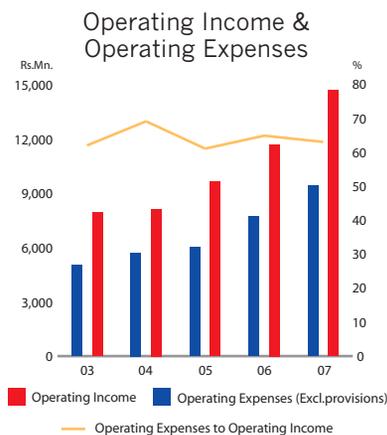
### Operating Expenses

With high inflation being the norm during the year, the Bank's operating expenses increased by 19.2% to Rs. 10.3 Billion compared to Rs. 8.7 Billion in 2006. This compares well against the average inflation rate of 18.3 % for the year.

We continue to manage our personnel costs well, with a marginal increase in staff head count despite the notable increase in our branch network and rising inflationary trends. Increase in staff emoluments of 15.9% was well below the annual average inflation.

Premises, equipment and establishment expenses were up 11.5% over the year, due to growth in the branch network, market rent increases, fuel expenses and increase in repair and maintenance cost of premises, computer hardware & software.

The provision for loan losses decreased by 2.6% from Rs. 931.8 Million in 2006 to Rs. 907.9 Million in 2007, reflecting the good health of the portfolios from a credit quality perspective. Keeping in line with the CBSL mandatory guideline on the general provision of 1% of the portfolio value to be provided as of 31st March 2009, HNB had already provided Rs. 855.0 Million which is 0.73% of the portfolio value as of end 2007.



Other operating expenses which include advertising, financial value added tax etc have recorded an increase of 39.4% over 2006. The increase in advertising cost from Rs. 336.6 Million to Rs. 438.8 Million in 2007 and an increase in financial VAT from Rs. 972.6 Million to Rs. 1,240.9 Million are reflected in the increase in other operating expenses.

The high tax regime is a tremendous challenge for the Sri Lankan banking industry to manage. However HNB over the past few years has managed to record exceptionally lower effective tax rates.

In 2007, effective income tax rate was 23.9%. Going forward the high tax burden will continue to put pressure on HNB in maintaining satisfactory capital adequacy ratios, ROE and ROA levels.

### Capital Adequacy Ratio

The bank's core capital as at the end of 2007 stands at Rs. 15,418 Million while the total capital was displayed at Rs. 18,041 Million. The Bank's Tier I ratio recorded an increase of 0.88% to reach 10.32%. The Bank's Total Capital Adequacy Ratio stands at 12.08% as of 31st December 2007, up from 11.32%. The Bank raised Rs. 1.2 Billion through subordinated, unsecured redeemable debentures during the year, which have maturities spanning up to 15 years. The Bank is in the process of increasing the long tenure debentures so that we will be able to systematically reduce the maturity mismatch on assets and liabilities as well as support the supplementary capital structure. Through this process so far the Bank has secured Rs. 2.3 Billion in long tenure debentures during the past two years.

### Return on Average Assets

Return on average assets (ROAA) was 1.4% depicting a healthy increase from 1.2% recorded last year. The Bank's medium term goal was to achieve a ROAA of above 1.5% within three years and this achievement is a sound proclamation of the resilience of the Bank. Return on Average Equity (ROAE) of the Bank increased to 19.3% from 18.4% reported last year.

High interest rates and rising inflation will be testing the Bank's ability to withstand such adversities in 2008. Giving due recognition to the multiple impacts of such macro economic adversities, the Bank is determined to forge ahead with impressive growth and to surpass the goals set by ourselves for 2008.

# CAPITAL ADEQUACY

Capital Adequacy is a measure of a commercial bank's ability to withstand the associated risks of its business. Capital Adequacy Ratio (CAR) was measured on the basis of Credit and Market risk under the Basel I accord and under Basel II it takes into account the Credit, Market and Operational risks. Central Bank of Sri Lanka (CBSL) last year increased the risk weightage on housing and other advances by 10% and included the Market risk for CAR calculation. Keeping with the international standards of Basel Committee on Banking Regulations and Supervisory Practices, Sri Lanka will follow Basel II CAR calculation from January 2008 after conducting parallel calculations in 2007.

## Available Capital

Basel I and Basel II accords both recognise three capital elements, namely Tier I, Tier II (after certain deductions) and Tier III capital.

Tier I capital includes paid up ordinary share capital, paid up non cumulative, non redeemable preference shares, share premium, statutory reserve fund, published retained earnings, general and other reserves less goodwill.

Tier II capital includes 50% of asset revaluation reserves (which are recognised for capital adequacy only once in 7 years), general provision for advances, hybrid debt/equity instruments and approved subordinated term debts. Tier II capital cannot exceed Tier I capital and Subordinated debt cannot exceed 50% of the total Tier I capital.

Tier III capital will consist only of short term debt instruments and will be used for calculation of Market risk only.

Equity investments in unconsolidated banking and financial subsidiaries and investments in capital of other banks/financial associates are deducted from total capital in arriving at the

capital base. Sri Lankan banks are required to maintain a minimum total risk weighted capital ratio of 10% in respect of domestic (DBU) and off-shore banking operations (FCBU) since 2003.

## Risk Assessment

In order to determine the Credit risk applicable for capital adequacy ratio, all assets are risk weighted in order to provide a broad indication of Credit risk. Seven risk weightings applicable are 0%, 10%, 20%, 50%, 55%, 100% and 110%. Off balance sheet transactions are converted to credit equivalents, using a credit conversion factor, before being allocated a risk weighting.

Under Basel II, companies or instruments that possess credit Rating from an acceptable rating agency will be risk weighted differently with lesser capital being allocated for best rated and higher capital being allocated to lower rated companies or instruments. Also the Small and Medium scale Enterprises (SME) and personal segment of the credit portfolio is allocated preferential risk weightage, subject to total portfolio meeting the granularity criteria specified by CBSL.

All marketable securities are allocated a risk weightage as directed by CBSL despite its Credit risk.

The operational risks too would be taken as directed by CBSL based on the total revenue of the bank.

Operational and Market risk will be calculated based on Basic Indicator Approach and Standard Measurement Method respectively and Advanced Approach would be adopted from 2013. However the banks have the discretion of adopting the advanced approach on an earlier date.

<b>Capital Base as at 31st December</b>	<b>2007</b>	2006
<b>Rupees Million</b>		
<b>TIER 1</b>		
Voting ordinary shares	<b>1,893</b>	947
Non-Voting ordinary shares	<b>462</b>	231
Share premium	<b>2,704</b>	2,704
Statutory reserve fund	<b>822</b>	670
Published retained profits	<b>2,747</b>	1,736
General and other reserves	<b>6,789</b>	6,402
<b>Total Tier 1 Capital</b>	<b>15,417</b>	12,690
<b>TIER 2</b>		
Approved assets revaluation reserves (1)	<b>1,042</b>	120
General provisions	<b>855</b>	573
Debentures	<b>2,957</b>	2,462
<b>Total Tier 2 Capital</b>	<b>4,854</b>	3,155
<b>Total Tier 1 and Tier 2 Capital</b>	<b>20,271</b>	15,845
Less: Holdings of other Banks/ Financial Associates (2)	<b>(2,230)</b>	(1,797)
<b>Capital Base</b>	<b>18,041</b>	14,048
<b>Risk Adjusted Capital Ratios</b>		
Tier 1 (Statutory minimum ratio required is 5%)	<b>10.32</b>	10.23
Total (Statutory minimum ratio required is 10%)	<b>12.08</b>	11.32

**ADJUSTED ASSETS AND OFF-BALANCE SHEET EXPOSURE**

	Balance		Risk Weights %	Risk Adjusted Balance	
	2007	2006		2007	2006
<b>As at 31st December</b>					
<b>Rupees Million</b>					
<b>ASSETS</b>					
Cash, Treasury Bills, statutory reserves with Central Bank	<b>34,466</b>	31,263	-	-	-
Loans secured by cash and guaranteed by Central Bank of Sri Lanka	<b>38,304</b>	30,582	-	-	-
Guaranteed by OECD Central Gov./Central Banks	<b>200</b>	1,511	<b>10</b>	<b>20</b>	151
Due from Local/Foreign Banks/Financial Institutions	<b>19,913</b>	18,216	<b>20</b>	<b>3,983</b>	3,643
Loans secured by residential properties	<b>33,435</b>	26,628	<b>55</b>	<b>18,389</b>	14,645
Loans guaranteed by external agencies	<b>4,926</b>	4,812	<b>50</b>	<b>2,463</b>	2,406
Loans and advances secured by:					
Other forms of securities	<b>83,776</b>	70,517	<b>110</b>	<b>92,154</b>	77,569
Other assets	<b>16,472</b>	11,697	<b>100</b>	<b>16,472</b>	11,697
<b>Total assets</b>	<b>231,492</b>	195,226		<b>133,480</b>	110,111

**OFF-BALANCE SHEET EXPOSURE**

Rupees Million As at 31st December	Amount of Off-Balance Sheet Items 2007	Credit Equivalent Amount 2007	Risk Weights %	Risk Weighted Balance	
				2007	2006
Financial guarantees, Bank acceptances and other guarantees	11,039	11,039	0 -100	11,039	11,355
Performance related guarantees and warranties, stand by credit lines	8,272	4,136	0 -100	3,964	1,495
Shipping guarantees, Documentary Letter of Credit	17,306	3,461	0 -100	-	-
Undrawn term and overdraft facilities	21,817		0 -100	-	-
< 1 Year					
> 1 Year	4,803	2,401	0 -100	-	-
Foreign Exchange Contracts	13,961	279	0 -100	-	-
Foreign Interest rate Contracts	4,192	293	0 -100	147	194
Total off-balance sheet exposures	81,390	21,609		15,150	13,044
Total risk adjusted assets				133,480	110,111

**CAPITAL CHARGE FOR MARKET RISK***(With effect from 31st March 2006)***Rupees Million**

As at 31st December	Capital charge		Risk adjusted assets	
	2007	2006	2007	2006
Interest rate	26.0	1.5	260	15
Equity	24.8	54.6	248	546
Foreign Exchange and Gold	21.1	34.7	211	347
Total risk adjusted assets for market risk	71.9	90.8	719	908
Total risk adjusted assets for credit risk, market risk and off-balance sheet exposure			149,350	124,063

**NOTES:**

(1) The Central Bank of Sri Lanka permits only 50% of the revaluation gains to be taken to the Tier 2 Capital.

(2) Holdings of other Banks/ Financial Associates

	2007	2006
	Rs. Mn.	Rs. Mn.
Additional Investment in Sithma Development (Pvt) Ltd.	900	900
Employee share option plan	152	145
Others	1,178	752

(3) The Capital Adequacy computation has been indicated for the Bank only.

<i>For the year ended 31st December</i>	<b>Bank</b>		<b>Group</b>	
	<b>2007</b>	2006	<b>2007</b>	2006
	<b>US\$.000</b>	US\$.000	<b>US\$.000</b>	US\$.000
<b>INCOME</b>	<b>274,869</b>	200,034	<b>294,025</b>	216,042
Interest income	<b>240,567</b>	171,726	<b>248,635</b>	179,816
Less: Interest expenses	<b>139,804</b>	91,181	<b>148,459</b>	100,403
<b>Net interest income</b>	<b>100,763</b>	80,545	<b>100,176</b>	79,413
Foreign exchange profit	<b>10,256</b>	7,192	<b>10,267</b>	7,196
Fee and commission income	<b>19,158</b>	16,709	<b>19,527</b>	17,319
Dividend income	<b>1,152</b>	716	<b>850</b>	529
Other income	<b>3,736</b>	3,691	<b>14,746</b>	11,182
<b>OPERATING INCOME</b>	<b>135,066</b>	108,853	<b>145,566</b>	115,639
Less:				
<b>OPERATING EXPENSES</b>				
Personnel expenses	<b>29,501</b>	25,740	<b>31,570</b>	26,940
Premises equipment and establishment expenses	<b>19,557</b>	17,730	<b>17,107</b>	16,305
Fee and commission expenses	<b>720</b>	950	<b>730</b>	1,154
Provision for staff retirement benefits	<b>4,159</b>	3,715	<b>4,209</b>	3,728
Bad debts written off	<b>13</b>	114	<b>13</b>	100
Provision for loan losses	<b>8,356</b>	8,672	<b>8,356</b>	8,672
Provision for fall in value of investment	-	-	<b>18</b>	88
Amortisation of goodwill/(negative goodwill)	-	-	-	-
Other expenses	<b>32,864</b>	23,831	<b>41,682</b>	29,971
	<b>95,170</b>	80,752	<b>103,685</b>	86,958
<b>PROFIT FROM OPERATIONS</b>	<b>39,896</b>	28,101	<b>41,881</b>	28,679
Share of Associate Companies' profit before taxation	-	-	<b>149</b>	127
<b>PROFIT BEFORE TAXATION</b>	<b>39,896</b>	28,101	<b>42,030</b>	28,806
Less: Income tax expense	<b>12,078</b>	7,436	<b>12,579</b>	7,628
<b>PROFIT FOR THE YEAR</b>	<b>27,818</b>	20,665	<b>29,451</b>	21,178
Attributable to:				
Equity Holders of the Bank	<b>27,818</b>	20,665	<b>28,996</b>	20,839
Minority Interest	-	-	<b>454</b>	340
<b>PROFIT FOR THE YEAR</b>	<b>27,818</b>	20,665	<b>29,450</b>	21,179
<b>BASIC EARNINGS PER SHARE (US\$)</b>	<b>0.12</b>	0.09	<b>0.12</b>	0.09
<b>DIVIDEND PER SHARE (US\$)</b>	<b>*0.03</b>	0.05	<b>*0.03</b>	0.05

Exchange rate of US\$ 1 was 108.65 as at 31.12.2007 (Rs. 107.45 as at 31.12.2006)

\*Calculated on 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.

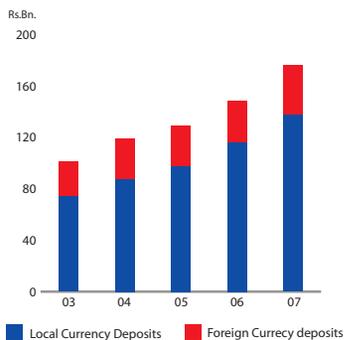
As at 31st December	Bank		Group	
	2007 US\$.000	2006 US\$.000	2007 US\$.000	2006 US\$.000
<b>ASSETS</b>				
Cash and cash equivalents	224,201	221,683	225,274	222,016
Statutory deposit with Central Bank of Sri Lanka	123,386	111,834	123,386	111,834
Government Treasury Bills	-	-	10,643	22,817
Commercial papers	2,176	2,705	2,176	2,705
Securities purchased under re-sale agreements	31,753	-	53,927	40,887
Dealing securities	5,426	6,880	6,558	9,081
Investment securities	186,809	191,354	193,076	206,736
Bills of Exchange	19,047	17,784	19,047	17,784
Loans and advances	1,286,558	1,064,316	1,272,104	1,060,300
Lease rentals receivable within one year	40,459	35,329	40,459	35,329
Lease rentals receivable after one year	81,855	72,186	81,855	72,186
Non-current assets held for sale	13	61	13	61
Investments in Associate Companies	1,218	1,232	1,519	1,534
Investments in Subsidiary Companies	21,111	21,346	-	-
Investment properties	1,736	1,767	1,662	1,722
Property, Plant and Equipment	55,983	27,062	123,680	68,735
Intangible assets	1,692	2,159	1,937	2,417
Other assets	60,215	47,062	60,838	46,797
<b>Total Assets</b>	<b>2,143,638</b>	<b>1,824,760</b>	<b>2,218,154</b>	<b>1,922,941</b>
<b>LIABILITIES</b>				
Deposits from customers	1,616,747	1,373,266	1,615,892	1,372,389
Dividends payable	279	355	279	355
Borrowings	91,097	106,717	91,159	106,717
Securities sold under re-purchase agreements	55,559	62,696	76,879	129,294
Bills payable	11,028	11,076	11,028	11,076
Long-term insurance funds	-	-	8,106	4,725
Non-life insurance reserves	-	-	3,134	2,974
Subordinated debentures	41,977	47,650	50,859	65,923
Current tax liability	14,167	7,089	14,774	7,204
Deferred tax liability	5,575	2,920	5,592	2,956
Other liabilities	137,682	92,657	142,392	97,448
<b>Total Liabilities</b>	<b>1,974,111</b>	<b>1,704,426</b>	<b>2,020,094</b>	<b>1,801,061</b>
<b>EQUITY</b>				
Stated capital	46,566	36,126	46,566	36,126
Statutory Reserve Fund	7,564	6,234	7,562	6,234
Retained Earnings	25,287	16,160	26,334	16,028
Other reserves	90,110	61,814	115,576	61,814
<b>Total Equity attributable to Equity Holders of the Bank</b>	<b>169,527</b>	<b>120,334</b>	<b>196,038</b>	<b>120,202</b>
<b>Minority Interest</b>	<b>-</b>	<b>-</b>	<b>2,022</b>	<b>1,678</b>
<b>Total Equity</b>	<b>169,527</b>	<b>120,334</b>	<b>198,060</b>	<b>121,880</b>
<b>Total Liabilities and Equity</b>	<b>2,143,638</b>	<b>1,824,760</b>	<b>2,218,154</b>	<b>1,922,941</b>
Commitments and Contingencies	533,489	416,798	533,489	416,798

Exchange rate of US\$ 1 was Rs. 108.65 as at 31.12.2007 (Rs. 107.45 as at 31.12.2006)

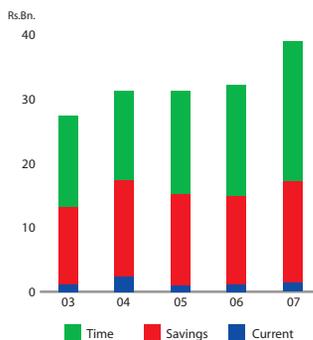
The Balance Sheet given on this page is solely for the convenience of the shareholders, bankers, investors, customers and other users of financial statements and do not form part of the audited financial statements.

	2003 Rs.000	2004 Rs.000	2005 Rs.000	2006 Rs.000	2007 Rs.000
<b>Local Currency Deposits</b>					
Current	7,929,485	8,852,609	12,511,256	12,635,473	<b>12,482,701</b>
Savings	36,452,976	42,108,475	47,380,753	50,697,086	<b>53,565,590</b>
Time	23,502,610	31,920,537	33,587,699	48,869,303	<b>66,836,282</b>
Certificate of Deposits	5,861,618	4,448,095	3,634,393	3,348,716	<b>4,021,045</b>
	<b>73,746,689</b>	<b>87,329,716</b>	<b>97,114,101</b>	<b>115,550,578</b>	<b>136,905,618</b>
<b>Foreign Currency Deposits</b>					
Current	1,154,625	2,331,555	1,013,589	1,188,634	<b>1,348,573</b>
Savings	11,936,063	15,009,655	14,166,198	13,600,463	<b>15,784,655</b>
Time	14,188,135	13,853,008	15,989,793	17,217,780	<b>21,620,727</b>
	<b>27,278,823</b>	<b>31,194,218</b>	<b>31,169,580</b>	<b>32,006,877</b>	<b>38,753,955</b>
<b>Total Deposits</b>					
Refinance	1,764,014	2,066,198	2,711,810	3,582,587	<b>5,749,624</b>
Total Deposits and Refinance	<b>102,789,526</b>	<b>120,590,132</b>	<b>130,995,491</b>	<b>151,140,042</b>	<b>175,659,573</b>

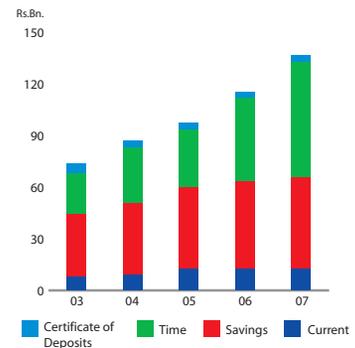
Analysis of Total Deposits



Analysis of Foreign Currency Deposits

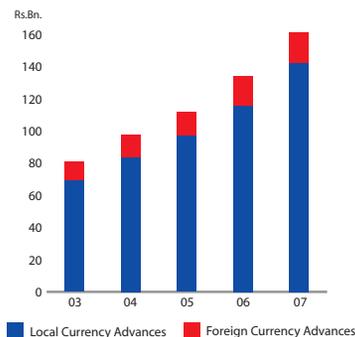


Analysis of Local Currency Deposits

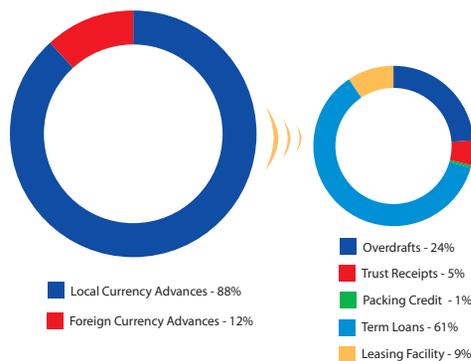


	2003 Rs.000	2004 Rs.000	2005 Rs.000	2006 Rs.000	2007 Rs.000
<b>Local Currency Advances</b>					
Overdrafts	17,247,347	20,165,063	22,952,834	27,455,224	<b>33,776,672</b>
Trust Receipts	3,880,713	4,957,006	5,193,080	6,876,898	<b>7,097,272</b>
Packing Credit	557,260	521,945	523,517	618,787	<b>763,188</b>
Term Loans	41,880,705	50,714,867	58,657,612	68,451,741	<b>86,692,434</b>
	63,566,025	76,358,881	87,327,043	103,402,650	<b>128,329,566</b>
Leasing Facilities	5,301,607	7,130,368	9,261,500	12,036,467	<b>13,772,361</b>
<b>Total</b>	<b>68,867,632</b>	<b>83,489,249</b>	<b>96,588,543</b>	<b>115,439,117</b>	<b>142,101,927</b>
<b>Foreign Currency Advances</b>					
	12,314,964	13,702,580	15,381,438	18,412,257	<b>18,917,313</b>
<b>Total</b>	<b>81,182,596</b>	<b>97,191,829</b>	<b>111,969,981</b>	<b>133,851,374</b>	<b>161,019,240</b>

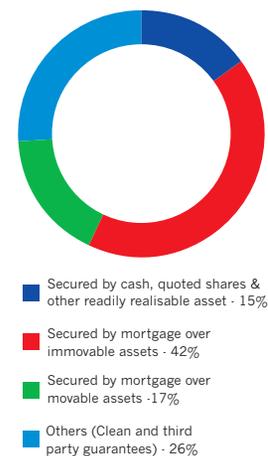
Analysis of Total Advances



Analysis of Advances - 2007



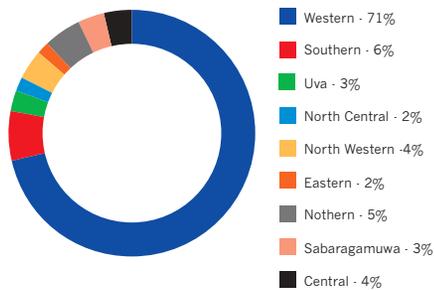
Analysis of Advances by Security - 2007



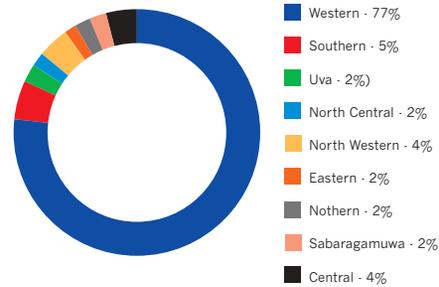
Provincewise Analysis of Deposits & Advances  
as at 31st December

Province	No of Branches	Deposits (Rs. Mn)	%	Advances Including Leasing (Rs. Mn)	%	Deposit Utilisation %
WESTERN	85	125,421	71	123,643	77	99
SOUTHERN	15	11,380	6	8,161	5	72
UVA	8	4,804	3	3,831	2	80
NORTH CENTRAL	4	3,179	2	2,905	2	91
NORTH WESTERN	13	6,885	4	6,633	4	96
EASTERN	9	2,835	2	2,521	2	89
NORTHERN	7	8,633	5	3,270	2	38
SABARAGAMUWA	9	6,088	3	3,565	2	59
CENTRAL	17	6,435	4	6,490	4	101
<b>TOTAL</b>	<b>167</b>	<b>175,660</b>	<b>100</b>	<b>161,019</b>	<b>100</b>	<b>92</b>

Provincewise Deposits - 2007



Provincewise Advances - 2007



**Sources of Income**

	2003	2004	2005	2006	2007
	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000
Interest	11,536,552	11,469,335	14,129,874	18,451,961	<b>26,137,648</b>
Exchange	506,436	662,176	646,460	772,826	<b>1,114,313</b>
Commission	1,241,588	1,519,924	1,663,545	1,795,340	<b>2,081,569</b>
Investments	356,830	288,193	329,322	225,722	<b>156,781</b>
Other	1,189,156	147,730	146,113	247,847	<b>374,295</b>
<b>Total</b>	<b>14,830,562</b>	<b>14,087,358</b>	<b>16,915,314</b>	<b>21,493,696</b>	<b>29,864,606</b>

**Utilisation of Income****Employees**

Salaries and other payments to staff	2,320,427	2,414,137	2,741,656	3,164,917	<b>3,657,112</b>
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**Suppliers**

Interest paid	6,909,095	5,962,041	7,280,851	9,797,449	<b>15,189,698</b>
Other expenses	4,440,289	4,418,999	4,922,800	4,529,175	<b>5,432,028</b>
<b>Total</b>	<b>11,349,384</b>	<b>10,381,040</b>	<b>12,203,651</b>	<b>14,326,624</b>	<b>20,621,726</b>

**Net Income before Government**

<b>Taxes &amp; Levies</b>	1,160,751	1,292,181	1,970,007	4,002,155	<b>5,585,768</b>
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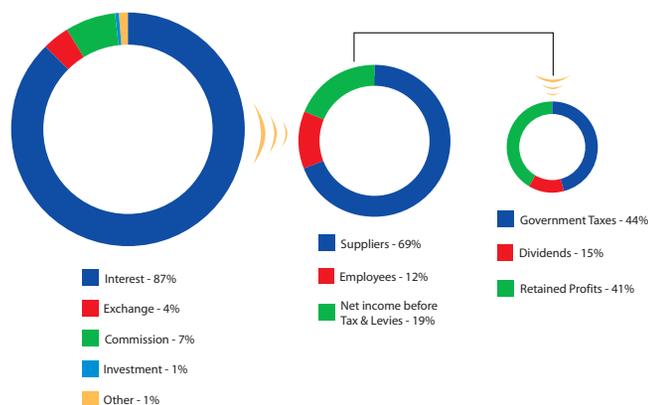
**Government**

Provision for Income tax, Provision for financial services VAT, Debit Tax and Defence Levy/National Security Levy	152,466	315,799	396,910	1,781,665	<b>2,306,885</b>
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**Shareholders**

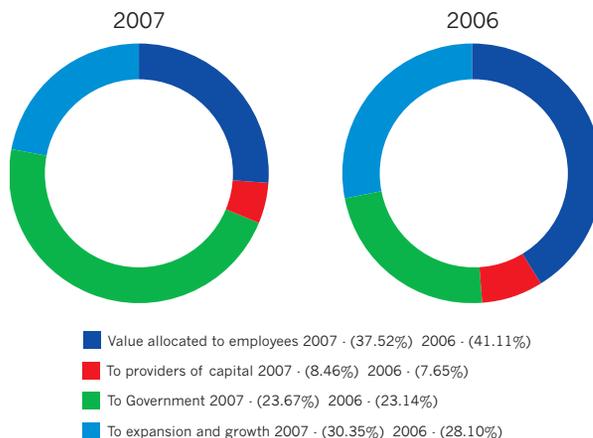
Dividends	286,000	350,350	471,059	588,824	<b>824,353</b>
Retained Profit	722,285	626,032	1,102,038	1,631,666	<b>2,454,530</b>
<b>Total</b>	<b>14,830,562</b>	<b>14,087,358</b>	<b>16,915,314</b>	<b>21,493,696</b>	<b>29,864,606</b>

Sources &amp; Utilisation of Income - 2007



	2007 Rs.000	%	2006 Rs.000	%
<b>Value added</b>				
Income earned by providing banking services	29,622,805		21,229,246	
Cost of services	19,208,616		12,863,185	
Value added by banking services	10,414,189		8,366,061	
Non-banking income	241,801		264,449	
Provision for bad debts	(907,913)		(931,828)	
	9,748,077		7,698,682	
<b>Value allocated to employees</b>				
Salaries, wages and other benefits	3,657,112	37.51	3,164,917	41.11
<b>To providers of capital</b>				
Dividends to shareholders	824,353	8.46	588,824	7.65
<b>To Government</b>				
Provision for financial services VAT	1,240,912		972,657	
Provision for Income Tax	1,037,908		798,961	
Debit Tax	10,102		8,977	
Stamp Duty	17,963	23.67	1,070	23.14
<b>To expansion and growth</b>				
Retained income	2,198,103	22.55	1,631,665	21.19
Depreciation/Amortisation	487,234	5.00	531,611	6.91
Deferred taxation	274,390	2.81	-	-
	9,748,077	100.00	7,698,682	100.00

Analysis of Value Addition



For the three months ended	2007				2006			
	December 31st	September 30th	June 30th	March 31st	December 31st	September 30th	June 30th	March 31st
<b>Balance Sheet Data</b>								
<i>(Rs. Million)</i>								
Total Assets	232,906	226,992	218,673	206,692	196,070	187,196	178,416	174,652
Loans, Leases and Bills	163,390	161,388	151,898	145,822	135,612	129,091	121,327	116,487
Deposits	175,660	168,220	160,381	154,490	147,557	141,063	137,623	133,089
Shareholders' Funds	18,419	17,061	16,361	12,951	12,930	12,347	11,758	11,264
Average Assets	229,949	222,833	212,683	201,381	191,633	182,806	176,534	170,332
<b>Income Statement Data</b>								
<i>(Rs.000)</i>								
Net Interest Income	2,838,974	2,837,731	2,816,880	2,454,365	2,304,367	2,269,430	2,165,580	1,915,135
Foreign Exchange Profit	319,560	291,567	257,266	245,920	245,126	186,993	171,738	168,969
Other Income	593,671	571,549	613,961	544,189	532,422	507,638	500,987	518,741
Total Revenue	3,752,205	3,700,847	3,688,107	3,244,474	3,081,915	2,964,061	2,838,305	2,602,845
Provision for Loan Losses	112,823	(136,896)	(160,981)	(435,002)	(330,012)	(93,717)	(115,211)	(195,973)
Non-interest Expenses	(2,206,835)	(2,385,080)	(2,566,477)	(2,272,431)	(1,657,894)	(2,081,361)	(1,999,205)	(1,994,303)
Provision for Income Tax	(382,438)	(397,090)	(311,216)	(221,554)	(233,846)	(200,615)	(212,438)	(152,062)
Net Profit after Tax	1,275,755	781,781	649,433	315,487	860,163	588,368	511,415	260,507
<b>Ordinary Share Information</b>								
<i>Market Price</i>								
per share (Rs.)	V	NV	V	NV	V	NV	V	NV
High	123.00	56.50	106.25	48.75	103.00	48.50	225.00	120.00
Low	99.75	44.00	90.25	37.75	90.00	35.00	100.00	47.00
Closing	122.50	53.25	101.25	44.75	94.75	42.50	100.00	47.75
Book value per Ordinary Share	78.20	72.44	69.46	54.99	54.90	52.42	49.92	47.82

V - Voting NV - Non-Voting

For the three months ended	2007				2006			
	December 31st	September 30th	June 30th	March 31st	December 31st	September 30th	June 30th	March 31st
<b>Financial Measures</b>								
<b>Profitability</b>								
Return on Average Shareholders' Equity	7.19%	4.68%	4.43%	2.44%	6.81%	4.88%	4.44%	2.32%
<b>Productivity</b>								
Non-interest Expenses to Total Revenue	58.81%	64.45%	69.59%	70.04%	53.79%	70.22%	70.44%	76.62%
<b>Capital</b>								
<b>Risk weighted capital ratios</b>								
Tier 1	10.32%	8.45%	8.90%	9.06%	10.23%	9.88%	10.25%	10.78%
Total (Tier 1 + 2)	12.08%	10.20%	10.42%	10.20%	11.32%	10.86%	12.02%	12.32%
*2007 figures are based on both credit risk and market risk								
<b>Asset Quality</b>								
Provision for Credit losses to average loans	-0.07%	0.09%	0.11%	0.31%	0.25%	0.07%	0.10%	0.17%

*Year ended*

31st December (Rs. Mn.)	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
<b>OPERATING RESULTS</b>										
Income	6,704	7,723	9,641	11,564	11,799	14,831	14,087	16,915	21,494	<b>29,865</b>
Interest Income	5,400	6,480	7,940	9,336	9,399	11,537	11,469	14,130	18,452	<b>26,138</b>
Interest Expenses	3,316	4,088	5,281	7,201	6,258	6,909	5,962	7,281	9,797	<b>15,190</b>
Exchange Income	428	313	364	516	382	506	662	646	773	<b>1,114</b>
Other Income	868	930	1,337	1,712	2,018	2,788	1,956	2,139	2,269	<b>2,613</b>
Operating Expenses	2,531	2,741	3,411	4,061	4,873	6,830	7,175	7,785	8,677	<b>10,340</b>
Profit before Income Tax	858	894	949	301	669	1,092	950	1,850	3,019	<b>4,335</b>
Income Tax on Profit	175	176	149	(2)	80	83	(26)	195	799	<b>1,312</b>
Profit after Taxation	683	718	800	303	589	1,008	976	1,655	2,220	<b>3,022</b>
<b>SHAREHOLDERS' FUNDS</b>										
Share Capital	300	650	650	650	715	715	1,001	1,178	1,178	<b>2,355</b>
Reserves	3,237	4,358	4,898	5,103	5,520	6,278	8,051	10,062	11,752	<b>16,064</b>
<b>LIABILITIES</b>										
Customer Deposits	46,032	53,858	62,758	75,599	87,884	101,026	118,524	128,284	147,557	<b>175,660</b>
Refinance Borrowings	1,129	1,636	1,655	1,565	1,659	1,764	2,066	2,712	3,583	<b>5,750</b>
Other Liabilities	13,805	15,732	17,540	15,999	19,354	23,161	22,788	23,463	31,687	<b>32,472</b>
Deferred Taxation	87	121	155	215	304	387	350	314	314	<b>606</b>
<b>ASSETS</b>										
Bills of Exchange	3,824	3,122	4,546	3,153	2,690	2,412	2,077	2,027	1,911	<b>2,069</b>
Loans and Advances	33,988	40,328	46,904	49,006	59,991	71,426	84,379	96,242	114,361	<b>139,785</b>
Lease Rentals Receivable	2,078	2,741	2,969	2,898	4,032	5,085	6,838	8,864	11,552	<b>13,289</b>
Cash, Short Term Funds and Statutory Deposits with										
Central Bank of Sri Lanka	14,495	17,325	15,212	18,844	23,640	25,019	29,228	29,766	35,836	<b>37,765</b>
Property, Plant & Equipment	1,675	1,914	2,273	2,509	2,781	3,414	3,387	3,059	2,908	<b>6,083</b>
Other Assets	5,003	10,924	15,752	22,722	22,301	25,975	26,870	26,053	29,502	<b>33,915</b>

## Year ended

31st December	1998	1999	2000	2001	2002	2003	2004	2005	2006	<b>2007</b>
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**RATIOS**

## Return on Average

Shareholders' Funds (%)	21	17	15	5	10	15	12	16	18	<b>19</b>
Income Growth (%)	10	15	25	20	2	26	(5)	20	27	<b>39</b>
Return on Average Assets (%)	1.2	1.0	1.0	0.3	0.6	0.8	0.7	1.0	1.2	<b>1.4</b>
Rate of Dividends (%)	45	40	40	15	30	40	35	40	50	<b>35</b>
Dividend Cover (times)	5.1	2.8	3.1	3.1	2.8	3.5	2.8	3.5	3.8	<b>3.7</b>
Gross Dividends (Rs. Mn.)	135	260	260	98	215	286	350	471	589	<b>824</b>
Advance to Deposits & Refinance (%)	85	82	84	71	76	77	77	82	85	<b>86</b>
Property, Plant & Equipment to Shareholders' Funds (%)	47	38	41	43	45	49	37	27	22	<b>33</b>
Total Assets to Shareholders' Funds (times)	18	15	16	17	19	19	17	15	15	<b>13</b>

**(AS SPECIFIED IN BANKING ACT NO. 30 OF 1988)**

## Capital Funds to Liabilities including

Contingent Liabilities (%)	1.2	1.0	1.2	1.2	1.2	1.0	1.0	1.0	1.0	<b>1.3</b>
Liquid Assets to Liabilities (%)	27	25	25	28	32	27	25	24	22	<b>22</b>

**SHARE INFORMATION**

## Market Value per Share (Rs.)

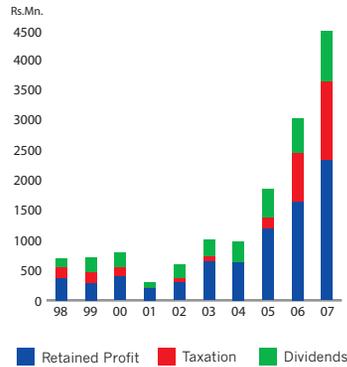
- Voting	174.00	87.00	46.25	52.00	79.00	69.00	57.00	112.50	155.75	<b>122.50</b>
- Non-Voting	-	-	36.75	36.00	47.00	36.75	32.75	41.50	70.00	<b>53.25</b>
Earnings per Share (Rs.)	9.27	9.75	10.86	4.11	8.00	13.69	12.51	15.09	9.43	<b>12.83*</b>
Price Earnings Ratio	18.77	8.92	4.26	12.65	9.88	5.04	4.56	7.46	16.52	<b>9.55</b>
Net Assets per Share (Rs.)	117.90	77.05	85.35	88.51	87.20	97.81	90.43	95.44	54.90	<b>78.20*</b>

**OTHER INFORMATION**

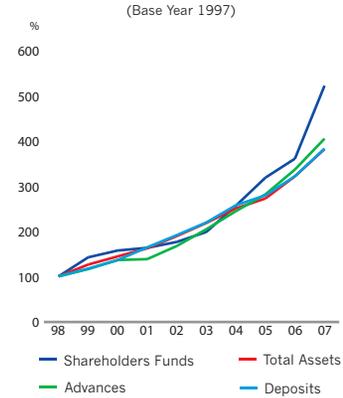
No. of Employees	3,744	4,035	4,119	4,137	4,280	4,203	4,180	4,259	4,287	<b>4,334</b>
No. of Customer Centres	103	111	117	123	137	138	142	148	151	<b>167</b>
No. of other Financial Centres	72	95	104	110	110	110	110	113	113	<b>114</b>

On 29th March 2007 the Bank issued 1:1 bonus shares (one ordinary share for each ordinary share outstanding as at 31st December 2006) resulting in dilution of EPS and Net Asset Value. Accordingly 2006 and 2007 EPS and Net Asset Value for the comparative period has been restated.

