

HATTON NATIONAL BANK

ANNUAL REPORT 2005



HNB

ANNUAL REPORT 2005

Two brush strokes

that make the difference

Over the years, HNB's dream of climbing the heights, from being a repository for personal funds, to be the driving force in capital funding; making home and vehicle ownership a reality, encouraging the banking habit in the young - the list is long and comprehensive - continues to touch lives everywhere. And accomplishment was not easy. In retrospect, it would seem HNB adopted the ancient Oriental philosophy illustrated by two brush strokes - one to write the word 'crisis' and the other for 'opportunity': In a crisis, be aware of what it holds, but recognize the opportunity within it. Just how thoroughly HNB adapted wrote its 117-year history and changed the face of banking in Sri Lanka. And that ability will not change.



HNB

HATTON NATIONAL BANK LTD

479 T B Jayah Mawatha, Colombo 10, Sri Lanka.
Phone +94 11 2661976 Fax +94 11 2662832
mktdiv@hnb.lk www.hnb.lk



**HNB
ASSURANCE**
For a brighter future

HNB ASSURANCE LTD

10 R A de Mel Mawatha, Colombo 03, Sri Lanka.
Phone +94 11 2421885 Fax +94 11 4724512
info@hnbassurance.com www.hnbassurance.com



HNB STOCK BROKERS (PVT) LTD

479 T B Jayah Mawatha, Colombo 10, Sri Lanka.
Phone +94 11 2663663 Fax +94 11 2663697
hnb@hnbstock.com



HNB SECURITIES LTD

479 T B Jayah Mawatha, Colombo 10, Sri Lanka.
Phone +94 11 2661199 Fax +94 11 2664801
info@hnbsl.lk www.hnbsl.lk

SITHMA DEVELOPMENT (PVT) LTD

479 T B Jayah Mawatha, Colombo 10, Sri Lanka.
Phone +94 11 2660702 Fax +94 11 2662801
kvpf@hnb.lk



LANKA VENTURES LTD

46/12, Nawam Mawatha, Colombo 02, Sri Lanka.
Phone +94 11 2439201 Fax +94 11 2439203
lankvent@sri.lanka.net www.lankaventures.lk

Corporate Information

NAME OF COMPANY

HATTON NATIONAL BANK LIMITED

LEGAL FORM

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

COMPANY REGISTRATION NO.

PBS/613

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 Luxemburg 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 – HBLILK LX
Email : moreinfo@hnb.net
Web: <http://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. R Sivaratnam
Mr. D R Ghazalli

BOARD SECRETARY

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

AUDIT COMMITTEE

Mr. R Sivaratnam (Chairman)
Mr. D.H.S Jayawardena
Mrs. P C Cooray

Mr. R. Seevaratnam – CONSULTANT
Former Partner KPMG Ford, Rhodes, Thornton & Co.,

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
SLA national credit rating for implied long term unsecured senior debt by Fitch Ratings Lanka Limited.

ASSOCIATE COMPANIES

Company	Holding	Principal Activity
Browns Engineering (Pvt) Ltd.	32.63%	Construction & Engineering
Lanka Ventures Ltd.	20.07%	Venture Capital

SUBSIDIARY COMPANIES

Company	Holding	Principal Activity
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 : kekulawe@sri.lanka.net

Correspondents throughout the world

Financial Calendar

2005

1st Quarter Results 2005 released on	4 May, 2005
2nd Quarter Results 2005 released on	1st August, 2005
3rd Quarter Results 2005 released on	9th November, 2005
20% Interim Dividend for 2005 paid on	9th December, 2005
Annual Report for 2005 on	6th March, 2006
37th Annual General Meeting	29th March, 2006
20% Final Dividend for 2005 payable on	5th April, 2006

2006

1st Quarter Results 2006	April, 2006
2nd Quarter Results 2006	August, 2006
3rd Quarter Results 2006	October, 2006
*% Interim Dividend for 2006	December, 2006
Annual Report for 2006	March, 2007
38th Annual General Meeting	March, 2007
*% Final Dividend for 2006	April, 2007

(*subject to confirmation by Directors)

Financial Goals/Performance

For the year ended 31st December

	Medium Term Goals	2005	Performance			
			2004	2003	2002	2001
Return on average assets (%)	over 1.5%	1.0%	0.7%	0.8%	0.6%	0.3%
Return on average shareholders' funds	over 20%	16.3%	12.2%	15.2%	9.8%	5.4%
Cost/Net income ratio (1)	65%	61.8%	70.4%	63.2%	72.8%	80.4%
Dividend rate	30%	40%	35%	40%	30%	15%
Capital Adequacy						
Tier 1 Capital ratio	9.00%	10.87%	9.83%	8.06%	9.98%	9.59%
Total Capital ratio	12.50%	11.55%	11.26%	11.47%	12.40%	9.53%

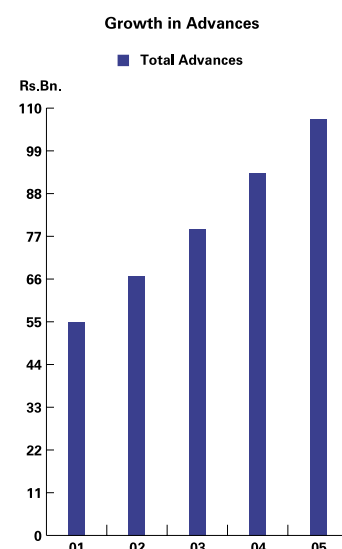
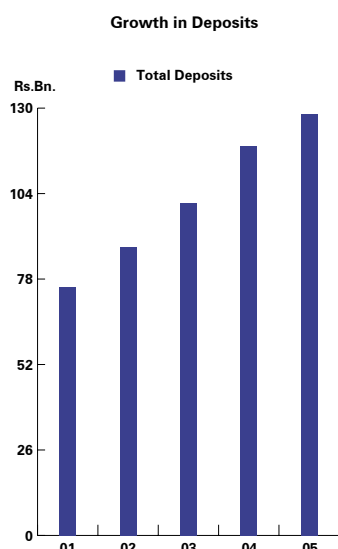
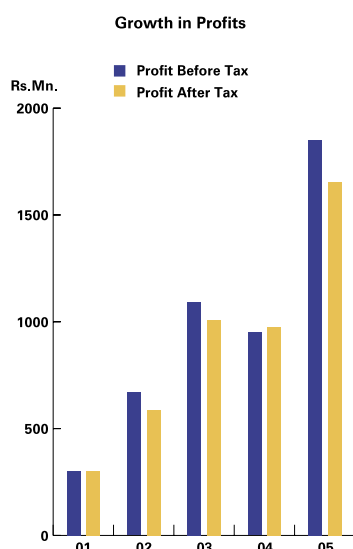
(1) Operating expenses as a percentage of net income.

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

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

Financial Highlights

	2005 Rs.000	2004 Rs.000		% Change
Results for the year				
Income	16,996,779	14,087,358	+	20.65
Net profit before income tax	1,849,962	950,055	+	94.72
Income tax on profits	195,400	(26,326)	-	842.23
Net profit after taxation	1,654,562	976,381	+	69.46
Gross dividends	471,059	350,350	+	34.45
Retained profit	1,183,503	626,031	+	89.05
At the year end				
Shareholders' funds (Capital and reserves)	11,239,260	9,051,880	+	24.16
Deposits from customers	128,283,681	118,523,934	+	8.23
Advances to customers including Leasing and Bills of Exchange	107,133,793	93,294,521	+	14.83
Total assets	166,012,410	152,779,694	+	8.66
Information per ordinary share				
Earnings (Rs.)	15.09	12.51	+	20.62
Dividends (Rs.)	4.00	3.50	+	14.29
Dividend Yield (%)	3.56	6.14	-	42.02
Net Asset Value (Rs.)	95.44	90.43	+	5.54
Market Value (Rs.) - Voting	112.50	57.00	+	97.37
Market Value (Rs.) - Non Voting	41.50	32.75	+	26.72
Ratios				
Return on average shareholders' funds (%)	16.31	12.17	+	34.02
Price earnings (Times)	7.46	4.56	+	63.60
Dividend cover (Times)	3.51	2.78	+	26.26
Capital adequacy ratios				
Tier 1 (%)	10.87	9.83	+	10.58
Tier 1 & 2 (%)	11.55	11.26	+	2.58



Sri Lankan Economic Profile

Macro Economic Data

		2001	2002	2003	2004	2005
Mid Year Population	Mn	18.70	19.00	19.30	19.50	19.70
GDP growth	%	(1.50)	4.00	5.90	5.40	5.30
Per Capita GDP	Rs	75,133.00	83,226.00	91,479.00	104,347.00	119,709.00
Inflation(CCPI)	%	14.20	9.60	6.30	7.60	12.60
12m T-Bill Yield (Y/E)	%	13.70	9.90	7.20	7.70	10.37
Prime Lending Rate (Y/E)	%	14.30	12.20	9.30	9.50	12.24
M2 Money Supply Growth	%	13.60	13.40	15.30	19.60	20.20
Exchange rate (yr-end)	Rs/US\$	93.10	96.70	96.70	104.60	102.04
Exports	Rs. Bn	430.00	450.00	496.00	584.00	649.00
Imports	Rs. Bn	533.00	585.00	644.00	811.00	936.00
Balance of Payments	% of GDP	1.30	2.00	2.80	(1.00)	1.28
Budget deficit	% of GDP	(10.90)	(8.90)	(8.00)	(8.20)	(8.20)
Unemployment rate	%	7.90	8.80	8.40	8.50	8.80
All Share Index (Y/E)	points	621.00	815.10	1,062.10	1,506.90	1,887.00
Tourist Arrivals	No.' 000	336.80	393.20	500.60	566.20	548.30

Sri Lanka's economy weathered number of shocks and emerged stronger during 2005, posting an encouraging 5.3% growth. The year started in crossroads amid the worst ever-natural disaster that struck the country in its history, but the economic impact was limited. In fact the worst affected sectors, Tourism, Fisheries and certain parts of agriculture accounted for approximately 8% of the overall economy. The tourist arrivals fell by 3% to 548,308 in 2005, while the impact on earnings from Tourism was larger as it dropped by around 17% compared to last year. After a brief setback during the first quarter, which slowed down the growth to 4.4%, economy picked up to post 6.0% and 6.3% expansion during the 2nd and 3rd quarters respectively.

Slowdown in affected sectors was compensated by the robust growth in construction and manufacturing sectors, which outperformed the historical rates. In a quota free environment (after the abolition of the Multi Fiber Agreement (MFA)), textiles and garments continued to grow and accounted for more than 46% of overall exports during the first ten months of 2005. This growth momentum was also benefited from the duty free access to the European Union under the GSP+ scheme and free trade agreements with India and Pakistan.

Meanwhile the agriculture sector managed to post a recovery during the latter part of the year, backed by favourable weather conditions. The services sector continued to be the dominant growth driver representing 56% of the total economy. Within the services sector, Telecommunication, Transportation, Banking and Trade continued to contribute heavily towards the overall growth.

Rupee gain strength thanks to the BOP surplus

The Sri Lankan rupee gained nearly 7.6% in early January 2005, with the expectation of a mammoth aid flow for Tsunami reconstruction efforts. The rupee was further supported by a debt moratorium offered by the G-7 nations that saved nearly US\$450 – 500 million on interest payments. This together with increased remittances helped the Balance of payments (BOP) to record a surplus of US\$ 259 million during 2005, offsetting the widening trade deficit amid the rising global oil prices. These factors eased the pressure on the rupee, which eventually closed the year at 102.04, appreciating 2.5% compared to December 2004.

Inflation easing hailed by supply improvements and a stronger currency

Point to point inflation declined towards mid 2005, supported by supply improvements lowering food prices, due to the favourable weather conditions. A strengthening currency also eased imported inflation, as the inflation measured by the Colombo Consumer Price Index (CCPI) reduced to 8.0% by December after reaching 15.9% in February 2005. While the Tsunami reconstruction efforts created some demand pull inflation, cost pressures were more significant amid rising global oil prices. The government was reluctant to pass the full effects to the consumer through upward revision to domestic fuel prices, but instead preferred to take a higher subsidy burden.

Sri Lankan Economic Profile

Real negative returns remain in most part of 2005

Despite rising inflation, Monetary Board preferred to hold the interest rates at modest levels, as 4 separate hikes pushed the policy rates by 125 basis points to 8.75%. The Monetary policy was highly skewed towards growth orientation and slower rate hikes, resulted in real negative returns throughout the year. Furthermore monetary expansion was controlled through other measures such as aggressive open market operations (OMO). A deceleration in monetary expansion was visible by the end of the year as the reserve money growth dropped to 15.8% by December, from 20% recorded previous December.

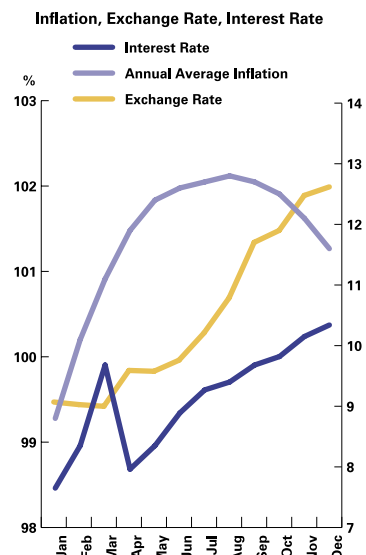
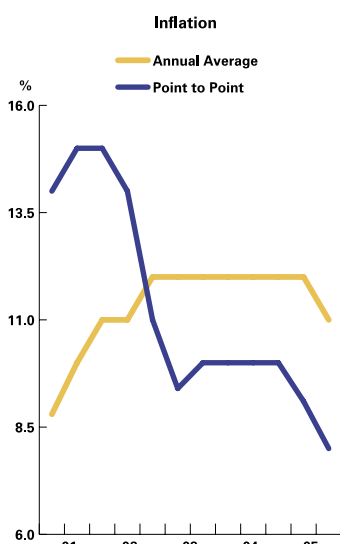
While welfare measures offered in the budget, Tsunami rebuilding together with supply constraints would lead to demand pull inflation, a long due revision to domestic fuel prices may result in cost-push inflation. Thus medium term inflationary outlook seem to be on the upside, pressurizing the interest rates in the medium term.

The Banking Sector and the economy

		2001	2002	2003	2004	2005
Commercial Banks	No	25.00	23.00	22.00	22.00	22.00
Domestic Banks	No	11.00	11.00	11.00	11.00	11.00
Foreign Banks	No	14.00	12.00	11.00	11.00	11.00
Number of bank branches	No	1,128.00	1,240.00	1,319.00	1,374.00	1,392.00
Number of ATMs	No	472.00	635.00	708.00	806.00	847.00
Number of credit cards	No	255,584.00	321,145.00	393,854.00	507,591.00	558,084.00
Banking Density	No	6.00	6.10	6.90	7.10	7.20

Banking Sector enjoyed a mix bag of goods during 2005, with steady growth in loan books, reasonable interest margins and improved fee based income. Furthermore strong economic recovery from the Tsunami devastation offered enhanced opportunities for banks, in terms of lending and the total loans & advances of commercial banks grew at a rate around 27.5% during the first 10 months. Overall the interest spreads stood higher around 2.6% (when comparing AWFDR and PLR) as opposed to past couple of years and improvements in capital markets helped selected banks to capitalize on their equity portfolio.

On a negative note the appreciation in the rupee during the first three months of 2005 adversely affected the foreign exchange income of the banks. This was a sharp contrast to 2004, where faster depreciation in the rupee enabled the banks to boost their foreign exchange income. However banks were able to recover somewhat during the latter part of the year with Rupee starting to depreciate. Nevertheless overall impact on the banking sector in terms of foreign exchange income was negative, with 29% YoY drop witnessed during the 1st nine months. On the other hand banks were also burdened with heavy taxes where both Corporate tax and VAT squeezing more than 40 - 45% of the Profit Before Tax (PBT) during 2005. The tax burden was further raised through budget 2006, which proposed to raise the financial VAT from 15% to 20%. High provisions were seen during this year as well due to the introduction of hair cut rule, but most banks have now cleaned their loan books while focusing on the quality of the portfolio.



Our Vision

is to provide leadership in nurturing the development of the emerging financial landscape

Our Mission

To be the most caring and versatile provider of excellence in financial services creating opportunities for more people in more places.

Values

To act as catalyst for the rapid growth and development of the financial services industry while proactively responding beyond expectation to customers' needs with professionalism and excellence.

To recognize our staff as our most valuable asset and linking rewards exclusively to performance and contribution, whilst providing opportunities for career development, within our organization.

To constantly endeavour to maintain financial stability and sustainable growth, whilst enhancing shareholder wealth.

To elevate our status as a socially responsible corporate that consistently surpasses the ethical, legal, commercial and public expectations.

To inculcate amongst all our employees, a culture of following and practicing ethical guidelines based on those adopted by relevant professional bodies or developed by our Bank, while continuously striving to improve them.

To educate and create awareness among our stakeholders so as to ensure the creation of a strong culture of environmental conservation and to achieve development in a manner in which the environment is protected.

Board of Directors

CHAIRMAN

MR. RIENZIE T. WIJETILLEKE

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

Chairman since March 2004. Managing Director & Chief Executive Officer from July 1988 to December 2004. Over forty-five years in Banking including overseas assignments.
Chairman – HNB Assurance Limi
Di

DEPUTY CHAIRMAN

DR. V P VITTACHI

B.Com. (London), Ph.D.

Director since 1988. Past Head of
Universities. C

Chairman – Browns Beach Hotels Ltd.

MANAGING DIRECTOR/CHIEF EXECUTIVE OFFICER

MR RAJENDRA THEAGARAJAH

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

Appointed Director/General Manager/Chief Executive Officer in December 2004. Appointed Managing Director/Chief Executive Officer in December 2005. Member of the
Corporate Management of HNB sin
Director – HNB Stockbrokers

DIRECTOR

MR. D H S JAYAWARDENA

Director since 1988. Chairman – Sri Lankan Airlines Ltd., the National Carrier, Managing Director and Chief Executive Officer – Distilleries Company of Sri Lanka Ltd.,
Managing Director and Chief Executive Officer – Lanka Milk Foods (CWE) Ltd., two large manufacturing Organisations. Managing Director and Chief Executive Officer – Stassen
Group of Companies, a widely diversified Group wi
Madulsima Plantat

DIRECTOR

MR. M.V THEAGARAJAH

F.C.M.A., F.C.I.A.A., F.I. Mgt. (London)

Associated with the Bank

is a diversified

Group with interest in Engineering, Trading, Manufacturing, Hoteliering and Tourism. Over forty years experience in Commerce, Finance, Industry and Management

DIRECTOR

MR. R.K. OBEYESEKERE

Director since 1998. Direct

Director – Balangoda Plantations Ltd. and Director – Lanka Dairies (Pvt.) Ltd.

DIRECTOR

MRS PAMELA C COORAY

LL.B. (Ceylon)

Appointed Director in April 2004. Former Director – Board of Investment of Sri Lanka and Associated Battery Manufacturers (Ceylon) Ltd.

DIRECTOR

MR RATNA SIVARATNAM

Appointed Directo

Past Chairman –

our Agencies,

Past Vice President – Ceylon Tourist Hotels Association, Past Vice President – Travel Agents Association of Sri Lanka, Former Chairman – Steering Committee of the Airports and
Port Development, Former Executive Chairman – Sri Lanka Export Development Board, Hony. Consul General for Finland in Sri Lanka, Director – Acme Printing & Packaging Ltd.
Director – Lanka Aluminium Industries Ltd.

DIRECTOR

MR RASHID GHAZALLI

B.Sc (Econ) (Banking & Finance) – University of Wales/Institute of Science & Technology, Wales

Appointed Director in September, 2005. Chief Executive Officer, MAA Corporate Advisory Sdn Bhd, Malaysia, the investment advisory division of the Melewar Group, Malaysia,
a conglomerate with core interests in financial and industrial services sector. Has wide experience in financial services industry in Malaysia and overseas, Director, Eversendai
Group, Malaysia, a steel engineering group, Executive Directorships held previously in the Maju Group, Malaysia – a conglomerate with core interests in property development, toll
highways, manufacturing steel, trading in building materials.

DIRECTOR ALTERNATE
(TO MR R GHAZALLI)

MR YEO TOOK KEAT

F.C.C.A

Director, HNB Assurance Ltd, Director/Group Chief Operating Officer, MAA Holdings Berhad, Malaysia, former Group Chief Financial Officer, MAAH,
Former Senior Vice President, Malaysian Assurance Alliance Berhad, Executive Committee Member – Federation of Public Listed Companies Berhad,
Contributor – Working Groups on Accounting & Standards – Malaysian Accounting Standards Board.

BOARD SECRETARY

MS. I GOONESEKERA

ATTORNEY-AT-LAW

Board of Directors



SEATED

MR RIENZIE T WIJETILLEKE - Chairman
DR. V P VITTACHI - Deputy Chairman
MR. RAJENDRA THEAGARAJAH - Managing Director/CEO
MRS. PAMELA C COORAY - Director
MR. D H S JAYAWARDENA - Director

STANDING

MR. R GHAZALLI - Director
MR. R.K. OBEYESEKERE - Director
MR. M.V THEAGARAJAH - Director
MR. RATNA SIVARATNAM - Director
MS. I GOONESEKERA - Board Secretary

Chairman's Statement



Group Income Grew by	26%
Group Cost Increase Curtailed to	6%
Group Post Tax Profit Increase of	134%
Growth in Group EPS	66%
Growth in Share Price	91%

Dear Shareholder,

It is my privilege to welcome you to the Thirty Seventh Annual General Meeting of Hatton National Bank and to present to you the annual report for the financial year ended 31st December 2005.

Chairman's Statement

Year 2005 was filled with many challenges which included the aftermath of the December 2004 Tsunami, rising oil prices, change in political leadership and many new opportunities to improve on our core business activities. As the figures reveal, 2005 was a great year for HNB. HNB has proved beyond doubt its resilience and inherent strengths to reinforce ourselves despite the few setbacks we faced in the recent past which hampered our rapid progress previously experienced.

2005 was also the year in which transition in leadership was successfully managed. Mr Rajendra Theagarajah took over the reins as Chief Executive Officer on 1st February, 2005 and I succeeded the late Mr J Chrisantha R Cooray as the non executive Chairman having served in the dual capacity of Chairman and Managing Director in 2004.

Looking forward, your board is delighted to have a strong management team in, to lead the bank towards greater heights. We are particularly pleased to note the manner in which the team has adopted to their new roles and responsibilities.

Corporate Governance

Corporate Governance continues to be a topic of intense discussion and interest among shareholders, regulators, press and community at large. Our goal at HNB is to maintain high standards of governance well above the minimum recommended by the 'ICASL code of best practice' and you will read in the Corporate Governance report elsewhere in this Annual Report that compliance is of high standard.

During the year, we have taken steps to enhance the effective contribution of board members. The ambit of our remuneration committee has been enhanced to cover strategic human resources issues. Two other sub committees were appointed to advice on matters relating to procurement and disposal of investment properties respectively.

It is with profound sadness that I report the demise of Mr Gemunu Gunatillake, Senior Partner of Ernst & Young. Mr Gunatillake was advisor to the Board Audit Committee and contributed immensely in that capacity. I warmly welcome Mr Ranjan Seevaratnam FCA as the advisor to the Board Audit Committee. Ranjan has recently retired from KPMG Ford Rhodes Thornton & Co., Chartered Accountants as partner after a long and distinguished career.

Board Changes

During the year, we appointed Mr Rashid David Ghazzali to the Board as an independent non-executive director. Mr Ghazzali is the Chief Executive Officer of MAA Corporate Finance which is the Corporate Finance arm of the Malaysian Insurer MAA and will no doubt contribute with his international and corporate finance expertise. We are also delighted that Mr D H S Jayawardena, Director was honoured by her Excellency Chandrika Kumaratunga, former President of Sri Lanka for his contribution to business and industry with the conferment of Deshamanya title.

Corporate Responsibility

We believe that attention to corporate responsibility is key to sustaining value creation for our stakeholders. Corporate responsibility is about business behaviour, which earns the trust and loyalty of our stakeholders. In this context, it was indeed encouraging for HNB to be recognised as one of Sri Lanka's ten most respected companies by the reputed Lanka Business Review Magazine. The Bank also received the first runner up award for Business Excellence by the National Chamber of Commerce.

Dividends

The board recommends a final dividend of Rs 2.00 per ordinary share. This makes the total dividend for the financial year Rs 4.00 per ordinary share. The total dividend payout for 2005 will be Rs 471 mn which reflects a growth of 34% over 2004.

Chairman's Statement

Global Economy and its Influence

Oil prices rising to unexpected levels caused problems to almost every economy despite their size. Balance of payment deficits, inflation, currency devaluation and early signs of high unemployment were few of the key hindrances faced by the non-oil producing countries. Naturally, the oil producing countries were enjoying the opposite and accumulated more wealth. Extensive rehabilitation and rebuilding work to be done in the natural disaster affected areas and extensive investment activities undertaken by the oil producing countries are expected to give a boost to the world economy in 2006.

The World Trade Organisation (WTO) has been advocating competitive market practices among its members and the debate on subsidising agricultural production in the first world and its negative implications on poorer nations, are continuing without being resolved. Much discussed Multi Fibre Agreement (MFA) became effective from 2005 but trade restrictions placed on China made it possible for the lesser developed nations to continue enjoying preferential tariff structures.

US interest rates were increased continuously for 12 times (8 of which were in 2005) to reach 4.25%. After a hold on policy for two years, the European Central Bank (ECB) too raised the Euro interest rates by 25 basis points in mid December '05.

Locally, Sri Lankan economy was expected to grow by 5.3% despite the devastating natural disaster, escalating oil prices, political turbulence and a government facing fiscal deficit. Sympathy of the European Commission earned Sri Lanka Generalised System of Preference (GSP+) duty advantage. As per the data released for the first three quarters for the year Electricity & Water, Transport, Storage & Communication, and Mining & Quarrying were the best performing sectors growing at 23%, 15% and 14% respectively. However, the

sectors, which were severely affected by tsunami i.e. fishing and tourism, did not recover even at the year-end.

The economic and political fabric of Sri Lanka was quite eventful in Sri Lanka during 2005. Despite the tough challenges and uncertainties the Colombo Stock Market grew by 28% proving it to be the true barometer of a market economy. Three new companies raised a total of Rs 9.7 Bn capital through initial public offers. Market Capitalisation grew by 53% and daily average turnover too reached a new record high of Rs 482 Mn.

Economic Outlook

The outlook for 2006 would heavily depend on four key factors; oil prices, US inflation, US home prices and business investment. Growth in the supply outstripping growth in demand, together with a promising build up of stocks would suggest that oil prices may not rise above current levels in 2006 and would ease slightly after the 2005 winter. US inflation too is expected to "ease" as oil prices stabilise and we see core inflation (excluding food and energy) declining since late 2004. Global economy is estimated to grow at 3.2% per annum similar to 2005. Amongst the industrialised countries China and India are set to grow at exceptional rates of 9% and 7% per annum respectively. The US Dollar is expected to fall against the Euro and the Yen. Interest rates look to rise with Fed expected to raise rates to 4.75% by first quarter 2006. Sri Lanka's main two problems can be easily summarised as security/ethnic issue and the rural poverty prevalent in the suburbs of the country. Solution to the poverty lies on structural adjustments and it is a task for a reformist government with a long-term vision. The ethnic problem needs urgent but strategic attention with support from the international community. With a change in the political leadership in late 2005, we hope that these two issues of national significance will be tackled in the most effective manner in the best interest of our nation.

Chairman's Statement

With India growing at an unprecedented rate, Sri Lanka has immense opportunity in supporting such growth by developing hub status for relevant peripheral services. India depends on its IT boom, which grew by 37% year on year in 2004 to a USD 17.2 Bn industry. India further controls 44% of the global outsourcing market. We believe that IT and Outsourcing are two industries Sri Lanka too could engage in, considering the highly educated youth population and the higher rate of literacy compared with other SAARC nations. Our natural advantage stemming from the geographic location must be exploited in aviation and shipping related activities. Further, we must concentrate on processing and providing the factors of production and services imported by India whilst taking advantage of the duty concessions granted through the FTA between India and Sri Lanka.