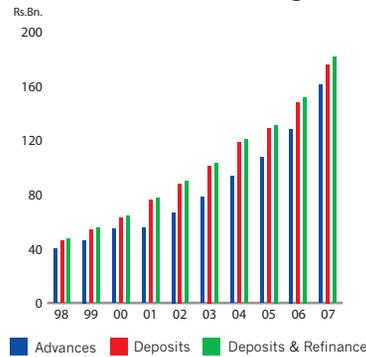
Distribution of Profit



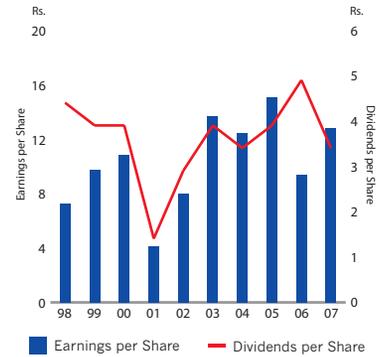
Balance Sheet Growth



Advances, Deposits and Re-Finance Borrowings



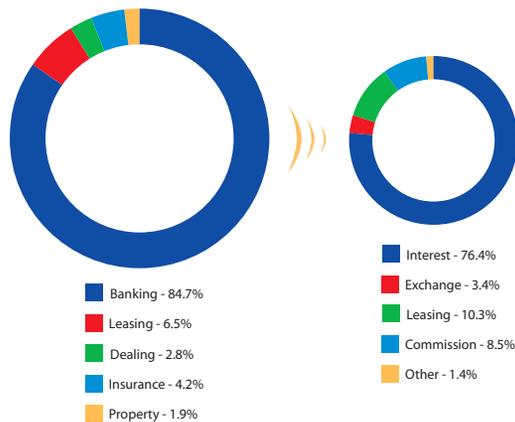
Earnings per Share and Dividends per Share



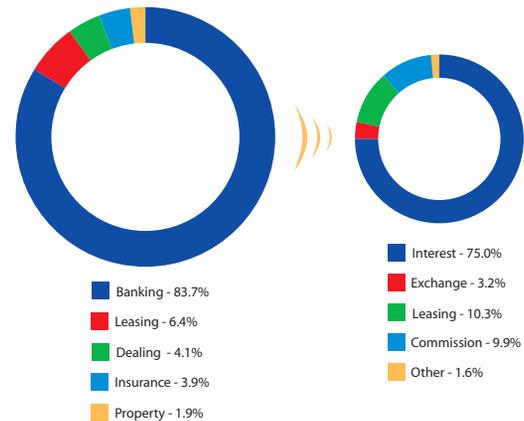
Business segments	Banking		Leasing		**Dealings		Property		Insurance		Total	
	2007	2006	2007	2006	2007	2006	2007	2006	2007	2006	2007	2006
	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000
Interest	23,997,260	16,913,119	-	-	806,736	878,742	216	-	200,866	105,977	25,005,078	17,897,838
Exchange	1,114,313	772,825	-	-	-	396	-	-	1,183	-	1,115,496	773,221
Lease/Premium/ Brokering Income	-	-	2,140,388	1,538,842	71,577	100,570	-	-	1,167,439	817,705	3,379,404	2,457,117
Commissions/Rent	2,167,846	1,895,642	-	-	387	5,409	610,011	460,604	-	-	2,778,244	2,361,655
Other	444,799	373,267	-	-	24,801	1,215	-	-	1,144	691	470,744	375,173
<b>Total revenue</b>	<b>27,724,218</b>	<b>19,954,853</b>	<b>2,140,388</b>	<b>1,538,842</b>	<b>903,501</b>	<b>986,332</b>	<b>610,227</b>	<b>460,604</b>	<b>1,370,632</b>	<b>924,373</b>	<b>32,748,966</b>	<b>23,865,004</b>

\*\*Stock Broking and Securities Dealings

Segmental Analysis of Revenue - 2007



Segmental Analysis of Revenue - 2006



## 1. Stock Exchange Listing

The issued ordinary shares of Hatton National Bank Limited are listed with the Colombo Stock Exchange. The audited Profit and Loss account for the year ended 31 st December 2006 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 Limited shares is "HNB". Reuter code of Hatton National Bank Limited is "HNBL"

## 2. Ordinary Shareholders

SHARE INFORMATION - VOTING  
As at 31 December 2007

	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	2,495	861,562	0.69	27	11,644	0.03	2,522	873,206	0.52
1,001 - 5,000	990	2,283,091	1.83	22	50,776	0.11	1,012	2,333,867	1.38
5,001 - 10,000	229	1,651,480	1.33	9	62,068	0.14	238	1,713,548	1.01
10,001 - 50,000	331	6,922,750	5.56	14	252,700	0.57	345	7,175,450	4.25
50,001 - 100,000	55	3,914,747	3.14	1	55,550	0.13	56	3,970,297	2.35
100,001 - 500,000	33	5,822,280	4.68	1	110,000	0.25	34	5,932,280	3.51
500,001 - 1,000,000	1	897,664	0.72	-	-	-	1	897,664	0.53
Over 1,000,000	8	102,175,692	82.05	2	43,774,606	98.78	10	145,950,298	86.44
	4,142	124,529,266	100.00	76	44,317,344	100.00	4,218	168,846,610	100.00

### Analysis of shareholders Resident/Non-Resident

	31/12/2007			31/12/2006		
	No of share-holders	No of shares	%	No of share-holders	No of shares	%
Resident	4,142	124,529,266	73.75	4,615	72,417,030	76.50
Non-Resident	76	44,317,344	26.25	87	22,247,670	23.50
Total	4,218	168,846,610	100.00	4,702	94,664,700	100.00

### Individuals/Institutions

	31/12/2007			31/12/2006		
	No of share-holders	No of shares	%	No of share-holders	No of shares	%
Individuals	3,985	18,524,700	10.97	4,439	10,720,705	11.32
Institutions	233	150,321,910	89.03	263	83,943,995	88.68
Total	4,218	168,846,610	100.00	4,702	94,664,700	100.00

As at 31/12/2007 the average size of holding of ordinary shareholding was 40,030 voting shares. (31/12/2006 - 20,133 voting shares)

As per the rule No. 8.7 (h) of Colombo Stock Exchange, percentage of public holding as at 31st December 2007 was 52.70 approximately.

SHARE INFORMATION - NON VOTING  
As at 31 December 2007

	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	7,511	2,634,942	5.90	47	18,440	1.18	7,558	2,653,382	5.74
1,001 - 5,000	3,866	8,525,233	19.10	40	102,520	6.54	3,906	8,627,753	18.67
5,001 - 10,000	474	3,435,622	7.70	11	79,540	5.07	485	3,515,162	7.61
10,001 - 50,000	437	8,657,138	19.40	11	194,360	12.40	448	8,851,498	19.16
50,001 - 100,000	33	2,279,560	5.11	1	90,900	5.80	34	2,370,460	5.13
100,001 - 500,000	30	6,026,079	13.50	1	154,000	9.82	31	6,180,079	13.38
500,001 - 1,000,000	4	2,534,592	5.68	1	928,200	59.20	5	3,462,792	7.50
Over 1,000,000	2	10,538,874	23.61	-	-	-	2	10,538,874	22.81
	12,357	44,632,040	100.00	112	1,567,960	100.00	12,469	46,200,000	100.00

**Analysis of shareholders  
Resident/Non-Resident**

	31/12/2007			31/12/2006		
	No of share-holders	No of shares	%	No of share-holders	No of shares	%
Resident	12,357	44,632,040	96.61	12,039	22,659,435	98.09
Non-Resident	112	1,567,960	3.39	98	440,565	1.91
Total	12,469	46,200,000	100.00	12,137	23,100,000	100.00

**Individuals/Institutions**

	31/12/2007			31/12/2006		
	No of share-holders	No of shares	%	No of share-holders	No of shares	%
Individuals	12,240	28,281,232	61.21	11,897	13,547,311	58.65
Institutions	229	17,918,768	38.79	240	9,552,689	41.35
Total	12,469	46,200,000	100.00	12,137	23,100,000	100.00

As at 31/12/2007 the average size of holding of ordinary shareholding was 3,705 voting shares.  
(31/12/2006 - 1,903 non-voting shares)

As per the rule No. 8.7 (h) of Colombo Stock Exchange, percentage of public holding as at 31st December 2007 was 95.42 approximately.

### 3 Share Trading

	2007	2006
<b>Voting Shares</b>		
Number of transactions	<b>4,370</b>	3,400
Number of shares traded (Mn)	<b>30.3</b>	5.6
Rank(As per CSE)	<b>18</b>	78
Value of shares traded (Rs.Mn)	<b>3,309.8</b>	706.7
Rank(As per CSE)	<b>5</b>	32
<b>Non-Voting Shares</b>		
Number of transactions	<b>17,669</b>	5,146
Number of shares traded (Mn)	<b>18.2</b>	5.0
Value of shares traded (Rs.Mn)	<b>1,126.4</b>	290.3

### 4 Dividends

	2007	2006
Interim (Rs.)	-	2.50 Paid in December 2006
Final (Rs.)	3.50 Proposed in April 2008	2.50 Paid in April 2007

### 5 Earnings

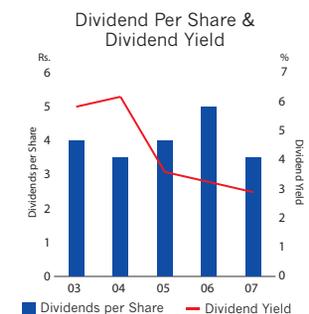
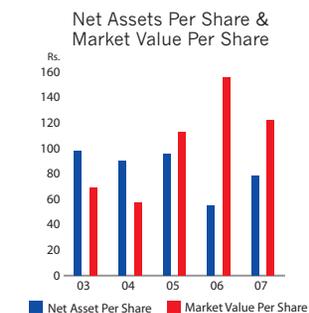
	2007	2006
Earnings per share (Rs.)	<b>12.83</b>	9.43
Price earnings ratio(Times)	<b>9.55</b>	16.52

### 6 Market Value

	Highest	Lowest	Year End
	Rs.	Rs.	Rs.
2003 - Voting	120.00	68.00	69.00
- Non Voting	75.00	35.00	36.75
2004 - Voting	80.00	50.25	57.00
- Non Voting	47.00	30.00	32.75
2005 - Voting	148.00	51.75	112.50
- Non Voting	65.75	32.25	41.50
2006 - Voting	161.00	100.00	155.75
- Non Voting	74.25	39.00	70.00
<b>2007 - Voting</b>	<b>215.00</b>	<b>92.00</b>	<b>122.50</b>
<b>- Non Voting</b>	<b>110.00</b>	<b>35.25</b>	<b>53.25</b>

### 7 Market Capitalisation (As at 31st December)

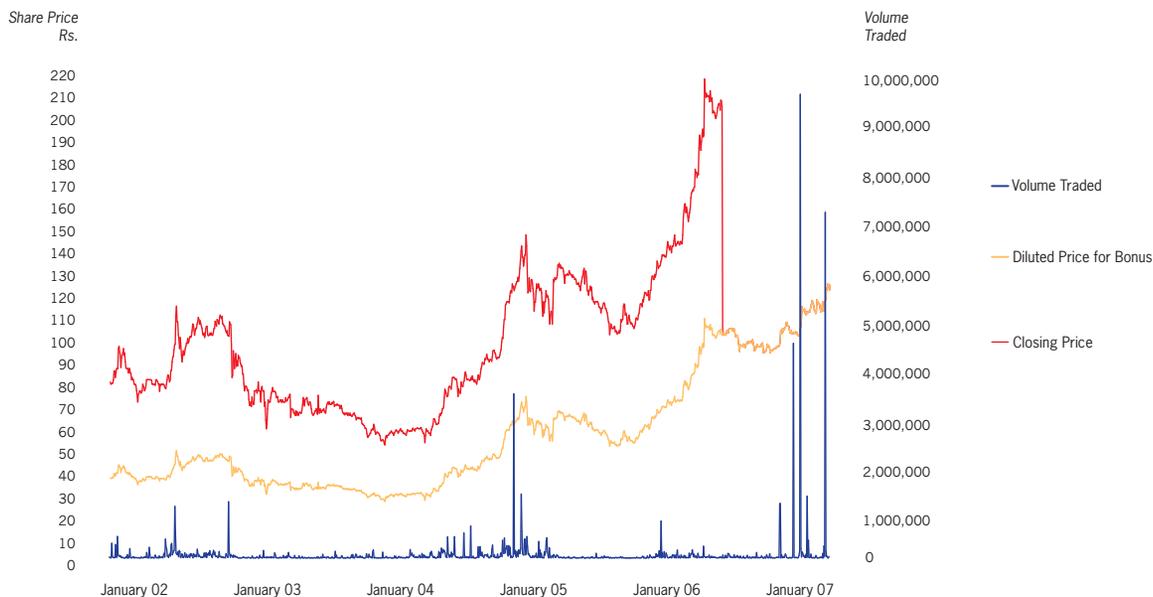
	Capital & Reserves Rs. Mn	HNB Market Capitalisation Rs. Mn	CSE Market Capitalisation Rs. Mn	HNB Market Capitalisation as a % of CSE Market Capitalisation	Market Capitalisation Ranking
2003	6,993	3,795	262,838	1.44	15
2004	9,052	4,389	382,065	1.15	20
2005	11,239	10,649	584,040	1.82	10
2006	12,930	14,744	834,763	1.77	10
<b>2007</b>	<b>18,419</b>	<b>23,193</b>	<b>820,652</b>	<b>2.83</b>	<b>6</b>



## 8 Record of Scrip Issues

Year	Issue	Basis	No. of Shares	Increase in Share Cap (Rs.)	Share Capital (Rs.)
	Prior to public issue		50,000	500,000	500,000
1971	Public issue		220,000	2,200,000	2,700,000
1977	Rights issue (@ Rs.10/-)	42:50	230,000	2,300,000	5,000,000
1980	Rights issue (@ Rs.10/-)	1:1	500,000	5,000,000	10,000,000
1982	Bonus	1:1	1,000,000	10,000,000	20,000,000
1988	Bonus	1:1	2,000,000	20,000,000	40,000,000
1990	Bonus	1:2	2,000,000	20,000,000	60,000,000
1993	Bonus	1:1	6,000,000	60,000,000	120,000,000
1996	Bonus	2:3	8,000,000	80,000,000	200,000,000
1998	Bonus	1:2	10,000,000	100,000,000	300,000,000
1999	Bonus	2:3	20,000,000	200,000,000	500,000,000
1999	Rights (non voting @ Rs.70/-)	3:10	15,000,000	150,000,000	650,000,000
2001	Bonus	1:10	6,500,000	65,000,000	715,000,000
2004	Rights (voting @ Rs.55/-)	2:5	22,000,000	220,000,000	935,000,000
2004	Rights (non voting @ Rs.33/-)	2:5	6,600,000	66,000,000	1,001,000,000
2005	Issue of underlying shares for GDR	-	17,664,700	176,647,000	1,177,647,000
<b>2007</b>	<b>Bonus</b>	<b>1:1</b>	<b>117,764,700</b>	<b>1,177,647,000</b>	<b>2,355,294,000</b>
	<b>Total</b>		<b>235,529,400</b>	<b>2,355,294,000</b>	

## 9 Price Volume Chart



**20 MAJOR VOTING SHAREHOLDERS – 31ST DECEMBER 2007**

Name	% on total capital	No.of shares		
		2007	2006	
1 Deutsche Bank Trust Company Americas	15.00%	<b>35,329,400</b>	17,664,700	
2 Brown & Co. Ltd	7.29%	<b>17,158,690</b>	8,441,760	
3 CBD Exports Ltd	6.53%	<b>15,384,600</b>	7,692,300	
4 Milford Exports (Cey) Ltd	6.53%	<b>15,373,050</b>	7,686,525	
5 Stassen Exports Ltd	5.66%	<b>13,324,850</b>	6,662,425	
6 Panchalingam Associates (Pvt) Ltd	5.19%	<b>12,232,942</b>	6,116,471	
7 Sri Lanka Insurance Corporation Ltd – Life Fund	4.88%	<b>11,499,132</b>	5,749,566	
8 Standard Finance Ltd	4.77%	<b>11,240,720</b>	5,620,360	
9 Sonetto Holdings Ltd	3.59%	<b>8,445,206</b>	4,222,603	
10 Distilleries Co. of Sri Lanka Ltd	2.53%	<b>5,961,708</b>	2,980,854	
11 Mr Sinnathamby Visuvanathan	0.38%	<b>897,664</b>	448,832	
12 Mr Narhari Choonilal Bhatt (Estate)	0.15%	<b>344,960</b>	172,480	
13 Ms Ponweera Arachchige Pemawathie	0.14%	<b>336,788</b>	168,394	
14 Mr Somapala Bope Hewage (Estate)	0.14%	<b>322,200</b>	161,100	
15 Mr Ajith Lasantha Devasurendra	0.13%	<b>311,100</b>	146,600	
16 Freudenberg Shipping Agencies Limited	0.11%	<b>255,800</b>	127,900	
17 Eagle Insurance Company Ltd - A/c No.3	0.11%	<b>253,200</b>	-	
18 N Vaitilingam & Co. Limited	0.09%	<b>220,000</b>	110,000	
19 Mrs Eileen Ravenshaw Frances Cooray (Estate)	0.09%	<b>215,888</b>	107,944	
20 Mr Mohamed Junaid Mohamed Zarook	0.09%	<b>204,432</b>	102,216	
<b>Sub Total</b>	63.39%	<b>149,312,330</b>	74,383,030	*
*Unregistered Shares	8.70%	<b>20,482,790</b>	-	
Balance Held By 4,198 Voting Shareholders	8.29%	<b>19,534,280</b>	20,281,670	(4,682 V.Sh)
<b>Total Voting Shares</b>	80.38%	<b>189,329,400</b>	94,664,700	
Shares held by 12,469 Non Voting Shareholders	19.62%	<b>46,200,000</b>	23,100,000	(12,137 NV.Sh)
<b>Total No.of Ordinary Shares</b>	100.00%	<b>235,529,400</b>	117,764,700	

\*Some foreign investors had purchased 20,482,790 shares during the period of October - December 2007 through the Central Depository Systems (Pvt) Ltd. of the Colombo Stock Exchange. Board Secretary was requested to obtain relevant information/documents from the purchasers and their representatives, in order to satisfy that the investments conformed to the Banking Act/regulations thereunder and other statutory provisions prior to registering and recognising the investors as shareholders. That was to ensure that the Bank does not become a party to any violation of statutory obligations. The Bank is awaiting information/documents to look into the aspects of compliance.

**20 MAJOR NON-VOTING SHAREHOLDERS**

Name	% on total capital	No. of shares	
		2007	2006
1 LegalinkTrustee Services (Pvt) Ltd	3.88%	<b>9,133,274</b>	4,566,637
2 Nawaloka Developments (Pvt) Ltd	0.60%	<b>1,405,600</b>	715,000
Galleon International Master Fund, SPC Limited	0.39%	<b>928,200</b>	-
4 DFCC Bank A/c No.1	0.34%	<b>797,600</b>	388,800
5 Distilleries Company of Sri Lanka	0.29%	<b>675,132</b>	337,566
6 Mr Dickowita Kankanamege Weeratunga	0.23%	<b>537,760</b>	318,880
3 Mr Weerahennedige Kingsley Valentine Mazenod Fernando	0.22%	<b>524,100</b>	174,600
8 Mr Sinnathamby Visuvanathan	0.19%	<b>440,000</b>	220,000
9 Employees Trust Fund Board - Standard Chartered Bank	0.15%	<b>353,880</b>	132,090
10 Mrs Kurukulasuriya Weerasinghe Shirani Helen Fernando	0.15%	<b>352,300</b>	174,000
11 Hatton National Bank Ltd A/c No.2	0.14%	<b>338,638</b>	169,319
Mr Bamunu Arachchige Mahipala	0.14%	<b>334,800</b>	-
12 M C A Trading Co. (Pvt) Ltd	0.14%	<b>330,000</b>	165,000
13 Miss Shanika Antoinette Fernando	0.14%	<b>319,700</b>	157,200
14 Ceylon Grain Elevators Ltd	0.12%	<b>275,000</b>	137,500
15 Miss Weerahennedige Niroshika Celestine Fernando	0.11%	<b>254,800</b>	105,200
18 Lanka Synthetic Fibre Co.Ltd	0.09%	<b>220,000</b>	110,000
Sri Lanka Insurance Corporation Ltd – General Fund	0.09%	<b>202,994</b>	101,497
19 Mrs Sembukuttiarachchige Fidelis Hemamali Alexander	0.09%	<b>202,940</b>	108,970
20 Wayamba Cooperative Rural Banks Union Limited	0.08%	<b>195,000</b>	-
Sub Total	7.57%	<b>17,821,718</b>	8,082,259
Balance held by 12,449 Non Voting Shareholders	12.05%	<b>28,378,282</b>	15,017,741 (12,137 NV.Sh)
Total No. of Non Voting Ordinary Shares	19.62%	<b>46,200,000</b>	23,100,000
Balance Held By 4,218 Voting Shareholders	71.69%	<b>168,846,610</b>	94,664,700 (4,702 NV.Sh)
Unregistered Shares	8.70%	<b>20,482,790</b>	-
Total Voting Shares	80.38%	<b>189,329,400</b>	94,664,700
Total No. of Ordinary Shares	100.00%	<b>235,529,400</b>	117,764,700

**HNB DEBENTURES 2002****i) Market Value**

12 months ended 31st December 2007

	Highest Rs.	Lowest Rs.	Year End Rs.
7 year Fixed Rate (14.00% p.a.)	94.05	88.00	88.00
7 year Floating Rate (TB + 1.10% p.a.)	99.75	99.75	N/T
10 year Fixed Rate (14.20% p.a.)	85.00	84.00	85.00
10 year Floating Rate (TB + 1.25% p.a.)	90.00	90.00	90.00

**ii) Interest Income**

12 months ended 31st December

Coupon Interest (Rs.)

	2007	2006
7 year Fixed Rate (14.00% p.a.)	<b>14.00</b>	14.00
7 year Floating Rate (TB + 1.10% p.a.)	<b>17.00</b>	12.00
10 year Fixed Rate (14.20% p.a.)	<b>14.20</b>	14.20
10 year Floating Rate (TB + 1.25% p.a.)	<b>17.00</b>	12.00

For an investment of Rs. 100/-. The above rupee coupon interest rates are applicable for the next interest payment due on the 15th of February 2008.

**iii) Yield to Maturity of last trade done (% p.a)**

12 months ended 31st December

	2007	2006
7 year Fixed Rate (14.00% p.a.)**	<b>20.75</b>	14.77
7 year Floating Rate (TB + 1.10% p.a.)**	<b>N/A</b>	N/A
10 year Fixed Rate (14.20% p.a.)	<b>18.91</b>	14.65
10 year Floating Rate (TB + 1.25% p.a.)**	<b>N/A</b>	N/A

\*\* The yield to maturity calculation is not applicable for floating rate debentures.

**iv) Yield as at last trade done (% p.a)**

12 months ended 31st December

	2007	2006
7 year Fixed Rate (14.00% p.a.)	<b>15.91</b>	14.29
7 year Floating Rate (TB + 1.10% p.a.)	<b>17.04</b>	12.03
10 year Fixed Rate (14.20% p.a.)	<b>16.71</b>	14.48
10 year Floating Rate (TB + 1.25% p.a.)	<b>18.89</b>	N/T

N/T – Not Traded as at ended 31 December 2005

**v) Yield on Equivalent Government Security (% p.a)**

	2007	2006
5 year Treasury Bond	19.50	11.45
6 year Treasury Bond	19.50	11.50
10 year Treasury Bond	N/T	11.75

N/T – Not Traded for the period ended 31 December

**HNB DEBENTURES 2003**

**i) Market Value  
12 months ended 31st December 2007**

	Highest Rs.	Lowest Rs.	Year End Rs.
5 year Fixed Rate (10.00% p.a.)	93.42	88.99	93.42
5 year Floating Rate (TB + 2.00% p.a.)	90.00	90.00	90.00

**ii) Interest Income  
12 months ended 31st December**

	2007	2006
Coupon Interest (Rs.)		
5 year Fixed Rate (10.00% p.a.)	10.00	10.00
5 year Floating Rate (TB + 2.00% p.a.)	20.34	14.39

For an investment of Rs. 100/-. The above rupee coupon interest rates are applicable for the next interest payment due on the 15th of June 2008.

**iii) Yield to Maturity of last trade done (% p.a)  
12 months ended 31st December**

	2007	2006
5 year Fixed Rate (10.00% p.a.)	20.70	17.56
5 year Floating Rate (TB + 2.00% p.a.) **	N/A	N/A

\*\* The yield to maturity calculation is not applicable for floating rate debentures.

**iv) Yield as at last trade done (% p.a)  
12 months ended 31st December**

	2007	2006
5 year Fixed Rate (10.00% p.a.)	10.70	11.11
5 year Floating Rate (TB + 2.00% p.a.)	22.60	13.58

**v) Yield on Equivalent Government Security (% p.a)**

	2007	2006
5 year Treasury Bond	<b>19.50</b>	11.45
6 year Treasury Bond	<b>19.50</b>	11.50
10 year Treasury Bond	<b>N/T</b>	11.75

N/T – Not Traded for the period ended 31 December

**HNB DEBENTURES 2006****i) Market Value**

12 months ended 31st December 2007

These debentures have not traded for the period ended 31st December 2007

**ii) Interest Income**

12 months ended 31st December

Coupon Interest (Rs.)

	2007	2006
6 year Floating Rate (TB + 2.25% p.a.)	<b>16.00</b>	14.95
7 year Floating Rate (TB + 2.25% p.a.)	<b>16.00</b>	14.95
8 year Floating Rate (TB + 2.25% p.a.)	<b>16.00</b>	14.95
15 year Fixed Rate (11.00% p.a.)	<b>11.00</b>	11.00
18 year Fixed Rate (11.25% p.a.)	<b>11.25</b>	11.25

} With a floor of 8%  
and cap of 16%

For an investment of Rs. 100/-. The above rupee coupon interest rates are applicable for the next interest payment due on the 30th June 2008.

**iii) Yield on Equivalent Government Security (% p.a)**

	2007	2006
5 year Treasury Bond	<b>19.50</b>	11.45
6 year Treasury Bond	<b>19.50</b>	11.50
10 year Treasury Bond	<b>N/T</b>	11.75

N/T – Not Traded for the period ended 31 December

**HNB DEBENTURES 2007****i) Market Value**

12 months ended 31st December 2007

These debentures have not traded for the period ended 31st December 2007

**ii) Interest Income**

12 months ended 31st December

Coupon Interest (Rs.)	2007	2006
10 year Fixed Rate (16.00% p.a.)	16.00	N/A
15 year Fixed Rate (16.75% p.a.)	16.75	N/A

For an investment of Rs. 100/-. The above rupee coupon interest rates are applicable for the next interest payment due on the 30th June 2008.

**iii) Yield on Equivalent Government Security (% p.a)**

	2007	2006
5 year Treasury Bond	19.50	11.45
6 year Treasury Bond	19.50	11.50
10 year Treasury Bond	N/T	11.75

**Ratios**

	2007	2006
Debt to equity ratio (%)	25.00	40.00
Interest cover (Times)	7.14	5.73
Quick asset ratio (%)	65.00	56.00











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**2007**

1st Quarter Results 2007 released on	10th May, 2007
2nd Quarter Results 2007 released on	10th August, 2007
3rd Quarter Results 2007 released on	20th November, 2007
Annual Report for 2007 on	3rd March, 2008
39th Annual General Meeting	28th, March, 2008
Rs. 3.50 per share Final Dividend for 2007 payable on	4th April, 2008

**2008**

1st Quarter Results 2008	May, 2008
2nd Quarter Results 2008	August, 2008
3rd Quarter Results 2008	November, 2008
..... Interim Dividend for 2008	December, 2008
Annual Report for 2008	March, 2009
40th Annual General Meeting	March, 2009
..... Final Dividend for 2008	April, 2009

The Directors take pleasure in presenting to members their report and the audited accounts of the Company for the year ended 31st December 2007. This was approved by the Directors at a meeting held on 15th February 2008.

### Principal Activities

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

### Review of Operations

A review of the operations of the Bank during the financial year and results of those operations are contained in the Chairman's Message and in the Chief Executive Officer's Review of Operations on Pages 7 to 17 of the Corporate Reviews section of the Annual Report. These reports form an integral part of the Directors' Report

### New Product Development

- During 2007 the Bank introduced the "HNB Big Bonus Savings account" which rewards customers with Bonus interest up to 100% on their Savings.
- The bank also introduced Trilingual Mobile Phone banking to provide customer convenience in accessing Internet Banking in all three languages. This was the first trilingual Internet Banking Service introduced in Sri Lanka.
- With the special scheme introduced by the Government to issue duty free vehicle permits for Senior Government Officials, the Bank introduced a loan scheme under HNB Personal Loans to meet their financial requirements.

### Network Expansion

Our stance of being a visible partner to people anywhere in the country was further augmented with the expansion of our Customer Centres and ATM networks. Customer service was a pivotal factor in this expansion process and continues to be the winning platform upon which the Bank is positioned. We also made a conscious effort to launch more customer centres to give accessibility to the disabled, for further mobility to our physically challenged customers.

Customer Centres opened	17
Number of new ATMs installed	39

### Risk & Internal Control

The Board considers that strong internal controls are integral to the sound management of the Bank and it is committed to maintaining 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, 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.

### Enterprise Governance

The Board is committed to maintaining high standards of enterprise governance, the process by which the Bank is directed and managed. Risks are identified and controlled and effective accountability assured. The Board of Directors is of the view that it has put in place the resources and the processes to ensure that the Bank is substantially compliant with the code of best practices on corporate governance issued by Institute of Chartered Accountants of Sri Lanka throughout the year ended 31st December 2007. The Enterprise Governance Report is given on pages 32 to 43 of the Corporate Reviews section of the Annual Report.

### Audit Committee

The Audit Committee comprises entirely of non-executive directors and the majority of them are independent. The members of the Committee are:

Mr. Ranjeevan Seevaratnam (Chairman)

Mr. D. H. S. Jayawardena

Mrs. P .C. Cooray

Mr. Ratneswara Sivaratnam (resigned with effect from 03.05.2007)

The Report of the Audit Committee is given on page 10 of Financial Reports of the Annual Report.