I believe the corporate sector particularly the financial institutions will be faced with many challenges in 2006 mainly due to the unsettled environment and inconsistency in Government Policy particularly with regard to the Corporate Sector involvement in the Economic Affairs of the Country.

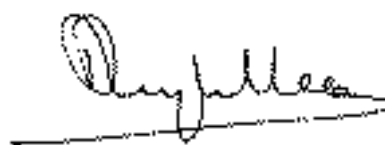
Changes effected too often in the broad tax policies of the Government undoubtedly affects the corporate planning of companies like ours. About three years ago, the Government announced in the budget that plans were afoot to broaden the tax net and specifically reduce the personal tax rate as well as the corporate tax rate gradually from 35% downwards. This year's budget has apparently reversed this medium term policy announcement made a few years ago by re-imposing the highest tax slab on corporates. This type of inconsistency naturally causes anxiety amongst the investors and also adversely affects the tax planning for companies particularly financial institutions which contribute substantial portion of their annual profits as tax in various forms. We sincerely hope that the new administration will look at this situation more constructively and the future budgets will make a more positive policy announcement on the medium term taxation plans.

Nevertheless, your Board of directors will make every effort to maintain its record of successes despite working in an age of rapid change. The Year 2006 will need to see critical decisions being taken by the political leaders of our country if we are to sustain prosperity for the country in the long term.

I take this opportunity to convey my appreciation to the former Minister of Finance Hon. Sarath Amunugama as well as the new Minister of Finance the Hon. President Mahinda Rajapakse and the officials of the Ministry of Finance, The Governor of the Central Bank of Sri Lanka and its officials for all the assistance and guidance given to the Bank during 2005.

I sincerely thank all shareholders for their continued support and the confidence and trust they have placed on the Board of Directors and the Management of the Bank.

I assure all of you that the Board of Directors will carry the organisation towards further progress and I remain confident that the strengths, diversity and the flexibility of HNB will enable us to continue to deliver superior value to our stakeholders.



Rienzie T Wijetilleke
Chairman

Thursday, February 16th, 2006

Colombo, SRI LANKA

Managing Director's Review of Operations



In our 2004 Annual report, we committed to implement those strategies designed to meet the set of challenges we had identified as critical for delivering superior value to our stakeholders. Your management team has pursued this path during the last twelve months with extraordinary vigour. Our challenge was to ensure that balanced attention was given to all six areas identified.

Income

As in the past few years, Net Interest Income continues to be a major contributor to Net Income of the Bank accounting for 70%. Net Interest Income grew by 24% which was led by a 23% increase in Interest Income. ***The year also saw the entire operating expense bill of Rs 5.7 Bn been***

Managing Director's Review of Operations

met by Net Interest Income from Core banking activity which was the first time in eleven years. As a key strategy, this gave us a solid foundation to be selectively aggressive in other areas such as forex trading, bond trading etc within our internal risk tolerance framework. The Sri Lankan rupee appreciated by a modest 2.44% from Rs 104.65 to Rs 102.10 against the US Dollar. Despite this limitation (Depreciation of the rupee in 2004 was 7.8 %) and a clearly defined strategy to exit from Trading in Futures, Options and Bullion, the dealing room generated Rs 646 Mn as Exchange income which was in line with the annual plan. Having recognized early in the year that opportunities for Capital Gains from fixed income securities was almost non-existent due to a slightly rising interest rate regime, the focus shifted to equity trading. Rs 500 Mn representing a mere 0.3% of the total asset base as at January 2005, was allocated for equity trading which contributed Rs 78 Mn in realised gains and dividend for the year.

Costs

Our Cost/Net Income ratio has been one of the highest in the local banking industry reaching an all-time high of 80.4% in 2001. Recognising this aspect as a key success factor, a brutal assault on cost control was launched at all levels in the organisation. This exercise worked on the simple belief that **"It is not about Not Spending but spending Wisely and for good value"**. Sound inventory management, aggressive negotiation with suppliers and waste minimization all contributed towards containing the rise in operating costs to just 5.8% which is among the lowest in the industry despite inflation estimated at 12%. Staff expenses grew by a modest 14% while premises related costs were contained at 15%. The Bank's Cost/

Net Income ratio declined by 8% to 62% in 2005. Despite this remarkable achievement, we are conscious that this is not good enough. This reality will keep us focused on continued improvement in our cost management.

Portfolio Quality

Provisioning for bad and doubtful debts in 2005 was Rs1.76 Bn. The Non Performing Advances ratio continues to come down at 8% (13.7% in 2003) while the NPA cover has reached an exceptionally healthy level of 62% (34% in 2003). Our Net NPA/Net Advances improved tremendously from 4.79% to 2.55% and we will continue with our quest for reducing it further. What we are not afraid of at HNB is taking risks. **Our approach will continue looking at business opportunities after assessing risks based on informed decisions backed by appropriate Risk-Reward trade off.**

Resource Deployment

We began the year recognizing that our Rs 152 Billion was the largest asset base among private sector commercial banks in Sri Lanka. At the same time we also accepted that size alone is not good enough if it is not profitable. Continuous spot light on the Bank's Balance Sheet together with a "clinical" review of asset yields has delivered a Pre-tax profit of Rs1.8 Bn for the Bank. This is a 94% increase over 2004 which has been delivered with an asset growth of just 9%. Our major milestone for this year was to achieve a Return on Assets (ROA) in excess of 1% which is right on track towards our 3 year goal of exceeding 1.5%. This will now enable HNB to qualify for the development oriented refinance schemes which are important to the growing Small and Medium Term industry segment. **Staff have**

Managing Director's Review of Operations

always been, are and will continue to be our greatest treasure. HNB has consistently strived to attract, train, develop and promote high calibre staff. Our pre tax profit per employee has grown by 67% while business per employee has increased by 19% reflecting the improvement in employee efficiency.

Technology

As mentioned in the 2004 report, we focused on four key deliverables relating to Information Technology. HNB's own payment gateway supporting MasterCard and Visa now provides our customers a virtual "point of sale" capability to facilitate web based transactions. The core banking application now functions with a 24 x 7 capability which has made our internet banking platform *Hatna-i* a reality. In November 2005 we replaced our existing two ATM switches with a new common ATM switch. This will enable all bank customers (regardless of branch of primary relationship) to withdraw cash from any of our network of 143 ATMs. Quality of Management Information has been much improved with our in-house developed *BanBis* data warehouse application which won the silver award (Financial Sector) at the 2005 National Best Quality Software Awards, organised by The British Computer Society and Computer Society of Sri Lanka.

Capital

We are conscious that a strong capital base is an integral part of the solid foundation necessary to support a growth momentum of our bank. During the first half of 2005 we completed the capital raising exercise of Rs 2.5 Billion which commenced during the latter part of 2004. The combined rights issue and Global Depository Receipts

(GDR) together with retained earnings up to 2005 has provided us with Rs.11.2 Billion by way of shareholders' funds. **The exhaustive preparation necessary to meet the stringent listing criteria of the Luxembourg Stock Exchange has raised our disclosure requirement above the minimum domestic requirements. HNB is the only banking institution in Sri Lanka to have a listing in a recognized stock exchange outside Sri Lanka.** The gruelling road shows in Europe and Asia not only exposed HNB to a wider pool of institutional investors but also gave us the unique experience of understanding the needs and expectations of sophisticated international investors. This will no doubt pay long term dividends. We also raised a further Rs 1.2 Billion by way of Long Term sub-ordinated debentures with maturities ranging from 6 to 18 years. The proceeds will be used predominantly to finance our growing housing loan portfolio. The Tier I Capital ratio as at 31st December was 10.87% while Tier I plus Tier II ratio was 11.55%. Both these ratios were above the minimum regulatory requirement of 5% and 10% respectively.

Regulatory Challenges

The Central Bank of Sri Lanka has engaged banks in a consultative process regarding the impending implementation of Basel II framework for Risk Management. **We propose to initially adopt the Standardised Approach to computing allocation of risk capital.** HNB carried out a comprehensive self assessment in 2005, of its readiness in complying with these new provisions. Efforts would be directed towards training of staff, capturing of historical data and monitoring the rating migration of our borrowing customers.

Managing Director's Review of Operations

The Future

Globalisation, Consolidation and Convergence of Financial Services are three forces which will create larger and stronger companies. **People need reassurance that scale and complexity does not threaten human values and expectations.** We will continue exploring opportunities to grow by organic means and otherwise with the objective of sharing the benefits of scale advantage with our stakeholders.

Our network of domestic customer centres is fast reaching maturity and stands at 146. We will continue the program of upgrading pay offices to full branches where business justification prevails and open further customer centres at selected locations. Our retail distribution will be further enhanced with expanding alternate channels. **We are in the process of finalizing a network sharing memorandum with two local commercial banks which will enable our customers to access a wider pool in excess of 350 ATMs in Sri Lanka.** With the introduction of "VISA Debit Card" during 2006, our cardholders will gain access to more than 900,000 ATM's and over 20 Mn merchants globally.

The 2006 national budget proposes increased taxation of the banking and financial service sector by way of a 5% increase in financial VAT and up to 5% increase in corporate taxes. *This will no doubt impact our after tax earnings growth.* **However, we will recognise the opportunities available to finance new industries encouraged (by the budget) to be set up outside Colombo and Gampaha.** We will closely follow the key development projects identified in the 2006 budget in the areas of bunkering, expressways, airport

development etc and explore opportunities to participate in multi source financing solutions.

My fellow members of **Team HNB** have worked as a cohesive united group during the past twelve months in delivering exceptional results. My sincere appreciation to each and everyone of them. A special thank you to all the family members who have supported my team in this endeavour. I eagerly look forward to continuing this effort and realizing our business plan with passion in 2006.

The guidance and encouragement received from my Chairman and colleagues on the Board have been invaluable. My deep gratitude to all of them and I look forward to their continued support in leading HNB towards another year of solid performance.



RAJENDRA THEAGARAJAH

Thursday, February 16th, 2006

Colombo, SRI LANKA

Business Review

The Bank has performed exceptionally well during the year 2005. This performance was achieved in the backdrop of the tsunami disaster which affected the tourism industry, fisheries and agriculture in North, East and Southern Provinces. Although the destruction posed a negative impact on export oriented industries in the first half of the year, the Bank witnessed a bounce back during the latter part. However, the tourism industry has still not reached the pre-tsunami level of operations.

Although tourism was affected, the impact on the macro economic environment was relatively small as none of the other industries such as garment exports, power & energy, plantation and manufacturing sectors or the Colombo Port were directly affected.

The strategic restructuring process which was initiated during latter part of 2004 brought positive results in many areas of the Bank.

Corporate Banking

The Bank's Corporate Banking business constituted approx. 63% of the total loans and advances portfolio. This division mainly caters to the banking needs of the corporate clients as well as medium to large size domestic commercial customers with its expertise in trade finance, project financing, working capital financing and related services. The Corporate Banking portfolio achieved a growth of 14% during the year under review with greater emphasis given to maintaining profitability and quality of the portfolio. Corporate Banking will continue to be one of the critical business segments of the Bank in achieving a sustainable and profitable lending portfolio.

Despite pressure on margins due to increased competition in the market and other uncertainties such as political instability/fragile peace process, a significant contribution was made to the overall profitability of the Bank. During the year, the division extended facilities to construction, health, leisure, apparel, financial services, telecommunication and manufacturing sectors whilst diversifying into investment in securitization of loans. As a step towards achieving portfolio diversity, the lending activities were extended in substantial levels to the transport and infrastructure sectors of the economy and are geared to play a bigger role in future as well exploiting further business opportunities.

Areas of credit risk management and improvement of the portfolio quality were given much consideration during the year. Credit Risk Monitoring Unit (CRMU) continued to monitor medium and large exposures and the unit closely interacted with Account Relationship Managers/Branch Managers in identifying potential risks and devising risk-mitigating strategies to enhance portfolio quality.

Project Finance

Project Division handles term loans over Rs 10.0 million for medium to long term/large industrial enterprises and infrastructure projects. In addition to term loans, facilities for working capital requirements of projects are also evaluated by the Project Division.

Portfolio of the Division stood at Rs 5.8 billion as at 31st December 2005. During the period under review, the division

approved facilities amounting to Rs. 1.97 billion, out of which 47% was for power & energy followed by 27% for the leisure industry which consisted of 6 hotel projects in Sri Lanka and an expansion of a resort hotel in Maldives.

The division actively participated in World Bank's Renewable Energy for Rural Economic Development (RERED) Credit Line under which the Bank financed 7 mini hydropower projects (total facilities amounting to Rs 804.5 million) with a capacity of 29 MW during the year.

Rest of the approvals were for the sectors of real estate, condominium apartments, manufacturing and food & beverages.

HNB envisages more growth in short term investments in the areas of support services such as health care and logistics while the long term investments are envisaged in infrastructure such as power and energy, construction industry, tourism, food and beverages etc, in the ensuing year.

Personal Banking

Deposit Mobilization

The total Sri Lankan Rupee deposit base of the Bank recorded a lower growth of 8% in comparison to year 2004. This was mainly attributable to the Bank's strategy of shedding short-term high cost funds, which in turn has reduced the funding cost to a great extent. The cost free demand and savings deposits in Sri Lankan Rupees recorded significant growths of 41% and 12% respectively. The Bank also used its fixed income bond portfolio to strategically generate cost effective funding by way of repurchase agreements.

The "Pathum Vimana" savings scheme celebrated its 12th Anniversary during the year and a special scheme was launched rewarding over 20,000 customers for the deposits made during the special promotion.

The Bank launched the "HNB 5 year Fixed Deposit" scheme to provide a long term investment opportunity to savers. This scheme was introduced with many value added features including Free Life Insurance Cover and mopped up Rs 875.0 million in 2005.

The "Singithi" Minor deposit base increased by Rs 521.0 million during the year. The Thrift campaign and the "Singithi" New Born Baby campaign were some of the key events that took place in the year to increase mobilization of minor savings.

"Shanthi" Housing Loans

The Shanthi Housing Loan portfolio reached Rs 10.2 billion at the end of year 2005 recording a growth of over 34%. The Bank plays a leading role in the housing market commanding a substantial market share. The portfolio is diverse throughout the Island covering all 9 provinces mainly concentrated in the Western Province (72%).

"Subasiri" & Consumer Loans

The Bank's personal loan scheme is designed to meet the middle and higher income category of borrowers and the Subasiri Personal Loan Scheme is meant for Executives and

Professionals and the Bank's existing credit worthy clientele. The Subasiri portfolio which is represented in the high volume of turnover over the period under review recorded a 5% growth.

New loans under the "Consumer Loans" category where the Bank maintains a substantial market share, recorded a modest growth during the year 2005. The present customer base of over 150,000 is used for cross-selling of the other products and services of the Bank, such as Housing Loans, Credit Cards, Personal Leases and Deposits.

Leasing

Leasing business continued to record an exceptional growth of 28% during the year. The growth is largely attributed to special innovative leasing packages tailored to suit varied needs of different clients in collaboration with renowned vehicle brand names such as TATA, Maruti, Mitsubishi and Kelisa.

According to the new business volumes executed during the year, the Bank ranked second position in the overall market, whilst retaining the number one position among the banking sector.

Pawning

During the year under review, the Bank's Pawning Portfolio grew by 9.5% to Rs12.5 billion.

The pawning business is carried out at 135 Customer Centres spread throughout the country against stiff competition from several other financial institutions. The total pawning portfolio represents 11.6% of the Bank's entire credit portfolio.

During this year the Pawning Division concentrated on consolidation of the portfolio, improving service quality and competence of the staff by conducting frequent training programmes.

Credit Cards

The Bank's Credit Card portfolio continued to record impressive growth rates of 26% and 10% in both areas of issuance and acquiring businesses respectively. The Credit Cardholders' loyalty programme, "Royalty 2005", gave a tremendous boost to our cardholders as the usage and number of transactions recorded growth rates of 20% and 17% respectively. The loan portfolio also grew by 35%.

The acquiring business of the Card Centre which suffered from the impact of "tsunami" during the first quarter of the year bounced back during the latter part to record very satisfactory progress as more emphasis was placed on canvassing merchants/business from non-coastal areas.

The Bank also introduced overseas travel insurance with the risk cover upto USD 100,000, which is yet another initiative taken to add value to its Credit Card business.

Development Banking

During the year under review HNB's Rural Credit portfolio increased by 24% to Rs 2.0 billion.

The island's renowned micro finance scheme "Gami Pubuduwa" continued to grow and the portfolio surpassed Rs 1.0 billion landmark during the year. The Bank entered

into an agreement with Savings Banks Foundation of Germany for a concessionary refinance scheme to grant Rs 250.0 million worth of loans for micro entrepreneurs in tsunami affected areas.

After the tsunami catastrophe, the Division took responsibility for handling "Susahana Credit Scheme", the CBSL sponsored refinance scheme targeted for revitalisation of tsunami devastated enterprises. The portfolio of same stood at Rs 601.0 million with a client base of 880.

Treasury and International Operations

Treasury Operations

During the year 2005, HNB Treasury focused on achieving sustainable growth and retaining its well-established market share & image in the local Foreign Exchange & Money Market.

The liquidity surplus, which resulted from the massive post-tsunami inflow of foreign funds, coupled with record high oil prices, fuelled inflation in the country to around 12%. To counter this, the Central Bank of Sri Lanka adopted a policy of monetary tightening and raised its benchmark rates by a total of 1.25% p.a., for the year 2005, at its meetings in May, June, September and December. Despite these, real interest rates remained negative, giving rise to expectations of further rate hikes. Consequently, bond prices continued to fall, providing banks with little opportunity to profit from bond trading. At HNB, trading in bonds came to a virtual halt, closing the door to a hitherto lucrative revenue source.

With limited appetite in the market for derivatives, HNB Treasury continued to focus on Plain Vanilla spot and forward transactions in the foreign exchange market. The emphasis was on providing competitive pricing and service excellence to the Bank's Corporate and Retail clientele, while maintaining and leveraging on its pre-eminent position in the inter-bank market. This strategy paid-off with the Corporate Banking Division being able to capture a larger share of its clients' trade business. However, the overall foreign exchange income was affected from the appreciation of the rupee due to massive aid following the tsunami.

In 2005, Treasury repatriated USD 59.0 million worth of currency notes and a further USD 3.0 million was sold locally. These figures represent a fall from the previous year, which is due to heightened activity in the unauthorised channels in foreign currency notes.

International Operations

'Remittances' was the keyword during the early part of the year particularly the inward remittances stemming from the tsunami disaster and retail donor reactions for helping the afflicted. In addition, the usual inflows from migrant workers and Sri Lankans now domiciled overseas continued, contributing to an overall growth of 27% in 2005. The Remittance Centre supported this cause by expeditiously delivering cash payments on specific remittance products through the network of Customer Centres. The Bank is also actively pursuing avenues of increasing its presence

Business Review

in the Middle East and countries where official remittance channels are not popularly in use with a view to further increasing the flow of remittances.

Our Representative Offices in Chennai and Karachi also continue to serve as strategic points for continuing the already established relationships and for harnessing new ones. The Chennai Office has established itself also as a service provider of logistical support for Sri Lankan entrepreneurs seeking to enter the Indian market.

Despite the growing competitive nature of Trade Business, the Bank recorded a growth of approximately 13% over 2004 in the non-fund income earned on Trade Products.

Import Business too showed a significant increase over 2004. However, Export Business handled showed a decline due to a substantial quantum being routed direct to buyers.

In recognition of the high standard of service offered, our Trade Services Department is ISO 9001 – 2000 certified.

The Bank has also established a Business Development unit for Trade Services to further strengthen the interface with customers and to focus more effectively on their needs.

Investment Banking

A notable achievement during the year was the consolidation of the Bank's Investment Banking services under the newly formed HNB Investment Banking Group, comprising of HNB Securities Ltd and divisions of the Bank carrying out Corporate Finance & Advisory, Fixed Income Securities and Equity Trading activities. HNB is now positioned as a full service Investment Banking services provider.

Corporate Finance

Corporate Finance activities fared well during the year 2005 as market conditions remained conducive for capital market transactions for much of the period under review despite continued political uncertainties and the stagnant peace process. Some of the key transactions successfully completed during the year are as follows;

Underwriting & Issue Management

- HNB was the Lead Manager, Joint Underwriter and Joint Banker for the Rs 600 million Initial Public Offering (IPO) of shares by Sierra Cables Limited. The IPO was a resounding success and was oversubscribed by 21 times.
- The USD 9.7 million Global Depository Receipt offering by the Bank was successfully concluded in mid 2005. HNB was the second corporate in Sri Lanka and the first bank in the country to obtain a foreign listing. HNB Investment Banking Group acted as the advisor to the Bank.

Structured Finance

- HNB was the Manager and Arranger for asset backed financing for a total of Rs 600 million.

A notable achievement during the year was the formation of the strategic alliance with ICICI Securities for Investment Banking activities in Sri Lanka through a Memorandum of Understanding. Primary motivation for this strategic alliance

was to further develop the ability to offer cross border and international capital raising expertise to Sri Lankan corporates through a range of equity, debt and hybrid products.

HNB Investment Banking Group has already been mandated for several large equity and debt capital raising assignments with more capital market and mergers & acquisitions transactions currently being negotiated.

Fixed Income Security (FIS)

FIS market continued to experience bearish sentiments due to the rising interest rates.

Equity Trading

Proprietary equity trading was extremely profitable due to active trading in the secondary market. HNB was one of the few financial institutions, which successfully captured the bull market in 2005 with realized trading profits exceeding Rs 75.0 million.

Information Technology

2005 was a busy year for the Information Technology Division.

The Bank's Software Development Team received the Silver Award in the Financial Sector category at the National Best Quality Software Awards 2005, organized by the British Computer Society and Computer Society of Sri Lanka. The award winning product, the Business Intelligence System (BanBIS), which incorporates MIS, Financial Reporting & Data Warehousing has been selected for the South-East Asian regional competition. HNB's Corporate Website, www.hnb.net was re-launched with a new look and concept to further strengthen our relationship with our valued customers locally as well as internationally.

An Enterprise Resource Planning (ERP) System was implemented which permits monitoring of fixed assets of all branches from the centre. "Non-stop banking" which was in operation since June 2005, permits online real time access to customer accounts via Internet, SMS & Tele-Banking, day or night including holidays.

Our ATM network too has now grown to 143 ATM machines which is spread island wide.

The Cheque Truncation & Image Clearing system implemented by HNB for scanning of Cheque for clearing purposes will be in operation once the National switch which is expected to be operational during 2006.

Performance of Subsidiaries/Associate Companies

Lanka Ventures Limited

Lanka Ventures Limited (LVL) recorded a pre-tax profit of Rs 118 million for the financial year ended 31st March 2005 compared to Rs 76 million in the previous year.

For the first time in the history of LVL, its investment income exceeded Rs 100 million representing 75% of its total income of Rs 136 million. Interest income of Rs. 35.0 million represented the balance 25%. During the year, LVL exited from three venture capital investments using

three different mechanisms typically employed by the industry. LVL exited from one investment through an introduction in the stock market, the second through a negotiated sale to a third party and the third through a share buy-back agreement entered into with the promoters of the project. These exits yielded a total profit of Rs 64 million for the company.

The dividend income also improved by a considerable margin of 75% to Rs 15 million from Rs 9 million in the previous year. The realized return on LVL's stock market portfolio of investments was 24% in IRR terms. The company paid a dividend of 15% for the financial year ended 31st March 2005.

Although the company is unlikely to achieve a higher profit in the current financial year compared to last year (mainly due to lack of exits from venture capital investments), LVL remains confident in improving on the budgeted performance.

HNB Stock Brokers (Pvt.) Ltd.

Company continued to achieve an excellent performance during the year registering the highest ever turnover of Rs 19 billion. Accordingly a Brokerage Income of Rs 164 million and a pre-tax profit of Rs 58 million were recorded for the period. The Company is ranked among the top four Stock-Brokering companies on the basis of number of transactions carried out at the Colombo Stock Exchange for the year 2005.

The Company has paid a dividend of Rs 32.3 million to its shareholders over the last three years, which is equal to an average of Rs 10.7 million, or 30% per annum compared to the issued share capital of Rs 36 million. The shareholders' funds, as at 31st December 2005 was Rs 99.3 million, which is a 57% increase compared to the previous year. This performance came within the fourth year of operation as a fully owned subsidiary of the Bank and is the best since the Company's inception in year 1992 as a member of the Colombo Stock Exchange.

HNB Securities Ltd

The year 2005 proved to be a challenging year for HNB Securities Ltd, due to the uncertainties which prevailed in the political and economic situation of the country. While the domestic interest rates remained stable during the first quarter of the year due to the post-tsunami cash inflows, the rates continued to take an upward trend thereafter due to weak economic fundamentals.

HNB Securities Ltd ended the year with a net profit after tax of Rs 87.4 million, which was a marked improvement from the loss of Rs 13.1 million incurred during the previous year. Whilst the asset base too grew to Rs 7.35 billion by the end of the year, shareholders' funds stood at more than half a billion at the year end, which is after the payment of dividends of Rs 50 million in 2004 and full retrospective taxes.

The Company maintained a strong presence in the domestic government securities market, with active participation in the primary and secondary markets.

Sithma Development (Pvt.) Ltd.

Sithma Development (Pvt.) Ltd. (Sithma) is a fully owned subsidiary of the Bank engaged in the activity of property

development. Sithma, a BOI Flagship Company, owns the 23 storied HNB Towers and a 7 storied building at 21, Janadhipathi Mawatha, Colombo 1.

HNB Towers is occupied by HNB and 23% of office space is occupied by non-group companies. The building at Janadhipathi Mawatha is occupied by a Government Ministry.

The company is also in the process of diversifying its activities in undertaking development of an apartment complex in Colombo.

HNB Assurance Ltd

HNB Assurance Ltd forged ahead recording impressive growth rates in both general and life insurance business during the year 2005. Its General Insurance premium income grew by 39% over the last year to reach Rs 470 million while its Life Insurance premium income grew by 72% to reach Rs 354 million. The combined registered turnover of Rs 824 million recorded a growth of 51% over 2004.

The profitability of the Company also improved registering a net profit after tax of Rs 60.3 million, recording a growth of 268% over the last year. This level of profitability was achieved despite investing significantly on expanding the distribution network and building up the brand value, both essential for the long-term success of the Company. In addition, the impact of the tsunami which considerably affected last year's results had a negative impact in 2005 too due to lower profit commissions from re-insurers based on 2004 results. The significant improvement in profitability enabled the Company to declare a 5% dividend to the shareholders for the first time since incorporation.

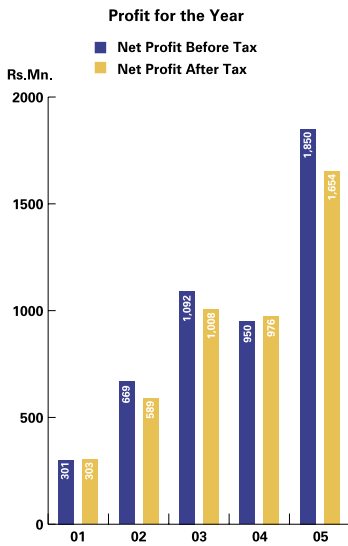
The Company launched several innovative new products during the year under review. Among them, "Motoguard" – a new motor vehicle insurance policy was introduced in May 2005 with several unique features such as a loyalty point scheme and a discount card in addition to offering on-site inspection facilities supported by a 24-hour helpline. This new product enabled the premium income from motor insurance to reach Rs 301 million registering a growth of 44% despite severe competition from larger companies.

HNB Assurance also introduced a new range of travel insurance products, branded as Travel Pal, Travel Wise and Travel Max meeting diverse needs of customers undertaking overseas travel. These products contributed over 60% of the premium income generated from the miscellaneous class of General Insurance business. The Company also launched two new life insurance products in the form of a 15-year single premium investment plan named as "Triple Power" providing a guaranteed return of 3 times the initial investment and a regular premium endowment plan for the entire family named as "Ran Kirana".

In order to support the growing number of insurance advisors and to provide a better service to all other intermediaries and clients, the company embarked on an ambitious expansion programme by increasing its branch network from 18 to 26 by end of the year.

Having significantly strengthened its capabilities in the areas of product development, distribution and customer service, HNB Assurance is well on the way to become a leading player in the local insurance market.