### 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 the Financial Statements.

### Code of Corporate Conduct

The Bank, in pursuance of its stated objectives, has outlined a Value System for conformity by all staff members, including the corporate management. Two documents, viz the Value Statement and the Code of Ethics, provide the basis of a value system which is communicated to the staff and implemented strictly. A disciplinary code has been formulated, incorporating rules of proper conduct to ensure compliance by the staff. A clearly defined set of rules and instructions are in place to ensure the functional accountability of staff.

The Corporate Value System identifies transparency in business processes, preserving confidentiality of the information received, professional integrity and passionate customer service, as key features. The Code of Ethics also recognises the importance of self dignity, equality of all human beings and propriety in behaviour as integral aspects of good corporate conduct. Apart from circulation of the code of ethics among the staff, the Bank, through Training programmes and performance Appraisal Schemes linked to the Value System, strives to promote good corporate governance. The emphasis placed on the need to uphold principles enshrined in the Code of Ethics and Value Statement helps to develop and sustain a value based organisation.

### Turnover/Gross Income

The Turnover/Gross Income of the Group for 2007 was Rs. 31,945,777,000/- (2006 - Rs. 23,213,724,000/-). An analysis of the Income is given in note 9 to the Accounts.

### Profit

The Group Profit for the year ended 31st December 2007 after payment of all expenses of management and providing for depreciation and

	2007 Rs.000	2006 Rs. 000
contingencies	4,566,462	3,095,211
Add/(Less)Taxation	(1,366,660)	(819,575)
Group Net Profit after taxation	3,199,802	2,275,636
Minority Interest	(49,333)	(36,530)
Unappropriated Profit brought forward from previous year	1,722,195	1,141,653
Deferred tax liability for revaluation reserve	-	66,377
Balance available for Appropriation	4,872,664	3,447,136

### Appropriations

	2007 Rs.000	2006 Rs.000
Transfer to General Reserve	1,565,000	1,150,000
Transfer to Reserve Fund	152,000	45,000
Interim Dividend paid (25% - 2006)	-	294,412
Final Dividend	294,412	235,529
Balance carried forward as at 31.12.2007	2,861,252	1,722,195

### Taxation

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

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

The Bank was also liable for Financial VAT at 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**

The Directors recommend a First and Final Dividend of Rs. 3.50 per share (2006 - Rs. 5/- per share) to be paid on 4th April 2008, to holders of Issued and Paid Up Ordinary shares of the Bank as at the close of business on 28th March 2008, subject to tax from the balance carried forward as at 31.12.2007 (Note 35).

### **Corporate Donations**

During the year the Bank made donations amounting to Rs. 29,451,000/- (2006 - Rs. 33,477,000/-) in terms of the resolution passed at the last Annual General Meeting. The donations made to Government approved charities from the above sum amount to Rs. 1,364,310/- (2006 - Nil).

### **Customers**

One of the Bank's primary objectives is to provide a caring customer service. To achieve this the Bank carries out regular customer service campaigns amongst its entire staff on the provision of a Courteous, Friendly and Caring Service to its customers. In addition the Bank also carries out customer awareness programmes at Branch level on new products and services offered by the Bank. The Bank offers financial services to both corporate and retail customers.

### **Suppliers**

It is the Bank's policy to call for competitive quotations for the supply of goods and services. Suppliers of goods and services are paid promptly.

### **Employment Policies**

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 align with organisational needs.

A manpower plan is formulated at the beginning of the year in setting out the human resource requirements of the Bank. In preparing this plan, a variety of factors such as IT developments, projected expansion of the network, business volumes and productivity initiatives

are taken into consideration. This exercise is initiated by the HR Division and is carried out in consultation with the heads of departments and branch managers.

Recruitment and selection is based on organisational needs and is strictly governed by specific recruitment & selection criteria such as qualifications, experience, external and internal examinations, assessment interviews, psychometric tests and aptitude tests. Recruitment will be from internal and external candidates with the selection processes culminating in obtaining approval from the required authority. Selected candidates are required to follow a well designed induction programme to facilitate smooth integration into the organisation.

Placement of selected candidates is determined by a Management Committee which is guided by a clearly laid out Transfer & Placement Policy.

Being an equal opportunity employer, the Bank does not discriminate on the basis of gender, race, religious or social backgrounds. The Bank is a founder member of the EFC Employer Network for Disability and is committed to providing employment opportunities for them. The Recruitment Policy also encourages the intake of sportsmen and women who excel in their fields.

### **Capital Expenditure**

The total capital expenditure on acquisition of Property, Plant & Equipment, Intangible Assets and Investment Property amounted to Rs. 1,170,408,000/- (2006 - Rs. 586,184,000/-), details of which are given in Notes 30,31 and 32 to the Accounts. Capital expenditure approved and contracted for after the year end is given in Note 44(a) to the Accounts.

### **Property, Plant & Equipment**

Details of the property, plant and equipment of the company are given in Note 31 to the Accounts.

### **Market Value of Freehold Properties**

The net book value of freehold properties owned by the Bank/Group as at 31st December 2007 is included in the accounts at Rs. 4,124,693,000/- / Rs. 9,263,921,000/- (Bank 2006 - Rs. 1,407,735,000/-, Group 2006 - Rs. 3,885,140,000/-). 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 31(b) to the Accounts.

## Reserves

The Group Reserves consist of :

	<b>2007</b>	2006
	<b>Rs.000</b>	Rs.000
Capital Reserve	<b>5,768,262</b>	240,262
Reserve Fund	<b>821,707</b>	669,707
Repairs & Renovation Reserve	<b>6,700</b>	6,700
Revenue Reserve	<b>9,643,605</b>	8,117,195
<b>Total</b>	<b>16,240,274</b>	9,033,864

The movement in these reserves is shown in the Statement of Changes in equity on page 14 of the Financial Reports section of the Annual Report.

## Stated Capital

The stated capital of the Bank as at 31st December 2007 was Rs. 5,059,390,000/-, consisting of 235,529,400 ordinary shares (189,329,400 - Voting and 46,200,000 - Non-voting) and Rs. 2,704,096,000/- Share premium.

## Shareholding

As at 31st December 2007 there were 16,687 Registered voting and non-voting shareholders. The distribution is indicated on pages 49 and 50 of the Management Discussion section of the Annual Report.

## Share Information

Information relating to earnings, dividend, net assets and market price per share is given in the Financial Highlights on page 2 of the Corporate Review section of the Annual Report. Information on share trading is given in Note 3 on page 51 of the Management Discussion section of the Annual Report.

## Major Shareholders

The twenty largest voting shareholders of the Bank as at 31st December 2007 are given on page 53 of the Management Discussion section of the Annual Report, together with an analysis of the shareholding.

## Future Developments

Information relating to future developments in the operations of the Bank which will not, in the opinion of the Directors, be prejudicial to the Bank's interest, is contained in the Chairman's Message and Chief Executive Officer's Review.

The Bank, while implementing and reviewing strategies specified under its business plan, will closely monitor the possible challenges imposed by the fiscal and monetary policy framework. Implementing a new core banking application, revamping the communication network, incorporating a joint venture exchange house in the Middle East, to reap economic benefits from remittance business are key initiatives taken in 2007 to be pursued in 2008. The Bank will continue extending the reach by aggressively increasing the branch network island wide and constantly improving the delivery and distribution channels, specifically with use of IT. The Bank also intends to draw synergies from its subsidiaries to harness greater business opportunities for the Group and consolidate the relationships developed so far for better profitability. In light of the above, the Bank will form a fully integrated investment banking operation in partnership with DFCC Bank during 2008.

## Directors

The Board of Directors of Hatton National Bank PLC consists of nine Directors with wide financial and commercial knowledge and experience.

The Directors of the Company and their experience as at the date of the report are shown on page 19 of the Corporate Reviews section of the Annual Report.

In accordance with the provisions of Article 87 of the Articles of Association, Mr R. K. Obeyesekere, Mrs. P. C. Cooray and Mr. Ratneswara Sivaratnam retire by rotation and being eligible offer themselves for re-election with the unanimous support of the Board. Resolutions will be proposed for re-election of Mr. R. Sivaratnam, Dr. V. P. Vittachi and Mr. M.V. Theagarajah notwithstanding the age limit of 70 years stipulated by Section 210 of the Companies Act No: 7 of 2007.

In accordance with the provisions of Article 93 of the Articles of Association, Mr. Ranjeevan Seevaratnam offers himself for re-election with the unanimous support of the Board.

### Directors' Interest in Shares and Debentures

Shareholdings of Directors, together with their spouses and dependent children, are as follows:

	As at 31/12/07	As at 31/12/06
Mr. R. T. Wijetilleke	7,806	3,913
Dr. V. P. Vittachi	10,010	5,005
Mr R. Theagarajah	18,644	9,322
Mr D. H. S. Jayawardena	10,010	5,005
Mr M. V. Theagarajah	289,948	133,374
Mr R. K. Obeyesekere	10,010	5,005
Mrs P. C. Cooray	25,010	12,505
Mr R. Sivaratnam	10,080	5,04
Mr Ranjeevan Seevaratnam	500	-

No Director directly holds debentures of the Bank

There has been no change in their interests between 31st December 2007 and 15th February 2008, being the date of Notice of the Annual General Meeting.

### Events occurring 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 the Note 48 to the accounts.

### Annual General Meeting

The 39th Annual General Meeting of the Bank is being convened on Friday the 28th day of March, 2008, 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 39th Annual General Meeting is on page 97 of Financial Reports section of the Annual Report.

### The Auditors

The retiring Auditors 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.

By Order Of The Board



**Indrani Goonesekera**

*Deputy General Manager (Legal)/Board Secretary*

15th February, 2008

Colombo, Sri Lanka

The Bank's Financial Statements for the year ended 31st December 2007 prepared and presented in this report are in conformity with the requirements of Sri Lanka Accounting Standards, the Banking Act No: 30 of 1988, the amendments thereto and Companies Act No: 7 of 2007. The Financial Statements reflect a true and fair view of the state of affairs of the Group as at that date. Financial information presented in this report is consistent with that in the Financial Statements.

The Board of Directors have instituted effective and comprehensive systems of Internal Control. This comprises Internal Check, 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 and secure as far as practicable the accuracy and reliability of the records.

The Bank's Auditors, KPMG Ford Rhodes, Thornton & Co., carry out reviews and test checks on effective internal control as they consider appropriate and necessary for providing their opinion on the Financial Statements.

The Board of Directors oversee the management's responsibilities for financial reporting through their regular meeting reviews and the Audit Committee. The Audit Committee comprises three non-executive directors who are responsible for reviewing and approving financial information contained in the Annual Report and overseeing the management's responsibilities for the preparation and presentation of Financial Statements and the effectiveness of the internal control systems in the Bank. The Board of Directors also review interim Financial Statements prior to their release. The Chief Financial Officer is required to submit a report explaining the fundamental accounting principles adopted and material variances, in order that the Board of Directors may examine and obtain, all information and explanation required, to ensure the reliability of the financial information presented therein.

KPMG Ford Rhodes, Thornton & Co., are the auditors appointed by the shareholders on the recommendation of the Audit Committee. They have examined the Financial Statements made available by the Board of Directors, together with all financial records, related data, minutes of shareholders and Directors meetings and express their opinion which appears as reported by the Auditors on page 11 of Financial Reports of the Annual Report.

By Order of the Board



**Indrani Goonesekera**

*Deputy General Manager (Legal)/Board Secretary*

15th February, 2008

Colombo, Sri Lanka

## Composition

The Audit Committee comprises three Non-Executive Directors a majority of whom are independent. Mr Ranjeevan Seevaratnam who is a fellow member of the Institute of Chartered Accountants of Sri Lanka and the Institute of Chartered Accountants, England & Wales was elected as the Chairman during the year.

The Directors of the Audit Committee during the year are:  
Mr Ranjeevan Seevaratnam (Appointed to the committee on 3-5-2007)  
Mr R Sivaratnam (Resigned from the committee on 3-5-2007)  
Mr D H S Jayawardena  
Mrs P C Cooray

The Company 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 43 of the Corporate Reviews section of the Annual Report. The MD/CEO, CFO and the Head of Internal Audit 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 and disclosure requirements. Matters of special interest in the current environment and the processes that support certifications of the financial statements by the Bank's MD/CEO and CFO 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 framework of the Bank's systems of internal control and has received quarterly reports on all unexpected losses resulting from frauds or operational failures.

The Committee has reviewed the processes for identification, evaluation and management of all significant risks throughout the Bank. The Committee received 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 the internal control report and their audit approach and procedures, including matters relating to the scope and auditor independence. The lead audit partner is rotated every five years.

The Committee reviewed the internal control report issued by the external auditor together with the management responses thereto.

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;

- (i) the guideline 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;
- (ii) the guidelines for Listed Companies on Audit and Audit Committees issued by the Securities and Exchange Commission of Sri Lanka.

The Letter of Representation issued to the External Auditors was tabled at an Audit Committee meeting.

The Audit Committee has recommended to the Board the Remuneration and the re-appointment of KPMG Ford, Rhodes, Thornton & Co. for approval by the shareholders at the Annual General Meeting.

## Internal Audit

During the year, the Audit Committee reviewed the Performance of the internal audit function, the findings of the audits completed, the Department's resource requirements including succession planning and also approved the internal audit plan.

The Committee filled the vacancy that existed for Head of Internal Audit during the year.

## Regulatory Compliance

The Committee reviewed the procedures established by management for compliance with the requirements of regulatory bodies. Assistant General Manager Risk & Compliance submitted to the Audit Committee on a quarterly basis, a report on the extent to which the Bank was in compliance with mandatory banking and statutory requirements.

## Committee Evaluation

A self evaluation on the effectiveness of the Committee was carried out during the year.

## Others

The Audit Committee reviewed issues relating to breach of ethics and the arrangements by which the staff of the Bank may in confidence raise concerns about possible improprieties. The Committee also ensured that the procedures for the independent investigations of such matters are appropriate and are in place.



**R Seevaratnam**

Chairman

Colombo, Sri Lanka

15th February 2008



KPMG (Pvt.) Limited, Chartered & Co.  
 Chartered Accountants  
 32A, Six Mahipala Mawatha, Maratha Mawatha,  
 P. O. Box 118,  
 Colombo 06003,  
 Sri Lanka

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 Fax : +94 11 244 9032  
 : 94 11 244 6068  
 : 94 11 254 1249  
 Internet : www.kpmg.lk

**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, and the consolidated financial statements of the Company and its subsidiaries as at 31 December, 2007, 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.

**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 principles 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 31 December, 2007 and the financial statements give a true and fair view of the Company's state of affairs as at 31 December, 2007 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 31 December, 2007 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 Sections 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.

*Lord Rhoades Shroton & Co*

**CHARTERED ACCOUNTANTS**

15th February 2008

Colombo, Sri Lanka

KPMG (Pvt.) Limited Chartered & Co. Chartered Accountants  
 and Chartered Accountants of the Chartered Accountants of Sri Lanka  
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For the year ended 31st December	Note	Bank		Group	
		2007 Rs.000	2006 Rs.000	2007 Rs.000	2006 Rs.000
<b>INCOME</b>	9	<b>29,864,606</b>	21,493,695	<b>31,945,777</b>	23,213,724
Interest income	10	<b>26,137,648</b>	18,451,961	<b>27,014,164</b>	19,321,247
Less: Interest expenses	11	<b>15,189,698</b>	9,797,449	<b>16,130,086</b>	10,788,317
<b>Net interest income</b>		<b>10,947,950</b>	8,654,512	<b>10,884,078</b>	8,532,930
Foreign exchange profit		<b>1,114,313</b>	772,825	<b>1,115,496</b>	773,222
Fee and commission income	12	<b>2,081,569</b>	1,795,340	<b>2,121,624</b>	1,860,960
Dividend income	13	<b>125,142</b>	76,983	<b>92,346</b>	56,842
Other income	14	<b>405,934</b>	396,586	<b>1,602,147</b>	1,201,453
<b>Operating Income</b>		<b>14,674,908</b>	11,696,246	<b>15,815,691</b>	12,425,407
Less:					
<b>OPERATING EXPENSES</b>	15				
Personnel expenses		<b>3,205,284</b>	2,765,728	<b>3,430,068</b>	2,894,711
Premises, equipment and establishment expenses		<b>2,124,829</b>	1,905,132	<b>1,858,684</b>	1,751,975
Fee and commission expenses		<b>78,212</b>	102,036	<b>79,268</b>	124,051
Provision for staff retirement benefits	16	<b>451,828</b>	399,189	<b>457,330</b>	400,602
Bad debts written off		<b>1,418</b>	12,205	<b>1,418</b>	10,796
Provision for loan losses	17	<b>907,913</b>	931,828	<b>907,913</b>	931,828
Provision for fall in value of investments		-	-	<b>2,006</b>	9,482
Other expenses		<b>3,570,670</b>	2,560,678	<b>4,528,737</b>	3,220,368
		<b>10,340,154</b>	8,676,796	<b>11,265,424</b>	9,343,813
<b>PROFIT FROM OPERATIONS</b>		<b>4,334,754</b>	3,019,450	<b>4,550,267</b>	3,081,594
Share of Associate Companies' profit before taxation		-	-	<b>16,195</b>	13,617
<b>PROFIT BEFORE TAXATION</b>		<b>4,334,754</b>	3,019,450	<b>4,566,462</b>	3,095,211
Less: Income tax expense	18	<b>1,312,298</b>	798,961	<b>1,366,660</b>	819,575
<b>PROFIT FOR THE YEAR</b>		<b>3,022,456</b>	2,220,489	<b>3,199,802</b>	2,275,636
<b>Attributable to:</b>					
<b>Equity Holders of the Bank</b>		<b>3,022,456</b>	2,220,489	<b>3,150,469</b>	2,239,106
<b>Minority Interest</b>		-	-	<b>49,333</b>	36,530
<b>PROFIT FOR THE YEAR</b>		<b>3,022,456</b>	2,220,489	<b>3,199,802</b>	2,275,636
<b>BASIC AND DILUTED EARNINGS PER SHARE (Rs.)</b>	19	<b>12.83</b>	9.43	<b>13.38</b>	9.51
<b>DIVIDEND PER SHARE (Rs.)</b>		<b>*3.50</b>	5.00	<b>*3.50</b>	5.00

The Notes to the Financial Statements from pages 16 to 94 form an integral part of these financial statements.

\*Calculated on Dividend proposed, which is to be approved at the Annual General Meeting.

	Note	Bank		Group	
		2007 Rs.000	2006 Rs.000	2007 Rs.000	2006 Rs.000
<b>ASSETS</b>					
Cash and cash equivalents	20	24,359,446	23,819,886	24,476,062	23,855,600
Statutory deposit with Central Bank of Sri Lanka	21	13,405,856	12,016,532	13,405,856	12,016,532
Government Treasury Bills		-	-	1,156,357	2,451,695
Commercial papers		236,411	290,668	236,411	290,668
Securities purchased under re-sale agreements		3,450,000	-	5,859,205	4,393,281
Dealing securities	22	589,584	739,270	712,489	975,704
Investment securities	23	20,296,769	20,560,936	20,977,676	22,213,786
Bills of Exchange	24	2,069,450	1,910,852	2,069,450	1,910,852
Loans and advances	25	139,784,524	114,360,728	138,214,132	113,929,224
Lease rentals receivable within one year	26	4,395,864	3,796,067	4,395,864	3,796,067
Lease rentals receivable after one year	26	8,893,584	7,756,408	8,893,584	7,756,408
Non-current assets held for sale	27	1,455	6,556	1,455	6,556
Investments in Associate Companies	28	132,326	132,326	165,093	164,869
Investments in Subsidiary Companies	29	2,293,663	2,293,663	-	-
Investment properties	30	188,661	189,855	180,628	185,025
Property, Plant and Equipment	31	6,082,558	2,907,789	13,437,804	7,385,573
Intangible assets	32	183,864	231,975	210,410	259,740
Other assets	33	6,542,333	5,056,838	6,610,073	5,028,305
<b>Total Assets</b>		<b>232,906,348</b>	<b>196,070,349</b>	<b>241,002,549</b>	<b>206,619,885</b>
<b>LIABILITIES</b>					
Deposits from customers	34	175,659,573	147,557,455	175,566,618	147,463,236
Dividends payable	35	30,321	38,103	30,321	38,103
Borrowings	36	9,897,731	11,466,694	9,904,451	11,466,694
Securities sold under re-purchase agreements		6,036,514	6,736,714	8,352,882	13,892,671
Bills payable		1,198,237	1,190,056	1,198,237	1,190,056
Long-term insurance fund	37	-	-	880,674	507,721
Non-life insurance reserves	38	-	-	340,562	319,538
Subordinated debentures	39	4,560,852	5,120,000	5,525,852	7,083,450
Current tax liability		1,539,288	761,729	1,605,160	774,035
Deferred tax liability	40	605,693	313,756	607,618	317,675
Other liabilities	41	14,959,109	9,956,034	15,470,851	10,470,773
<b>Total Liabilities</b>		<b>214,487,318</b>	<b>183,140,541</b>	<b>219,483,226</b>	<b>193,523,952</b>
<b>EQUITY</b>					
Stated capital	43	5,059,390	3,881,743	5,059,390	3,881,743
Statutory Reserve Fund		821,707	669,707	821,707	669,707
Retained Earnings		2,747,440	1,736,396	2,861,252	1,722,195
Other reserves		9,790,493	6,641,962	12,557,315	6,641,962
<b>Total Equity attributable to Equity Holders of the Bank</b>		<b>18,419,030</b>	<b>12,929,808</b>	<b>21,299,664</b>	<b>12,915,607</b>
<b>Minority Interest</b>		<b>-</b>	<b>-</b>	<b>219,659</b>	<b>180,326</b>
<b>Total Equity</b>		<b>18,419,030</b>	<b>12,929,808</b>	<b>21,519,323</b>	<b>13,095,933</b>
<b>Total Liabilities and Equity</b>		<b>232,906,348</b>	<b>196,070,349</b>	<b>241,002,549</b>	<b>206,619,885</b>
Commitments and Contingencies	44	57,963,574	44,784,964	57,963,574	44,784,964

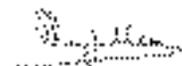
The Notes to the Financial Statements from pages 16 to 94 form an integral part of these financial statements.

These Financial Statements are in compliance with the requirements of Companies Act No. 7 of 2007.

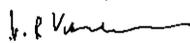


**Nihal Kekulawala**  
Chief Financial Officer

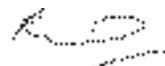
For and on behalf of the Board



**Rienzie T Wijetilleke**  
Chairman



**Dr V. P. Vittachi**  
Deputy Chairman



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



**Indrani Goonesekera**  
Deputy General Manager  
Legal/Board Secretary

15th February 2008  
Colombo, Sri Lanka

For the year ended 31st December 2007

Bank	Attributable to Equity Holders of the Bank									
	Stated capital			Statutory Reserve Fund	Other Reserves			Retained Earnings	Minority Interest	Total
	Voting Shares	Non-Voting Shares	Share Premium		Capital Reserve	General Reserve	Repairs & Renovation Reserve			
	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000
Balance as at 31.12.2005	946,647	231,000	2,704,096	624,707	306,639	5,245,000	6,700	1,174,471	-	11,239,260
Profit for the year 2006	-	-	-	-	-	-	-	2,220,489	-	2,220,489
Final dividend for 2005	-	-	-	-	-	-	-	(235,529)	-	(235,529)
Interim dividend for 2006	-	-	-	-	-	-	-	(294,412)	-	(294,412)
Deferred tax liability for										
Revaluation Reserve [Note 40 (a)]	-	-	-	-	(66,377)	-	-	66,377	-	-
Transfers during the year 2006	-	-	-	45,000	-	1,150,000	-	(1,195,000)	-	-
<b>Balance as at 31.12.2006</b>	<b>946,647</b>	<b>231,000</b>	<b>2,704,096</b>	<b>669,707</b>	<b>240,262</b>	<b>6,395,000</b>	<b>6,700</b>	<b>1,736,396</b>	<b>-</b>	<b>12,929,808</b>
<b>Profit for the year 2007</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>3,022,456</b>	<b>-</b>	<b>3,022,456</b>
<b>Bonus issue</b>	<b>946,647</b>	<b>231,000</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(1,177,647)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Final dividend for 2006</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(294,412)</b>	<b>-</b>	<b>(294,412)</b>
<b>Revaluation surplus [Note 31]</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>2,778,725</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>2,778,725</b>
Deferred tax liability for										
Revaluation Reserve [Note 40 (a)]	-	-	-	-	(17,547)	-	-	-	-	(17,547)
Transfers during the year 2007	-	-	-	152,000	-	1,565,000	-	(1,717,000)	-	-
<b>Balance as at 31.12.2007</b>	<b>1,893,294</b>	<b>462,000</b>	<b>2,704,096</b>	<b>821,707</b>	<b>3,001,440</b>	<b>6,782,353</b>	<b>6,700</b>	<b>2,747,440</b>	<b>-</b>	<b>18,419,030</b>

Group	Attributable to Equity Holders of the Bank									
	Stated capital			Statutory Reserve Fund	Other Reserves			Retained Earnings	Minority Interest	Total
	Voting Shares	Non-Voting Shares	Share Premium		Capital Reserve	General Reserve	Repairs & Renovation Reserve			
	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000
Balance as at 31.12.2005	946,647	231,000	2,704,096	624,707	306,639	5,245,000	6,700	1,141,653	148,795	11,355,237
Profit for the year 2006	-	-	-	-	-	-	-	2,239,106	36,530	2,275,636
Final dividend for 2005	-	-	-	-	-	-	-	(235,529)	(4,999)	(240,528)
Interim dividend for 2006	-	-	-	-	-	-	-	(294,412)	-	(294,412)
Deferred tax liability for										
Revaluation Reserve [Note 40 (a)]	-	-	-	-	(66,377)	-	-	66,377	-	-
Transfers during the year 2006	-	-	-	45,000	-	1,150,000	-	(1,195,000)	-	-
<b>Balance as at 31.12.2006</b>	<b>946,647</b>	<b>231,000</b>	<b>2,704,096</b>	<b>669,707</b>	<b>240,262</b>	<b>6,395,000</b>	<b>6,700</b>	<b>1,722,195</b>	<b>180,326</b>	<b>13,095,933</b>
<b>Profit for the year 2007</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>3,150,469</b>	<b>49,333</b>	<b>3,199,802</b>
<b>Bonus issue</b>	<b>946,647</b>	<b>231,000</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(1,177,647)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Final dividend for 2006</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(294,412)</b>	<b>(10,000)</b>	<b>(304,412)</b>
<b>Revaluation surplus [Note 31]</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>5,545,547</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>5,545,547</b>
Deferred tax liability for										
Revaluation Reserve [Note 40 (a)]	-	-	-	-	(17,547)	-	-	-	-	(17,547)
Transfers during the year 2007	-	-	-	152,000	-	1,565,000	-	(1,717,000)	-	-
<b>Balance as at 31.12.2007</b>	<b>1,893,294</b>	<b>462,000</b>	<b>2,704,096</b>	<b>821,707</b>	<b>5,768,262</b>	<b>6,782,353</b>	<b>6,700</b>	<b>2,861,252</b>	<b>219,659</b>	<b>21,519,323</b>

In accordance with Section 58 of Companies Act No 7 of 2007, share capital and share premium have been reclassified 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.

Share Premium account is generally used for the writing-off of share issue expenses. There are no restrictions on the distribution of balance to shareholders.

Capital Reserve relates to revaluation of Freehold Land & Buildings carried out in 1989, 1993 & 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.

Repairs and Renovation Reserve includes the amounts allocated for repairs and renovation.

The Notes to the financial statements from page 16 to 94 form an integral part of these financial statements.

For the year ended 31st December	Bank		Group	
	2007 Rs.000	2006 Rs.000	2007 Rs.000	2006 Rs.000
<b>Cash flows from operating activities</b>				
Interest and commission receipts	28,219,217	20,247,301	29,135,788	21,115,183
Interest payments	(15,189,698)	(9,797,449)	(16,130,086)	(10,788,317)
Receipts from other operating activities	1,224,512	1,037,846	2,421,361	1,825,495
Cash payments to employees	(3,657,112)	(3,164,917)	(3,881,896)	(3,293,900)
Cash payments to suppliers	(1,637,594)	(1,361,315)	(1,233,152)	(1,119,178)
Payments for other operating activities	(3,360,808)	(2,801,356)	(3,925,954)	(3,128,752)
<b>Operating profit before changes in operating assets and liabilities [Note (a)]</b>	<b>5,598,517</b>	<b>4,160,110</b>	<b>6,386,061</b>	<b>4,610,531</b>
<b>(Increase)/Decrease in operating assets:</b>				
Treasury bills/commercial papers	(3,395,747)	282,746	(1,411,668)	(306,947)
Deposits held for regulatory or monetary control purposes	(1,389,324)	(3,450,903)	(1,389,324)	(3,450,903)
Loans and advances	(27,818,910)	(21,498,176)	(26,683,851)	(21,515,088)
Other short term assets	(1,854,315)	71,190	(1,829,515)	(107,928)
<b>Increase/(Decrease) in operating liabilities:</b>				
Deposits from customers	27,429,789	19,559,451	27,431,053	19,618,111
Negotiable certificates of deposit	672,329	(285,677)	672,329	(285,677)
Other liabilities	5,011,256	(450,284)	5,043,107	(380,302)
<b>Net cash generated from/(used in) operating activities before income tax</b>	<b>4,253,595</b>	<b>(1,611,543)</b>	<b>8,218,192</b>	<b>(1,818,203)</b>
Income taxes paid	(260,349)	-	(263,138)	(21,210)
<b>Net cash generated from/(used in) operating activities</b>	<b>3,993,246</b>	<b>(1,611,543)</b>	<b>7,955,054</b>	<b>(1,839,413)</b>
<b>Cash flows from investing activities</b>				
Dividend income	125,142	76,983	92,346	56,842
Income from investment securities	117,918	188,141	117,918	188,141
Net proceeds from sale of securities	182,347	(335,804)	112,144	(1,340,572)
Net proceeds from sale of investment securities	149,395	(3,932,135)	2,453,118	(3,703,326)
Purchase of Property, Plant & Equipment	(912,300)	(483,396)	(1,147,630)	(559,443)
Purchase of Intangible assets	(16,813)	(21,200)	(22,778)	(26,716)
Improvements to Investment properties	-	(25)	-	(25)
Proceeds from sale of Property, Plant & Equipment	31,130	11,268	32,122	11,268
<b>Net cash generated from/(used in) investing activities</b>	<b>(323,181)</b>	<b>(4,496,168)</b>	<b>1,637,240</b>	<b>(5,373,831)</b>
<b>Cash flows from financing activities</b>				
Increase/(Decrease) in Debentures	(559,148)	1,120,000	(1,557,598)	1,106,659
Increase/(Decrease) of borrowings	(2,269,163)	8,149,652	(7,102,040)	9,315,379
Dividends paid	(302,194)	(542,129)	(312,194)	(547,129)
<b>Net cash generated from/(used in) financing activities</b>	<b>(3,130,505)</b>	<b>8,727,523</b>	<b>(8,971,832)</b>	<b>9,874,909</b>
Net increase in cash and cash equivalents	539,560	2,619,812	620,462	2,661,665
Cash and cash equivalents at beginning of the year	23,819,886	21,200,074	23,855,600	21,193,935
<b>Cash and cash equivalents at end of the year [Note (20)]</b>	<b>24,359,446</b>	<b>23,819,886</b>	<b>24,476,062</b>	<b>23,855,600</b>
<b>Note (a) Reconciliation of operating profit</b>				
Profit before taxation	4,334,754	3,019,450	4,566,462	3,095,211
Dividend income	(125,142)	(76,983)	(92,346)	(56,842)
Income from investment securities	(117,918)	(188,141)	(117,918)	(188,141)
(Profit)/loss on sale of Property, Plant and Equipment	(18,653)	(4,064)	(19,201)	(4,064)
Bad debts recovered	(289,275)	(209,120)	(289,275)	(209,120)
Loss on FCBU revaluation	13,796	58,603	13,796	58,603
Depreciation of Property, Plant and Equipment	420,970	430,211	548,881	523,343
Depreciation of Investment Properties	1,194	1,284	4,397	4,487
Amortization of Intangible Assets	65,070	100,116	72,254	106,379
Provision for loan losses	907,913	931,828	907,913	931,828
Loss on marked to market valuation of dealing securities	30,037	45,319	30,037	45,319
Unclaimed VAT written off	200,310	-	200,310	-
Provision made for gratuities	-	-	5,502	1,413
Impairment loss on fixed assets	87,764	-	87,764	-
Profit/(loss) from sale of dealing securities	86,279	39,402	86,279	36,033
Provision for non-life and long term insurance fund	-	-	393,977	259,421
Loans written off during the year	1,418	12,205	1,418	10,796
Provision for fall in value in investments	-	-	2,006	9,482
Share of associate Company profit	-	-	(16,195)	(13,617)
	<b>5,598,517</b>	<b>4,160,110</b>	<b>6,386,061</b>	<b>4,610,531</b>

The Notes to the Financial Statements from pages 16 to 94 form an integral part of these 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. The registered office of the Bank is situated at No. 479, T B Jayah Mawatha, Colombo 10. The staff strength of the Bank as at 31st December 2007 is 4,334 (2006 – 4,287).

The consolidated financial statements of the Bank for the year ended 31st December 2007 comprise the Bank and its Subsidiaries, HNB Securities Limited, HNB Stockbrokers (Pvt) Limited, HNB Assurance PLC and Sithma Development (Pvt) Limited (together referred to as the "Group") and the Group's interest in its Associate company M/s Lanka Ventures PLC.

There were no significant changes in the nature of the principal activities of the Bank and the Group during the financial year under review.

The principal activities of the Bank continued to be banking and related activities such as accepting deposits, corporate and retail credit, personal financial services, off shore banking, foreign currency operations, trade services, investment banking, development banking, rural finance, project finance, dealing in government securities etc.

The principal activities of HNB Securities Limited, HNB Stockbrokers (Pvt) Limited, HNB Assurance PLC and Sithma Development (Pvt) Limited, are dealing in government securities as primary dealer, stock brokering, insurance services and property development. The principal activities of Lanka Ventures PLC is providing venture capital services.

## 2. Approval of Financial Statements by Directors

The financial statements were authorised for issue by the Board of Directors on 15th February 2008.

## 3. Basis Of Preparation

### 3.1 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, Companies Act No. 7 of 2007 and Banking Act No. 38 of 1988 and amendments thereto.

## 3.2 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. Land and buildings have been revalued on a rolling basis within a short period to reflect the up-to-date value.
- Dealing securities are measured at market value.
- Foreclosed properties are measured at lower of cost or market value on an individual property basis.