Financial Review

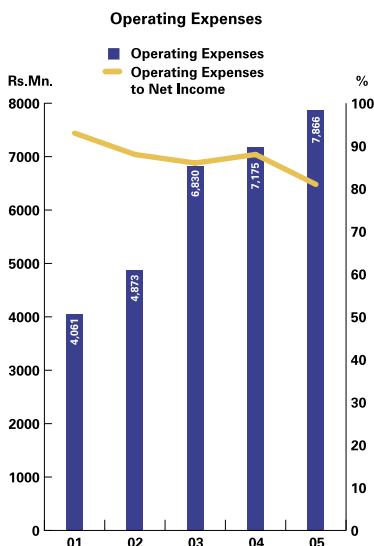
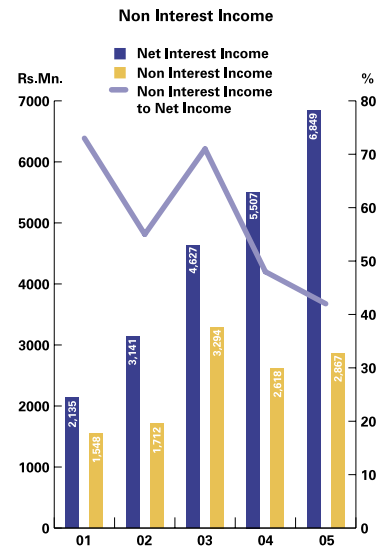


Profit for the year

Improved performance in the core banking activities coupled with sound management of operating expenses enabled the bank to achieve profit before tax of Rs. 1,849.9 Bn. This reflects an impressive growth of 95% over the previous year. Profit after tax too had a significant growth of 69% in 2005 to reach Rs 1,654.6Bn. Surplus income generated in the core business increased the income tax provision compared to the previous year. Growth in interest income of 23%, commission and fees income of 9% and other income of 83% increased the total revenue by 21% while operating expenses increased by 10% over the corresponding year. Main components that contributed to the increase in operating expenses were staff costs, premises related costs and loan loss/investment provisions. Other expenses declined by 18%. Recoveries improved in 2005 reducing the interest in suspense by Rs.100 Mn despite a 14% growth in loans and bills. The Bank made use of incremental revenue during the year to improve its NPA cover by making additional loan loss provision on account of a few large accounts. Accordingly loan loss provision charged to the Income Statement increased by 12%. Trading in equities generated a profit of Rs 142 Mn but was offset by marking the trading portfolio to market by Rs. 77.3 Mn. This was necessitated due to the sharp decline in Colombo Stock Exchange experienced in the latter part of the year.

Non Interest Income

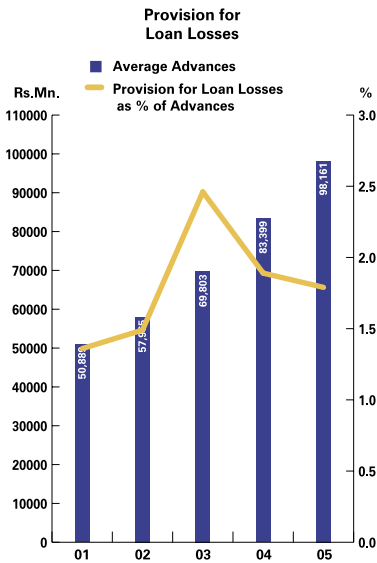
HNB's non interest income recorded a 10% growth over the corresponding year. Fee and Commission based income grew by 9% gaining from enhanced opportunities during the year. Improvement in the domestic capital market in the early part of the year helped the bank to capitalize on its equity portfolio recording a profit of Rs.142 Mn up 968% over the previous year. Foreign Exchange contributed Rs. 646 Mn at similar levels to 2004, reflecting the Bank's strategy to keep out of derivatives and bullion trading activities. Stronger growth in interest income compared to non interest income resulted in a decline in the ratio of non interest over net interest ratio to 42% from 48% in 2004.



Operating Expenses

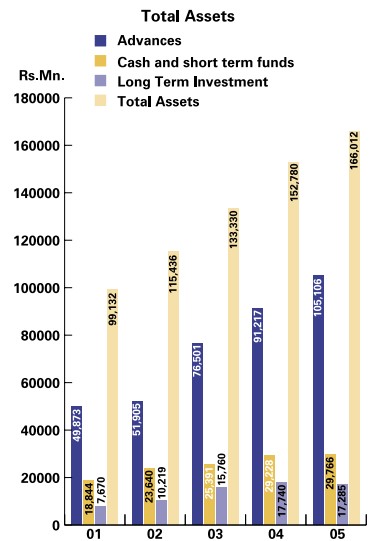
The Bank continued its focus in controlling the overhead bill during the year 2005. Accordingly, other expenses declined by 18%. Stable inflationary trends, favourable weather conditions and strengthening of the rupee consequent to tsunami aid inflows, complimented bank's own efforts. Notable declines in other expenses were advertising, charges on Visa/Master card related payments, and overseas traveling. Bank's operating expenses to net income ratio improved from last year's 88% to 81% in the year under review.

Financial Review



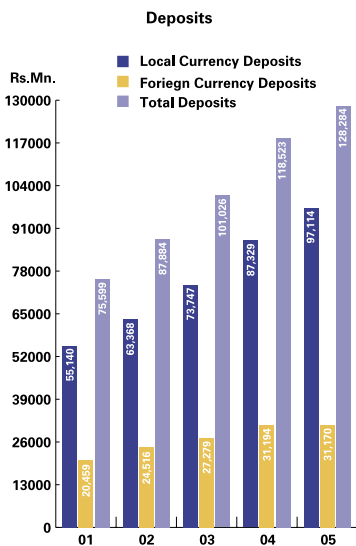
Provision for Loan Losses

Consolidated efforts by the branch network and central monitoring units enabled the Bank to improve overall quality of its loan book. HNB's non performing advances declined from Rs 10.6 Bn in 2004 to Rs 9.7 Bn in 2005 reflecting an improvement of 8.5%. This reduced the ratio of non performing advances over total advances (net of interest in suspense) to 8% from 9.7% in 2004. The provision of Rs. 1,759 Mn provided in 2005 improved HNB's provision cover to 62% from 55% in 2004.



Total Assets

Total assets recorded a modest growth of 9% to reach Rs 166 Bn. The growth is reflected in advances/leases and cash & short term funds which increased by Rs. 13.8 Bn and Rs.1.1 Bn. respectively. The impact of this 14% growth in our loan book is evident in the Income Statement. Main contributors for the advances growth were overdrafts by 15%, term loans by 14% and housing loans by 35%. Assets relating to investments and fixed assets were reduced by 4%.



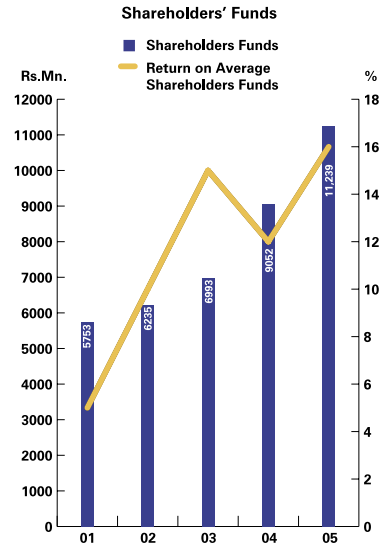
Current, Savings and Other Deposits

Bank's deposits increased to Rs 128.2 Bn recording a growth of 8% from Rs 118.5 Bn in 2004. This growth was achieved in a controlled monetary environment where interest rates changed within modest intervals though inflation stayed above interest rates. Current account deposits recorded the highest growth of 21% while savings and time deposits grew by 8% and 6% respectively. Deposit mix of Sri Lanka rupee current and savings over total rupee deposits improved from 58% in 2004 to 62% in the year under review. The Bank's foreign currency deposits remained at Rs. 32.2 Bn. Deposit mix of foreign currency current and savings over total foreign currency deposits declined from 56% to 49% in 2005.

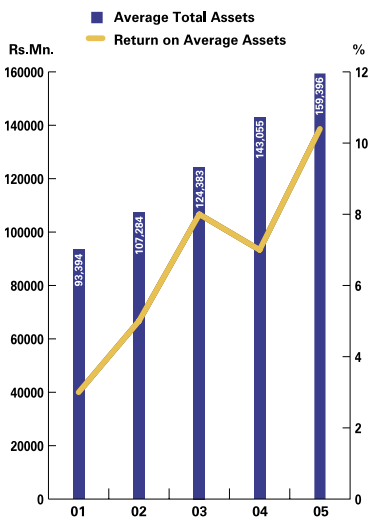
Financial Review

Share Holders' Funds

Share Holders' Funds reported a healthy growth of 24% from Rs 9 Bn to Rs 11.2 Bn, year-on-year. Of this growth, 11% was accounted from Global Depository Receipts (GDR) and the balance 13% from profit generated during the year. This significant growth has boosted the Return on Average Shareholders' Funds from previous year's 12% to 16% in 2005. Bank's Shareholders Funds over total liabilities ratio increased from 6% to 7% in the year under review.



Return on Average Assets



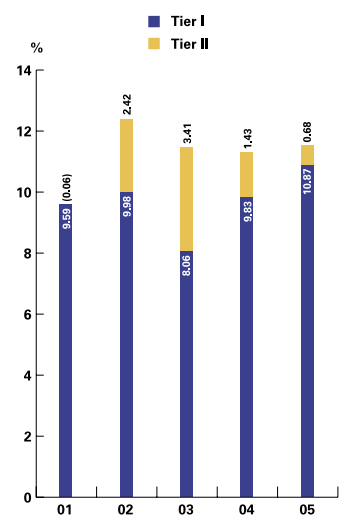
Return on Average Assets

Return on asset increased by 36 basis points from 0.68% to 1.04%, year-on-year. Growth of assets had complemented the Bank's profitability. Bank's strategy of not achieving balance sheet growth at the expense of profitability is amply reflected in this performance. Gains from interest income growth and check on overheads paved the way to surpass 1% Return On Assets.

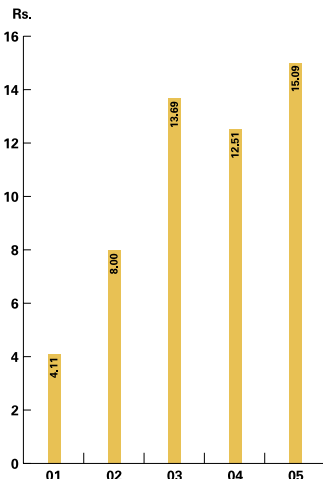
Capital Adequacy Ratio (CAR)

The Bank's Tier I capital ratio as at end of 2005 reached 10.87%, an increase of 104 basis points over the previous year. Tier II capital reduced to 0.68% due to annual discounting made to the outstanding subordinated debentures. Total risk weighted assets grew by 13% compared to 2004. On balance sheet assets falling within 100% risk weighted category grew only by a modest 10% reducing the burden on the CAR. Tier I capital improved during the year due to a combination of GDR proceeds of Rs 0.9 Bn and retained profits of Rs 1.6 Bn. The CAR of the Bank increased by 29 basis points to reach 11.55% at the end of 2005.

Capital Adequacy



Earnings Per Share

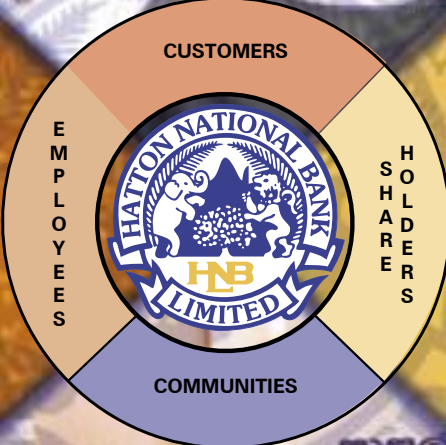


Earnings per Share

Earnings per share increased by 20% to Rs.15.09 by end of 2005. This is after dilution of earnings due to the GDR issue (taken after time weighting).

Sustainability Report 2005

“Partnering our stakeholders in sustainable development”





"At HNB we have fostered the belief that Corporate Social Responsibility (CSR) is Voluntary in approach and, that it compliments rather than replaces legislation and social dialog. It enables us to commit ourselves to going beyond standards and rules, rather than raising standards and simply not complying with them. For the first time our annual report includes a dedicated section on 'Sustainability Reporting', which endorses our shift in focus from interest of shareholders to the interests of our stakeholders, with the objective of " Partnering our stakeholders in sustainable development".

This change in our focus has, and will continue to enhance our commitment to our mission "To be the most caring and versatile provider of excellence in financial services creating opportunities for more people".

The following sections of this report explore the circumstances which require judgment relating to financial transactions. To illustrate this, consider the following four examples:

- **Customers** - Lending to the lesser affluent with the view of improving quality of life and helping small businesses to grow. However, if we encourage 'over indebtedness' it will first impact the customer and then us. It is our responsibility to judge whether a customer's aspiration to borrow is affordable and meets with the bank's expectation of adequate return.
- **Employees** - Fostering a talent pool that gives the bank superior efficiency and profits. However, it is our responsibility to judge and ensure that such efficiency is not achieved at the expense of depriving staff from balancing work with personal life.
- **Shareholders** - We need the trust of our shareholders; if not they will move their investments elsewhere. Profits are important but the ability to sustain a stable stream of earnings is more important. It is our responsibility to judge whether a business decision will generate superior profits without compromising on integrity.
- **Environment and Communities we serve** - We demand so much from nature be it drinking safe water or clean air but seldom give back anything in return. It is our responsibility to ensure that environmentally friendly policies are implemented as we actively engage the communities we serve. However, our responsibility to the public as a financial service company does not end there. No amount of waste paper recycling or philanthropy will substitute for failure to combat financial crime or poor lending.

Businesses are today required to meet ever-increasing standards of corporate behavior. It is only by listening to our stakeholders and grasping the real nature of our responsibilities which stem from the impact banking services have on people's lives, that we can make balanced judgments and create sustainable value exceeding the expectations of our stakeholders.

We hope this report in which we have explained to you our actions, will assist you in gauging our performance against your expectations of the HNB Group as one of Sri Lanka's premier financial service providers. Your feedback is important to us."