## 4. Functional and Presentation Currency

The financial statements are presented in Sri Lankan Rupees, which is the Group's functional currency. Except as indicated, financial information presented in Sri Lankan Rupees has been rounded to the nearest thousand.

## 5. Use of Estimates and Judgements

The preparation of financial statements 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.

## 6. Materiality and Aggregation

Each material class of similar items is presented separately in the financial statements. Items of a dissimilar nature or function are presented separately unless they are immaterial.

## 7. Comparative Information

Comparative information in respect of interest expenses, foreign exchange profit investment securities, dealing securities, loans and advances, cash and cash equivalents, deposits from customers, borrowings, other assets, other liabilities, stated

capital and other reserves have been reclassified to conform to the current year's classification in order to provide a better presentation.

## 8. 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 any deviations have been disclosed accordingly.

### 8.1 Basis Of Consolidation

All entities which are controlled by the Bank are consolidated in the financial statements. The consolidated financial statements are prepared on the historical cost basis except that certain assets are stated at their fair value. Such assets are dealing securities, certain land and buildings and foreclosed properties.

#### 8.1.1 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 Interests are presented in the consolidated Balance Sheet within Equity, separately from the equity attributable to the Equity Holders of the Bank. Minority Interests in the profit or loss of the Group are disclosed separately in the consolidated Income Statement.

The consolidated financial statements are prepared to a common financial year end of 31st December. A list of Subsidiaries within the Group is provided in Note No. 29.

#### 8.1.2 Associates

Associates are entities in which the Group has significant influence, but no control over the financial and operating policies. The consolidated financial statements include the Group's share of the total recognised gains and losses of

Associates under the equity method, from the date that significant influence effectively commences until the date that significant influence effectively ceases.

The Group discontinues the use of the equity method from the date that it ceases to have significant influence over an Associate and accounts for the investment in accordance with Sri Lanka Accounting Standard 22 "Accounting for Investments". A list of Associates within the Group is provided in Note No. 28.

#### 8.1.3 Transactions Eliminated On Consolidation

Intra-group balances and transactions and any unrealised gains arising from intra-group transactions, 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 Associate against the investments 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.

## 8.2 Foreign Currency Translation

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 retranslated to Sri Lankan Rupees at the middle rate of exchange ruling at that date. Foreign exchange differences arising on the settlement or reporting of the Bank's monetary items at rates different from those which were initially recorded are dealt with in the Income Statement.

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.

The Income Statement of the Foreign Currency Banking Unit is translated to Sri Lankan Rupees at the middle rate of exchange ruling at the balance sheet date.

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

### 8.3 Cash and Cash equivalents

Cash and cash equivalents include cash in hand, balances with banks, placements with banks, money at call and short notice and money market funds. They are brought to account at the face value or the gross value where appropriate.

### 8.4 Statutory Deposit with Central Bank of Sri Lanka

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 reserve is an amount equal to 10% of the total of such Rupee deposit liabilities.

### 8.5 Government of Sri Lanka Treasury Bills and Bonds

#### 8.5.1 Investment in Treasury Bills and Bonds held for trading

Investments in Treasury Bills and Treasury Bonds in dealing portfolio are marked to market and carried at that market value in the Balance Sheet. Gains and losses on marked to market valuation are dealt with through the Income Statement.

#### 8.5.2 Investment in Treasury Bills and Bonds held to maturity

Investment in Treasury Bills and Bonds held to maturity are reflected at the value of the bills/bonds purchased and the discount/premium accrued thereon. Discount received/premium paid is taken to the income statement based on a pattern reflecting a constant periodic rate of return.

#### 8.5.3 Securities Purchased Under Re-sale Agreements

Securities purchased under resale agreements are recorded separately in the financial statements at cost.

The difference between the purchase and sale price represents interest income and is recognised in the Income Statement over the period of the resale agreement.

## 8.6 Investments

### 8.6.1 Dealing Securities

These are marketable securities acquired and held with the intention of resale over a short period of time. Such securities are recorded at market value. Adjustment for changes in market value is accounted for in the Income Statement.

### 8.6.2 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.

### 8.6.3 Investments in Subsidiaries

Investments in Subsidiaries are stated at cost in the Bank's financial statements.

### 8.6.4 Investments in Associates

Investments in Associates are 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 Investments in Associates are initially accounted for at cost and the carrying amount is adjusted for post acquisition changes in the Group's share of net assets of the Associates, less any impairment in the Group's net Investments in Associates.

## 8.7 Non-Current Assets held for Sale

Non-current assets are classified as "Non-current assets 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 only to 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.

## 8.8 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).

### 8.8.1 Non-performing Loans

Loans, advances and finance leases which are 90 days or more in arrears of due capital and/or interest are classified as non-performing. 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 the directions issued by the Central Bank of Sri Lanka and disclosed in the financial statements of the Bank.

### 8.8.2 Foreclosed Properties

Foreclosed properties represent properties acquired in full or partial settlement of loans and advances and are yet to be disposed. These are accounted for at the lower of cost or market value on an individual property basis. The shortfall between the prevailing market value of the foreclosed property and the related loan outstanding is recognised as a provision for loan losses in the Income Statement during the year of acquiring the foreclosed property in satisfaction of the debt. Any shortfall between the carrying amount of the foreclosed properties and their respective market values identified subsequently is charged as a provision for loan losses in the Income Statement. Subsequent gains and losses on the disposal of the foreclosed properties are treated as provisions written back or charged to the Income Statement respectively. Foreclosed properties are recorded under loans and advances until they are disposed of.

## 8.8.3 Provision for Loan Losses

### 8.8.3 (a) Specific provisions for loan losses are made as follows:

Period outstanding	Classification	Provision made net of realisable value of security
6-12 months	Sub-standard	20%
12-18 months	Doubtful	50%
18 months and over	Loss	100%

The provision made relates to all categories of advances including pawning and leasing identified as sub-standard, doubtful and loss.

Where necessary, specific provisions have been made over and above the minimum percentages stipulated above, on a case by case basis.

### 8.8.3 (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 performing loans and advances and overdue loans and advances, net of Interest in Suspense and loans and advances secured by cash deposits, gold or Government securities. The general provision was commenced with a minimum of 0.1% provision as at 31st December 2006 and thereafter, incremental provisions are 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.

#### **8.8.4 Revenue Recognition on Non-performing Loans**

When an advance is classified as non-performing as set out in Note No 8.8.1, interest income ceases to be recognised and is taken to income only on a cash basis.

### **8.9 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 Rentals 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.

#### **8.9.1 Provision for Lease Receivables**

Specific provision has been made in relation to identified bad and doubtful leases as stated above in Note No 8.8.3 (a). In addition, a general provision has been made as stated above in Note No. 8.8.3 (b).

### **8.10 Intangible Assets**

#### **8.10.1 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.

#### **8.10.1 (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 will no longer be amortised. Instead, goodwill will be 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. If an impairment loss is identified, it will be recognised immediately in the Income Statement.

#### **8.10.1 (b) Software**

All computer software costs incurred, licensed for use by the Bank, 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.

#### **8.10.2 Subsequent Expenditure**

Expenditure incurred on software is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

#### **8.10.3 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. The estimated useful life of software is six years.

### **8.11 Investment Properties**

Investment properties are properties held either to earn rental income or for capital appreciation or both.

#### **8.11.1 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 Bank and cost of the investment property can be reliably measured.

#### **8.11.2 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 is its cost at the date when the construction or development is complete.

The Bank applies the cost model for investment properties in accordance with Sri Lanka Accounting Standard 40, - "Investment Property" (revised 2005). Accordingly, land classified as investment properties are stated at cost and buildings classified as investment

properties are stated at cost less any accumulated depreciation and any accumulated impairment losses.

### 8.11.3 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 Freehold buildings	2.5% per annum
Sithma Development (Pvt) Ltd* Freehold buildings (Smart building)	2.5% per annum
Plant, machinery & equipment integral to freehold buildings	20% per annum

\* Sithma Development (Pvt) Limited

The HNB Towers building 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 building, is a significant component of the arrangement as a whole. Therefore, HNB Towers building is not classified as Investment Property in the financial statements of Sithma, but has been classified under Property, Plant and Equipment in the financial statements of Sithma, in accordance with Sri Lanka Accounting Standard 40 "Investment Property" (revised 2005).

### 8.11.4 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 property only when there is a change in use.

## 8.12 Property, Plant & Equipment

Property, Plant & Equipment are tangible items that are held for servicing, or for administrative purposes and are expected to be used during more than one period.

### 8.12.1 Basis of Recognition

Property, Plant & Equipment are recognised if it is probable that future economic benefits associated with the asset will flow to the Bank and cost of the asset can be reliably measured.

### 8.12.2 Measurement

An item of Property, Plant & 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.

### 8.12.3 Cost Model

The Bank applies cost model to Property, Plant & Equipment except freehold land & buildings and records at cost of purchase or construction together with any incidental expenses thereon less accumulated depreciation and any accumulated impairment losses.

### 8.12.4 Revaluation Model

The Bank applies the revaluation model for 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 & buildings of the Bank are revalued every seven years to ensure that the carrying amounts do not differ materially from the fair values at the balance sheet date. Freehold land and buildings are revalued on a rolling basis, so as to complete the revaluation within a short period. 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 debited 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.

### 8.12.5 Subsequent Costs

The cost of replacing part of an item of Property, Plant & Equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within that part will flow to the Bank and its cost can be reliably measured. The costs of day to day servicing of Property, Plant & Equipment are charged to the Income Statement as incurred.

### 8.12.6 Derecognition

The carrying amount of an item of Property, Plant & Equipment is derecognised on disposal or when no future economic benefits are expected from its use. The gain or loss arising from the derecognition of an item of Property, Plant & 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 & 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.

### 8.12.7 Depreciation

The Bank and its subsidiary companies provide 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 of the different types of assets, except for which are disclosed separately.

HNB and subsidiary companies (except for Sithma Development (Pvt) Ltd.)

	%
	per annum
Freehold buildings	2.5
Motor vehicles	25
Computer equipment	
– Additions before 1.7.2000	25
– Additions after 1.7.2000	16.7
– Additions before 1.1.2005 (HNB Assurance)	25

– Additions after 1.1.2005 (HNB Assurance)	16.7
Office equipment	20
Furniture and fittings	10
Fixtures	10

Depreciation is not provided for freehold land. Improvements made to leasehold buildings are amortised over the lease period except for HNB Stockbrokers (Pvt) Ltd who amortise at 20% per annum.

Sithma Development (Pvt) Ltd.	%
	per annum
Freehold buildings	-
Sithma building	1
Generators, generator panels and associated power cables	2
Chillers, cooling towers and associated equipment	4
Lifts and escalator	4
Building management systems	4
Plant and machinery	20
Equipment	20
Motor vehicles	25

### 8.12.8 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.

#### 8.12.8 (a) Sithma Development (Pvt) Ltd.

Sithma Development (Pvt) Ltd. commenced a project to develop a residential apartment complex. The expenses that are of a capital nature will be accounted as capital work-in-progress until the completion of the project.

### 8.12.9 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 cease when substantially all the activities necessary to prepare the qualifying asset for its intended use are completed.

## 8.13 Impairment

### 8.13.1 Financial Assets

The Bank assesses at each Balance Sheet date whether there is objective evidence that a financial asset or a portfolio of financial assets is impaired. A financial asset or portfolio of financial assets 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 future cash flows of the financial asset (or the portfolio), that can be reliably estimated.

The Bank first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant and collectively for financial assets that are not individually significant (except for loans and advance explained below). Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

For loans and advances, impairment loss is measured individually and collectively as explained in Note No 8.8.3. 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.

### 8.13.2 Non Financial Assets

Tangible and intangible assets (excluding deferred tax assets which are explained in Note No. 40) are written down to recoverable amount where their carrying value exceeds recoverable amounts.

The carrying values of Property, Plant & 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 cost 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

### 8.14 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.

### 8.15 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.

### 8.16 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.

### 8.17 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 purchase price represents interest expense, which is recognised in the Income Statement over the period of the re-purchase agreement.

### 8.18 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.

### 8.19 Employee Retirement Benefits

#### 8.19.1 Defined Benefit Plan

A defined benefit plan is a post employment benefit plan other than a defined contribution plan.

#### 8.19.1 (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

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 will be determined by an independent 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 of the pension fund as at 31st December 2007 was carried out by Mr. M Poopalanathan (A.I.A) of M/S Actuarial and Management Consultant (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 benchmark method recommended by the Sri Lanka Accounting Standard No. 16 "Retirement Benefit Cost".

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.

If the results of the actuarial valuation indicate that the actuarial present value of the promised retirement benefit and that the fair value of the fund assets result in a past service deficit in the Pension Fund due to the changes in actuarial assumptions that took place since the previous actuarial valuation, the past service deficit is amortised by regular contributions over the full working lifetime of the current employees by incorporating it into the ongoing contribution rate.

The Subsidiaries do not operate Pension Funds.

#### 8.19.1 (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 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 No. 8.19.1 (a) above.

### **8.19.2 Defined Contribution Plans**

A defined contribution plan is a post employment benefit plan under which an entity pays fixed contributions into a separate entity and will have no legal or constructive obligation to pay a further amount. Obligations for contributions to defined contribution pension plans are recognised as an employee benefit expense in the Income Statement as and when they are due.

#### **8.19.2 (a) Employees' Provident Fund**

The Bank/Group and employees contribute 12% and 8% respectively on the salary of each employee to the approved private Provident Fund.

#### **8.19.2 (b) Employees' Trust Fund**

The Bank/Group contributes 3% of the salary of each employee to the Employees' Trust Fund.

### **8.19.3 Gratuities**

No provision has been made in the financial statements of the Bank for gratuities to employees who complete 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 through its own non-contributory pension scheme which is in force.

Provisions have been made for retirement gratuities in the financial statements of the Subsidiaries from the first year of service for all employees in conformity with Sri Lanka Accounting Standards - 16. However, under the Payment of Gratuity Act No. 12 of 1983, the liability to an employee arises only on completion of five years of continual service. The gratuity liability is not externally funded.

#### **8.19.4 Employee Share Option Plan**

The Employee Share Option Plan offered to executive and high rank officers was introduced in 2005. The shares allotted to the respective employee 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 Option Plan has no potential dilutive effect in the earnings per share of the Bank.

### **8.20 Provisions**

Provisions are recognised when a legal or constructive obligation exists as a result of a past event and it is probable that an outflow of benefits will be required to settle the obligation and it can be reliably estimated. Provisions for non-performing loans and advances are made as set out in Note No. 8.8.3.

### **8.21 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.

### **8.22 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 or an Associate 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.

### **8.23 Events Occurring After the Balance Sheet Date**

All material and important events which occur after the Balance Sheet date have been considered and disclosed in Note No. 48.

## INCOME STATEMENT

### 8.24 Revenue Recognition

#### 8.24.1 Interest Income

Interest receivable is recognised on an accrual basis. Interest from loans and advances ceases to be accrued when the recovery of interest or principal is in arrears for ninety days. 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.

#### 8.24.2 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.

#### 8.24.3 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.

#### 8.24.4 Discount on Bills of Exchange

Income on discounting Bills of Exchange is recognised proportionately over the period of the instrument.

#### 8.24.5 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.

#### 8.24.6 Fee and Commission Income

Fee and commission income relating to specific transactions or events are recognised in the Income Statement in the period in which they are earned. However, when they relate to services provided over a period, they are recognised in the Income Statement on an accrual basis.

#### 8.24.7 Profit/loss from Sale of Property, Plant & Equipment

Profit/loss from sale of Property, Plant & Equipment is recognised in the period in which the sale occurs and is classified as other income.

#### 8.24.8 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.

#### 8.24.9 Rental Income

Rental income is recognised on an accrual basis.

## 8.25 Expenses

#### 8.25.1 Interest Expenses and Other Expenses

Interest payable and other expenses are recognised on an accrual basis.

#### 8.25.2 Operating Leases

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 No. 44(b).

#### 8.25.3 Fee and Commission Expenses

Fee and commission expenses are recognised on an accrual basis.

## 8.26 Taxation

#### 8.26.1 Income Tax

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.

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 No. 18.

#### **8.26.2 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.

Deferred tax assets are not recognised for the following temporary differences: 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.

#### **8.26.3 Withholding Tax on Dividends Distributed by Subsidiaries and Associate Company**

Dividend distributed out of taxable profit of the Subsidiaries and Associate company 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 Subsidiary companies and Associate companies in the Group financial statements as a consolidation adjustment.

#### **8.26.4 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, computed on prescribed rates and emoluments of employees.

### **8.27 Insurance Business**

#### **8.27.1 Non-life (General) Insurance Business Premium**

Upon inception of the policy, 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.

#### **Outward Reinsurance**

Premiums ceded to reinsurers are recognised as an expense in accordance with the pattern of reinsurance services received. Accordingly, a portion of outward reinsurance premium is treated at the Balance Sheet date as a prepayment.

#### **Unearned Premium**

The unearned premium reserve represents the portion of the premiums and outward reinsurance premiums written in the current year in respect of risks related to subsequent periods. Unearned premiums are calculated on the 24th basis in accordance with the Regulation of Insurance Industry Act No. 43 of 2000.

### 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.

### Deferred Acquisition Expenses

Deferred acquisition expenses represent net commissions relating to unearned premiums.

### Receivables

All premiums and other debtors are recognised at the amounts receivable, as they are due for settlement no more than 60 days from the date of recognition. Collectibility of premiums and other debtors are reviewed on an ongoing basis. Debts which are known to be uncollectible are written off. A provision for doubtful debts is provided on the following basis:

Debt outstanding	Provision
180 - 270 days	25%
271 - 365 days	50%
Over 365 days	100%

Reinsurance assets include the balances due from both insurance and reinsurance companies for paid and unpaid losses and loss adjustment expenses. Amounts recoverable from reinsurers are estimated in a manner consistent with the claim liability associated with the reinsured policy. Reinsurance is recorded gross in the Balance Sheet unless a right to offset exists.

### Claims

Claims incurred include provisions for the estimated cost of claims and related handling expenses in respect of incidents up to 31st December, including those which had not been notified, net of salvage, anticipated reinsurance and other recoveries. The provision in respect of claims Insured But Not Reported (IBNR) is actuarially valued to ensure a more realistic estimation of the future liability based on the past experience and trends. Actual valuations are performed on an annual basis.

While the Directors consider that the provision for claims is 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.

## 8.27.2 Life (Long Term) Insurance Business

### Premiums (Revenue)

Premiums are accounted for as and when received and in the same period as the policy liabilities are created.

### Reinsurance

Reinsurance premium expense is accrued on active policies on a monthly basis.

### 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 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.

The actuarial valuation takes into account all liabilities and is based on assumptions recommended by the Consultant Actuary.

## 8.28 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.

## 8.29 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.

Unallocated items include depreciation and amortisation costs.

### **8.30 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 and money market funds.

### **8.31 New Standard not Effective as at Balance Sheet Date**

Sri Lanka Accounting Standard 16 - Employee Benefits , (SLAS 16 (Revised 2006)), which is applicable to financial statements covering annual periods beginning on or after 1st July 2007, and not effective for the year ended 31st December 2007, has not been applied in preparing these consolidated financial statements.

SLAS 16 (Revised 2006) requires extensive disclosures about the method adopted for the actuarial valuation of the defined benefit plan, measurements of the actuarial gains and losses, and the policy adopted to recognise such gains and losses. The Bank/Group has not yet determined the potential effect of this standard.

For the year ended 31st December

	Bank		Group	
	2007 Rs.000	2006 Rs.000	2007 Rs.000	2006 Rs.000
<b>9 INCOME</b>				
Interest income (Note 10)	26,137,648	18,451,961	27,014,164	19,321,247
Foreign exchange profit	1,114,313	772,825	1,115,496	773,222
Fee and commission income (Note 12)	2,081,569	1,795,340	2,121,624	1,860,960
Dividend income (Note 13)	125,142	76,983	92,346	56,842
Other income (Note 14)	405,934	396,586	1,602,147	1,201,453
	<b>29,864,606</b>	<b>21,493,695</b>	<b>31,945,777</b>	<b>23,213,724</b>
<b>10 INTEREST INCOME</b>				
Government securities	1,481,938	1,295,467	2,422,628	1,326,477
Placements with Banks	724,011	525,053	724,011	525,053
Customer advances	23,389,008	16,188,916	23,297,015	16,188,917
Other interest income	542,691	442,525	570,510	1,280,800
	<b>26,137,648</b>	<b>18,451,961</b>	<b>27,014,164</b>	<b>19,321,247</b>
<b>Notional Credit for Withholding Tax on Government Securities on Secondary Market Transactions</b>				
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 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, no notional tax credit was recognised by the Bank for the year as there was no net income earned from secondary market transactions in Government Securities for the year (2006 - Rs. 5.58 Mn).				
Net income earned from secondary market transactions in Government Securities for the year by the Group has been grossed up in the financial statements and the resulting notional tax credit amounts to Rs. 28.6 Mn (2006 - Rs. 12.05 Mn).				
<b>11 INTEREST EXPENSES</b>				
Short term borrowings	2,033,449	1,162,752	2,692,548	1,916,594
Refinance borrowings	287,974	138,265	287,974	138,265
Customer deposits	11,859,924	7,624,051	11,840,520	7,622,307
Interest paid on debentures	706,416	637,964	1,006,695	876,135
Other interest expenses	301,935	234,417	302,349	235,016
	<b>15,189,698</b>	<b>9,797,449</b>	<b>16,130,086</b>	<b>10,788,317</b>
<b>12 FEE AND COMMISSION INCOME</b>				
Fee income	16,747	45,213	35,393	45,213
Commission income	2,064,822	1,750,127	2,086,231	1,815,747
	<b>2,081,569</b>	<b>1,795,340</b>	<b>2,121,624</b>	<b>1,860,960</b>

For the year ended 31st December	Bank		Group	
	2007 Rs.000	2006 Rs.000	2007 Rs.000	2006 Rs.000
<b>13 DIVIDEND INCOME</b>				
Dealing securities	6,290	12,054	6,290	12,054
Investment securities - quoted	92,236	64,692	65,740	44,551
Investment securities - unquoted	26,616	237	20,316	237
	<b>125,142</b>	<b>76,983</b>	<b>92,346</b>	<b>56,842</b>
<b>14 OTHER INCOME</b>				
Loss from sale of dealing securities	(86,279)	(39,402)	(86,279)	(36,033)
Income from investment securities	117,918	188,141	117,918	188,141
Loss on marked to market valuation of dealing securities	(30,037)	(45,319)	(30,037)	(45,319)
Rent received	69,504	84,168	74,885	89,272
Rent received from Investment Properties	16,773	16,134	34,923	29,981
Bad debts recovered [Note 25(a) and 26(c)]	289,275	209,120	289,275	209,120
Profit/(loss) from Sale of property plant & equipment	18,653	4,064	19,201	4,064
Profit from sale of Foreclosed Properties	15,419	21,783	15,419	21,783
Gain on sale of Government Securities	4,419	1,789	24,207	1,789
Profit on gold/silver trading	867	11,617	867	11,617
Loss on FCBU revaluation	(13,796)	(58,603)	(13,796)	(58,603)
Insurance premium income	-	-	1,144,932	784,426
Others	3,218	3,094	10,632	1,215
	<b>405,934</b>	<b>396,586</b>	<b>1,602,147</b>	<b>1,201,453</b>
<b>15 OPERATING EXPENSES</b>				
Operating expenses, among others, include the following:				
Legal expenses & professional fees	47,251	61,658	51,657	68,368
Depreciation of Property, Plant and Equipment	420,970	430,211	548,881	523,343
Amortisation of Intangible Assets	65,070	100,116	72,254	106,379
Depreciation of Investment Property	1,194	1,284	4,397	4,487
Charge to provide for operational risk event losses	13,756	24,000	13,756	24,000
Directors' emoluments [Note 15(a)]	24,755	24,505	35,264	31,015
Auditors' remuneration - Audit services	3,450	2,900	4,737	3,763
- Non audit services	395	360	626	360
Advertising expenses	438,819	336,582	460,450	336,784
Donations	29,451	33,477	29,701	33,677
Impairment losses recognised on Property, Plant & Equipment	87,764	-	87,764	-
<b>15 (a) Directors' emoluments</b>				
Emoluments of Chairman	3,706	3,168	3,766	3,228
Emoluments of Executive Director/s	20,029	20,317	30,478	26,357
Emoluments of other Directors (fee only)	1,020	1,020	1,020	1,430
	<b>24,755</b>	<b>24,505</b>	<b>35,264</b>	<b>31,015</b>

For the year ended 31st December	Bank		Group	
	2007 Rs.000	2006 Rs.000	2007 Rs.000	2006 Rs.000
<b>16 PROVISION FOR STAFF RETIREMENT BENEFITS</b>				
Contribution made to Pension Fund	451,828	399,189	451,828	399,189
Provision made for Gratuities	-	-	5,502	1,413
	<b>451,828</b>	<b>399,189</b>	<b>457,330</b>	<b>400,602</b>
Details of contribution made by the Bank are given in note No. 42 [(a)]				
<b>17 PROVISION FOR LOAN LOSSES</b>				
Specific provision for loans and advances	559,690	435,997	559,690	435,997
Specific provision for Foreclosed properties	-	99,379	-	99,379
General provision for pawning advances	311	-	311	-
General provision for housing advances	6,130	6,275	6,130	6,275
Statutory general provision for performing and overdue loans and advances	239,750	294,363	239,750	294,363
	<b>805,881</b>	<b>836,014</b>	<b>805,881</b>	<b>836,014</b>
Provision for loans and advances [Note 25(a)]	805,881	836,014	805,881	836,014
Specific provision for Bills of Exchange [Note 24(a)]	9,095	-	9,095	-
General provision for leases [Note 26(c)]	35,448	53,084	35,448	53,084
Specific provision for leases [Note 26(c)]	57,489	42,730	57,489	42,730
Total provision made during the year	<b>907,913</b>	<b>931,828</b>	<b>907,913</b>	<b>931,828</b>
<b>18 INCOME TAX EXPENSE</b>				
<b>18 (a) Current tax expense</b>				
Income tax on profits for the year [Note 18 (e)]	1,037,908	795,454	1,093,928	809,961
Under/(over) provision during prior years	-	3,507	(1,543)	2,883
Income tax on profits on Associate companies	-	-	1,878	5,373
	<b>1,037,908</b>	<b>798,961</b>	<b>1,094,263</b>	<b>818,217</b>
<b>18 (b) Deferred tax expense</b>				
Adjustments to opening deferred tax liability resulting from increase in tax rate	-	89,482	-	89,482
Net opening balance adjustment [Note 40(c)]	(81,933)	(81,933)	(81,933)	(81,933)
Deferred tax asset reversed during the year [Note 40(b)]	537,955	(200,682)	537,955	(200,682)
Charge/(Reversal) from deferred tax liability [Note 40 (a)]	(181,632)	193,133	(183,625)	194,491
	<b>274,390</b>	<b>-</b>	<b>272,397</b>	<b>1,358</b>
Total income tax expense	<b>1,312,298</b>	<b>798,961</b>	<b>1,366,660</b>	<b>819,575</b>
<b>18 (c) Income tax on profits of Subsidiary companies</b>				
HNB Assurance PLC	-	-	20,485	2,000
HNB Stockbrokers (Pvt) Ltd.	-	-	9,147	12,507
HNB Securities Ltd.	-	-	26,388	-
<b>18 (d) Income tax on profits of Associate companies</b>				
Lanka Ventures PLC	-	-	1,878	5,373
Total	-	-	<b>57,898</b>	<b>19,880</b>

For the year ended 31st December

	Bank		Group	
	2007 Rs.000	2006 Rs.000	2007 Rs.000	2006 Rs.000
<b>18 (e) Reconciliation of Accounting Profit and Taxable Income</b>				
Profit before taxation	<b>4,334,754</b>	3,019,450	<b>4,550,267</b>	3,081,594
Disallowable expenses	<b>8,849,489</b>	7,517,312	<b>8,932,254</b>	7,629,637
Allowable expenses	<b>(4,430,151)</b>	(3,794,009)	<b>(4,460,612)</b>	(3,819,351)
Tax exempt income	<b>(4,044,733)</b>	(3,036,505)	<b>(4,112,904)</b>	(3,051,712)
Tax losses brought forward and utilised [Note 18(e)i]	<b>(1,648,276)</b>	(1,297,187)	<b>(1,689,450)</b>	(1,389,772)
<b>Taxable Income</b>	<b>3,061,083</b>	2,409,061	<b>3,219,555</b>	2,450,396
Of which,				
Taxable income at 35%	<b>2,769,433</b>	2,038,443	<b>2,927,905</b>	2,073,825
Taxable income at 20%	<b>291,650</b>	370,618	<b>291,650</b>	370,618
Taxable income at 33 1/3%	-	-	-	5,953
	<b>3,061,083</b>	2,409,061	<b>3,219,555</b>	2,450,396
Income tax provision for the year is made up of the following:				
Income taxable at 35%	<b>969,301</b>	713,455	<b>1,024,767</b>	725,838
Income taxable at 32.5%	-	-	-	-
Income taxable at 33 1/3%	-	-	-	1,984
Income taxable at 30%	-	-	-	-
Income taxable at 20%	<b>58,330</b>	74,124	<b>58,330</b>	74,124
	<b>1,027,631</b>	787,579	<b>1,083,097</b>	801,946
Social Responsibility levy at 1%	<b>10,277</b>	7,875	<b>10,831</b>	8,015
<b>Income tax on profits for the year</b>	<b>1,037,908</b>	795,454	<b>1,093,928</b>	809,961
Effective tax rate	<b>23.94%</b>	26.34%	<b>24.04%</b>	26.28%

**18(e)i Tax losses brought forward and utilised during the year**

Tax losses brought forward	<b>2,376,608</b>	3,673,795	<b>2,738,384</b>	3,880,997
Tax losses not utilised and carried forward	<b>(728,332)</b>	(2,376,608)	<b>(1,048,934)</b>	(2,491,225)
<b>Tax losses utilised</b>	<b>1,648,276</b>	1,297,187	<b>1,689,450</b>	1,389,772

**18 (f)** The Bank's Domestic Banking Unit (DBU) is liable for taxation on its income from banking operations at the rate of 35% (2006 - 35%) for the year. 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 (2006 - 35%). The taxable income from Off Shore Operations of FCBU is liable for taxation at the rate of 20% (2006 - 20%).

The Bank has recorded a taxable income of Rs. 3,061.08 Mn. during the year 2007. The cumulative tax losses, which are available for setting off against future taxable income, (after set off during the year) amounted to Rs. 728.332 Mn. as at 31st December 2007 (31st December 2006 - Rs. 2,376.6 Mn.). The amounts reflected above are provisional.

HNB Stock brokers (Pvt) Ltd., is liable for income taxation at the rate of 35% (2006 - 35%) on its taxable income. Provision has been made in the financial statements accordingly.

HNB Assurance PLC., is liable for income taxation at the rate of 35% (2006 - 33 1/3%) on its taxable income. Provision has been made in the financial statements accordingly.

**18 INCOME TAX EXPENSE (Contd.)****18 (f) Contd.**

HNB Securities Ltd., is liable for income taxation at the rate of 35% (2006 - 35%) on its taxable income. Provision has been made in the financial statements accordingly.

**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 of 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).

**19 EARNINGS PER SHARE**

Basic Earnings per Share have been calculated dividing the profit for the period attributable to Equity Holders of the Bank, by the number of ordinary shares on issue (both Voting and Non-Voting) during the year ended 31st December 2007, as per the requirements of the Sri Lanka Accounting Standard 34 - "Earnings per Share".

On 29th March 2007 the Bank issued 1:1 bonus shares (one ordinary share for each ordinary share outstanding as at 31st December 2006) resulting in dilution of EPS. Accordingly the EPS for the comparative period has been restated.

	Bank		Group	
	2007	2006	2007	2006
For the year ended 31st December				
Profit attributable to Equity Holders of the Bank (Rs.000)	<b>3,022,456</b>	2,220,489	<b>3,150,469</b>	2,239,106
Number of ordinary shares used as the denominator ('000)	<b>235,529</b>	235,529	<b>235,529</b>	235,529
Basic & Diluted Earnings per Share (Rs.)	<b>12.83</b>	9.43	<b>13.38</b>	9.51
As at 31st December				
	<b>2007</b>	2006	<b>2007</b>	2006
	<b>Rs.000</b>	Rs.000	<b>Rs.000</b>	Rs.000

**20 CASH AND CASH EQUIVALENTS**

Local currency in hand	<b>2,543,573</b>	1,866,835	<b>2,544,295</b>	1,869,645
Foreign currency in hand	<b>369,173</b>	164,731	<b>369,173</b>	164,731
Balances with local banks	<b>28,430</b>	1,204	<b>144,324</b>	34,108
Balances with foreign banks	<b>11,710,540</b>	8,695,017	<b>11,710,540</b>	8,695,017
Money at call and short notice		- 5,500,000		5,500,000
Money market funds	<b>5,200,740</b>	5,636,464	<b>5,200,740</b>	5,636,464
Placements with banks by FCBU	<b>4,506,990</b>	1,955,635	<b>4,506,990</b>	1,955,635
	<b>24,359,446</b>	23,819,886	<b>24,476,062</b>	23,855,600

As at 31st December

Bank		Group	
2007 Rs.000	2006 Rs.000	2007 Rs.000	2006 Rs.000

**21 STATUTORY DEPOSIT WITH CENTRAL BANK OF SRI LANKA**

Statutory deposit with Central Bank of Sri Lanka	<b>13,405,856</b>	12,016,532	<b>13,405,856</b>	12,016,532
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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 at 31st December 2007, the minimum cash reserve requirement is 10% of the rupee deposit liabilities. There are no reserve requirement for deposit liabilities of the Foreign Currency Banking Unit and foreign currency deposits liabilities in the Domestic Banking Unit.