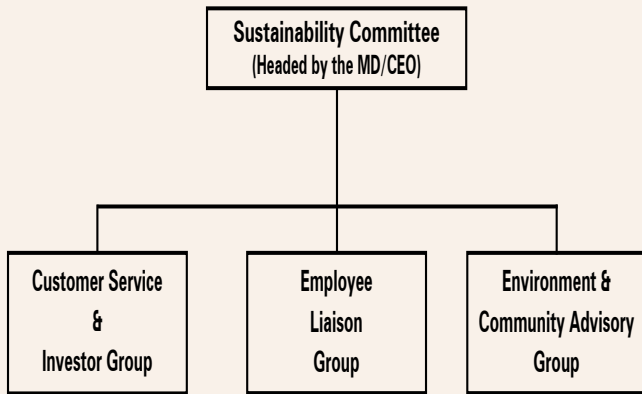
A handwritten signature in black ink, appearing to read 'Rajendra Theagarajah'.

Rajendra Theagarajah
Managing Director
February 2006.

HOW WE ORGANISE CSR

At HNB we endeavour to make Corporate Social Responsibility (CSR) a way of life.

CSR is the process of integration of sustainability into our business process. CSR puts a 'human perspective' to our endeavours, to be proactive for the future socially, environmentally and economically.



Good governance is the basis from which we manage our approach to CSR.

An internal sustainability committee has been formulated to do the following:

- Oversee progress as a socially responsible citizen
- Act as think-tank for development of the HNB CSR agenda.
- Ensure conformity of all business to CSR guidelines
- Proactively evaluate all decisions that could affect HNB's reputation by considering social, ethical and environmental factors
- Identify and manage areas of non-compliance within the CSR framework of HNB's activities
- Setting standards for HNB's policies & procedures

The Committee comprises of ;

Managing Director/CEO
 Senior Deputy General Manager – Corporate Banking
 Chief Financial Officer
 Deputy General Manager – Human Resources & Administration
 Deputy General Manager – Personal Banking & Network Management

Three Sub-Committees; in the areas of Customer/Investor, Employee Liaison and Environment/Community report to the Sustainability Committee.

In addition, Bank's Risk Committee oversee the CSR activities carried out by HNB.

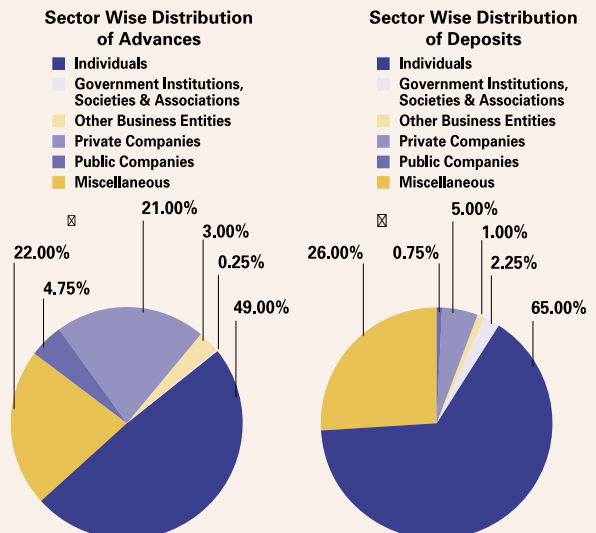
RESPONSIBILITY TO OUR CUSTOMERS



HNB has committed itself to serving all segments of society to the best of its ability and has developed its activities over the years, so as to bring these different segments of the population within its fold. We have reached out to the poor and the rich alike and our present customer base encompasses a wide spectrum with large corporates at one end and small farmers at the other. We consider this diversity of customer base and the concomitant versatility in product range and distribution systems as our unique strength. These aspects are dealt with in detail in the following sections.

Our Customer Base – Its Diversity

HNB has, over the years, built up a truly diverse customer base in line with its policy of reaching out to and serving all sections of society. There are customers with advances as small as Rs.10,000- among our borrowing clientele and likewise customers with deposits as small as Rs.2,000- among our deposit clientele. At the other end of the spectrum, there are several large corporate/institutional customers with deposits/advances running into millions/billions of rupees.



Sustainability Report

Delivery & Distribution Network

Expansion of Branch Network

In keeping with our policy of taking our services to the people, the Bank has been expanding the branch-network quite rapidly and at present it is represented in all nine provinces of the country. We have fully fledged Customer Service Centres in all major cities and towns and in order to reach out to the people in interior areas, smaller Customer Service Centres are being opened in satellite towns.

The Bank has also focused on inculcating the "saving and banking habit" among school children by opening School Savings Units. This Network expansion has not only

strengthened the distribution and delivery of the Bank's services throughout the country, but has also contributed to the development of the banking habit among the people.

Network Strength

Number of Fully Fledged Customer Service Centres	111
Number of other Customer Service Centres	<u>37</u>
Total Number of Customer Service Centres	<u>148</u>
Total Number of School Units	152
Gami Pubudu Units (Village Banking)	109

Leaders of Our Network



Sustainability Report

Overseas Presence

We have opened Representative Offices in Chennai and Karachi mainly in order to facilitate our constituents' regional trading activities. Similarly, we have our own staff positioned as our representatives in Abu Dhabi & Dubai, Bahrain and Kuwait to cater to the remittance and other requirements of Sri Lankans working in these countries.

Delivery through Technology

Island wide HNB ATM Network



In order to improve operational efficiency and customer service, the Bank embarked on computerization of its operations several years ago. The Bank is now operating in a fully computerized environment, with an island-wide inter-linked ATM Network consisting of 143 Automated Teller Machines including 13 off-site ATMs. This Island-wide ATM Network facilitates 24 hour cash withdrawal and other facilities, such as account balance enquiry and

transfer between accounts for all ATM cardholders, from any point in the Network.

Expansion of ATM Network through Sharing Arrangements

Arrangements are being made to tie-up with two other local banks in order to establish a Shared - ATM Network in excess of 350 ATMs. The Shared ATM Network which is expected to come into operation during the course of 2006, will add another dimension to the, "Anywhere Banking Facility" already introduced, in that it will immensely enhance customer convenience in accessing their accounts for cash withdrawals and other purposes.

Other Electronic Banking Facilities

The following electronic banking facilities are provided in order to make our services more easily accessible to customers.

"Anywhere Banking Facility" through the Branch Network

- Internet Banking Facility
- Payment Gateway Facility
- SMS/Mobile Banking Facility

Internet & SMS Banking Facilities

The Bank provides Internet Banking Solutions to selected customer needs/requirements and at present over 2,730 customers are enjoying the benefits of our Internet and Mobile Banking Options.

Services provided under the Internet & SMS Banking Facilities include the following:

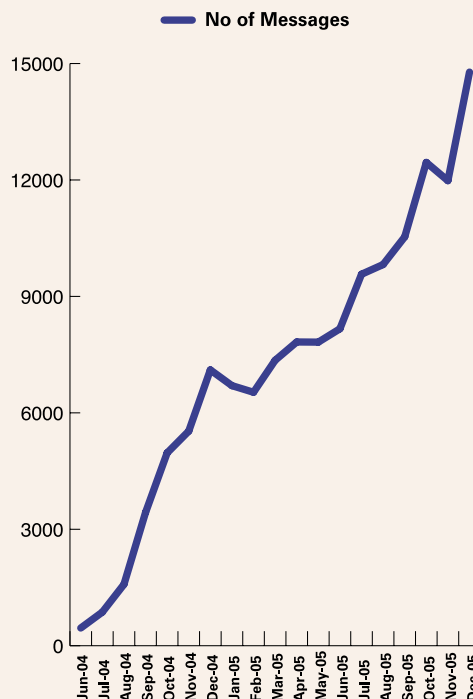
Internet Banking Services

- Balance inquiries on savings, current, FCBU and NRFC accounts
- Access to transactions details and uncleared effects
- Access to Credit Card Accounts and Card Settlement Facility
- Fund transfers to and from own accounts and pre-registered 3rd party accounts
- Access to exchange rate information

SMS Banking Services

- Balance checking
- Funds transfer within own accounts
- Access to exchange rate information
- SMS Alert for credit card transaction (the card holder is alerted by a SMS message every time a transaction is processed using his/her credit card number)

Growing Usage



Payment Gateway

HNB launched its Payment Gateway facility during the year, which enables a large number of customers and others to make online – payments for products and services purchased from Franchised Merchants. The Project is progressing well with increasing use of the facility.

Pictorial Representation of the Bank's Delivery & Distribution Network



Our Concern for the Disabled



We have recognized the need to make our branches easily accessible to people with disabilities. Accordingly, special provision has been made at Dambulla, Kollpupitiya, Horana and Wellawatte branches for physically disabled people to access the counters and other relevant sections. ATMs at most of these locations also have “disabled friendly” access.

This special facility will also be provided at other locations where the existing branch buildings are renovated. A number of branches including Homagama, Thimbrigasyaya, Kahawatte, Hatton and Panchikawatte will have this facility very soon. Likewise, all new branches and locations will have “disabled friendly” access.

Week- End Banking

Weekend Banking Option is another way in which customer convenience is enhanced in accessing our services. At present 15 customer centres including Wellawatte, Cinnamon Gardens, Kandy, Negombo, Kiribathgoda, Nugegoda, Kotte, Kotahena and Jaffna are open for business for limited hours on Saturdays and Sundays.

We are planning to further expand our week-end banking services in the coming year.

Customer Education/Customer Information

Customer Education

The Bank undertakes special educational activities from time to time to enable customers to keep abreast of latest developments in banking, the economy and even in their own fields of activities. With this objective in mind, the following events, amongst many others, were organized by us during the year:

Latest Technology for Dambulla Farmers

This was a special Awareness Programme conducted with the assistance of resource persons from CIC, Brown & Company and the Department of Agriculture at Hotel Lihini Village, Dambulla for the benefit of about 160 farmers from the Dambulla area. Areas covered included modern cultivation practices, latest agri-technology, new crop varieties and other similar aspects.

Special Awareness Programme for Small Entrepreneurs from Puttalam

This programme was organized by us in order to impart knowledge to small entrepreneurs on various business management aspects, including business development, banking, marketing and financial management. Over 60 small entrepreneurs from Wanathavilluwa and Puttalam benefited from this programme. The event was conducted with the assistance of resource persons from relevant Government Institutions and NGOs.

Seminar On International Trade

This programme covering advanced macro economic and international trade & investment was conducted for the benefit of corporate customers.

Customer Information

The Bank's Website

Our website www.hnb.net provides easy access to a detailed update of our wide ranging products and services. Essential information about virtually all products and

Sustainability Report

services, together with updates on interest and exchange rates could be obtained from our website. Account opening as well as facility application forms could be down loaded.

There are continuous improvements made to the website in order to develop it into a major customer information channel. Usage of the site is increasing daily and over 14,400 "site visits" have been recorded during the last 3 months of 2005.

Staff Training for Enhanced Customer Service

Top priority is given to training our operational and other staff to enhance customer service and to help them develop customer service skills. The ultimate objective of the training and development is to provide our customers with an excellent service.

The HR Division has designed and issued to each staff member a special Booklet titled "**Service Excellence – Our Passion**" covering various aspects of customer service. This Booklet which defines customer care in terms of financial and psychological needs of customers, offers valuable advice and guidelines as how to interact with customers and deliver excellence in service. Ethical aspects of service are also emphasized in this Booklet. These service aspects figure prominently in the regular customer service training programmes conducted by our Training Centre.

Monitoring & Assessment of Service Quality

From 2004, the Bank has been conducting a Region-wise Customer Service Competition between the Branches. Service quality at each of the 148 Customer Service Centres is monitored and assessed for the purpose of this competition. This exercise is carried out by the respective Regional Offices according to a comprehensive set of guidelines developed by the Customer Service Committee. The committee comprises of a Senior Deputy General Manager, two Deputy General Managers and the Zonal Heads. Under this internally – developed scheme, service quality is monitored and evaluated in the following ways.

- On-the-Spot-Assessment of Specified Aspects of Customer Service Against Stipulated Standards (Twice a Year)
- Internal Customer Satisfaction Surveys (Twice a Year)
- Scrutiny of Customer Complaints

Internal Customer Satisfaction Surveys

These surveys are conducted among customers of each branch twice a year. Specially designed questionnaires are sent to a random sample of customers from each branch and the satisfaction level is measured based on the responses received. Information obtained is used not only to measure customer satisfaction levels, but also to initiate remedial action where necessary. About 1,860 customers participated in the surveys conducted during the year.

Major areas covered by these Surveys are:

- Counter Service and Speed of Delivery
- Knowledge, Skills and Attitudes of Staff
- Accessibility and Service Orientation of Branch Managers
- Complaints handling
- Customer Information - Materials, Advices and Correspondence
- Service Logistics

Results of the Internal Customer Satisfaction Surveys – 2005

Results of the Customer Satisfaction Surveys conducted during 2005 could be summarized as follows.

Very Good/Good	Satisfactory	Improvement Needed
<ul style="list-style-type: none"> • Knowledge, skills and attitude of staff • Accessibility and Customer Rapport of staff including Managers • Complaints Handling • Customer Information - Materials and Correspondence 	<ul style="list-style-type: none"> • Overall Counter Service and speed of delivery • ATM Service • Dispatch of Statements and Advices 	<ul style="list-style-type: none"> • Parking Facilities • Counter Service, ATM Service and Dispatch of Statements/Advices though generally rated as satisfactory were indicated by quite a number of respondents as areas for improvement.
<i>OVERALL RATING - GOOD</i>		

Independent External Surveys Mystery Shopping

A Mystery Shopping Exercise was also carried out by an External Market Research Agency during the year covering 28 Colombo and suburban branches.

This Mystery Shopping Exercise focused on the following broad areas at each branch.

- Overall Staff Attitude
- Overall Product Knowledge and Professionalism
- Dynamic Service Behavior of the Staff – Enthusiasm, Extra Effort and Selling Skills
- Overall Service Disposition of Branch Managers/Assistant Managers
- Ambience – Exterior and Interior Cleanliness of Branch Premises

According to this survey, the overall service quality at most of the 28 branches covered is satisfactory/fairly satisfactory. However, the survey has also revealed some areas where improvement is necessary as shown by summary of the findings on the next page.

Sustainability Report

The Bank has taken positive action to improve the weak areas identified, through appropriate Staff Training, Focus Group Meetings and other measures.

Very Good/Good	Satisfactory	Improvement Needed
<ul style="list-style-type: none"> Overall Product knowledge and Professionalism of the Staff including Branch Managers. Communication Skills Customer Information Facilities and Response to Customer Queries 	<ul style="list-style-type: none"> Ambience and Parking Facility Overall attitude and Service Disposition of the Staff including Branch Managers. 	<ul style="list-style-type: none"> Customer Reception at the Entrance and at the Counters Dynamic Service Behavior of the staff

Comprehensive External Customer Survey Planned for 2006

Considering the importance of obtaining an independent insight into customer satisfaction and customer perceptions, the Bank is planning to engage a reputed Specialized External Market Research Agency to carry out a full scale Market Survey next year.

Customer Rapport

Special Customer Get-together

The Bank has a tradition of conducting branch-based Customer Get-togethers attended by Senior Officers of the Head Office in addition to the respective Regional/Zonal Heads. Customer feed-back from these Get-togethers helps in improving customer service and in solving specific problems of customers. Seven such Customer Get together were held during the year.



Customer Get-together - Ja -Ela Branch

Complaints Handling Process

Listening to our customers

Customers of HNB have many avenues to lodge complaints and suggestions. All complaints are promptly looked into and necessary relief is provided. There is a Complaint Handling Unit functioning at the Head Office under the overall direction of D G M – Personal Banking and Network Management who is the Complaints Resolution Officer of the Bank.

During the current year, the Complaints Handling Unit functioning at the Personal Banking Division has inquired into and responded to over 360 customer complaints. Most of these customer complaints were resolved to the satisfaction of the complainants with relief or a proper explanation as appropriate. Following are some of the complaints.

- Delay in processing loans and related requests
- Non-Receipt of Account Statements
- Issues arising from closure of current accounts
- Issues regarding cash withdrawals from ATMs
- Issues relating to Electronic Banking
- Tariff related matters

The Independent Financial Ombudsman Scheme

HNB joined the Independent Financial Ombudsman Scheme initiated jointly by the CBSL and the banks at the very inception of the Scheme in December 2003. The Bank has extended its full support to the Ombudsman in making it a success. The Independent Financial Ombudsman is authorized to entertain and investigate complaints relating to specified areas of customer service from all categories of customers. These complaints are resolved within a stipulated time limit.

The Independent Financial Ombudsman Scheme

- The complaint should first be made to the Bank and if not resolved by the Bank, the Financial Ombudsman could be approached.
- The Cause of Complaint should have occurred within the preceding 12 months.
- The complaint should be in respect of matters covered by the Scheme.
- The decision of the Ombudsman is binding on the Bank.

Special Assistance to Tsunami Affected Customers

The Bank's active participation in the government sponsored 'Susahana' Credit Scheme saw about Rs.600 million reaching around 875 entrepreneurs by the end of December 2005. This scheme financed many self-employment projects among others.

Sustainability Report

The Bank has also entered into a partnership with the German Savings Banks Foundation for International Co-operation for a micro finance loan schemes for customers, and other entrepreneurs and business people affected by the Tsunami. It has enabled many people to recommence their business activities.

Over Rs.240 Mn has already been committed by the German Savings Banks for disbursement through us. The Bank has already disbursed over Rs.55 Mn to 213 affected entrepreneurs/small business owners to help them to get back to business.

The Map below shows the district-wise distribution of these loan disbursements.

District-wise distribution of HNB's Tsunami Loan disbursements



Loans disbursed to affected Customers from unaffected districts such as Moneragala and Vavuniya are also included.

SUCCESS BEGINS WITH OUR PEOPLE

Broad Human Resource development for sustained growth of the organization is a key factor focused upon by the Bank.

The Vision of the Bank's Human Resource Division is;

"To be the Organization with the best Human Resources Management Practices ("HRM") in Sri Lanka".

HRM is an integrated part of our business development process. The Bank is proactive in training, developing and nurturing our people and our approach is futuristic. The HR Division's key focus is to strengthen the link between Human Resource Management and business strategy.

In this context, the strategic alignment of Human Resources to the goals of the Bank has been strongly enunciated through a positive Performance Culture. We have therefore, made an assessment of the future needs and focused on certain key initiatives. These would sustain the HRM practices from the stand point of employee commitment and development, high level of integrity and ethic, strong values and benchmark standards.

Recruitment of Staff

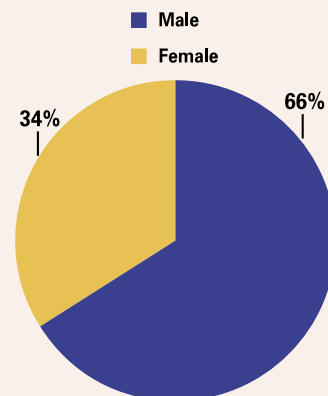
As a proactive measure, the recruitment and selection policy has been based on the following needs:

- Equal employment opportunity organization concept.
- A broad approach towards encouraging job seekers from across the country to gain access to the Bank, particularly bearing in mind the broad network of customer centres within the Bank.
- The need to attract a pool of talent from which the cream of the crop could be recruited
- The need to balance staffing needs through the process of recruitment, promotions, job rotation and job enrichment.

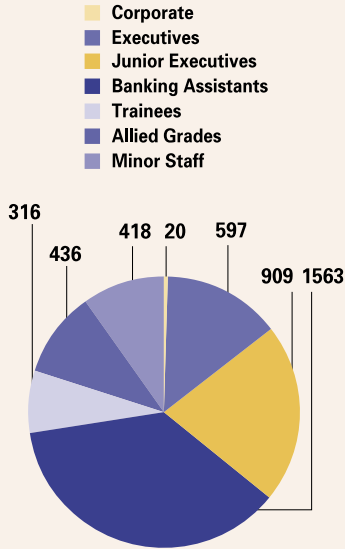
Data Analysis of Staff

Following is an analysis of staff

Gender Wise Analysis of Staff



Category Wise Analysis of Staff



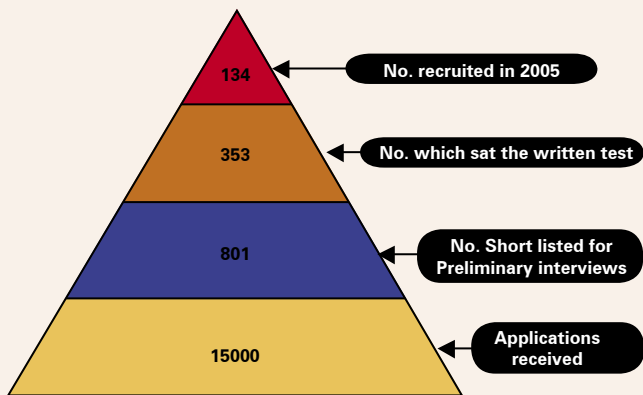
Recruitment Process

The Bank aims to recruit the best talent from external sources. Therefore, it has enhanced the standards for entry requirements of the clerical level in 2005. Furthermore, continuous development of employees enables the Bank to develop a talent pool for an effective succession planning process.

The main category of staff recruited from among the external candidates are the Banking Trainees who are mostly school leavers. The pyramid given below sets out the results of the process of recruitment of trainees in 2005.

This recruitment process was carried out in batches, depending on vacancies which occurred during the course of the year.

The Bank had total of 4,259 employees as at 31st December 2005.



Staff Development

Continuous Professional Development

The Bank has a Continuous Professional Development (CPD) system through a process of continuous learning aimed at creating a learning organization.

This is amply demonstrated by the Efficiency Bar Examinations which creates an avenue for employees at clerical level to earn CPD points which are linked to their promotion prospects.

e-Learning

As a further key initiative, an E-learning process has been developed in-house whereby, employees within the organization would be able to learn electronically. Some of the key features in the E-learning tool are as follows.

Online Courses & Online Examinations

Courses are prepared in all important areas of training and made available in user friendly interactive modules, which the staff members can access and learn at their leisure. Staff members may study the course material provided and sit for on – line examinations. The results will be maintained in the staff member’s personal profile. The HR department will draw information required from this database. The “My Profile” tool enables each user to review his/her examination results.

Just in time learning & Banking Glossary

This tool provides the user with quick solutions to problems and the glossary is created to give definitions for difficult banking terms.

e-Manual/ Virtual Class Room

E-manual is an electronic means of simulating a real-life classroom, where the subject/content is presented to the users by means of video, audio images.

e-Library

Materials (Books, VCDs, etc) available in the training centre library are made available to users.

Training Activities

In-house Training

Based on the Training Needs Analysis, a Training Plan is in place for each year. Based on the number of occasions each staff member has attended Training Programmes, the Training Centre has trained 4,885 employees with the total number of programmes being 156. These programmes cover staff induction, technical training on specialized business lines and other specific areas. Management Development Programmes and Supervisory Development Programmes, training on service quality, counselling skills, self managing leadership for Executives, product knowledge and emotional intelligence are among other training areas covered. Corporate and Senior Management have also being exposed to special workshops and development programmes.

Local Training

A streamlined process of nominating staff members for training in external training institutions has been a regular practice at the Bank. Such training is based on specific needs of the Bank and individual development needs. As many as 534 have been nominated for such programmes during the year.

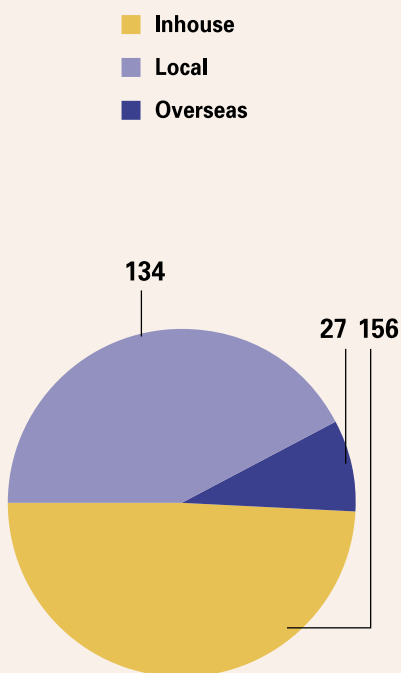
Overseas Training

Overseas training is provided to give broad exposure to management personnel and others in areas such as leadership development and knowledge enhancement. Some of the specific overseas institutions where the Bank staff have been trained are Mt. Eliza School of Management, Australia, Singapore Institute of Management, National University of Singapore, National Institute of Bank Management, Pune India and Management Development Institute, Haryana, India. A total of 35 staff members have been exposed to training in overseas institutions.

Data Analysis of Training Activities

A graph depicting the number of training programmes conducted by the Bank during the year is shown below.

**No. of Training Programmes
January to December 2005**



The annual cost of staff training on an average over the last 5 years has been a minimum of 1% of pre tax profits which has contributed to the broad training initiatives.

Inter-Branch Quiz Competition

An annual Inter Branch Quiz Competition is conducted in Colombo and in the regions covering all staff members at head office departments and branches. This is a continuous process which creates broad self development. Almost 950 staff members took part in the competition.

HNB Toast Masters Club

The HNB Toast Masters Club was inaugurated in July 2002. The club is quite active with 10 meetings being held in 2005. The club aims to develop communication and presentation skills of our staff members.

Performance Culture and Rewards

The concept of 'what gets measured gets done' is strongly infused into the Bank's performance culture. Objective setting at the beginning of the year under the 'Balanced Scorecard,' sees that the Executives and managerial staff are given targets to achieve during the year, under four key perspectives, namely:

- Financial outcomes
- Customer perspective
- Internal business processes
- Learning and development outcomes

This process is directly linked to the Vision & Mission of the Bank and is a strong contributor to bottom line results. A performance based rewards system has been introduced, whereby salary increases and bonuses are dependent on actual performance of individuals. Thus, variable pay and bonus schemes are in place to drive the performance culture.

This in turn has a further link to career progression. The results of Performance Appraisal are a strong indicator of the skills and abilities of staff, current competency level and the degree of development which has taken place, which ultimately leads to career success.

Feedback on Performance Appraisal

The main objective of Performance Appraisal is to give feedback on strengths and weaknesses and thereby develop staff through an action plan. The Performance Appraisal Interview ensures that the process of feedback is being put into practice. The need for job rotation, training, counselling etc. are also determined through this process.

Counselling

Counselling is required to address many situations such as poor performance, absenteeism and indiscipline. Specific cases based on facts and data are identified and the HR Division carries out the process of counselling. Senior Officers who have experience in this area are generally deployed for this purpose.

Sustainability Report

Employee Satisfaction Survey

As a special initiative to assess the level of satisfaction and motivation among the workforce, it is intended to initiate a process of an Employee Satisfaction Survey. This exercise will be carried out by an external agency during the next financial year.

Service Awards

Those who complete 25 years service in the Bank, have been annually felicitated by the management since 1997. At this felicitation function, they are awarded a special Gold Coin and a Trophy in recognition of their services. In 2005, 43 employees were honoured for completing 25 years service in the Bank.



A group of service award recipients

Employee Share Ownership Programme

The Bank launched an Employee Share Ownership Programme whereby 626 Executives in the Bank were allocated shares in accordance with their service and position. Both these aspects were given equal weightage in the process of deciding on the allocation of shares. This programme has led to higher motivation levels for the staff. A well motivated staff becomes a greater value adding proposition towards the sustained growth of the bank.

Industrial Relations

There are two organizations representing staff of the Bank. They are the Ceylon Bank Employees' Union and the HNB Officers' Association. The relationship between the Management and these organizations is harmonious. Monthly meetings are conducted as a process of ongoing communication and resolution of problems. Collective bargaining which is a feature in the Bank, brings about a

Collective Agreement every 3 years between the Ceylon Bank Employees' Union and the Management. This spells out various terms & conditions of employment of the clerical and allied staff. The Bank has not experienced any industrial dispute during the year under review.

Staff Welfare

Tsunami Assistance to staff

A total of 39 staff members who were affected by the Tsunami were given immediate relief. The Bank initiated a fund through voluntary contributions of staff members and well wishers and collected a sum of Rs 6.94 Mn. 18 Staff members were approved funds for the reconstruction of their homes or to purchase land based on the need. Several Refugee Camps were provided with food, clothing and medicine in the aftermath of the Tsunami, in order to give immediate relief to those who were affected.