**22 DEALING SECURITIES****22 (a) Quoted Shares - Bank**

As at 31st December

	2007				2006		
	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>							
Union Assurance PLC	-	-	-	-	332,300	23,895	34,061
<b>Beverage Food and Tobacco</b>							
Distilleries Company of Sri Lanka PLC	<b>386,700</b>	<b>35,201</b>	<b>21.15</b>	<b>38,863</b>	561,900	51,149	50,852
<b>Construction and Engineering</b>							
Colombo Dockyard PLC	<b>55</b>	<b>2</b>	-	<b>3</b>	721,955	23,000	25,990
<b>Diversified Holdings</b>							
Hayleys PLC	<b>238,600</b>	<b>26,620</b>	<b>15.99</b>	<b>25,710</b>	258,600	26,416	33,489
Hemas Holdings PLC	<b>175,200</b>	<b>20,558</b>	<b>12.35</b>	<b>16,644</b>	150,200	17,401	17,536
John Keells Holdings PLC	<b>4,323</b>	<b>716</b>	<b>0.43</b>	<b>550</b>	-	-	-
		<b>47,894</b>	<b>28.77</b>	<b>42,904</b>		43,817	51,025
<b>Health Care</b>							
Lanka Hospitals PLC	<b>1,454,700</b>	<b>42,914</b>	<b>25.78</b>	<b>24,731</b>	-	-	-
<b>Hotel and Travel</b>							
Connaissance Holdings PLC	-	-	-	-	307,520	11,371	11,378
<b>Manufacturing</b>							
ACL Cables PLC	-	-	-	-	200,000	24,865	42,550
Richard Pieris and Co PLC	-	-	-	-	401,900	36,940	31,348
Tokyo Cement (Lanka) PLC	-	-	-	-	74,000	14,042	14,412
Tokyo Cement (Lanka) PLC Non-Voting	-	-	-	-	1,000,000	14,305	17,000
		-	-	-	-	90,152	105,310

**22 DEALING SECURITIES (Contd.)****22 (a) Quoted shares - Bank (Contd.)**

As at 31st December

	2007				2006		
	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>Plantations</b>							
Horana Plantations PLC	-	-	-	-	162,500	3,926	2,966
<b>Telecommunications</b>							
Dialog Telekom PLC	174,350	4,199	2.52	3,487	-	-	-
Sri Lanka Telecom PLC	1,501,900	36,111	21.70	47,310	1,565,400	36,497	43,440
		40,310	24.22	50,797		36,497	43,440
<b>Trading</b>							
Odd lots & delisted shares		135	0.08	-	-	139	5
<b>Total</b>		166,456	100.00	157,298		283,946	325,027
Marked to market valuation gain/(loss)		(9,158)				41,081	
<b>Total Quoted Shares - Bank</b>		157,298		157,298		325,027	325,027

**22 DEALING SECURITIES (Contd.)**

As at 31st December

			2007		2006	
			Cost of Investment Rs.000	Market Value Rs.000	Cost of Investment Rs.000	Market Value Rs.000
<b>22 (b) Bills - Bank</b>						
<b>Government of Sri Lanka Treasury Bills</b>						
Face Value	Year of Maturity	Discounted Value (Rs. 000)				
Rs.150Mn	2008	145,211	145,211	145,022	-	-
Marked to market valuation loss			(189)		-	-
<b>Total Bills - Bank</b>			<b>145,022</b>	<b>145,022</b>	-	-
<b>22 (c) Bonds - Bank</b>						
<b>Government of Sri Lanka Treasury Bonds</b>						
Face Value	Year of Maturity	Discounted Value (Rs. 000)				
Rs. 50 Mn.	2009	49,537	49,537	43,192	49,245	43,930
Marked to market valuation loss			(6,345)		(5,315)	
			<b>43,192</b>	<b>43,192</b>	43,930	43,930
<b>Foreign Currency Bonds</b>						
Face Value	Year of Maturity	Discounted Value				
US\$ 5 Mn.	2010	US\$ 2,246,406	244,072	244,072	532,863	370,313
Marked to market valuation loss			-		(162,550)	
			<b>244,072</b>	<b>244,072</b>	370,313	370,313
<b>Total Bonds - Bank</b>			<b>287,264</b>	<b>287,264</b>	414,243	414,243
<b>Total Dealing Securities - Bank [Note 22(a), (b), (c)]</b>			<b>589,584</b>	<b>589,584</b>	739,270	739,270
<b>22 (d) Bonds - Subsidiaries</b>						
<b>Government of Sri Lanka Treasury Bonds</b>						
Face Value	Year of Maturity	Discounted Value (Rs. 000)				
Rs. 121.5 Mn.	2008	120,543				
Rs. 5.3 Mn.	2009	4,821	125,436	125,364	245,762	239,331
Marked to market valuation loss			(72)		(6,431)	
<b>Total Bonds - Subsidiaries</b>			<b>125,364</b>	<b>125,364</b>	239,331	239,331
Intercompany adjustment			(2,459)	(2,459)	(2,897)	(2,897)
<b>Total Dealing Securities - Group</b>			<b>712,489</b>	<b>712,489</b>	975,704	975,704

**23 INVESTMENT SECURITIES****23 (a) Quoted shares**

As at 31st December

	2007			2006		
	No. of Ordinary Shares	Cost of Investment Rs.000	Market Value of Shares Rs.000	No. of Ordinary Shares	Cost of Investment Rs.000	Market Value of Shares Rs.000
<b>Bank</b>						
Asha Central Hospital PLC	-	-	-	120,000	1,578	4,890
Browns' Beach Hotels PLC	-	-	-	75,000	1,622	2,100
Commercial Bank of Ceylon PLC	<b>1,430,574</b>	<b>95,813</b>	<b>210,294</b>	825,332	61,645	156,813
DFCC Bank PLC	<b>16,054,570</b>	<b>911,399</b>	<b>2,038,930</b>	10,581,037	519,711	1,899,296
Distilleries Company of Sri Lanka PLC	<b>1,481,500</b>	<b>11,158</b>	<b>148,891</b>	1,481,500	11,158	134,076
Lanka Hospital Corporation PLC	-	-	-	1,455,000	22,055	37,830
Magpek Exports PLC	<b>359,000</b>	<b>14,360</b>	*	359,000	14,360	*
Metal Recyclers Colombo PLC	<b>69</b>	<b>3</b>	*	69	3	*
		<b>1,032,733</b>	<b>2,398,115</b>		632,132	2,235,005
Provision for diminution in market value b/f		<b>(14,363)</b>			(14,363)	
<b>Total Quoted Shares - Bank</b>		<b>1,018,370</b>	<b>2,398,115</b>		617,769	2,235,005
<i>* Shares de-listed – Market value shown as nil.</i>						
<b>Subsidiaries</b>						
Commercial Bank of Ceylon PLC						
cumulative redeemable preference shares	<b>725,000</b>	<b>7,250</b>	<b>6,525</b>	725,000	7,250	6,706
Hemas Holdings PLC	<b>4,200</b>	<b>447</b>	<b>399</b>	4,200	447	490
John Keells Holdings PLC	<b>41,856</b>	<b>5,521</b>	<b>5,326</b>	20,000	2,672	3,900
Dialog Telekom PLC	<b>247,500</b>	<b>5,865</b>	<b>4,950</b>	100,000	2,075	2,650
Sri Lanka Telecom PLC	<b>155,000</b>	<b>4,265</b>	<b>4,883</b>	100,000	2,101	2,775
Asian Hotels & Properties PLC	<b>19,500</b>	<b>890</b>	<b>780</b>	-	-	-
		<b>24,238</b>	<b>22,863</b>		14,545	16,521
Provision for diminution in value of investment		<b>(2,550)</b>			(545)	
<b>Total Quoted Shares - Subsidiaries</b>		<b>21,688</b>	<b>22,863</b>		14,000	16,521
<b>Total Quoted Shares - Group</b>		<b>1,040,058</b>	<b>2,420,978</b>		631,769	2,251,526

**23 INVESTMENT SECURITIES (Contd.)****23 (b) Unquoted shares**

As at 31st December

	2007			2006		
	No. of Ordinary Shares	Cost Rs.000	Directors' Valuation Rs.000	No. of Ordinary Shares	Cost Rs.000	Directors' Valuation Rs.000
<b>Bank</b>						
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	500,000	5,000	5,000	-	-	-
S.W.I.F.T.	21	2,051	2,051	21	2,051	2,051
Dialog Telekom PLC						
Rated cumulative redeemable preference shares	720,000,000	720,000	720,000	-	-	-
<b>Total Unquoted Shares - Bank</b>		<b>750,706</b>	<b>750,706</b>		<b>25,706</b>	<b>25,706</b>
<b>Subsidiaries</b>						
Splendor Media (Pvt.) Ltd	25,000	250	250	-	-	-
<b>Total unquoted shares - Subsidiaries</b>	<b>25,000</b>	<b>250</b>	<b>250</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Total unquoted shares - Group</b>		<b>750,956</b>	<b>750,956</b>		<b>25,706</b>	<b>25,706</b>

**23 (c) Bonds and Debentures**

As at 31st December

	2007		2006	
	Cost Rs.000	Directors' Valuation Rs.000	Cost Rs.000	Directors' Valuation Rs.000
<b>Bank</b>				
<b>23 (c)i Long Term Investments</b>				
Long Term Non-negotiable Bonds maturing on 14.11.2016	489,000	489,000	489,000	489,000
Mercantile Leasing Ltd - Debentures	-	-	60,000	60,000
People's Leasing Co. Ltd. - Securitised Notes Trust 04	-	-	5,341	5,341
People's Leasing Co. Ltd. - Securitised Notes Trust 10	33,333	33,333	83,333	83,333
People's Leasing Co. Ltd. - Securitised Notes Trust 14	57,291	57,291	125,000	125,000
People's Leasing Co. Ltd. - Securitised Notes Trust 20	47,917	47,917	72,917	72,917
People's Leasing Co. Ltd. - Securitised Notes Trust 29	110,985	110,985	177,978	177,978
Sampath Leasing Securitised Notes	90,000	90,000	-	-
Sri Lanka Development Bonds maturing in 2008	4,246,717	4,246,717	4,202,859	4,202,859
Sri Lanka Development Bonds maturing in 2009	4,996,138	4,996,138	2,794,740	2,794,740
<b>Total</b>	<b>10,071,381</b>	<b>10,071,381</b>	<b>8,011,168</b>	<b>8,011,168</b>

**23 INVESTMENT SECURITIES (Contd.)****23 (c) Bonds and debentures (Contd.)**

As at 31st December

2007		2006	
Cost of Investment Rs.000	Market Value Rs.000	Cost of Investment Rs.000	Market Value Rs.000

**23(c)ii Government of Sri Lanka Treasury Bonds**

Face value	Year of Maturity	Discounted Value (Rs.000)
Rs. 3,699.10 Mn	2008	3,731,221
Rs. 2,740.00 Mn	2009	2,787,276
Rs. 251.00 Mn	2013	259,719

As at 31st December

2007		2006	
Cost of Investment Rs.000	Directors' Valuation Rs.000	Cost of Investment Rs.000	Directors' Valuation Rs.000

**23(c)iii Foreign Currency Bonds****Total - Bonds & Debentures**

-	-	2,235,692	2,235,692
<b>16,849,597</b>	<b>16,727,268</b>	19,917,461	19,225,091

**23(c)iv Government of Sri Lanka Treasury Bills**

Face Value	Year of Maturity	Discounted Value (Rs'000)
Rs.1,753 Mn	2008	1,678,096

**Total Bonds, Bills & Debentures - Bank****Total Investments Securities - Bank**

2007		2006	
Cost of Investment Rs.000	Market Value Rs.000	Cost of Investment Rs.000	Directors' Valuation Rs.000
<b>1,678,096</b>	<b>1,674,090</b>	-	-
<b>18,527,693</b>	<b>18,401,358</b>	19,917,461	19,225,091
<b>20,296,769</b>	<b>21,550,179</b>	20,560,936	21,485,802

As at 31st December

2007		2006	
No. of Debentures Rs.000	Cost of Investment Rs.000	No. of Debentures Rs.000	Cost of Investment Rs.000

**Subsidiaries****23(c)v Quoted Debentures**

Commercial Bank of Ceylon Ltd - Debentures (Rs. 1000/- each)	7,250	7,250	7,250	7,250
DFCC Bank (Rs. 1000/- each)	10,000	10,000	10,000	10,000
Seylan Bank Ltd. (Rs. 100/- each)	250,000	25,000	150,000	15,000
Sampath Bank PLC	250,000	25,000	50,000	5,000
Singer (Sri Lanka) Ltd. (Rs. 100/- each)	50,000	5,000	-	-

**Total Quoted Debentures - Subsidiaries****72,250**      **37,250**

**23 INVESTMENT SECURITIES (Contd.)****23 (c) Bonds and debentures (Contd.)**

As at 31st December

	2007		2006	
	Cost of Investment Rs.000	Market Value Rs.000	Cost of Investment Rs.000	Market Value Rs.000
<b>23(c)vi Government of Sri Lanka Treasury Bonds</b>				
Face value				
Year of Maturity				
Discounted Value (Rs.000)				
Rs. 59.484 Mn.			89,945	
Rs. 295.938 Mn.			292,849	
Rs. 102 Mn.			94,380	
Rs. 155 Mn.			109,545	
	<b>586,719</b>	<b>493,485</b>	1,601,600	1,539,654
Total Bonds and Debentures - Subsidiaries	<b>658,969</b>	<b>565,735</b>	1,638,850	1,576,904
Total Bonds and Debentures - Group	<b>19,186,662</b>	<b>18,967,093</b>	21,556,311	21,940,218
Total Investments Securities - Group	<b>20,977,676</b>	<b>22,139,027</b>	22,213,786	24,217,450

As at 31st December

	Bank		Group	
	2007 Rs.000	2006 Rs.000	2007 Rs.000	2006 Rs.000
<b>24 BILLS OF EXCHANGE</b>				
Inland bills	<b>560,313</b>	372,205	<b>560,313</b>	372,205
Import bills	<b>285,653</b>	458,655	<b>285,653</b>	458,655
Export bills	<b>1,120,777</b>	954,300	<b>1,120,777</b>	954,300
	<b>1,966,743</b>	1,785,160	<b>1,966,743</b>	1,785,160
Foreign Currency Banking Unit bills	<b>403,674</b>	416,863	<b>403,674</b>	416,863
	<b>2,370,417</b>	2,202,023	<b>2,370,417</b>	2,202,023
Less: Specific provision [Note 24(a)]	<b>300,967</b>	291,171	<b>300,967</b>	291,171
	<b>2,069,450</b>	1,910,852	<b>2,069,450</b>	1,910,852

**24 (a) Movement in provision for Bills of Exchange**

Balance brought forward	<b>291,171</b>	288,044	<b>291,171</b>	288,044
Exchange rate variance on foreign currency provision	<b>701</b>	3,127	<b>701</b>	3,127
Specific provision made during the year (Note 17)	<b>9,095</b>	-	<b>9,095</b>	-
	<b>300,967</b>	291,171	<b>300,967</b>	291,171

As at 31st December	Bank		Group	
	2007 Rs.000	2006 Rs.000	2007 Rs.000	2006 Rs.000
<b>25 LOANS AND ADVANCES</b>				
<b>Sri Lanka Rupee loans and advances</b>				
Overdrafts	33,776,672	27,455,224	33,202,042	27,023,615
Trust receipts	7,097,272	6,876,898	7,097,272	6,876,898
Packing credit loans	763,188	618,787	763,188	618,787
Staff loans	5,744,015	4,818,325	5,748,253	4,818,430
Term loans	48,064,735	37,130,160	47,064,735	37,130,160
Housing loans	16,062,341	12,987,528	16,062,341	12,987,528
Pawning advances	16,783,984	13,446,308	16,783,984	13,446,308
Foreclosed properties [Note 25(f)]	37,359	69,420	37,359	69,420
	<b>128,329,566</b>	103,402,650	<b>126,759,174</b>	102,971,146
<b>Foreign currency loans and advances</b>				
Overdrafts	2,058,947	1,588,638	2,058,947	1,588,638
Trust receipts	1,389,521	1,647,432	1,389,521	1,647,432
Packing credit loans	3,387,234	3,460,009	3,387,234	3,460,009
Term loans	11,263,612	10,451,499	11,263,612	10,451,499
Housing Loans	390,022	399,933	390,022	399,933
Foreclosed properties [Note 25(f)]	427,977	423,250	427,977	423,250
	<b>18,917,313</b>	17,970,761	<b>18,917,313</b>	17,970,761
<b>Sri Lanka Rupee and Foreign currency loans and advances</b>	<b>147,246,879</b>	121,373,411	<b>145,676,487</b>	120,941,907
Less:				
Specific provision for loans and advances	5,551,017	5,356,108	5,551,017	5,356,108
Specific provision for Foreclosed properties [Note 25(g)]	402,952	468,218	402,952	468,218
General provision for pawning advances	16,784	16,473	16,784	16,473
General provision for housing loans	32,905	26,775	32,905	26,775
Statutory general provision for performing and overdue loans and advances	534,114	294,363	534,114	294,363
Total provision for loan losses [Note 25(a)]	<b>6,537,772</b>	6,161,937	<b>6,537,772</b>	6,161,937
Loans and advances after provision	<b>140,709,107</b>	115,211,474	<b>139,138,715</b>	114,779,970
Less: Interest in suspense [Note 25(e)]	924,583	850,746	924,583	850,746
Net loans and advances	<b>139,784,524</b>	114,360,728	<b>138,214,132</b>	113,929,224
<b>25 (a) Movement in provision for loan losses</b>				
Balance brought forward	6,161,937	5,463,140	6,161,937	5,463,140
Exchange rate variance on foreign currency provision	39,360	165,251	39,360	165,251
	<b>6,201,297</b>	5,628,391	<b>6,201,297</b>	5,628,391
Provision made during the year (Note 17)	805,881	836,014	805,881	836,014
Fully provided loans written off	(203,844)	(101,900)	(203,844)	(101,900)
Recoveries made during the year	(274,795)	(200,568)	(274,795)	(200,568)
Recoveries made on loans written off in previous years	9,233	-	9,233	-
	<b>6,537,772</b>	6,161,937	<b>6,537,772</b>	6,161,937

**25 LOANS AND ADVANCES (Contd.)****25(b) Total provision for loan losses**

As at 31st December

	2007		2006	
	Rs.000	Rs.000	Rs.000	Rs.000
<b>25(b)i Specific provision</b>				
Bills of Exchange [Note 24(a)]	<b>300,967</b>		291,171	
Loans and advances	<b>5,953,969</b>		5,824,326	
Lease rentals receivable within one year [Note 26(a)]	<b>211,699</b>	<b>6,466,635</b>	248,227	6,363,724
<b>25(b)ii General provision</b>				
Loans and advances	<b>49,689</b>		43,248	
Lease rentals receivable within one year	<b>89,712</b>		80,801	
Lease rentals receivable after one year	<b>181,502</b>		154,964	
Statutory general provision for performing and overdue loans and advances	<b>534,114</b>	<b>855,017</b>	294,363	573,376
<b>Total provision [Note 24(a), 25(a) and 26(c)]</b>		<b>7,321,652</b>		6,937,100

As explained in Note no 8.8.3, 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 Shanthi Housing Loans. A further provision of Rs 534.1 Mn.(2006: Rs. 294.4 Mn.) was made to meet the regulatory requirement. The total general provision of Rs. 855.02 Mn. (2006 - Rs 573.4 Mn) is 0.73% (2006 - 0.56%) of the total performing and overdue loans and advances, net of interest in suspense as at the Balance Sheet date and is above the regulatory requirement of 0.5% as at 31st December 2007 (2006 - 0.1%).

**25(c) Asset quality - Bank****Non-performing lending portfolio**

As explained in Note no 8.8.1, loans, advances and finance leases which are 90 days or more in arrears of due capital and/or interest are classified as non-performing. 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 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.

As at 31st December	2007		2006	
	Rs.000	Rs.000	Rs.000	Rs.000
Bills of Exchange	<b>334,635</b>		297,189	
Loans and advances	<b>9,176,794</b>		9,072,583	
Foreclosed properties	<b>465,336</b>		492,670	
Lease rental receivable	<b>566,538</b>		518,882	
	<b>10,543,303</b>		10,381,324	
Less: Specific provisions				
- Bills of Exchange	<b>300,967</b>		291,171	
Loans and advances	<b>5,551,017</b>		5,356,108	
Foreclosed properties	<b>402,952</b>		468,218	
Lease rental receivable	<b>211,699</b>	<b>6,466,635</b>	248,227	6,363,724
		<b>4,076,668</b>		4,017,600
Less: Interest in suspense [Note 25(e)]		<b>924,584</b>		850,746
<b>Net non-performing lending portfolio</b>		<b>3,152,084</b>		3,166,854

Net non-performing lending portfolio of Rs. 3,152 Mn. (2006: Rs 3,167 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 no 25 (h).

## 25 LOANS AND ADVANCES (Contd.)

### 25(d) Credit risk - Bank

#### 25(d)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 value/realisable value 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	2007		2006	
	Rs.000	%	Rs.000	%
Secured by immovable assets	4,276,985	41	5,582,734	54
Secured by movable assets	1,624,176	15	1,343,955	13
Secured by cash/shares	202,679	2	409,260	4
Other securities	1,666,107	16	1,418,634	14
Clean	2,745,347	26	1,626,741	15
Pawning	28,009	-	-	-
	<b>10,543,303</b>	<b>100</b>	<b>10,381,324</b>	<b>100</b>

#### 25(d)ii Sector/Productwise analysis of gross lending portfolio

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/ Type of Loan	Overdrafts	Short Term	Medium Term	Long Term	Pawning	Total	%
	Rs.000	Loans Rs.000	Loans Rs.000	Loans Rs.000	Rs.000	Rs.000	
<b>Bank - 2007</b>							
Food, beverages and tobacco	1,905,792	1,841,321	2,489,557	1,944,913	-	8,181,583	5.08
Agriculture, agro business and fisheries	3,547,059	2,669,906	3,309,842	2,361,495	-	11,888,302	7.38
Textiles and wearing apparel	2,924,330	1,713,441	2,635,567	2,718,701	-	9,992,039	6.21
Wood and paper products	1,150,216	614,141	929,115	633,441	-	3,326,913	2.07
Rubber and leather products	964,642	1,165,952	629,295	407,556	-	3,167,445	1.97
Metals, chemicals and engineering	2,687,515	889,878	1,328,106	4,478,662	-	9,384,161	5.83
Hotels	1,703,959	97,613	1,745,608	1,233,504	-	4,780,684	2.97
Services	3,659,537	2,523,061	4,272,560	4,529,580	-	14,984,738	9.31
Foreclosed properties	-	-	-	465,336	-	465,336	0.29
Others	17,292,568	12,948,053	22,763,260	25,060,172	16,783,984	94,848,039	58.89
<b>Total</b>	<b>35,835,618</b>	<b>24,463,366</b>	<b>40,102,910</b>	<b>43,833,360</b>	<b>16,783,984</b>	<b>161,019,240</b>	<b>100.00</b>

Gross Loans and Advances (Note 25)	147,246,879	91.45
Lease Rentals Receivable	13,772,361	8.55
	<b>161,019,240</b>	<b>100.00</b>

The "others" category comprises the following advances:

Exports	693,748	1,398,569	1,333,895	143,021	-	3,569,233	3.76
Imports	1,631,596	3,677,412	1,674,144	463,742	-	7,446,894	7.85
Trading	4,036,931	1,143,499	3,129,833	1,597,670	-	9,907,933	10.45
Financial	3,176,281	492,311	1,749,150	861,599	-	6,279,341	6.62
Housing	-	193,811	2,282,731	13,975,821	-	16,452,363	17.35
Consumption	2,237,657	1,949,404	3,263,202	2,700,097	-	10,150,360	10.70
Miscellaneous	5,516,355	4,093,047	9,330,305	5,318,222	16,783,984	41,041,915	43.27
<b>Total</b>	<b>17,292,568</b>	<b>12,948,053</b>	<b>22,763,260</b>	<b>25,060,172</b>	<b>16,783,984</b>	<b>94,848,039</b>	<b>100.00</b>

**25 LOANS AND ADVANCES (Contd.)****25(d) Credit risk - Bank (Contd.)****25(d)ii Sector/Productwise analysis of gross lending portfolio**

Sector/ Type of Loan	Overdrafts	Short Term	Medium Term	Long Term	Pawning	Total	%
	Rs.000	Loans Rs.000	Loans Rs.000	Loans Rs.000	Rs.000	Rs.000	
<b>Bank - 2006</b>							
Food, beverages and tobacco	827,071	1,447,401	1,188,518	971,986	-	4,434,976	3.32
Agriculture, agro business and fisheries	1,164,392	1,591,911	1,882,628	1,065,122	-	5,704,053	4.28
Textiles and wearing apparel	1,514,654	1,599,581	1,862,494	1,707,790	-	6,684,519	5.01
Wood and paper products	205,257	320,054	351,341	216,364	-	1,093,016	0.82
Rubber and leather products	439,025	858,715	206,214	288,766	-	1,792,720	1.34
Metals, chemicals and engineering	2,094,038	1,577,494	1,860,076	3,467,819	-	8,999,427	6.75
Hotels	507,700	51,733	702,354	822,350	-	2,084,137	1.56
Services	2,385,341	1,795,575	3,663,720	3,295,731	-	11,140,367	8.35
Foreclosed properties	-	-	-	492,670	-	492,670	0.37
Others	18,317,747	14,655,170	19,993,322	24,571,446	13,446,308	90,983,993	68.20
<b>Total</b>	<b>27,455,225</b>	<b>23,897,634</b>	<b>31,710,667</b>	<b>36,900,044</b>	<b>13,446,308</b>	<b>133,409,878</b>	<b>100.00</b>
Gross Loans and Advances (Note 25)						121,373,411	90.98
Lease Rentals Receivable						12,036,467	9.02
						133,409,878	100.00
The "others" category comprises the following advances:							
Exports	525,510	998,262	340,776	360,250	-	2,224,798	2.45
Imports	1,358,493	3,544,561	503,801	616,636	-	6,023,491	6.62
Trading	3,978,768	1,113,713	1,987,816	779,297	-	7,859,594	8.64
Financial	1,597,645	419,677	1,851,222	1,709,185	-	5,577,729	6.13
Housing	-	99,202	1,902,238	11,386,021	-	13,387,461	14.71
Consumption	5,064,223	4,403,939	7,543,128	5,176,783	-	22,188,073	24.39
Miscellaneous	5,793,108	4,075,816	5,864,341	4,543,274	13,446,308	33,722,847	37.06
<b>Total</b>	<b>18,317,747</b>	<b>14,655,170</b>	<b>19,993,322</b>	<b>24,571,446</b>	<b>13,446,308</b>	<b>90,983,993</b>	<b>100.00</b>

**25 LOANS AND ADVANCES (Contd.)**

**25 (d) Credit risk - Bank (Contd.)**

**25 (d)ii Sector/Product wise analysis of gross lending portfolio (Contd.)**

Sector/ Type of Loan	Overdrafts	Short Term Loans	Medium Term Loans	Long Term Loans	Pawning	Total	%
	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	
<b>Group - 2007</b>							
Food, beverages and tobacco	1,905,792	1,841,321	2,489,557	1,944,913	-	8,181,583	5.13
Agriculture, agro business and fisheries	3,547,059	2,669,906	3,309,842	2,361,495	-	11,888,302	7.46
Textile and wearing apparel	2,924,330	1,713,441	2,635,567	2,718,701	-	9,992,039	6.27
Wood and paper products	1,150,216	614,141	929,115	633,441	-	3,326,913	2.09
Rubber and leather products	964,642	1,165,952	629,295	407,556	-	3,167,445	1.99
Metals, chemicals and engineering	2,687,515	889,878	1,328,106	4,478,663	-	9,384,162	5.89
Hotels	1,703,959	97,613	1,745,608	1,233,504	-	4,780,684	3.00
Services	3,659,537	2,523,061	4,272,560	4,529,580	-	14,984,738	9.40
Foreclosed properties	-	-	-	465,336	-	465,336	0.29
Others	16,717,938	12,948,117	22,767,434	24,060,173	16,783,984	93,277,646	58.50
<b>Total</b>	<b>35,260,988</b>	<b>24,463,430</b>	<b>40,107,084</b>	<b>42,833,362</b>	<b>16,783,984</b>	<b>159,448,848</b>	<b>100.00</b>
Gross Loans and Advances (Note 25)						145,676,487	91.36
Lease Rentals Receivable						13,772,361	8.64
						159,448,848	100.00

The "others" category comprises the following advances:

Exports	693,748	1,398,569	1,333,895	143,021	-	3,569,233	3.83
Imports	1,631,596	3,677,412	1,674,144	463,742	-	7,446,894	7.98
Trading	4,036,932	1,143,499	3,129,833	1,597,670	-	9,907,934	10.62
Financial	3,176,281	492,311	1,749,150	861,599	-	6,279,341	6.73
Housing	-	193,811	2,282,731	13,975,821	-	16,452,363	17.64
Consumption	2,237,657	1,949,404	3,263,202	2,700,097	-	10,150,360	10.88
Miscellaneous	4,941,724	4,093,111	9,334,479	4,318,223	16,783,984	39,471,521	42.32
<b>Total</b>	<b>16,717,938</b>	<b>12,948,117</b>	<b>22,767,434</b>	<b>24,060,173</b>	<b>16,783,984</b>	<b>93,277,646</b>	<b>100.00</b>

**25 LOANS AND ADVANCES (Contd.)****25 (d) Credit risk - Bank (Contd.)****25 (d)ii Sector/Product wise analysis of gross lending portfolio (Contd.)**

Sector/ Type of Loan	Overdrafts	Short Term	Medium Term	Long Term	Pawning	Total	%
	Rs.000	Loans Rs.000	Loans Rs.000	Loans Rs.000	Rs.000	Rs.000	
<b>Group - 2006</b>							
Food, beverages and tobacco	827,071	1,447,401	1,188,518	971,986	-	4,434,976	3.34
Agriculture, agro business and fisheries	1,164,392	1,591,911	1,882,628	1,065,122	-	5,704,053	4.29
Textiles and wearing apparel	1,514,654	1,599,581	1,862,494	1,707,790	-	6,684,519	5.03
Wood and paper products	205,257	320,054	351,341	216,364	-	1,093,016	0.82
Rubber and leather products	439,024	858,714	206,215	288,767	-	1,792,720	1.35
Metals, chemicals and engineering	2,094,038	1,577,494	1,860,075	3,467,820	-	8,999,427	6.77
Hotels	507,700	51,733	702,354	822,350	-	2,084,137	1.57
Services	2,385,341	1,795,575	3,663,720	3,295,731	-	11,140,367	8.38
Foreclosed properties	-	-	-	492,670	-	492,670	0.37
Others	17,886,137	14,655,276	19,993,322	24,571,446	13,446,308	90,552,489	68.08
<b>Total</b>	<b>27,023,614</b>	<b>23,897,739</b>	<b>31,710,667</b>	<b>36,900,046</b>	<b>13,446,308</b>	<b>132,978,374</b>	<b>100.00</b>
Gross Loans and Advances (Note 25)						120,941,907	90.95
Lease Rentals Receivable						12,036,467	9.05
						132,978,374	100.00
The "others" category comprises the following advances:							
Exports	525,509	998,262	340,776	360,249	-	2,224,796	2.46
Imports	1,358,493	3,544,561	503,801	616,636	-	6,023,491	6.65
Trading	3,978,768	1,113,713	1,987,816	779,297	-	7,859,594	8.68
Financial	1,597,645	419,677	1,851,222	1,709,185	-	5,577,729	6.16
Housing	-	99,202	1,902,238	11,386,021	-	13,387,461	14.78
Consumption	5,064,224	4,403,939	7,543,128	5,176,784	-	22,188,075	24.50
Miscellaneous	5,361,498	4,075,922	5,864,341	4,543,274	13,446,308	33,291,343	36.76
<b>Total</b>	<b>17,886,137</b>	<b>14,655,276</b>	<b>19,993,322</b>	<b>24,571,446</b>	<b>13,446,308</b>	<b>90,552,489</b>	<b>100.00</b>

**25 LOANS AND ADVANCES (Contd.)**

As at 31st December

	<b>2007</b>	2006
	<b>Rs.000</b>	Rs.000
<b>25 (e) Movement in Interest in Suspense - Bank</b>		
Balance brought forward	<b>850,746</b>	909,026
Interest suspended	<b>835,788</b>	280,784
Amounts recovered	<b>(732,277)</b>	(315,850)
Interest written off	<b>(29,674)</b>	(23,214)
Balance as at 31st December	<b>924,583</b>	850,746

As a policy, the Bank seals off interest on non-performing loans and advances after one year of classification in to 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.

**25 (f) Movement in Foreclosed properties**

Balance brought forward	<b>24,452</b>	137,089
Disposals during the year	<b>(32,061)</b>	(69,804)
Exchange translation	<b>157</b>	(11,085)
Reclassified to provision for loan losses	<b>(10,847)</b>	43,410
Provision for the year	<b>-</b>	(99,379)
Provision recoveries during the year	<b>80,683</b>	24,221
Balance as at 31st December	<b>62,384</b>	24,452

The total of Foreclosed properties and related provisions have been classified under loans and advances

Sri Lanka Rupee loans and advances	<b>37,359</b>	69,420
Foreign currency loans and advances	<b>427,977</b>	423,250
Specific provision for foreclosed properties [Note 25(g)]	<b>(402,952)</b>	(468,218)
Balance as at 31st December	<b>62,384</b>	24,452

**25 (g) Movement in provision for Foreclosed properties**

Balance brought forward	<b>468,218</b>	420,451
Reclassified to provision for loan losses	<b>10,847</b>	(43,410)
Exchange rate variance in foreign currency provision	<b>4,570</b>	16,019
Specific provisions made during the year	<b>-</b>	99,379
Recoveries made during the year	<b>(80,683)</b>	(24,221)
Balance as at 31st December	<b>402,952</b>	468,218

**25 (h) Valuation of Securities for Provisioning Purposes**

As per an amendment to the directions issued by the Central Bank of Sri Lanka on 15th August 2003 (effective from 1st January 2004) under section 46 (A) of the Banking Act No. 30 of 1988, as amended by Banking (Amendment) Act No. 33 of 1995, the initial and progressive discounts that need to be applied to the forced sale value of immovable properties held as collateral are as follows:

At the time of first provisioning for a loan, only 75% of the forced sale value (FSV) of the property based on a current professional valuation report is considered as the value of collateral (i.e. an initial haircut of 25% will be applied);

When an advance is transferred to the 'Loss' category, the following progressive discounts apply to the forced sale value of immovable property held as collateral, based on a current professional valuation report, depending on the time period for which it remains in the 'Loss' category:

No. of years in loss category	% of FSV of immovable property that can be considered as the value of collateral
1 - 2 years	60%
2 - 3 years	50%
3 - 4 years	40%

All immovable property held as collateral, relating to loans in the 'Loss' category for more than four years, are reviewed on a regular basis and discounted further at the discretion of management.

**25 (i) Provision for Kabool Lanka (Pvt) Ltd.**

The bank has made a total provision of Rs. 2.6 Bn. as at 31st December 2006 against the exposure to Kabool Lanka (Pvt) Ltd. of approximately Rs. 2.8 Bn. as a measure of Prudence, despite the fact that land and building has a value adequate to cover the un-provided exposure.

The assets jointly owned by Hatton National Bank Ltd. and Bank of Ceylon, acquired through the legal process was subsequently acquired by the Government under the Provisions of the Land Acquisition Act and the Banks have lodged their claim for compensation.

As at 31st December	Bank		Group	
	2007 Rs.000	2006 Rs.000	2007 Rs.000	2006 Rs.000

**26 TOTAL LEASE RENTALS RECEIVABLE**

Gross lease rentals receivable	<b>30,411,111</b>	24,521,330	<b>30,411,111</b>	24,521,330
Initial rentals received	<b>(123,589)</b>	(127,769)	<b>(123,589)</b>	(127,769)
Lease rentals received	<b>(12,724,249)</b>	(9,379,697)	<b>(12,724,249)</b>	(9,379,697)
Total Lease rentals receivable	<b>17,563,273</b>	15,013,864	<b>17,563,273</b>	15,013,864

**26 (a) Lease rentals receivable within one year**

Lease rentals receivable within one year from				
Balance Sheet date	<b>6,606,245</b>	5,639,588	<b>6,606,245</b>	5,639,588
Unearned lease income	<b>(1,908,970)</b>	(1,514,493)	<b>(1,908,970)</b>	(1,514,493)
Provision for lease receivable				
Specific [Note 26(c)]	<b>(211,699)</b>	(248,227)	<b>(211,699)</b>	(248,227)
General	<b>(89,712)</b>	(80,801)	<b>(89,712)</b>	(80,801)
Balance as at 31st December	<b>4,395,864</b>	3,796,067	<b>4,395,864</b>	3,796,067

**26 TOTAL LEASE RENTALS RECEIVABLE (Contd.)**

As at 31st December	Bank		Group	
	2007 Rs.000	2006 Rs.000	2007 Rs.000	2006 Rs.000
<b>26 (b) Lease rentals receivable after one year</b>				
Lease rentals receivable after one year from				
Balance Sheet date	10,957,028	9,374,276	10,957,028	9,374,276
Unearned lease income	(1,881,942)	(1,462,904)	(1,881,942)	(1,462,904)
Provision for lease receivable				
General	(181,502)	(154,964)	(181,502)	(154,964)
Balance as at 31st December	<b>8,893,584</b>	7,756,408	<b>8,893,584</b>	7,756,408

There were no lease rentals receivable beyond five years.

**26 (c) Movement in provision for lease rentals receivable**

As at 31st December	2007 Rs.000 Specific	2007 Rs.000 General	2006 Rs.000 Specific	2006 Rs.000 General
<b>Bank</b>				
Balance brought forward	248,227	235,765	214,484	182,665
Exchange rate variance on foreign currency provision	-	1	-	16
	<b>248,227</b>	<b>235,766</b>	214,484	182,681
Additional provision made (Note 17)	57,489	35,448	42,730	53,084
Recoveries made during the year	(14,480)	-	(8,552)	-
Fully provided debts written off	(79,537)	-	(435)	-
	<b>211,699</b>	<b>271,214</b>	248,227	235,765
<b>Group</b>				
Balance brought forward	248,227	235,765	214,484	182,665
Exchange rate variance on foreign currency provision	-	1	-	16
	<b>248,227</b>	<b>235,766</b>	214,484	182,681
Additional provision made (Note 17)	57,489	35,448	42,730	53,084
Recoveries made during the year	(14,480)	-	(8,552)	-
Fully provided debts written off	(79,537)	-	(435)	-
	<b>211,699</b>	<b>271,214</b>	248,227	235,765

**27 NON CURRENT ASSETS HELD FOR SALE**

	Bank		Group	
	2007 Carrying amount Rs.000	2006 Carrying amount Rs.000	2007 Carrying amount Rs.000	2006 Carrying amount Rs.000
As at 31st December				
Balance as at 1st January	6,556	-	6,556	-
Reclassified from Property, Plant & Equipment	-	6,556	-	6,556
Less : Disposals	(5,101)	-	(5,101)	-
Balance as at 31st December	1,455	6,556	1,455	6,556

**27 (a) Non-current assets held for sale**

Freehold land [Note 27(b)]	1,455	5,614	1,455	5,614
Computer equipment	-	378	-	378
Equipment, furniture and fixtures	-	564	-	564
	1,455	6,556	1,455	6,556

**27 (b) Freehold land**

	2007		2006	
	Extent (perches)	Cost of land Rs.000	Extent (perches)	Cost of land Rs.000
Land at No. 118A, Negombo Road, Narammala	Disposed	-	40	4,159
Land at No. 67/11, Kumaradola Road, Monaragala	20	1,455	20	1,455
		1,455		5,614

**28 INVESTMENTS IN ASSOCIATE COMPANIES**

As at 31st December	2007				2006		
	Principal Activity	% Holding	Balance Rs.000	Market Value Rs.000	% Holding	Balance Rs.000	Market Value Rs.000
<b>28 (a) Bank</b>							
Quoted							
Lanka Ventures PLC (10,036,250 shares)	Venture Capital	20.07	132,326	110,399	20.07	132,326	132,980
			132,326	110,399		132,326	132,980
Unquoted							
Brown's Engineering (Pvt) Ltd. (2,056,000 ordinary shares)	Engineering	32.63	20,560		32.63	20,560	
Provision for diminution in value			(20,560)			(20,560)	
Total for the Bank			132,326			132,326	

Brown's Engineering (Pvt) Limited is under liquidation and the Bank's investment in the Company has been fully provided for.

**28 INVESTMENTS IN ASSOCIATE COMPANIES (Contd.)**

As at 31st December

	2007 Rs.000	2006 Rs.000
<b>28 (b) Group</b>		
<b>Quoted Investments</b>		
Investment in Associate Companies (at cost)	132,326	132,326
Negative goodwill on acquisition	5,830	5,830
<b>Group share of Associate Company retained profits</b>		
Balance as at 1st January	26,713	32,436
Current year's share of profits after tax	14,317	8,244
Dividends received during the year	(14,093)	(13,967)
Group share of Associate Company net assets	165,093	164,869
Group investment in Associate Companies (equity basis)	165,093	164,869

**28 (c) SUMMARISED FINANCIAL INFORMATION OF ASSOCIATE COMPANIES**

	2007 Rs.000	2006 Rs.000
<b>Lanka Ventures PLC</b>		
Revenue	122,445	101,817
Expenses	(29,515)	(27,117)
Profit/(Loss)	92,930	74,700
Current assets	281,930	332,283
Non current assets	553,248	506,268
Total assets	835,178	838,551
Current liabilities	10,560	14,747
Non current liabilities	2,031	986
Total liabilities	12,591	15,733

**29 INVESTMENTS IN SUBSIDIARY COMPANIES****Bank****29 (a) Quoted**

As at 31st December

	2007				2006		
	Principal Activity	% Holding	Balance Rs.000	Market Value Rs.000	% Holding	Balance Rs.000	Market Value Rs.000
HNB Assurance PLC (14,996,500 shares)	Insurance	60	149,965	551,121	60	149,965	374,912

**29 (b) Unquoted**

	2007				2006		
	Principal Activity	% Holding	Balance Rs.000	Directors' Valuation Rs.000	% Holding	Balance Rs.000	Directors' Valuation Rs.000
Sithma Development (Pvt) Ltd (206,000,000 ordinary shares)	<b>Property Development</b>	100	1,973,000	1,973,000	100	1,973,000	1,973,000
HNB Securities Ltd. (15,000,000 ordinary shares)	<b>Primary Dealer in Government Securities</b>	100	150,000	150,000	100	150,000	150,000
HNB Stockbrokers (Pvt) Ltd. (3,600,000 ordinary shares)	<b>Share Broking</b>	100	20,698	20,698	100	20,698	20,698
			<b>2,143,698</b>	<b>2,143,698</b>		2,143,698	2,143,698
Total for Bank			<b>2,293,663</b>			2,293,663	

**30 INVESTMENT PROPERTIES**

	Bank		Group	
	2007 Rs.000	2006 Rs.000	2007 Rs.000	2006 Rs.000
<b>Cost</b>				
Balance as at 1st January	195,505	-	242,499	-
Reclassified from Property, Plant & Equipment Improvements	-	195,480	-	242,474
	-	25	-	25
Balance as at 31st December [Note 30 (a)i and 30(a)ii]	195,505	195,505	242,499	242,499
<b>Accumulated depreciation</b>				
Balance as at 1st January	5,650	-	57,474	-
Reclassified from Property, Plant & Equipment	-	4,366	-	52,987
Charge for the year	1,194	1,284	4,397	4,487
Balance as at 31st December	6,844	5,650	61,871	57,474
<b>Net book value as at 31st December 2007</b>	<b>188,661</b>		<b>180,628</b>	
Net book value as at 31st December 2006		189,855		185,025

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 SLAS 40, the said lands are treated as Property, Plant & Equipment in the Group Balance Sheet, since these are leased to a Group entity.

**30 (a) Investment Properties****30 (a)i Bank**

	Cost/Carrying amount					Fair Value		
	Building sq.ft	Extent perches	Land Rs.000	Building Rs.000	Total Rs.000	Land Rs.000	Building Rs.000	Total Rs.000
As at 31st December 2007								
23 & 23 1/1, Independence Avenue, Colombo 7.	9,975	60.40	37,081	47,754	84,835	472,500	42,500	515,000
479 T B Jayah Mawatha, Colombo 10.	Land	100.00	75,781	-	75,781	508,320	-	508,320
21, 21A, 23 & 25, Janadhipathi Mawatha, Colombo 1.	Land	26.62	34,889	-	34,889	39,930	-	39,930
					195,505			1,063,250

**30(a)ii Group**

	Cost/Carrying amount					Fair Value		
	Building sq.ft	Extent perches	Land Rs.000	Building Rs.000	Total Rs.000	Land Rs.000	Building Rs.000	Total Rs.000
As at 31st December 2007								
23 & 23 1/1, Independence Avenue, Colombo 7.	9,975	60.40	37,081	47,754	84,835	472,500	42,500	515,000
Smart building, 21, 21A, 23 & 25, Janadhipathi Mawatha, Colombo 1.	42,765	-	-	157,664	157,664	-	197,050	197,050
					242,499			712,050

The fair value of the investment properties as at 31.12.2006 was based on market valuations carried out by Messrs J. M. T. Fernando, F.I.V., D.I.V. (Sri Lanka), K. C. B. Condegama, A.I.V. (Sri Lanka), members of the Institute of Valuers of Sri Lanka, who are independent valuers not connected with the Bank. The Directors have reviewed the values of the investment properties as at 31.12.2007 and concluded that there were no impairment.

**31 PROPERTY, PLANT & EQUIPMENT****Bank**

	Leasehold Buildings	Freehold Land and Buildings	Computer Equipment	Equipment Furniture and Fixtures	Motor Vehicles	Capital Work-in Progress	<b>2007 Total</b>	2006 Total
	Note 31(c) Rs.000	Note 31(b) Rs.000	Note 31(a) Rs.000	Rs.000	Rs.000	Rs.000	<b>Rs.000</b>	Rs.000
<b>Cost/Valuation as at 31/12/2006</b>	661,918	1,560,520	1,240,454	1,966,383	118,978	228,227	<b>5,776,480</b>	6,202,763
Transfers to Intangible Assets	-	-	-	-	-	-	-	(611,422)
<b>Adjusted Cost/Valuation as at 31/12/2006</b>	661,918	1,560,520	1,240,454	1,966,383	118,978	228,227	<b>5,776,480</b>	5,591,341
Revaluation adjustment on accumulated depreciation	-	(148,421)	-	-	-	-	<b>(148,421)</b>	-
Revaluation surplus	-	2,778,725	-	-	-	-	<b>2,778,725</b>	-
Impairment*	-	(87,764)	-	-	-	-	<b>(87,764)</b>	-
Transfers to Investment Property	-	-	-	-	-	-	-	(195,480)
Transfers to Non-current Assets held for sale	-	-	-	-	-	-	-	(60,356)
Transfers to intangible assets	-	-	-	(146)	-	-	<b>(146)</b>	-
Sub category transfers	(3,040)	82	9,615	(6,657)	-	-	-	-
Additions and improvements	75,742	54,245	184,379	176,129	54,865	366,940	<b>912,300</b>	483,396
Disposals during the year	(3,243)	(5)	(18,810)	(6,593)	(22,111)	-	<b>(50,762)</b>	(42,421)
Transfers from capital work-in-progress	61,009	1,739	33,878	40,208	-	(136,834)	-	-
<b>Cost/Valuation as at 31/12/2007</b>	<b>792,386</b>	<b>4,159,121</b>	<b>1,449,516</b>	<b>2,169,324</b>	<b>151,732</b>	<b>458,333</b>	<b>9,180,412</b>	5,776,480
<b>Accumulated depreciation as at 31/12/2006</b>	354,463	152,785	918,803	1,358,329	84,311	-	<b>2,868,691</b>	2,832,394
Transfers to Intangible assets	-	-	-	-	-	-	-	(300,531)
<b>Adjusted accumulated depreciation as at 31/12/2006</b>	354,463	152,785	918,803	1,358,329	84,311	-	<b>2,868,691</b>	2,531,863
Revaluation adjustment on accumulated depreciation	-	(148,421)	-	-	-	-	<b>(148,421)</b>	-
Transfers to Investment Property	-	-	-	-	-	-	-	(4,366)
Transfers to Non-current Assets held for sale	-	-	-	-	-	-	-	(53,800)
Sub category transfers	(150)	135	(21,551)	21,566	-	-	-	-
Charge for the year	64,616	29,933	115,482	192,474	18,465	-	<b>420,970</b>	430,211
Disposals during the year	(3,173)	(4)	(17,456)	(642)	(22,111)	-	<b>(43,386)</b>	(35,217)
<b>Accumulated depreciation as at 31/12/2007</b>	<b>415,756</b>	<b>34,428</b>	<b>995,278</b>	<b>1,571,727</b>	<b>80,665</b>	-	<b>3,097,854</b>	2,868,691
<b>Net book value as at 31/12/2007</b>	<b>376,630</b>	<b>4,124,693</b>	<b>454,238</b>	<b>597,597</b>	<b>71,067</b>	<b>458,333</b>	<b>6,082,558</b>	
Net book value as at 31/12/2006	307,455	1,407,735	321,651	608,054	34,667	228,227		2,907,789

**31 PROPERTY, PLANT & EQUIPMENT (Contd.)**

Group	Leasehold	Freehold	Computer	Equipment	Motor	Capital	<b>2007</b>	2006
	Buildings	Land and	Equipment	Furniture	Vehicles	Work-in		
	Note 31(c)	Buildings		and		Progress	<b>Total</b>	Total
	Rs.000	Rs.000	Rs.000	Fixtures	Rs.000	Rs.000	<b>Rs.000</b>	Rs.000
	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	<b>Rs.000</b>	Rs.000
<b>Cost/Valuation as at 31/12/2006</b>	<b>661,918</b>	<b>4,139,766</b>	<b>1,301,383</b>	<b>4,086,718</b>	<b>130,256</b>	<b>277,499</b>	<b>10,597,540</b>	<b>10,034,596</b>
Transfers to Intangible Assets	-	-	-	-	-	-	-	(650,935)
<b>Adjusted Cost/Valuation as at 31/12/2006</b>	<b>661,918</b>	<b>4,139,766</b>	<b>1,301,383</b>	<b>4,086,718</b>	<b>130,256</b>	<b>277,499</b>	<b>10,597,540</b>	<b>9,383,661</b>
Revaluation adjustment on accumulated depreciation	-	(256,935)	-	-	-	-	<b>(256,935)</b>	-
Revaluation surplus	-	5,545,548	-	-	-	-	<b>5,545,548</b>	-
Impairment*	-	(87,764)	-	-	-	-	<b>(87,764)</b>	-
Transfers to Investment Property	-	-	-	-	-	-	-	(242,474)
Transfers to Non-current Assets held for sale	-	-	-	-	-	-	-	(60,356)
Transfers to intangible assets	-	-	-	(146)	-	-	<b>(146)</b>	-
Sub category transfers	(3,040)	82	9,615	(6,657)	-	-	-	-
Additions and improvements	75,742	54,245	193,982	199,775	49,666	574,220	<b>1,147,630</b>	559,443
Disposals	(3,243)	(5)	(19,232)	(7,381)	(29,755)	-	<b>(59,616)</b>	(42,734)
Transfers from capital work-in-progress	61,009	1,739	33,878	40,208	-	(136,834)	-	-
<b>Cost/Valuation as at 31/12/2007</b>	<b>792,386</b>	<b>9,396,676</b>	<b>1,519,626</b>	<b>4,312,517</b>	<b>150,167</b>	<b>714,885</b>	<b>16,886,257</b>	<b>10,597,540</b>
<b>Accumulated Depreciation as at 31/12/2006</b>	<b>354,463</b>	<b>254,626</b>	<b>944,174</b>	<b>1,563,866</b>	<b>94,838</b>	-	<b>3,211,967</b>	<b>3,142,442</b>
Transfers to Intangible Assets	-	-	-	-	-	-	-	(311,532)
<b>Adjusted accumulated depreciation as at 31/12/2006</b>	<b>354,463</b>	<b>254,626</b>	<b>944,174</b>	<b>1,563,866</b>	<b>94,838</b>	-	<b>3,211,967</b>	<b>2,830,910</b>
Revaluation adjustment on accumulated depreciation	-	(260,599)	-	-	-	-	<b>(260,599)</b>	-
Transfers to Investment Property	-	-	-	-	-	-	-	(52,987)
Transfers to Non-current Assets held for sale	-	-	-	-	-	-	-	(53,800)
Sub category transfers	(150)	135	(21,551)	21,566	-	-	-	-
Charge for the year	64,616	138,597	125,140	200,361	20,167	-	<b>548,881</b>	523,343
Disposals during the year	(3,173)	(4)	(17,868)	(996)	(29,755)	-	<b>(51,796)</b>	(35,499)
<b>Accumulated Depreciation as at 31/12/2007</b>	<b>415,756</b>	<b>132,755</b>	<b>1,029,895</b>	<b>1,784,797</b>	<b>85,250</b>	-	<b>3,448,453</b>	<b>3,211,967</b>
<b>Net book value as at 31/12/2007</b>	<b>376,630</b>	<b>9,263,921</b>	<b>489,731</b>	<b>2,527,720</b>	<b>64,917</b>	<b>714,885</b>	<b>13,437,804</b>	-
Net book value as at 31/12/2006	307,455	3,885,140	357,209	2,522,852	35,418	277,499	-	7,385,573

**31 PROPERTY, PLANT & EQUIPMENT (Contd.)**

\*As set out in Note No.8.12.4, the Bank/Group has revalued its freehold land & buildings as at 01st 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. has been credited to the Revaluation Reserve Account in respect of Bank/Group respectively. An impairment loss of Rs. 87.76 Mn. has been recognised during the year in respect of Freehold land & buildings which was identified during the process of revaluation of such properties.

**31 (a) Computer Equipment - Bank**

	Additions Prior to 1.7.2000 Rs.000	Additions After 1.7.2000 Rs.000	<b>2007 Total Rs.000</b>	2006 Total Rs.000
Rate of depreciation	25%	16.67%		
Cost/valuation as at 01.01.2007	576,822	663,632	<b>1,240,454</b>	1,332,058
Additions and improvements	-	184,379	<b>184,379</b>	64,767
Transfers from capital work-in-progress	-	33,878	<b>33,878</b>	38,811
Sub category transfers	-	9,615	<b>9,615</b>	(181,619)
Transfers to Non-current Assets held for sale	-	-	-	(6,559)
Transfers to Intangible Assets	-	-	-	-
Disposals during the year	-	(18,810)	<b>(18,810)</b>	(7,004)
Cost/Valuation as at 31.12.2007	576,822	872,694	<b>1,449,516</b>	1,240,454

**31 (b) Freehold Land and Buildings - Bank**

	Buildings Sq.ft.	Extent (perches)	Cost/ Valuation of Land Rs.000	Cost/ Valuation of Buildings Rs.000	Total Value Rs.000	Accumulated Depreciation Rs.000	Net Book Value Rs.000
<b>Within Colombo City Limits</b>							
<b>Borella Branch</b> 53/1, D S Senanayake Mawatha, Borella.	9,750	28.00	98,000	52,000	150,000	1,368	148,632
<b>Gunasinghepura Pay Office &amp; Stores</b> 11, Mohandiram's Road, Colombo 12.	6,990	37.53	112,600	16,000	128,600	464	128,136
<b>Bambalapitiya Branch</b> 285, Galle Road, Colombo 4.	14,801	20.00	80,000	97,000	177,000	3,036	173,964
<b>City Office</b> 16, Janadhipathi Mawatha, Colombo 1. & 25, Chatham Street, Colombo 1.	42,270	84.00	252,000	68,809	320,809	2,259	318,550

**31 PROPERTY PLANT & EQUIPMENT (Contd.)****31 (b) Freehold Land and Buildings - Bank (Contd.)**

	Buildings Sq.ft.	Extent (perches)	Cost/ Valuation of Land Rs.000	Cost/ Valuation of Buildings Rs.000	Total Accumulated Value Depreciation Rs.000	Rs.000	Net Book Value Rs.000
<b>Within Colombo City Limits (Contd.)</b>							
<b>Centralised Operations Bldg.</b> 90, Vinayalankara Mawatha, Colombo 10.	10,250	249.00	996,000	35,875	1,031,875	908	1,030,967
<b>Main Branch</b> 10, R. A. De Mel Mawatha, Colombo 03.	49,500	40.00	72,000	101,335	173,335	3,153	170,182
<b>Pettah Extension Office</b> 149-151, Main Street, Colombo 11.	6,848	6.29	47,100	17,288	64,388	423	63,965
<b>Sea Street Branch</b> 60, Sea Street, Colombo 11.	9,000	6.93	48,500	23,474	71,974	614	71,360
<b>Wellawatte Branch</b> 102, Galle Road, Wellawatte.	17,560	36.05	140,000	50,000	190,000	1,350	188,650
<b>Grandpass Branch</b> 182, St. Joseph Street, Colombo 14.	9,440	24.00	36,000	23,141	59,141	622	58,519
<b>Pettah Branch</b> 88, Main Street, Colombo 11.	13,535	13.03	85,000	45,395	130,395	1,412	128,983
<b>Total freehold land and buildings within Colombo City Limits</b>			<b>1,967,200</b>	<b>530,317</b>	<b>2,497,517</b>	<b>15,609</b>	<b>2,481,908</b>
<b>Outside Colombo City Limits</b>							
<b>Akkaraipattu Branch</b> 1, Main Street, Akkaraipattu.	8,805	17.00	20,400	15,600	36,000	395	35,605
<b>Ambalangoda Branch</b> 94/1, New Road, Ambalangoda.	5,282	32.56	31,000	12,000	43,000	334	42,666
<b>Badulla Branch</b> 15 151/1, Udayaraja Mawatha, Badulla.	5,550	27.75	26,200	9,650	35,850	299	35,551

**31 PROPERTY PLANT & EQUIPMENT (Contd.)****31 (b) Freehold Land and Buildings - Bank (Contd.)**

	Buildings Sq.ft.	Extent (perches)	Cost/ Valuation of Land Rs.000	Cost/ Valuation of Buildings Rs.000	Total Accumulated Value Depreciation Rs.000	Rs.000	Net Book Value Rs.000
<b>Outside Colombo City Limits (Contd.)</b>							
<b>Boralesgamuwa Branch</b> 24, Maharagama Road, Boralesgamuwa.	5,500	30.34	33,375	15,125	48,500	407	48,093
<b>Dambulla Branch</b> 622, Anuradhapura Road, Dambulla.	6,862	94.50	42,525	15,466	57,991	350	57,641
<b>Galle Branch</b> 3, Wakwella Road, Galle.	7,271	13.80	41,000	22,371	63,371	545	62,826
<b>Gampola Branch</b> 12, Kandy Road, Gampola.	5,604	11.88	13,800	11,700	25,500	358	25,142
<b>Hatton Branch</b> 78, Dambulla Road, Hatton.	10,141	69.48	35,180	11,820	47,000	371	46,630
<b>Mount Bungalow</b> 7, Mount Road, Hatton.	5,088	160.00	16,000	6,000	22,000	188	21,812
<b>Jaffna Property</b> 181/5C, Ponnambalam Road, Jaffna.	Under Development	80.00	1,994	34	2,028	7	2,021
<b>Kandy Branch</b> 1, Dalada Veediya, Kandy.	29,196	57.65	432,375	16,974	449,349	512	448,837
<b>Kurunegala Branch/Car Park</b> 6, St. Anne's Street, Kurunegala.	9,600	36.25	32,374	32,291	64,665	725	63,940
<b>Nawalapitiya Branch</b> 92, Gampola Road, Nawalapitiya.	3,900	7.00	6,400	6,800	13,200	213	12,987
<b>Negombo Branch</b> 18, Rajapakse Broadway, Negombo.	5,440	8.88	11,100	15,954	27,054	456	26,598
<b>Nittambuwa Branch</b> 22, Kandy Road, Nittambuwa.	5,840	12.30	8,000	8,743	16,743	273	16,470

**31 PROPERTY PLANT & EQUIPMENT (Contd.)****31 (b) Freehold Land and Buildings - Bank (Contd.)**

	Buildings Sq.ft.	Extent (perches)	Cost/ Valuation of Land Rs.000	Cost/ Valuation of Buildings Rs.000	Total Value Rs.000	Accumulated Depreciation Rs.000	Net Book Value Rs.000
<b>Outside Colombo City Limits (Contd.)</b>							
<b>Nochchiyagama Branch</b> 10, Puttalam Road, Nochchiyagama.	9,890	40.00	10,000	13,075	23,075	408	22,667
<b>Wattala Branch</b> 270-270/1, Negombo Road, Wattala.	8,090	53.00	60,570	32,782	93,352	937	92,415
<b>Nugegoda Branch</b> 181, High Level Road, Nugegoda.	11,560	19.50	58,500	71,500	130,000	2,238	127,762
<b>Nuwara Eliya Branch</b> <b>/Bungalow</b> 42, Queen Elizabeth Drive, Nuwara Eliya.	13,507	149.03	41,700	23,590	65,290	634	64,656
<b>Trincomalee Branch</b> 59, Ahambaram Road, Trincomalee.	6,802	20.51	1,451	16,313	17,764	3,810	13,954
<b>Anuradhapura Branch</b> 30, Maithripala Senanayake Mawatha, Anuradhapura.	9,980	25.59	30,700	12,725	43,425	390	43,035
<b>Maskeliya Branch</b> 9, New Town, Maskeliya.	3,397	20.32	4,100	5,400	9,500	169	9,331
<b>Mannar Branch</b> 68, Main Street, Mannar.	4,200	23.00	619	5,374	5,993	1,087	4,906

**31 PROPERTY PLANT & EQUIPMENT (Contd.)****31 (b) Freehold Land and Buildings - Bank (Contd.)**

	Buildings Sq.ft.	Extent (perches)	Cost/ Valuation of Land Rs.000	Cost/ Valuation of Buildings Rs.000	Total Value Rs.000	Accumulated Depreciation Rs.000	Net Book Value Rs.000
<b>Outside Colombo City Limits (Contd.)</b>							
<b>Ratnapura Branch</b> 21 & 23, Senanayake Mawatha, Ratnapura.	3,805	16.40	19,680	4,688	24,368	141	24,227
<b>Ja - Ela Branch</b> 73, Old Negombo Road, Ja - Ela.	4,918	19.00	11,400	12,176	23,576	356	23,220
<b>Matale Branch</b> 660, Trincomalee Road, Matale.	8,493	22.80	13,700	18,300	32,000	573	31,427
<b>Kuliyapitiya Branch/Additional Property</b> 225, Main Street, Kuliyapitiya.	4,506	31.80	15,150	10,890	26,040	327	25,713
<b>Mount Lavinia Branch</b> 100, Galle Road, Mount Lavinia.	12,674	22.66	34,000	31,750	65,750	994	64,756
<b>Marawila Branch</b> 534, Chilaw Road, Marawila.	7,352	43.80	19,545	14,688	34,233	389	33,844
<b>Matara Branch</b> 29, Anagarika Dharmapala Mw, Matara.	9,850	26.00	22,000	33,269	55,269	309	54,960
<b>Kegalle Property</b> Main Street, Kegalle.	Bare Land	48.70	15,600	-	15,600	-	15,600
<b>Kahawatte Branch</b> 772A, Main Street, Kahawatta.	8,331	16.14	12,100	32,019	44,118	624	43,494
<b>Total freehold land and buildings outside Colombo City Limits</b>			<b>1,122,538</b>	<b>539,067</b>	<b>1,661,604</b>	<b>18,819</b>	<b>1,642,785</b>
<b>Total freehold land and buildings as at 31st December 2007</b>			<b>3,089,738</b>	<b>1,069,384</b>	<b>4,159,121</b>	<b>34,428</b>	<b>4,124,693</b>

### 31 PROPERTY, PLANT & EQUIPMENT (Contd.)

#### 31 (c) Leasehold Buildings

As at 31st December	Bank 2007			Group 2007			Bank 2006	Group 2006
	Cost of Buildings	Accumulated Depreciation	Net Book Value	Cost of Buildings	Accumulated Depreciation	Net Book Value	Net Book Value	Net Book Value
	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000
Up to 1 year	54,904	50,088	4,816	54,904	50,088	4,816	4,649	4,649
01 - 05 years	216,695	155,736	60,959	216,695	155,736	60,959	18,352	18,352
05 - 10 years	143,283	62,910	80,373	143,283	62,910	80,373	42,056	42,056
10 - 15 years	7,515	1,084	6,431	7,515	1,084	6,431	19,492	19,492
15 - 20 years	4,697	1,564	3,133	4,697	1,564	3,133	1,809	1,809
Above 20 years	365,292	144,374	220,918	365,292	144,374	220,918	221,097	221,097
	<b>792,386</b>	<b>415,756</b>	<b>376,630</b>	<b>792,386</b>	<b>415,756</b>	<b>376,630</b>	307,455	307,455

#### 31 (d) Freehold Land and Buildings - Subsidiaries

As at 31st December	2007					2006
	Buildings Sq.ft.	Cost of Buildings Rs.000	Total Value Rs.000	Accumulated Depreciation Rs.000	Net Book Value Rs.000	Net Book Value Rs.000
<b>Smart Building</b> 21, 21A, 23, 25, Janadhipathi Mawatha, Colombo 1.	42,765	128,115	128,115	25,478	102,637	105,840
<b>Sithma Building</b> 479, T. B. Jayah Mawatha, Colombo 10.	499,554	5,133,558	5,133,558	53,525	5,129,790	2,366,735
		<b>5,261,673</b>	<b>5,261,673</b>	<b>79,003</b>	<b>5,232,427</b>	2,472,575

#### 31 (e) Fully depreciated property

The initial cost of fully depreciated plant, machinery and equipment as at 31st December 2007, which are still in use as at Balance Sheet date.

	Rs.000
Motor vehicles	51,371
Leasehold Building	155,831
Computer equipment	697,605
Equipment, furniture and fixtures	620,593

#### 31 (f) Temporarily idle property, plant & equipment

The carrying amount of the temporarily idle property, plant & equipment as at 31st December 2007 is Rs. 179.9 Mn.

	Rs.000
Computer equipment	178,621
Equipment, furniture and fixtures	1,282

#### 31 (g) Retired from active use

The carrying amount of property, plant & equipment which are retired from active use and not classified as held for sale as at 31st December 2007 is Rs. 1.6 Mn.

	Rs.000
Computer equipment	242
Equipment, furniture and fixtures	1,393

**32 INTANGIBLE ASSETS**

	Bank		Group	
	2007 Rs.000	2006 Rs.000	2007 Rs.000	2006 Rs.000
As at 31st December				
Cost as at 1st January	<b>632,622</b>	611,422	<b>677,651</b>	650,935
Additions and improvements during the year	<b>16,813</b>	21,200	<b>22,778</b>	26,716
Transfer from property plant & equipment	<b>146</b>	-	<b>146</b>	-
<b>Cost as at 31st December</b>	<b>649,581</b>	632,622	<b>700,575</b>	677,651
Accumulated amortisation as at 1st January	<b>400,647</b>	300,531	<b>417,911</b>	311,532
Amortisation for the year	<b>65,070</b>	100,116	<b>72,254</b>	106,379
<b>Accumulated amortisation as at 31st December</b>	<b>465,717</b>	400,647	<b>490,165</b>	417,911
<b>Net book value as at 31st December</b>	<b>183,864</b>	231,975	<b>210,410</b>	259,740

As stated in Note No.8.10.1(b), all computer software costs incurred by the Bank which are not integrally related to associated hardware have been classified as Intangible Assets.

**33 OTHER ASSETS**

	Bank		Group	
	2007 Rs.000	2006 Rs.000	2007 Rs.000	2006 Rs.000
As at 31st December				
Deposits and prepayments	<b>3,478,854</b>	2,642,806	<b>2,963,406</b>	2,642,806
Items in transit	<b>490,266</b>	403,005	<b>532,760</b>	403,005
Claims receivable	<b>67,961</b>	393,607	<b>100,744</b>	393,607
VAT recoverable	<b>583,454</b>	617,842	<b>585,217</b>	620,923
Inventory	<b>154,683</b>	134,164	<b>180,431</b>	134,164
Other debtors	<b>1,767,115</b>	865,414	<b>2,247,515</b>	833,800
	<b>6,542,333</b>	5,056,838	<b>6,610,073</b>	5,028,305

**34 DEPOSITS FROM CUSTOMERS**

<b>Local Currency Deposits</b>				
Current Account Deposits	<b>12,482,701</b>	12,635,473	<b>12,454,599</b>	12,588,089
Savings deposits	<b>53,565,590</b>	50,697,086	<b>53,563,068</b>	50,697,076
Time Deposits	<b>66,836,282</b>	48,869,303	<b>66,834,032</b>	48,836,363
Certificates of Deposit	<b>4,021,045</b>	3,348,716	<b>4,021,045</b>	3,348,716
	<b>136,905,618</b>	115,550,578	<b>136,872,744</b>	115,470,244
<b>Foreign Currency Deposits</b>				
Current Account Deposits	<b>1,348,574</b>	1,188,634	<b>1,348,573</b>	1,188,634
Savings Deposits	<b>15,784,655</b>	13,600,463	<b>15,773,454</b>	13,586,578
Time Deposits	<b>21,620,726</b>	17,217,780	<b>21,571,847</b>	17,217,780
	<b>38,753,955</b>	32,006,877	<b>38,693,874</b>	31,992,992
Total deposits	<b>175,659,573</b>	147,557,455	<b>175,566,618</b>	147,463,236
Deposits from Non-Bank Customers	<b>174,322,238</b>	147,139,233	<b>174,322,238</b>	147,045,014
Deposits from Banks	<b>591</b>	24,354	<b>591</b>	24,354
Deposits from Finance Companies	<b>1,336,744</b>	393,868	<b>1,243,789</b>	393,868
	<b>175,659,573</b>	147,557,455	<b>175,566,618</b>	147,463,236

	Bank		Group	
	2007 Rs.000	2006 Rs.000	2007 Rs.000	2006 Rs.000
As at 31st December				
<b>35 DIVIDENDS PAYABLE</b>				
Balance as at 1st January	<b>38,103</b>	50,291	<b>38,103</b>	50,291
Dividends declared during the year	<b>294,412</b>	529,941	<b>294,412</b>	529,941
Dividends paid	<b>(302,194)</b>	(542,129)	<b>(302,194)</b>	(542,129)
Balance as at 31st December	<b>30,321</b>	38,103	<b>30,321</b>	38,103

**35 (a) Proposed first & final dividend**

Board of Directors have recommended the payment of a first & final dividend of Rs. 3.50 per share for the year ended 31st December 2007 (2006 interim - Rs. 2.50 per share, final - Rs. 2.50 per share), which is to be approved at the Annual General Meeting to be held on 28th March 2008. In accordance with Sri Lanka Accounting Standard No. 12-(Revised), "Events After the Balance Sheet Date", this proposed final dividend has not been recognised as a liability as at 31st December 2007. Under the Inland Revenue Amendment Act No.10 of 2002, a withholding tax of 10% has been imposed on dividends declared from 1st April 2004.

**35 (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 has satisfied the solvency test in accordance with the section 57, prior to recommending the first and final dividend. A statement of solvency completed and duly signed by the directors on 15th February 2008 has been audited by M/s KPMG Ford Rhodes Thornton & Co.

	Bank		Group	
	2007 Rs.000	2006 Rs.000	2007 Rs.000	2006 Rs.000
As at 31st December				
<b>36 BORROWINGS</b>				
Call and time deposits from banks	<b>2,913,002</b>	4,584,620	<b>2,913,002</b>	4,584,620
Refinance borrowings	<b>5,749,624</b>	3,581,526	<b>5,749,624</b>	3,581,526
Borrowings from foreign banks	<b>1,212,900</b>	1,300,548	<b>1,212,900</b>	1,300,548
Borrowings from local banks	<b>22,205</b>	2,000,000	<b>28,925</b>	2,000,000
	<b>9,897,731</b>	11,466,694	<b>9,904,451</b>	11,466,694

**37 LONG TERM INSURANCE FUND**

The Long Term Insurance Fund balance represents the Life Fund of the Subsidiary HNB Assurance PLC., which is carrying out life and non-life insurance business. This balance represents the amounts attributable to life policy holders included in the Group's net assets. The valuation of the Long Term Insurance Fund as at 31st December 2007 was made by Mr M Poopalanathan, AIA, of M/s Actuarial and Management Consultants (Pvt) Ltd. for and on behalf of HNB Assurance PLC. The life fund stands at Rs. 880.67 Mn. as at 31st December 2007 (2006 - Rs 507.72 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 2008.

**38 NON-LIFE INSURANCE RESERVES**

Non Life Insurance Reserves 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:

**Group**

As at 31st December	<b>2007</b> Rs.000	<b>2007</b> Rs.000	2006 Rs.000	2006 Rs.000
Unearned premium				
Gross		<b>357,344</b>		327,174
Reinsurance		<b>(99,230)</b>		(101,057)
Net		<b>258,114</b>		226,117
Deferred acquisition expenses		<b>(4,137)</b>		(393)
Unexpired Risk Reserve		<b>6,135</b>		4,489
		<b>260,112</b>		230,213
Claims outstanding - Gross	<b>70,022</b>		82,207	
Claims incurred but not reported - Gross	<b>10,428</b>	<b>80,450</b>	7,118	89,325
Total		<b>340,562</b>		319,538

**39 SUBORDINATED DEBENTURES**

As at 31st December	<b>Bank</b>		<b>Group</b>	
	<b>2007</b> Rs.000	2006 Rs.000	<b>2007</b> Rs.000	2006 Rs.000
Balance as at 1st January	<b>5,120,000</b>	4,000,000	<b>7,083,450</b>	5,976,791
Debentures issued	<b>1,200,000</b>	1,120,000	<b>1,200,000</b>	1,120,000
Debentures held by Group Companies	-	-	-	(13,341)
Debentures redeemed*	<b>(1,759,148)</b>	-	<b>(2,757,598)</b>	-
Balance as at 31st December	<b>4,560,852</b>	5,120,000	<b>5,525,852</b>	7,083,450

**39(a)** Consists of twenty million unsecured, subordinated, redeemable debentures of Rs. 100/- each. The six types of debentures have fixed or floating interest rate options as follows,

<b>Redemption period</b>	<b>7 Years</b> <b>p.a</b>	<b>10 Years</b> <b>p.a.</b>
Fixed	14.00%	14.20%
Effective Annual Yield	14.49%	14.70%
Floating	TB+1.10%	TB+1.25%

The floating rate is based on the six month treasury bill rate with a cap of 17% p.a. and a floor of 12% p.a. Based on the duration, the debentures are redeemable on September 10th 2009 and September 10th 2012. These debentures are listed on the Colombo Stock Exchange.

\*The following debenture instruments were redeemed during the year on 10th September 2007 with the reinvestment option.

	<b>5 year</b> <b>p.a.</b>
Fixed	13.75%
Effective Annual Yield	14.22%
Floating	TB+1.00%

**39 SUBORDINATED DEBENTURES (Contd.)**

**39(b)** Consist of twenty million unsecured, subordinated, redeemable debentures of Rs. 100/- each. The six types of debentures have fixed or floating interest rate options as follows:

Redemption Period	5 Year
	p.a.
Fixed	10%
Effective annual yield	10.25%
Floating	TB + 2.00%

The debentures are redeemable on July 23rd 2008 and are listed on the Colombo Stock Exchange.

**39(c)** Consist of eleven point two million unsecured, subordinated, redeemable debentures of Rs.100 /- each. The five types of debentures have fixed or floating interest rate options as follows:

Redemption Period	6 Year p.a.	7 Year p.a.	8 Year p.a.	15 Year p.a.	18 Year p.a.
Fixed				11%	11.25%
Effective annual yield				11%	11%
Floating	TB + 2.25%	TB + 2.25%	TB + 2.25%		

The above floating rate is based on the six month treasury bill rate with a cap of 16% p.a. and a floor of 8 % p.a. Based on the duration, the debentures are redeemable on 31st March 2012, 31st March 2013, 31st March 2014, 31st March 2021 and 31st March 2024.

**39(d)** Consist of twelve million unsecured, subordinated, redeemable debentures of Rs.100/- each. The two types of debentures are fixed rated.

	10 years p.a.	15 years p.a.
Fixed	16%	16.25%

Based on the duration the debentures are redeemable on July 2017, July 2022. The debentures are listed on the Colombo Stock Exchange.

**40 DEFERRED TAX LIABILITY**

As at 31st December	Bank		Group	
	2007 Rs.000	2006 Rs.000	2007 Rs.000	2006 Rs.000
Deferred tax liability [Note 40(a)]	<b>878,564</b>	819,510	<b>880,489</b>	823,429
Deferred tax asset [Note 40(b)]	<b>(272,871)</b>	(505,754)	<b>(272,871)</b>	(505,754)
	<b>605,693</b>	313,756	<b>607,618</b>	317,675

**40 DEFERRED TAX LIABILITY (Contd.)****40 (a) Deferred Tax Liability**

	<b>Bank</b>				<b>Group</b>			
	<b>2007</b>		2006		<b>2007</b>		2006	
	<b>Temporary Difference Rs.000</b>	<b>Tax Effect Rs.000</b>	Temporary Difference Rs.000	Tax Effect Rs.000	<b>Temporary Difference Rs.000</b>	<b>Tax Effect Rs.000</b>	Temporary Difference Rs.000	Tax Effect Rs.000
Balance as at 1st January	<b>2,341,459</b>	<b>819,510</b>	1,045,853	313,756	<b>2,353,876</b>	<b>823,429</b>	1,054,390	316,317
Originating/(Reversal) during the year	<b>(518,949)</b>	<b>(181,632)</b>	551,809	193,133	<b>(524,646)</b>	<b>(183,625)</b>	555,689	194,491
Deferred tax liability attributable to revaluation surplus charged to equity	<b>50,134</b>	<b>17,547</b>	189,648	66,377	<b>50,134</b>	<b>17,547</b>	189,648	66,377
Impact on rate increase	-	-	-	89,482	-	-	-	89,482
Opening balance adjustment as per transitional provision	<b>637,540</b>	<b>223,139</b>	743,797	223,139	<b>637,540</b>	<b>223,139</b>	743,797	223,139
Deferred tax asset recognised in excess of deferred tax (net) charged to income statement in 2006	-	-	(189,648)	(66,377)	-	-	(189,648)	(66,377)
	<b>2,510,184</b>	<b>878,564</b>	2,341,459	819,510	<b>2,516,904</b>	<b>880,489</b>	2,353,876	823,429

**Deferred Tax liability charged directly to Equity**

According to Sri Lanka Accounting Standard 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 & equipment of Rs. 17,547 Mn. has been charged directly to Revaluation Reserve in the Statement of Changes in Equity.

Deferred tax liability has not been recognised for Sithma Development (Pvt) Ltd., in view of the tax holiday enjoyed by the company. The details have been given in note No. 18 (f).

**40 DEFERRED TAX LIABILITY (Contd.)****40 (b) Deferred Tax asset**

	Bank				Group			
	2007		2006		2007		2006	
	Temporary Difference Rs.000	Tax Effect Rs.000	Temporary Difference Rs.000	Tax Effect Rs.000	Temporary Difference Rs.000	Tax Effect Rs.000	Temporary Difference Rs.000	Tax Effect Rs.000
Balance as at 1st January	<b>1,445,011</b>	<b>505,754</b>	-	-	<b>1,445,011</b>	<b>505,754</b>	-	-
Opening balance adjustment as per transitional provision, - Amount recognised in the year [Note 40(c)]	<b>871,634</b>	<b>305,072</b>	871,634	305,072	<b>871,634</b>	<b>305,072</b>	871,634	305,072
Deferred tax asset recognised/ (reversed) on general provisions	<b>(522,077)</b>	<b>(182,727)</b>	573,377	200,682	<b>(522,077)</b>	<b>(182,727)</b>	573,377	200,682
Reversal of deferred tax asset during the year	<b>(1,014,937)</b>	<b>(355,228)</b>	-	-	<b>(1,014,937)</b>	<b>(355,228)</b>	-	-
	<b>779,631</b>	<b>272,871</b>	1,455,011	505,754	<b>779,631</b>	<b>272,871</b>	1,455,011	505,754

**40(b) (i) Deductible temporary difference - General provision**

Recognition of deferred tax asset arising from general provisions at balance sheet date was limited to 6% of the temporary difference. In management's view the Bank's NPA ratio of 6% 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 general provision.

**40(b) (ii) Unused tax losses**

The deferred tax asset was recognised in respect of carried forward tax loss amounting to Rs 728,332 Mn. (2006 871,634 Mn.) which do not expire under current tax law, since it is probable that future taxable profit will be available, against which the unused tax losses can be utilised by the Bank.

**40 (c) Application of transitional provision**

As per the transitional provision in Sri Lanka Accounting Standard 14 - "Income Taxes", (SLAS 14), the Bank has made an irrevocable choice to recognise the opening balance increase on a straight line basis over two years from 1st January 2006, the date of adoption of this standard. Accordingly the opening balance increase has been fully accounted for as at 31st December 2007.

**i) The amount recognised in the current year**

	Bank		Group	
	2007 Rs.000	2006 Rs.000	2007 Rs.000	2006 Rs.000
Deferred tax asset	<b>305,072</b>	305,072	<b>305,072</b>	305,072
Deferred tax liability	<b>(223,139)</b>	(223,139)	<b>(223,139)</b>	(223,139)
Income tax expense [Note 18(b)]	<b>81,933</b>	81,933	<b>81,933</b>	81,933
The net amount of increase to be recognised next year	-	81,933	-	81,933

**40 (d) Unrecognised Deferred Tax asset**

A deferred tax asset of Rs. 527 Mn. arising from the balance carry forward unutilised tax losses of Rs. 1,505 Mn. has not been recognised as at 31st December 2006.

Recognition of the total unutilised tax losses would have resulted in an additional credit of Rs. 527 Mn., to the Income Statement, which would have caused wide fluctuation in the 2006 Income Statement, 2006 being the year of adoption of SLAS 14 as these tax losses were expected to be fully utilised in the immediate future. Accordingly such tax losses were fully utilised in 2007 and there are no unrecognised deferred tax asset as at 31st December 2007.

**41 OTHER LIABILITIES**

	Bank		Group	
	2007 Rs.000	2006 Rs.000	2007 Rs.000	2006 Rs.000
As at 31st December				
Cheques sent on clearing	<b>2,723,138</b>	1,216,711	<b>2,723,138</b>	1,216,711
Accrued expenditure and interest	<b>7,526,637</b>	4,613,891	<b>7,650,078</b>	4,613,340
Claims payable	<b>70,585</b>	175,939	<b>70,585</b>	175,939
Margins	<b>1,359,923</b>	1,463,057	<b>1,359,923</b>	1,463,057
Pension fund	<b>1,683,510</b>	1,235,693	<b>1,684,033</b>	1,235,873
Widows'/widowers' & orphans' pension fund (WW&OP)	<b>288,528</b>	228,862	<b>288,528</b>	228,862
Employees Provident Fund (EPF)	<b>135,229</b>	106,904	<b>135,492</b>	106,904
Lease creditors	<b>217,874</b>	216,382	<b>219,297</b>	218,191
Refundable deposits & advances	-	-	<b>61,601</b>	6,052
Other creditors	<b>953,685</b>	698,595	<b>1,278,176</b>	1,205,844
	<b>14,959,109</b>	9,956,034	<b>15,470,851</b>	10,470,773

## 42 Employee Retirement Benefits

### 42(a) Defined Benefit Plans

#### 42(a) i Pension Fund

An actuarial valuation of the pension fund was carried out as at 31st December 2007 by M/s 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 benchmark method recommended by the Sri Lanka Accounting Standard No. 16 "Retirement Benefit Cost".

The principal financial assumptions used in the valuation are as follows:

- Long term rate of interest (Gross) 15% p.a.
- Salary increases (long term) 15% p.a.
- Increase in Cost of Living Allowance (long term) 15% p.a.

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 results of the actuarial valuation indicate that the actuarial present value of the promised retirement benefit is Rs. 5,275.07 Mn. and that the fair value of the fund assets is Rs. 3,857.7 Mn resulting in a past service deficit of Rs. 1,417.37 Mn. (2006 - 842 Mn.) in the Pension Fund due to the changes in actuarial assumptions that took place since the previous actuarial valuation as at 31st December 2006.

The actuary recommended the amortisation of the past service deficit by regular contributions over the full working lifetime of the current employees by incorporating it into the ongoing contribution rate. The fund is solvent on a discontinuance basis

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 amount recognised as an expense for the current year is Rs. 451.8 Mn. (2006 – 399.2 Mn.). The assets of the fund, which are independently administered by the Trustees as per the provision of the Trust Deed held separately from those of the Bank.

No additional provision has been made in the accounts of the Bank for gratuities to employees who complete five or more years of service payable under the payment of Gratuity Act No. 120 of 1983 as the Bank contributes for all permanent employees to its own non-contributory pension scheme, which is in force.

#### 42 (a)ii 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. 125.91 Mn. and that the fair value of the fund assets is Rs. 287.03 Mn. resulting in a past service surplus of Rs. 161.12 Mn. (2006 - deficit of 78 Mn.) in the Widows, Widowers and Orphans Pension Scheme as at 31st December 2007.

No contribution is made by the Bank and the members contribution during the period amounted to Rs. 26.67 Mn.

### 42 (b) Defined Contribution Plans

#### 42 (b) (i) Employees' Provident Fund

The contribution made by the Bank for the Employees' Provident Fund in 2007 amounts to Rs. 233.93 Mn. while the Group contribution amounts to Rs. 246.7 Mn.

#### 42 (b) (ii) Employees' Trust Fund

The contribution made by the Bank for the Employees' Trust fund in 2007 amounts to Rs. 59.03 Mn. while the Group contribution amounts to Rs. 62.2 Mn.

#### 42 (c) Employee Share Option Plan

The amount released to the employees who left the service in 2007 is Rs. 17.75 Mn.

#### 43 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 reclassified as stated capital. The comparative information has also been reclassified accordingly.

As at 31st December	2007		2006	
	Rs.000	Rs.000	Rs.000	Rs.000
<b>VOTING ORDINARY SHARES</b>				
As at 1st January				
94,664,700 (2006 - 94.7 Mn.) voting ordinary shares	<b>946,647</b>		946,647	
Bonus issue on 29th March 2007				
94,664,700 voting ordinary shares	<b>946,647</b>		-	-
As at 31st December				
189,329,400 voting ordinary shares		<b>1,893,294</b>		946,647
<b>NON-VOTING ORDINARY SHARES</b>				
As at 1st January				
23,100,000 non-voting ordinary shares	<b>231,000</b>		231,000	
Bonus issue 29th March 2007				
23,100,000 non-voting ordinary shares	<b>231,000</b>		-	-
As at 31st December				
46,200,000 non-voting ordinary shares		<b>462,000</b>		231,000
		<b>2,355,294</b>		1,177,647
<b>SHARE PREMIUM</b>	<b>2,704,096</b>			2,704,096
<b>STATED CAPITAL AS AT 31ST DECEMBER</b>	<b>5,059,390</b>			3,881,743

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.

#### 44 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

##### 44 (a) Capital commitments

Capital expenditure approved by the Board of Directors for which provision has not been made in the accounts amount to approximately Rs. 1,078 Mn.

As at 31st December	Bank		Group	
	2007 Rs.000	2006 Rs.000	2007 Rs.000	2006 Rs.000
Approved and contracted for	<b>1,016,493</b>	225,527	<b>1,021,102</b>	225,527
Approved and not contracted for	<b>61,023</b>	-	<b>61,023</b>	-
	<b>1,077,516</b>	225,527	<b>1,082,125</b>	225,527

**44 COMMITMENTS AND CONTINGENCIES - GROUP AND BANK (Contd.)****44 (b) Future monthly commitments on operating leases - Bank**

As at 31st December

	<b>2007</b>	2006
	<b>Rs.000</b>	Rs.000
1 - 5 years	<b>8,030</b>	6,971
6 - 10 years	<b>2,729</b>	1,578
11 - 15 years	<b>285</b>	859
16 - 20 years	<b>143</b>	
	<b>11,187</b>	9,408

**44 (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. 32.388 Mn. (2006 - Rs. 23.894 Mn).

**44 (d) Contingent Liabilities**

As at 31st December

	<b>2007</b>	2006
	<b>Rs.000</b>	Rs.000
Acceptances	<b>4,272,048</b>	3,626,830
Documentary credits	<b>12,145,882</b>	7,408,853
Guarantees	<b>20,242,394</b>	16,485,243
Bills for collection	<b>7,342,126</b>	7,198,400
Interest rate swap	<b>547</b>	499
	<b>44,002,997</b>	34,719,825
Forward Exchange Contracts	<b>13,960,577</b>	10,065,139
Total Contingencies Group and Bank	<b>57,963,574</b>	44,784,964

**44 (e) Litigation against the Bank**

1. HC (Civil) Case No. 132/2001 (i), a depositor's claim for damages against Habib Bank AG Zurich Sri Lanka Branch (HBZ) for setting off a customer liability with a deposit - the Bank substituted with acquisition of HBZ business.
2. 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.
3. Labour Tribunal Cases Nose. 13/42/98, 03/148/99, 18022, 08/2114/2002, 08/2115/2002, 8/2176/2002, 23/7957/2002, 26/02/2004, 26/122/2004, 26/06/2005, 9/11/2005, 21/Addl./489/05, 3/149/2005, 27/1725/2007, 126/2007, 83/2007, 13/53/2007 and LT Appeal Cases Nose. HCA/74/2005 and HCA/224/2005

Based on the above information and current status of the above cases, 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 which is not disclosed above which would have a material impact on the financial position of the Bank.

#### 44 COMMITMENTS AND CONTINGENCIES - GROUP AND BANK (Contd.)

##### 44 (f) Tax assessments against the Bank

- (i) VAT on financial services for 2003 and 2004, amounting to Rs. 247 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 against which, the Bank has appealed to the Board of Review.
- (ii) VAT for the year 2002 taxes amounting to Rs. 111.9 Mn. on Assessment Nose. 8340174, 8340175, 8340176, 8340177 and 8340178 against which the Bank has duly appealed.
- (iii) VAT for the year 2003, taxes amounting to Rs. 324.4 Mn. on Assessment Nose. 8290566, 8290567, 8290568, 8290569, 8290570, 8290571, 8290572, 8290573, 8290574, 8290575, 8290576, 8290577 against which, the Bank has duly appealed.
- (iv) VAT for the year 2004, taxes amounting to Rs. 74.6 Mn. on Assessment Nose. 8325523, 8325524, 8325525, 8325526, 8325527, 8325528, 8325533 and 8325534 against which the Bank has duly appealed.
- (v) VAT for the year 2005, taxes amounting to Rs. 142.9 Mn. on Assessment Nose. 8334997, 8334998, 8334999, 8335000, 8335001, 8335002, 8335003, 8335006, 8335007 and 8335008 against which the Bank has duly appealed.
- (vi) VAT for the year 2006, taxes amounting to Rs. 36.2 Mn. on Assessment Nose. 8341405, 8341406, 8341407 against which the Bank has duly appealed.
- (vii) PAYE Taxes amounting to Rs. 407 Mn. on Assessment Nose. 8018210, 8202714 & 8364152 for the years 2003, 2004 & 2005 respectively, against which the bank has duly appealed.

The Bank is of the view that the above assessments will not have any material impact on the financial statements.

#### 45 RELATED PARTY TRANSACTIONS

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 "Related Party Disclosures (revised 2005)", 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.

##### 45 (a) Transactions with/between Subsidiaries

##### 45 (a)i Sithma Development (Pvt) Ltd.

Sithma Development (Pvt) Ltd. ("Sithma"), is a wholly owned subsidiary of Hatton National Bank PLC. (HNB). The details of the overdraft facility with HNB is as follows:

Type of Facility	Rate of Interest	Limit Rs.000	Outstanding as at 31/12/07 Rs.000	Security	Review
Overdraft	2% above the one year *WATB. to be reviewed every 6 months.	800,000	548,791	Registered primary floating mortgage for Rs. 1,800 Mn. over land and building at No. 479, T B Jayah Mw., Colombo 10.	30th June 2008
Term Loan	1.5% above the 6 month treasury bill rate (gross). To be reviewed every 6 months	2,000,000	1,000,000	A primary Mortgage bond over immovable property at No 479 T B Jayah Mw., Colombo 10. (standing concurrent to existing primary concurrent mortgage bonds)	14th June 2008
Letter of Guarantee	Commission	9,000	9,000	Cash margin of Rs. 9 Mn.	Expires on 12th March 2008

\*WATB - Weighted Average Treasury Bill Rate

**45 RELATED PARTY TRANSACTIONS (Contd.)****45 (a) Transactions with/between Subsidiaries (Contd.)****45 (a)i Sithma Development (Pvt) Ltd. (Contd.)**

A summary of transactions of Sithma with HNB and other group companies is given below:

	HNB SECURITIES Rs.000	HNB STOCKBROKERS Rs.000	HNB ASSURANCE Rs.000	HNB Rs.000
Rent income received	6,537	7,762		518,349
Rent advance received (as at 31.12.2007)	953	1,133		79,233
Refundable deposit received	3,000	3,000		500,000
Consultancy fee received				1,905
Insurance premium paid			2,940	
Overdraft Interest paid				79,993
Term Loan Interest paid				11,550
Ground rent paid				3,753

**45(a)ii HNB Securities Ltd.**

HNB Securities Ltd.("Securities"), is a fully owned subsidiary of Hatton National Bank PLC.

Securities maintains a current account with HNB and the balance as at 31.12.2007 amounts to Rs. 10.3 Mn. (2006-Rs. 4.6 Mn.).

A summary of transactions of Securities with HNB and other group companies are given below:

	SITHMA Rs.000	HNB STOCKBROKERS Rs.000	HNB ASSURANCE Rs.000	HNB Rs.000
Interest received				10,443
Insurance premium paid			200	
Interest paid			19,905	197
Rent paid	6,537			
Rent advance paid (as at 31.12.2007)	953			
Refundable deposit paid	3,000			
Commission paid				272

**45(a)iii HNB Assurance PLC**

HNB Assurance PLC ("Assurance"), is a subsidiary of Hatton National Bank PLC

Assurance held deposits with the Bank amounting to Rs 77.2 Mn. (2006 - Rs. 63 Mn.) as at 31.12.2007. Further company held debentures of the Bank amounting to Rs 35 Mn. (2006 - Rs.36.6 Mn.)

A summary of transactions of Assurance with HNB and other group companies are given below:

	SITHMA Rs.000	HNB STOCKBROKERS Rs.000	HNB ASSURANCE Rs.000	HNB Rs.000
Premium received	2,940	549	200	17,626
Interest received			19,905	8,385
Interest paid				190
Rent paid				15,077
Commission paid				47,178
Dividend paid				13,547

**45 RELATED PARTY TRANSACTIONS (Contd.)****45 (a) Transactions with/between Subsidiaries (Contd.)****45(a)iv HNB Stockbrokers (Pvt) Ltd.**

HNB Stockbrokers (Pvt) Ltd. ("Stockbrokers"), is a wholly owned subsidiary of Hatton National Bank PLC.

Stockbrokers held deposits with the Bank amounting to Rs. 10.1 Mn. (2006 - Rs. 18.7 Mn.) as at 31.12.2007.

A summary of transactions of Stockbrokers with HNB and other group companies are given below:

	SITHMA Rs.000	HNB STOCKBROKERS Rs.000	HNB ASSURANCE Rs.000	HNB Rs.000
Interest received				360
Insurance Premium Paid		549		
Interest paid				65
Rent paid	7,762			
Rent advance paid	1,133			
Refundable Deposits paid	3,000			
Commission Received				2,459

Mr R T Wijetilleke, who is the Chairman of the Bank is also the Chairman of the above four subsidiary companies.

Mr R Theagarajah, a Director of the Bank, is also a Director of the four subsidiary companies mentioned above.

Mr Yeo Took Keat alternate to Mr D R Ghazalli, Director of the Bank is also a Director of HNB Assurance PLC.

**45 (b) Transactions with Associates****Lanka Ventures PLC**

Lanka Ventures PLC has invested Rs. 23.5 Mn. (2006 - Rs. 23.5 Mn) in quoted debentures of HNB and has term deposits of Rs. 51.5 Mn. (2006 - Rs. 60 Mn) placed with the Bank as at 31st December 2006, in respect of which interest amounting to Rs. 7.63 Mn. has been paid by the Bank for the financial year 2007.

Lanka Ventures PLC has invested in Treasury Bills and Repurchase transactions through HNB Securities totaling Rs. 48.14 Mn and received interest amounting to Rs. 9.07 from HNB Securities

**45 (c) Transactions with Key Management Personnel**

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 Board of Directors (including executive and non-executive Directors) have been classified as Key Management Personnel of the Bank.

As the Bank is the ultimate parent of its subsidiaries listed out in Note No. 29, and the Board of directors of the Bank have the authority and responsibility of planning, directing and controlling the activities of the Group, the Board of directors of the Bank have been identified as the Key Management Personnel of the Group.

Therefore, officers who are only directors of the subsidiaries and not of the Bank have been classified as Key Management Personnel of that respective subsidiary only.

**45 RELATED PARTY TRANSACTIONS (Contd.)**

**45(c)i Compensation to KMP**

	Bank	Group
Short term employment benefits	21,332	31,233
Post employment benefits	3,423	4,031
	24,755	35,264

**45(c)ii Credit Card facilities to KMP**

	Limit as at 31.12.07 Rs. Mn.	Outstanding Rs. Mn.
Mr. R T Wijetilleke (Chairman)	0.50	0.22
Dr. V P Vittachi (Deputy Chairman)	0.50	Nil
Mr. D H S Jayawardena	12.50	4.42*
Mr. M V Theagarajah	0.50	0.35
Mr. R K Obeyesekere	0.50	0.01
Mrs. P Cooray	0.50	0.0007
Mr. R Sivaratnam	1.24	0.23*
Mr. R Theagarajah	0.40	0.04
Mr. R Seevaratnam	0.31	Nil

\* Rs. 0.5 Mn clean and the balance is secured by cash deposits.

**45(c)iii Facilities Granted to KMP**

Name of Director	Aggregate Amount of Accommodation		Security
	Limit (Rs.Mn.)	Outstanding as at 31.12.2007 (Rs.Mn.)	
Mr. R T Wijetilleke	1.14	0.77	- Cash deposits
Mr. M V Theagarajah	4.60	-	- Cash deposits
Mr. R K Obeyesekere	10.48	10.48	- Cash deposits - Absolute ownership of the motor vehicle.
Mr. R Sivaratnam	1.50	-	- Cash deposits
Mr. R Seevaratnam	1.50	1.39	- Cash deposits

**45(c)iv Deposits held by KMP with the Bank**

As at Balance Sheet date the aggregate deposits held by the KMP with the Bank are as follows.

Rs. '000	47,662
USD	9,510
GBP	1,750

**45 RELATED PARTY TRANSACTIONS (Contd.)****45 (d) Transactions with other related entities - Bank**

Other related entities are those which are controlled or significantly influenced, directly or indirectly by KMP

**45 (d)i Lending transactions with Other related entities**

Name of Related Party	Name of Director (Relationship)	Nature of Transaction	Aggregate Amount of Accommodation			Security
			Limit (Rs. Mn.)	Outstanding as at 31.12.07 Direct      Indirect		
Stassen Exports Ltd.	Mr D H S Jayawardena Chairman/Shareholder	Overdraft I	1,653.50	1,734.12	-	Cash Deposits Quoted Co. Shares
	Dr V P Vittachi Director/Shareholder	Overdraft II Temporary Overdraft	60.00 300.00			Inventories
	Mr R K Obeyesekere Director/Shareholder	Letters of Guarantee Letters of Credit	60.00 15.00	-	56.90 1.90	
			2,088.50	1,734.12	58.80	
Stassen International Ltd	Dr V P Vittachi Chairman	Letters of Credit	70.00	-	23.28	Cash Deposits Quoted Co. Shares
	Mr D H S Jayawardena Managing Director	Overdraft Letters of Guarantee	20.00 125.00	25.91	-	Inventories
	Mr R K Obeyesekere Director			-	111.72	
			215.00	25.91	135.00	

**45 RELATED PARTY TRANSACTIONS (Contd.)****45 (d) Transactions with other related entities (Contd.)****45 (d)i Lending transactions with Other related entities**

Name of Related Party	Name of Director (Relationship)	Nature of Transaction	Aggregate Amount of Accommodation			Security
			Limit (Rs. Mn.)	Outstanding as at 31.12.07 Direct Indirect		
Milford Exports (Cey) Ltd	Dr V P Vittachi	Letters of Credit	2.00	-	0.60	Quoted Co. Shares Inventories
	Chairman	Overdraft	0.50	-	-	
	Mr D H S Jayawardena	Letters of Guarantee	30.00	-	24.01	
	Managing Director Mr R K Obeyesekere Director					
			32.50	-	24.61	
Madulsima Plantations PLC	Dr V P Vittachi	Overdraft	120.00	112.50	-	Quoted Co. Shares Mortgage over leasehold property. Inventories
	Chairman	Temporary Overdraft	33.00			
	Mr D H S Jayawardena	Letters of Guarantee	1.00	-	0.07	
	Managing Director Mr R K Obeyesekere Director					
			154.00	112.50	0.07	
Stassen Natural Food (Pvt) Ltd	Dr V P Vittachi	Letters of Guarantee	15.00	-	15.00	Quoted Company shares
	Chairman					
	Mr D H S Jayawardena	Letters of Credit	6.00	-	0.60	
	Managing Director Mr R K Obeyesekere Director					
			21.00	-	15.60	
CBD Exports Ltd	Mr. R K Obeyesekere	Letters of Guarantee	10.00	-	-	Quoted Company shares
	Managing Director		10.00	-	-	
Browns Beach Hotels PLC	Mr D H S Jayawardena	Letters of Guarantee	0.24	-	0.24	Cash Deposits
	Director	Temporary Overdraft	-	1.53	-	
	Mr. M V Theagarajah Director					
			0.24	1.53	0.24	

**45 RELATED PARTY TRANSACTIONS (Contd.)****45 (d) Transactions with other related entities (Contd.)****45 (d)i Lending transactions with Other related entities**

Name of Related Party	Name of Director (Relationship)	Nature of Transaction	Aggregate Amount of Accommodation			Security
			Limit (Rs. Mn.)	Outstanding as at 31.12.07 Direct      Indirect		
Sri Lanka Insurance Corporation Ltd	Mr D H S Jayawardena Chairman Mr. R K Obeyesekere Deputy Chairman	Letter of Guarantee	2.50	-	2.50	Cash Deposits
			2.50	-	2.50	
Lanka Milk Foods (CWE) PLC	Dr V P Vittachi Chairman Mr D H S Jayawardena Managing Director Mr R K Obeyesekere Director	Letters of Credit	600.00	-	-	Quoted Company Shares
		Letters of Guarantee	30.00	-	25.57	Immovable Property (Leasehold) / Plant & Machinery
		Overdraft	300.00	257.47	-	
			930.00	257.47	25.57	
Lanka Dairies (Pvt) Ltd	Dr V P Vittachi Chairman Mr D H S Jayawardena Managing Director Mr R K Obeyesekere Director	Overdraft	50.00	18.19	-	Title to goods imported.
		Letters of Credit	10.00	-	-	
			60.00	18.19	-	
Ambewela Products (Pvt) Ltd	Dr V P Vittachi Chairman Mr D H S Jayawardena Managing Director Mr R K Obeyesekere Director	Overdraft	10.00	10.17	-	Quoted Company Shares
		Letters of Credit	50.00	-	8.35	Immovable Property (Leasehold) / Plant & Machinery
			60.00	10.17	8.35	
Ambewela Livestock Co. Ltd	Dr V P Vittachi Chairman Mr D H S Jayawardena Managing Director Mr R K Obeyesekere Director	Overdraft	50.00	24.96	-	Quoted Company Shares
		Letters of Credit	10.00	-	-	Immovable Property (Leasehold) / Plant & Machinery
			60.00	24.96	-	

**45 RELATED PARTY TRANSACTIONS (Contd.)****45 (d) Transactions with other related entities (Contd.)****45 (d)j Lending transactions with Other related entities**

Name of Related Party	Name of Director (Relationship)	Nature of Transaction	Aggregate Amount of Accommodation			Security	
			Limit (Rs. Mn.)	Outstanding as at 31.12.07 Direct Indirect			
Pattipola Livestock Co. Ltd	Dr V P Vittachi Chairman	Overdraft	50.00	22.39	-	Quoted Company Shares Immovable Property (Leasehold) / Plant & Machinery	
	Mr D H S Jayawardena Managing Director	Letters of Credit	10.00	-	-		
	Mr R K Obeyesekere Director						
			60.00	22.39	-		
Distilleries Company of Sri Lanka PLC	Mr D H S Jayawardena Chairman/CEO	Letters of Credit	3.39	-	3.39	Cash Deposits	
	Mr R K Obeyesekere Director	Letters of Guarantee	2.87	-	2.87		
			6.26	-	6.26		
Periceyl (Pvt) Ltd	Mr D H S Jayawardena Chairman	Letter of Guarantee	9.84	-	9.84	Cash Deposits	
	Mr. R K Obeyesekere Director	Letters of Credit	13.43	-	13.43		
			23.27	-	23.27		
The Lanka Hospital Corporation PLC	Mr D H S Jayawardena Director	Letter of Credit	80.00	-	80.00	Mortgage over movable and immovable assets	
		Import Loan	(80.00)	-	-		
		Temp. Letter of Guarantee	-	-	0.35		
		Overdraft	220.00	193.85	-		
		Term Loan	109.37	109.37	-		
			409.37	303.22	80.35		
Balangoda Plantations PLC	Dr V P Vittachi Chairman Mr D H S Jayawardena Managing Director Mr R K Obeyesekere Director	Letter of Guarantee	7.99	-	7.99	Immovable Property (Leasehold) Cash Deposits	
		Overdraft	45.00	-	-		
		Development Loan	9.04	9.04	-		
			62.03	9.04	7.99		

**45 RELATED PARTY TRANSACTIONS (Contd.)****45 (d) Transactions with other related entities (Contd.)****45 (d)i Lending transactions with Other related entities**

Name of Related Party	Name of Director (Relationship)	Nature of Transaction	Aggregate Amount of Accommodation			Security
			Limit (US\$. Mn.)	Outstanding as at 31.12.07 (US\$. Mn.)		
				Direct	Indirect	
Texpro Industries Ltd	Mr D H S Jayawardena Chairman	Letters of Credit	1.60	-	1.93	Immovable Property/ Machinery Cash deposits Inventories
		Export Loans	(1.30)	0.03	-	
		Bill Purchased	(0.30)	0.19	-	
		Term Loan	0.24	0.24	-	
		Term Loan	0.12	0.12	-	
		Term Loan	0.08	0.08	-	
		Term Loan	0.14	0.14	-	
		Term Loan	0.23	0.23	-	
		Overdraft	0.05	-	-	
		Overdraft	(Rs. Mn.) 13.33	7.50	-	
Letter of Guarantee	(Rs. Mn.) 0.22	-	0.22			
			2.46	1.03	1.93	
			(Rs. Mn.) 13.55	7.50	0.22	

Name of Related Party	Name of Director (Relationship)	Nature of Transaction	Aggregate Amount of Accommodation			Security
			Limit (Rs. Mn.)	Outstanding as at 31.12.07 (Rs. Mn.)		
				Direct	Indirect	
Falcon Commodities (Pvt) Ltd	Mr. D H S Jayawardena Through the share- holding of Stassen Exports Ltd. in Falcon Commodities (Pvt) Ltd (Since disposed)	Overdraft/Import Bills	Cancelled	84.85	228.36	Cash Deposits Inventories Accommodation granted to Falcon Commodities (Pvt) Ltd continues to be classified as non- performing. The outstanding of Rs. 326.0 Mn as at 31.12.2007 is fully covered by the capital provisioning of Rs. 276.0 Mn made during the previous years.
		Overdraft (Habib Bank AG Zurich (Ltd)		13.20	-	
			Nil	98.05	228.36	

**45 RELATED PARTY TRANSACTIONS (Contd.)****45 (d) Transactions with other related entities (Contd.)****45 (d)i Lending transactions with Other related entities**

Name of Related Party	Name of Director (Relationship)	Nature of Transaction	Aggregate Amount of Accommodation			Security
			Limit (Rs. Mn.)	Outstanding as at 31.12.07 Direct      Indirect		
Elpitiya Plantations PLC	(Subsidiary of Aitken Spence Plantation Management Ltd)	Overdraft	25.00	81.23	-	Inventories
		Overdraft	50.00		-	Immovable Property
		Commercial Paper/ Money Mkt Loan	100.00	100.00	-	Absolute ownership of the equipment / vehicles leased
		Term Loan	4.06	4.37	-	Cash Deposits
		Revolving Loan	6.00	6.00	-	
		Term Loan	22.50	21.25	-	
		Term Loan	31.50	31.50	-	
		Revolving Loan	4.00	4.00	-	
		Short Term Loan	0.65	1.50	-	
		Leases	13.54	13.54	-	
		Revolving Loan	6.00	6.00	-	
Letters of Guarantee	-	-	17.67			
		263.25	269.39	17.67		
Aitken Spence Travels Ltd	(Subsidiary of Aitken Spence & Co. PLC)	Foreign Drafts & Travellers Cheque Purchase	3.00	1.77	-	Cash Deposits
			3.00	1.77	-	
A E N Palm Oil Processing (Pvt) Ltd	(Subsidiary of Aitken Spence & Co. PLC)	Term Loan	50.00	49.23	-	Immovable property (leasehold)
			50.00	49.23	-	
Aitken Spence Hotel Holdings PLC	(Subsidiary of Aitken Spence & Co. PLC)	Term Loan	1,000.00	1,000.00	-	Corporate Guarantee
			1,000.00	1,000.00	-	
Aitken Spence Resources (Pvt) Ltd	(Subsidiary of Aitken Spence & Co. PLC)	Letter of Guarantee	0.25	-	0.25	Corporate Guarantee
			0.25	-	0.25	
Ace Containers (Pvt) Ltd	(Subsidiary of Aitken Spence & Co. PLC)	Overdraft	25.00	4.99	-	Corporate Guarantee
			25.00	4.99	-	
Ace Distriparks (Pvt) Ltd	(Subsidiary of Aitken Spence & Co. PLC)	Overdraft	25.00	0.09	-	Corporate Guarantee
			25.00	0.09	-	

**45 RELATED PARTY TRANSACTIONS (Contd.)****45 (d) Transactions with other related entities (Contd.)****45 (d)i Lending transactions with Other related entities**

Name of Related Party	Name of Director (Relationship)	Nature of Transaction	Aggregate Amount of Accommodation			Security
			Limit (US\$. Mn.)	Outstanding as at 31.12.07 Direct Indirect (US\$ Mn.)		
Ace Container Repair (Pvt) Ltd	(Subsidiary of Aitken Spence & Co. PLC)	Overdraft	4.00	-	-	Corporate Guarantee
			4.00	-	-	
Ace Freight Management (Pvt) Ltd	(Subsidiary of Aitken Spence & Co. PLC)	Overdraft	1.00	0.50	-	Corporate Guarantee
			1.00	0.50	-	
Ace Haulage	(Subsidiary of Aitken Spence & Co. PLC)	Overdraft	15.00	1.48	-	Corporate Guarantee
			15.00	1.48	-	
Aitken Spence Garments Ltd	(Subsidiary of Aitken Spence & Co. PLC)	Letters of Credit	1.50	-	0.25	Immovable property Quoted Company Shares Inventories
		Short Term Export Loan	(1.50)	0.35	-	
		Overdrafts	0.25	0.15	-	
		Overdraft (Rs. Mn.) (2.50)	(Rs. Mn.) (2.50)	0.15	-	
		Letter of Guarantee (Rs. Mn.) 1.33	(Rs. Mn.) 1.33	-	1.33	
		1.75	0.50	0.25		
		(Rs. Mn.) 1.33	(Rs. Mn.) 1.33	0.15	1.33	
Cowie Investments (Pvt) Ltd	(Subsidiary of Aitken Spence Hotel Holdings PLC)	Term Loan	2.87	2.87	-	Immovable property (leasehold)
		Overdraft	2.00	1.95	-	
			4.87	4.82	-	
Ace Power Generation Horana (Pvt) Ltd	Mr D H S Jayawardena Chairman	Standby Letters of Credit	0.39	-	0.39	Immovable property Bank Guarantee
		Term Loan	0.24	0.24	-	
		Term Loan	0.67	0.67	-	
		Overdraft	1.20	0.06	-	
		Standby Letters of Credit (Rs.Mn.) 150.00	(Rs.Mn.) 150.00	-	150.00	
		Overdraft (Rs.Mn.) (120.00)	(Rs.Mn.) (120.00)	-	-	
		Letter of Guarantee	(0.14)	-	0.08	
		2.50	0.97	0.39		
		(Rs.Mn.) 150.00	(Rs.Mn.) 150.00	-	150.08	

**45 RELATED PARTY TRANSACTIONS (Contd.)****45 (d) Transactions with other related entities (Contd.)****45 (d)i Lending transactions with Other related entities**

Name of Related Party	Name of Director (Relationship)	Nature of Transaction	Aggregate Amount of Accommodation			Security
			Limit (US\$. Mn.)	Outstanding as at 31.12.07 (US\$. Mn.)		
				Direct	Indirect	
Ace Power Generation Matara (Pvt) Ltd	Mr D H S Jayawardena Chairman	Term Loan	0.12	0.12	-	
		Term Loan	0.41	0.41	-	Immovable Property (Leasehold) / Plant & Machinery Bank Guarantee
		Standby Letters of Credit	0.42	-	0.42	
		Overdraft	1.20	0.01	-	
		Letters of Credit	(0.40)	-	0.02	
		Standby Letters of Credit (Rs. Mn.)	150.00	-	150.00	
		Letter of Guarantee	(0.13)	-	0.13	
		Overdraft	(120.00)	-	-	
		2.15	0.54	0.44		
		(Rs. Mn.) 150.00	-	150.13		
Ace Power Generation Embilipitiya (Pvt) Ltd	(Subsidiary of Aitken Spence & Co. PLC)	Term Loan	0.28	0.28	-	Immovable Property Machinery
		Term Loan	1.21	1.21	-	
		Overdraft	0.62	2.19	-	
		Overdraft	2.63	-	-	
		Letter of Credit	0.13	-	0.13	
		Letter of Guarantee (Rs. Mn.)	33.50	-	33.50	
		Letter of Guarantee (Rs. Mn.)	(100.00)	-	100.00	
		Overdraft (Rs. Mn.)	200.00	0.73	-	
		4.87	3.68	0.13		
		(Rs. Mn.) 233.50	0.73	133.50		
Elpitiya Lifestyle Solutions (Pvt) Ltd	(50% owned by Elpitiya Plantations PLC)	Term Loan	0.16	0.16	-	Immovable Property (Leasehold) / Plant & Machinery
		Overdraft	(Rs. Mn.) 1.00	1.00	-	
			0.16	0.16	-	
		(Rs. Mn.) 1.00	1.00	-		
ADS Resorts (Pvt) Ltd	(Subsidiary of Aitken Spence Hotel International Ltd)	Term Loan	2.46	2.46	-	Immovable Property
			(US\$.Mn) 2.46	2.46	-	
Unique Resorts (Pvt) Ltd	(Subsidiary of Aitken Spence Hotel International Ltd)	Term Loan	8.00	8.00	-	Corporate Guarantee
			(US\$.Mn) 8.00	8.00	-	

**45 RELATED PARTY TRANSACTIONS (Contd.)****45 (d) Transactions with other related entities (Contd.)****45 (d)i Lending transactions with Other related entities**

Name of Related Party	Name of Director (Relationship)	Nature of Transaction	Aggregate Amount of Accommodation			Security
			Limit (Rs. Mn.)	Outstanding as at 31.12.07 Direct Indirect		
Ceylon Biscuits Ltd	Mr. R T Wijetilleke Director	Leases	1.25	1.25	-	Absolute ownership of the leased assets.
			1.25	1.25	-	
Plenty Foods (Pvt) Ltd	(Subsidiary of Ceylon Biscuits Ltd)	Lease	7.80	7.80	-	Absolute ownership of the leased assets.
			7.80	7.80	-	
Soy Foods (Lanka) Ltd	(Subsidiary of Ceylon Biscuits Ltd)	Overdraft	15.00	-	-	Negative pledge over the project assets
		Letter of Guarantee	23.00	-	0.40	
		S/T Money Market Loan	20.00	-	-	
		Letter of Credit	40.00	-	41.89	
			98.00	-	42.29	
<b>Exposure to Sunshine Group</b>						
Sunshine Holdings Ltd	Mr. R T Wijetilleke Chairman	Term Loan	27.95	27.95	-	Corporate Guarantee
			27.95	27.95	-	
Watawala Plantations PLC	(Subsidiary of Sunshine Holdings Ltd)	Letter of Credit	5.00	-	-	Mortgage over Immovable property (Leasehold) Absolute ownership of the vehicle, Machinery, equipment leased etc.
		Overdraft	100.00	79.17	-	
		Term Loan	10.20	-	-	
		Block Lease	15.00	14.12	-	
		E-Friends Loans	5.10	5.10	-	
		Packing Credit	50.00	10.10	-	
		Letters of Guarantee	15.00	-	18.49	
	200.30	108.49	18.49			
Swiss Biogenics Ltd	(Subsidiary of Sunshine Holdings Ltd)	Letter of Credit	145.00	-	126.51	Corporate Guarantee
		Import Loan	(100.00)	2.86	-	
		Overdraft	5.00	-	-	
	150.00	2.86	126.51			

**45 RELATED PARTY TRANSACTIONS (Contd.)****45 (d) Transactions with other related entities (Contd.)****45 (d)i Lending transactions with Other related entities**

Name of Related Party	Name of Director (Relationship)	Nature of Transaction	Aggregate Amount of Accommodation			Security
			Limit (Rs. Mn.)	Outstanding as at 31.12.07 Direct Indirect (Rs. Mn.)		
Sunshine Travels & Tours Ltd	(Subsidiary of Sunshine Holdings Ltd)	Letter of Guarantee	10.00	-	10.00	Cash Deposits
		Overdraft	5.00	4.30	-	
			15.00	4.30	10.00	
Sunshine Teas (Pvt) Ltd	(Subsidiary of Swiss Biogenics Ltd)	Letters of Credit	50.00	-	-	Inventories
		Short Term Loan	(25.00)	-	-	
		Overdraft	(25.00)	27.44	-	
		Letter of Guarantee	10.00	-	9.71	
		Packing Credit Loans	(US\$.Mn) 1.45	(US\$.Mn) 0.68	-	
			Rs. Mn 60.00	27.44	9.71	
			(US\$.Mn) 1.45	0.68	-	
<b>Exposure to Nawaloka Group</b>						
Nawaloka Hospitals PLC	Mr. R T Wijetilleke Director	Temporary Overdraft	37.62	37.62	-	Clean
			37.62	37.62	-	
New Nawaloka Hospitals PLC	(Subsidiary of Nawaloka Hospitals PLC)	Letter of Credit	10.00	-	4.76	Mortgage over immovable property
		Term Loan I	17.86	17.86	-	
		Term Loan II	49.99	49.99	-	
		Import LC/Term Loan	79.28	79.28	-	
		Overdraft	10.00	17.98	-	
			167.13	165.11	4.76	

**45 RELATED PARTY TRANSACTIONS (Contd.)****45 (d) Transactions with other related entities (Contd.)****45 (d)ii Trading transactions with Other related entities**

Name of Related Party (Relationship)	Name of Director	2007	2006	Nature of Transactions
		Amount Rs. Mn.	Amount Rs. Mn.	
Madulsima Plantations PLC	Dr V P Vittachi Chairman Mr D H S Jayawardena Managing Director Mr R K Obeysekera Director	1.16	0.9	Payment for lease of holiday bungalow Ltd. at Bogawantalawa.
Lanka Bell (Pvt) Ltd.	Mr D H S Jayawardena Chairman	16.65	22.893	Payment for Telecommunication charges.
Sri Lanka Insurance Corporation Ltd.	Mr D H S Jayawardena Chairman Mr R K Obeysekera Deputy Chairman	30.86	39.18	Insurance premiums paid, inclusive of taxes.
Aitken Spence Printing (Pvt) Ltd.	Subsidiary of Aitken Spence Co. Ltd.	8.267	15.986	Printing charges

The details of the lending transactions with companies in which there is an interest by Directors of the Bank are disclosed in Note No. 45(d) "Related Party Transactions".

**45 RELATED PARTY TRANSACTIONS (Contd.)****45 (e) Related Party Transaction - Group****45 (e)i Sithma Development (Pvt) Ltd.**

Name of Related Party	Name of Director	Nature of Transaction (Relationship)	Amount (Rs. Mn.)
Sri Lanka Insurance Corporation Ltd.	Mr D H S Jayawardena Chairman	Insurance premium paid	14.00
	Mr R K Obeysekera Deputy Chairman	Debenture interest paid (Rs. 2 Bn. debenture)	300.28

**45 (e)ii HNB Securities Ltd**

Name of Related Party	Name of Director	Nature of Transaction (Relationship)	Cumulative Face Value (Rs. Mn)	Cumulative Investment/ Recd (Rs. Mn)	Balance Interest paid/ (Rs. Mn)
Lanka Ventures PLC	Mr J M J Perera Director	Repurchase Agreements of Treasury Bonds/Bills	1.45 Bn	4.00	8.1
	Mr J D N Kekulawela Director	Sale of Treasury Bills	415.30	-	-
		Purchase of Treasury Bills	50.40		

**45(e)iii HNB Stockbrokers (Pvt) Ltd**

Name of Related Party	Name of Director	Nature of Transaction (Relationship)	Amount (Rs. Mn.)
Sri Lanka Insurance Corporation Ltd.	Mr D H S Jayawardena Chairman	Brokerage income	0.28
	Mr R K Obeysekera Deputy Chairman		
Sri Lanka Insurance Corporation Ltd. Life Fund	Mr D H S Jayawardena Chairman	Brokerage income	5.93
	Mr R K Obeysekera Deputy Chairman		
Lanka Milk Foods (CWE) PLC	Dr V P Vittachi Chairman	Brokerage income	7.47
	Mr D H S Jayawardena Managing Director		
	Mr R K Obeysekera Director		

**45 RELATED PARTY TRANSACTIONS (Contd.)****45 (e) Related Party Transaction - Group (Contd.)****45(e)iii HNB Stockbrokers (Pvt) Ltd**

Name of Related Party	Name of Director	Nature of Transaction (Relationship)	Amount (Rs. Mn.)
Lanka Dairies (Pvt) Limited	Dr V P Vittachi Chairman Mr D H S Jayawardena Managing Director Mr R K Obeyesekere Director	Brokerage income	0.053
AEGIS Fund Management (Pvt) Ltd	Mr R K Obeyesekere Director	Brokerage income	71.10

**45(e)ivHNB Assurance PLC**

Name of Related Party	Name of Director	Nature of Transaction (Relationship)	Amount (Rs. Mn.)
Stassen Exports Ltd.	D H S Jayawardena Chairman V P Vittachi Director R K Obeysekere Director	Non-life Insurance business	10.33
Stassen International Ltd.	Dr V P Vittachi Chairman D H S Jayawardena Managing Director R K Obeysekere Director	Non-life Insurance business	364.06
Stassen Natural Foods (Pvt.) Ltd.	Dr V P Vittachi Chairman D H S Jayawardena Managing Director R K Obeysekere Director	Non-life Insurance business	178.84
Sri Lanka Insurance Corporation Ltd.	D H S Jayawardena Chairman R K Obeysekere Deputy Chairman	Insurance	7.25

**45 RELATED PARTY TRANSACTIONS (Contd.)****45 (e) Related Party Transaction - Group (Contd.)****45(e)ivHNB Assurance PLC (Contd.)**

Name of Related Party	Name of Director	Nature of Transaction (Relationship)	Amount (Rs. Mn.)
Ceylon Garden Coir (Pvt) Ltd.	Dr V P Vittachi Chairman D H S Jayawardena Managing Director R K Obeysekere Director	Non-life Insurance business	128.43
Milford Developers (Pvt) Ltd.	Dr V P Vittachi Chairman D H S Jayawardena Managing Director R K Obeysekere Director	Non-life Insurance business	590.00
Milford Exports (Ceylon) Ltd.	Dr V P Vittachi Chairman D H S Jayawardena Managing Director R K Obeysekere Director	Non-life Insurance business	102.55
Aitken Spence PLC	D H S Jayawardana Chairman	Non-life Insurance business	0.05
Aitken Spence (Garments) Ltd.	Joint Venture of Aitken Spence PLC	Non-life Insurance business	179.10
Elpitiya Plantations PLC	Subsidiary of Aitken Spence Plantation Management Ltd.	Non-life Insurance business	214.71
Nawaloka Hospitals PLC	R T Wijetilleke Director	Non-life Insurance business	46.12
Pronto Lanka (Pvt.) Ltd.	P Amarasinghe Consultant-in-Charge (Up to 1st August 2007)	provision of courier service	2.73
Transnational Lanka Records Solutions (Pvt.) Ltd.	P Amarasinghe Consultant-in-Charge (Up to 1st August 2007)	Storage of records	0.31
Transnational Logistics Solutions Lanka (Pvt.) Ltd.	P Amarasinghe Consultant-in-Charge (Up to 1st August 2007)	Non-life Insurance business	117.61

**46 MATURITY ANALYSIS - 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:

	Upto 3 Months Rs.000	3 to 12 Months Rs.000	1 to 3 Years Rs.000	3 to 5 Years Rs.000	More Than 5 Years Rs.000	Total 2007 Rs.000
<b>Interest earning assets</b>						
Cash and Short term Funds	9,736,158	-	-	-	-	<b>9,736,158</b>
Balances with foreign banks which are interest bearing	11,710,540	-	-	-	-	<b>11,710,540</b>
Securities purchased under resale agreements	3,450,000	-	-	-	-	<b>3,450,000</b>
Commercial papers	236,411	-	-	-	-	<b>236,411</b>
Investment Securities-Bonds & Debentures	2,813,942	7,081,495	7,883,537	-	748,719	<b>18,527,693</b>
Bills of Exchange	1,791,846	124,825	130,457	-	22,322	<b>2,069,450</b>
Loans & Advances	59,579,069	17,083,158	18,639,599	20,060,017	24,422,681	<b>139,784,524</b>
Lease Rentals Receivable	1,995,417	2,400,447	3,267,512	5,626,072	-	<b>13,289,448</b>
	<b>91,313,383</b>	<b>26,689,925</b>	<b>29,921,105</b>	<b>25,686,089</b>	<b>25,193,722</b>	<b>198,804,224</b>
<b>Non interest earning assets</b>						
Cash and Short term Funds	2,912,748	-	-	-	-	<b>2,912,748</b>
Statutory deposit with CBSL	13,405,856	-	-	-	-	<b>13,405,856</b>
Dealing Securities	589,584	-	-	-	-	<b>589,584</b>
Quoted - Shares	-	-	-	1,018,370	-	<b>1,018,370</b>
Unquoted - Shares	-	-	-	750,706	-	<b>750,706</b>
Investment in associate companies	-	-	-	-	132,326	<b>132,326</b>
Investment in subsidiary companies	-	-	-	-	2,293,663	<b>2,293,663</b>
Intangible Assets	-	-	-	-	183,864	<b>183,864</b>
Investment Properties	-	-	-	-	188,661	<b>188,661</b>
Property, Plant & Equipment	-	-	-	-	6,082,558	<b>6,082,558</b>
Non-current Assets held for sale	1,455	-	-	-	-	<b>1,455</b>
Other Assets	-	6,542,333	-	-	-	<b>6,542,333</b>
	<b>16,909,643</b>	<b>6,542,333</b>	<b>-</b>	<b>1,769,076</b>	<b>8,881,072</b>	<b>34,102,124</b>
<b>Total assets</b>	<b>108,223,026</b>	<b>33,232,258</b>	<b>29,921,105</b>	<b>27,455,165</b>	<b>34,074,794</b>	<b>232,906,348</b>
<b>Percentage - 31/12/2007</b>	46.47	14.27	12.85	11.78	14.63	<b>100</b>
<b>Percentage - 31/12/2006</b>	30.87	25.00	18.47	11.83	13.83	<b>100</b>
<b>Interest bearing liabilities</b>						
Deposits from customers	120,243,155	30,973,204	4,428,873	3,428,410	2,754,656	<b>161,828,298</b>
Borrowings - Money at call	2,913,002	-	-	-	-	<b>2,913,002</b>
Borrowings - Refinance	842,460	174,895	497,808	955,341	3,279,120	<b>5,749,624</b>
Borrowings - Local Banks	22,205	-	-	-	-	<b>22,205</b>
Borrowings - Foreign Banks	1,212,900	-	-	-	-	<b>1,212,900</b>
Repo agreements	6,036,514	-	-	-	-	<b>6,036,514</b>
Subordinated debentures	-	2,000,000	127,628	375,724	2,057,500	<b>4,560,852</b>
	<b>131,270,236</b>	<b>33,148,099</b>	<b>5,054,309</b>	<b>4,759,475</b>	<b>8,091,274</b>	<b>182,323,395</b>

**46 MATURITY ANALYSIS - BANK (Contd.)**

	Up to 3 Months Rs.000	3 to 12 Months Rs.000	1 to 3 Years Rs.000	3 to 5 Years Rs.000	More Than 5 Years Rs.000	<b>Total 2007 Rs.000</b>
<b>Non Interest bearing liabilities</b>						
Deposits from customers	13,831,275	-	-	-	-	<b>13,831,275</b>
Dividend payable	30,321	-	-	-	-	<b>30,321</b>
Bills payable	1,198,237	-	-	-	-	<b>1,198,237</b>
Current tax liability	1,539,288	-	-	-	-	<b>1,539,288</b>
Deferred tax Liability	605,693	-	-	-	-	<b>605,693</b>
Other liabilities	-	14,959,109	-	-	-	<b>14,959,109</b>
Equity	-	-	-	-	18,419,030	<b>18,419,030</b>
	17,204,814	14,959,109	-	-	18,419,030	<b>50,582,953</b>
<b>Total Liabilities &amp; Shareholders' Funds</b>	<b>148,475,050</b>	<b>48,107,208</b>	<b>5,054,309</b>	<b>4,759,475</b>	<b>26,510,307</b>	<b>232,906,348</b>
<b>Percentage - 31/12/2007</b>	63.75	20.66	2.17	2.04	11.38	<b>100</b>
<b>Percentage - 31/12/2006</b>	64.87	16.83	6.70	2.58	9.02	<b>100</b>

"Up to 3 months" deposits include the Bank's Savings Deposit Base of Rs. 69.3 Bn. (2006 - Rs. 64.3 Bn.).

## 47 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 /Unallocated	
	2007 Rs.000	2006 Rs.000	2007 Rs.000	2006 Rs.000										
Revenue from external customers :														
Interest	23,905,457	16,835,610	-	-	795,933	864,275	-	-	172,576	82,520	2,140,198	1,538,842	27,014,164	19,321,247
Exchange/Premium	1,114,313	772,825	-	-	-	396	-	-	1,149,795	801,868	-	-	2,264,108	1,575,089
Lease/Brokerage	-	-	2,140,198	1,538,842	69,118	97,673	-	-	-	-	(2,140,198)	(1,538,842)	69,118	97,673
Commissions/Rent	2,120,396	1,858,180	-	-	387	5,409	62,514	18,951	-	-	-	-	2,183,297	1,882,540
Other	425,969	356,100	-	-	24,801	1,215	-	-	1,144	692	-	-	451,914	358,007
Total revenue from external customers	27,566,135	19,822,715	2,140,198	1,538,842	890,239	968,968	62,514	18,951	1,323,515	885,079	-	-	31,982,601	23,234,556
Inter-segment revenue	158,083	132,138	190	-	13,262	17,364	547,713	441,653	47,117	39,294	(766,365)	(630,449)	(36,824)	(20,832)
Total revenue	27,724,218	19,954,853	2,140,388	1,538,842	903,501	986,332	610,227	460,604	1,370,632	924,373	(766,365)	(630,449)	31,945,777	23,213,724
Segment result	3,394,050	2,604,334	1,427,938	946,727	115,592	22,393	120,616	58,204	164,753	109,401	(47,150)	(25,256)	5,175,799	3,715,803
Unallocated expenses													625,532	634,209
Profit from operations													4,550,267	3,081,594
Income from associates													16,195	13,617
Income tax expense													(1,366,660)	(819,575)
Profit for the period													3,199,802	2,275,636
Minority interests													(49,333)	(36,530)
Profit for the Equity Holders of the Bank													3,150,469	2,239,106
Segment assets	179,619,276	152,107,998	13,289,448	11,552,475	3,343,590	8,268,188	7,804,904	4,820,926	2,008,881	1,475,485	(2,800,278)	(1,753,943)	203,265,821	176,471,129
Investment in associates													165,093	164,869
Unallocated assets													37,571,635	29,983,887
Total Assets													241,002,549	206,619,885
Segment liabilities	163,568,362	137,195,036	13,289,448	11,552,475	2,647,569	7,641,013	3,291,346	3,085,193	1,459,738	1,024,673	(2,402,745)	(1,367,468)	181,853,718	159,130,922
Unallocated liabilities													37,629,508	34,393,030
Total liabilities													219,483,226	193,523,952
Cash flows from operating activities	2,257,352	(4,386,510)	1,735,894	2,774,967	65,681	(34,132)	94,945	188,381	488,182	340,809	3,313,000	(722,928)	7,955,054	(1,839,413)
Cash flows from investing activities	(323,181)	(4,496,168)	-	-	(33,599)	(5,462)	(214,889)	(49,902)	(475,267)	(292,373)	2,684,176	(529,926)	1,637,240	(5,373,831)
Cash flows from financing activities	(3,130,505)	8,727,523	-	-	(7,000)	-	-	-	(610)	(610)	(5,833,717)	1,147,996	(8,971,832)	9,874,909
Capital Expenditure	928,819	504,598	294	23	4,383	7,488	207,137	49,012	37,761	25,063	(7,986)	-	1,170,408	586,184
Depreciation	421,004	430,257	1,160	1,238	5,622	3,657	109,581	80,724	15,911	11,954	-	-	553,278	527,830
Amortization	63,297	98,343	1,773	1,773	1,641	1,517	33	-	5,510	4,746	-	-	72,254	106,379

\*\*Stock Broking & Securities Dealings

#### **48 EVENTS OCCURRING AFTER THE BALANCE SHEET DATE**

There are no events occurring after the Balance Sheet date which require adjustments to or disclosures in the financial statements, other than those disclosed below:

##### **48 (a) Proposed dividends**

Refer Note No. 35(a).

##### **48(b) Investment Bank-Joint venture**

Regulatory clearances were obtained from the necessary statutory and financial bodies in December 2007, to set up an investment bank as an equally owned joint venture with DFCC Bank, with an initial stated capital of Rs. 500 Mn. The new company is expected to commence operations in the first quarter of 2008. The subscription of the initial capital will be through the transfer of equity investment held by the Bank in the relevant entities to the joint venture company without any additional cash investment.

#### **49 DIRECTORS' RESPONSIBILITY STATEMENT**

The Board of Directors is responsible for the preparation and presentation of these financial statements. Please refer to page 9 for the statement of the Directors' Responsibility for Financial Reporting.

**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.

**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 of 1988 and shall not be reduced or impaired without the approval of the Monetary Board.

**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.

**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-push Inflation**

A continuous increase in average price levels due to an increase in production costs.

**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.

**Dividend Yield**

Dividend earned per share as a percentage of its market value.

**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.

**Documentary Letters of Credit (L/Cs)**

Written undertakings by a bank on behalf of its customer, 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.

**Earnings Per Share (EPS)**

Profit attributable to ordinary shareholders, divided by the number of ordinary shares in issue.

**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.

**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.

**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.

**Impairment**

When recoverable amount declines below 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**

Represents the difference between the average interest rate earned and the average interest rate paid on funds.

**Key Management Personal**

Key Management Personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly.



**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)

**Market Capitalisation**

Number of ordinary shares in issue multiplied by the market value of each share at the year end.

**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).

**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.

**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.

**Reverse Repo**

A purchase of government securities with an agreement to resell them 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.

**Segment Reporting**

Segment reporting indicates the contribution to the revenue derived from business segments such as banking operations, leasing operations, stock broking & 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 issued and fully paid ordinary share capital plus capital and revenue reserves.

**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.

**Tier 1 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 2 Capital**

Consists of the sum total of revaluation reserves, general provisions, hybrid capital instruments and approved subordinated debentures.

**Total Capital**

Is the sum of Tier 1 and Tier 2 capital.

**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 is hereby given that the Thirty Ninth (39th) Annual General Meeting of the Hatton National Bank PLC is convened on Friday the Twenty Eighth (28th) of March 2008 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 Report of the Directors, the Statement of Accounts and the Balance Sheet of the Company for the year ended 31st December 2007 with the Auditors' Report thereon.

To declare a dividend of Rs. 3.50 per share as recommended by the Directors to the shareholders.

To re-elect Mr R K Obeyesekere who retires, at the Annual General Meeting in terms of Article 87 of the Articles of Association of the Company, a Director of the Company.

To re-elect Mrs P C Cooray who retires, at the Annual General Meeting in terms of Article 87 of the Articles of Association of the Company, a Director of the Company.

To re-elect Mr Ratneswara Sivaratnam who retires, at the Annual General Meeting in terms of Article 87 of the Articles of Association of the Company a Director of the Company and to adopt the following resolution :-

### Resolution

"That Mr Ratneswara Sivaratnam (a Director retiring by rotation) who has attained the age of 70 years on 7th January 2008, be and is hereby re-elected a Director of the Company and it is hereby declared that the age limit of 70 years referred to in Section 210 of the Companies Act No. 7 of 2007, shall not apply to the said Director".

To re-elect Dr V P Vittachi a Director of the Company and to adopt the following resolution :-

### Resolution

"That Dr Vijaya Perera Vittachi who has attained the age of 70 years on 2nd December 1992, be and is hereby re-elected a Director of the Company and it is hereby declared that the age limit of 70 years referred to in Section 210 of the Companies Act No. 7 of 2007, shall not apply to the said Director".

To re-elect Mr M V Theagarajah a Director of the Company and to adopt the following resolution :-

### Resolution

"That Mr Manickam Vallipuram Theagarajah who has attained the age of 70 years on 13th October 2001, be and is hereby re-elected a Director of the Company and it is hereby declared that the age limit of 70 years referred to in Section 210 of the Companies Act No. 7 of 2007, shall not apply to the said Director".

To re-elect Mr. Ranjeevan Seevaratnam in terms of Article 93 of the Articles of Association of the Company, a Director of the Company.

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 2008 for charitable and other purposes set out in the Companies Donations Act (Cap. 147).

By Order Of The Board



**INDRANI GOONSEKERA**  
DGM-LEGAL/BOARD SECRETARY

Colombo, Sri Lanka.

15th February 2008

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 at the Registered Office of the Company at No: 479, T.B. Jayah Mawatha, Colombo 10 before 10.00 in the forenoon on 26th March, 2008.