Staff Benefits

Among the many benefits to staff, is the Loan Scheme. Staff members are entitled to Housing and other loans at concessionary rates of interest. This has paved the way for many staff members to acquire their own homes and upgrade their standard of living.

Staff in outstations are provided with fully furnished living quarters with all amenities. Salary reviews in accordance with performance occur once a year and revisions are carried out once in 3 years.

Health & Safety

Adequate ventilation, lighting, drinking water and sanitary facilities are provided to all staff in the Bank while all precautions with regard to security and safety of staff and other resources are provided.

Beyond Banking

Staff Participation Schemes

The Bank promotes a series of activities to ensure the bonding



Staff members at the staff talent show

Sustainability Report

The Sports Fiesta carried out throughout the Bank is one example. Staff get-togethers are organized by the Sports Clubs in the respective branches and departments. Staff meetings on a monthly basis, ensure the exchange of ideas and suggestions for ongoing problem solving. Staff are encouraged to write Articles in the in-house Magazine 'Hatnamag' which is issued on a quarterly basis.

The Bank has its own Choir with large numbers of staff members taking part in Annual Christmas Carols and Bhakthi Gee during the Wesak festival. In December every year, a bank wide Christmas party is organized specially for the children of staff members, which is held at 'Sathutu Uyana', Colombo.

Sports Achievements



The Victorious hockey team

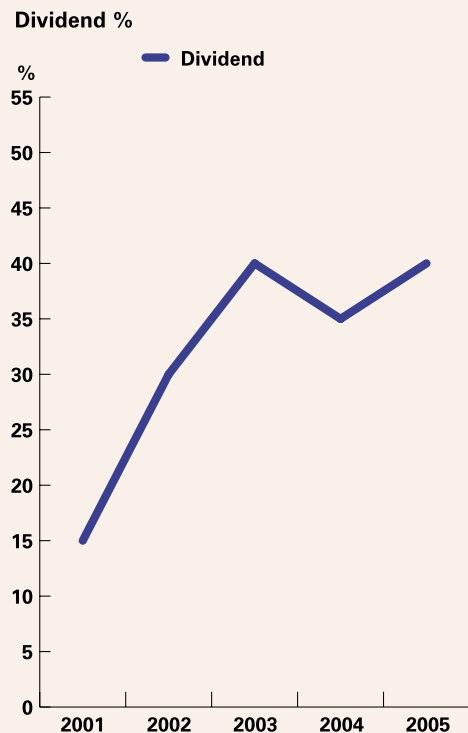
The Bank has continuously progressed in sports over the years becoming champions in many events such as Cricket, Hockey, Netball, Basket ball etc. In 2005, the Bank's Cricket Team became the Mercantile Knock-out Champions while the Hockey Team won three Championship Trophies.



A selection of our awards

ADDING SHAREHOLDER VALUE

HNB has an excellent track record of delivering continuous, enhanced, shareholder value over an extended period. The existence of a sustainable earnings base means that the Bank is in a position to reward its shareholders with a consistent dividend payout, which has been delivered, as shown below.



HNB Brand

The HNB brand is one of our most significant intangible assets. Brand Value is the measurement of this intangible asset and represents the advantage to the owner of the brand. The December issue of the "LMD Voice of Business" ranked the HNB brand as the first brand in the financial sector and third leading brand in the country. The valuation was performed by Brand Finance (UK) using the "relief from royalty" approach, which is an intuitive approach that assumes that a company does not own its brand and calculates how much it would need to pay to license it from a third party.

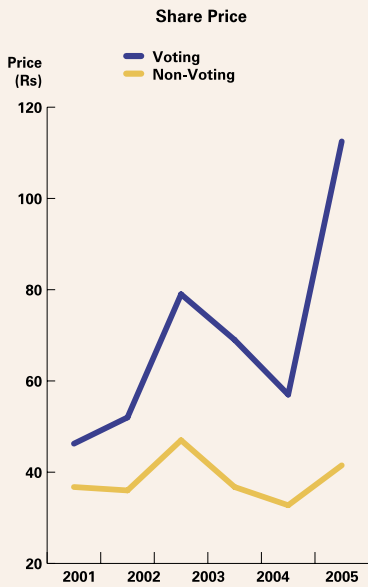
Your Bank's brand value has increased by 6% in 2005 to 3,033Mn.

HNB has been nominated as one of Sri Lanka's Superbrands by the Superbrands Council of Sri Lanka.

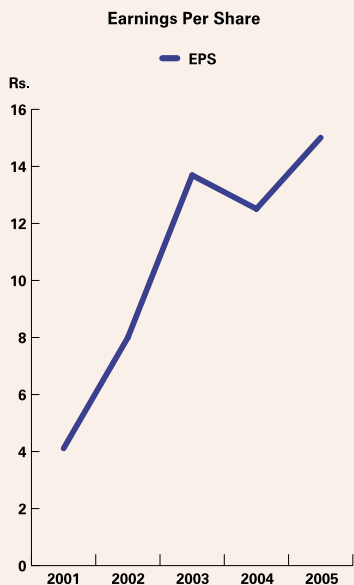
This is a supreme endorsement of our brand's exceptional status.

Sustainability Report

Share Price



The continuous increase in our share price is an indication of the value placed by the market on our stability. HNB rewards its stakeholder with an increasing share price and an earnings per share, as depicted here.



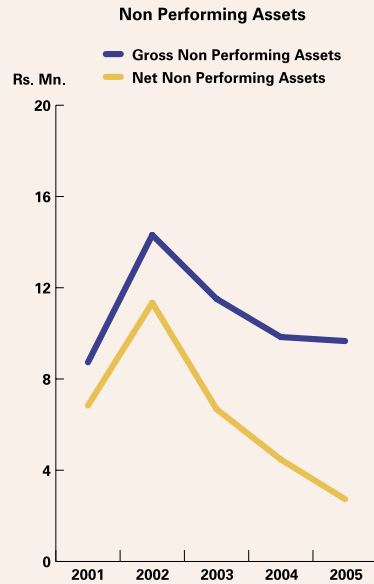
Global Depository Receipts

The market acceptance of HNB extends beyond our borders as shown by the successful placement of our shares with a consortium of international investors this year. This is the first occasion in the history of the banking industry in Sri Lanka and

only the second instance for all industries, that an overseas listing has been obtained. The placement; which includes the "dual fungibility feature", amounts to 15% of the share capital of the Bank.

Asset Growth

HNB has delivered a sustained asset growth and enjoys improved holding period and market value addition ratios. We have also been successful in progressively reducing our non-performing assets over the past few years.



Market Capitalization

HNB has remained amongst the top 15 listed companies, commanding a share in excess of 1% of the Colombo Stock Exchange market capitalization for the past 6 years.

Key Indicators

Key indicators relating to 'Shareholder Value' are stated on pages No 43 and 44

ENGAGING THE COMMUNITY WE SERVE

HNB considers it important to interact with the community and go beyond the traditional business relationship. The Bank focuses on engaging more intimately in capacity building, social services and protecting the environment in and around our community. In the short run HNB may incur additional expenditure in exhibiting our commitment, but in the long run we will develop an economically stable customer base and develop brand loyalty for HNB. Though we could identify some economic return in indirect form through our projects undertaken for the benefit of the community and environment, HNB derives immense satisfaction from immeasurable benefits which may be enjoyed by the society in the form of achieving higher quality of life, cleaner environment, sustainable eco system and improving the standards of the community infrastructure. HNB's ability to improve the community and environment does not only stem from our financial strength, but from our island wide branch network, strength of our employees who are committed to achieving the goals set by the company and the loyal customer base.

Community Development

HNB recognized the necessity for higher social involvement in the rural sector and was active in various capacity building, infrastructure improvement and charitable activities for a long period.

Developing rural entrepreneurs

HNB's community development flag ship project "Gami Pubuduwa" was launched in 1989 in the backdrop of an extremist unrest, and the Bank was hoping that its visionary and ambitious formula would bring rural Sri Lankans into the formal economy. In hindsight, we believe we served the right mechanics for a refreshingly new social revolution. A 95% rate of repayment and a new and growing deposit base serve as a poignant testimony to Gami Pubuduwa's success. The Bank's bottom-line in relation to Gami Pubuduwa proves that micro-financing could indeed be a sustainable banking instrument, while serving to uplift a developing economy. We have not only extended credit to small scale entrepreneurs who live through their traditional occupations, but assisted in technology transfer, education and capacity building. We are happy to acknowledge the assistance granted by many multi national organisations to this program. Recently the Association of German Savings Banks extended a credit line and expertise to develop HNB staff and our clients. We will continue programmes which will contribute positively towards meeting our goals. The programme also lets us really live by and practice our "values".

Today, HNB's Gami Pubuduwa continues to touch the lives of the poor. The Gami Pubuduwa success story is filled with rags to riches testimonies where what started as a life-changing Rs.5,000 (US\$ 50) loan had taken many people to a position of financial stability that allows them to take loans up to Rs.1,000,000 (US\$ 10,000).

With some 50,000 families from around Sri Lanka now an integral part of the country's formal economy, many more will continue to reap the rich rewards of this banking revolution.

Recognition

- The World Bank carried out a study on Gami Pubuduwa and published a discussion paper in 1995.
- In 1998, HNB was the only invitee from Sri Lanka by the micro-finance network in Washington DC, a forum on effective governance of micro-finance institution.
- HNB received a special award in 1999 from the Asian Bankers Association in Manila for a joint program with Care International under Gami Pubuduwa.

A Success Story:

W K Senaviratne – Customer of HNB Kahawatte Branch



After my wedding in 1987, I built a house and a small grocery shop on my ¼ acres of land. I opened my grocery store with Rs. 2000 worth of goods. In June 1990, I obtained Rs. 10,000 from Hatton National Bank under Gami Pubuduwa Scheme with which I was able to buy additional merchandise and further develop my store.

Subsequently, I began to grow passion fruit. Hatton National Bank helped me again and supported with a Rs. 20,000 loan to lease an acre of pre-used land and a further Rs. 5,000 to cultivate passion fruit on the new land. Due to the success of the passion fruit cultivation, I leased another 5 acres of land and began another plantation.

Sustainability Report

Sadly, my passion fruit crop was affected by a plant virus that destroyed it. I then decided to plant tea. So, in 1994 I purchased that land which was on lease and obtained a further loan of 50,000 under HNB's Gami Pubuduwa.

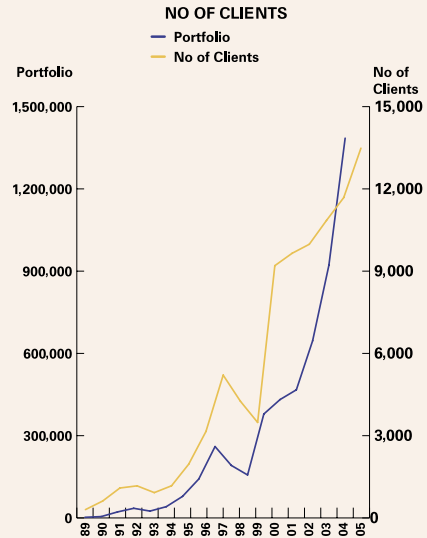
As my grocery store was doing well, I was making daily trips to the town of Godakawela to bring stocks for the store. This made me to carry Coconuts, Arecanuts and other types of vegetables from the village to the town of Godakawela to sell at a higher price. Depending on hired vehicles made me undergo a lot of discomfort and inconvenience so I obtained a sum of Rs. 725,000 from HNB and purchased a new lorry in 1996.

In 1997 I further developed the store by introducing building materials and insecticides to its stocks. For this purpose I received Rs. 30,000 from the bank. I acquired the services of a driver and began to collect raw tea leaves. In order to further develop this business activity I bought another old lorry in mid 1998 for a price of Rs. 200,000. To finance this purchase, I obtained a loan of Rs. 75,000 towards the end of 1998.

In the year 2000, I obtained another 'Gami Pubuduwa' loan of Rs. 500,000. With it, I purchased a grain mill and a coconut mill. In order to sustain these, I began constructing a 5 room house. In 2002 I obtained a Housing loan of Rs. 500,000 under "Shanthi" scheme and completed building of the house. Also in this year I obtained a lease for a Leyland bus worth Rs. 950,000 which earned an income of Rs. 80,000 each month. I was aware of the transport difficulties in my area. So I took another lease and obtained a sum of Rs. 2.5Mn with which I bought a lorry and expanded the business of transporting tea leaves in my village area. By this time, my monthly payment to the bank was around Rs.450,000 whilst enjoying an overdraft facility of Rs. 200,000.

Thanks to the support of Hatton National Bank, I am now the proud owner of 5 vehicles, a grain mill, a coconut mill, 5 acres of land and a number of businesses. My prosperity enabled me to give my two daughters every possible comfort and spend for their higher education. For someone who started with just 1/4 an acre of land, I owe a debt of gratitude to Hatton National Bank, particularly their branch in Kahawatte, for their incomparable help and support. HNB was truly the partner of my progress.

Gami Pubuduwa customer base and portfolio growth



Developing Entrepreneurial Opportunities for Women

HNB conducted an 'entrepreneur development program' exclusively for women in cooperation with the NGO, Relief International at Mirijjawala Viharamahadevi Resource Centre in May 2005. Sixty participants from the lower and middle income groups were selected by Hambantota's Gami Pubuduwa Unit together with Women Development Federation and Social Development Foundation – two highly successful community based organizations. The topics covered micro finance, business development, and resolution of problems, basic marketing and financial management.

Village Electrification

HNB has coupled its Project Financing activities with CSR by taking part in the Energy Services Delivery Project (ESDP) and Renewable Energy for Rural Economic Development (RERED) Project of the World Bank.

In 1997, HNB commenced financing of Hydro power projects with the support of the World Bank. This scheme facilitated the funding of Village Hydro projects contributing to the upliftment of their quality of life. Under both of these schemes, HNB has financed Village Hydro power projects committing an amount of Rs.33 Mn for 60 projects. These have provided electricity for over 2,500 village households having no access to the electricity supply from the National Grid.

The Bank's Off Grid Village Hydropower financing scheme received a Runner-up Award in the Development Project Financing category at the Asian Banking Awards 2004.

Special Socio-Economic Development Support Programmes

HNB gave the fishermen of Panama a New Lease of Life.

The tsunami devastated the people's livelihood of Panama village in Eastern Province. HNB distributed 15 boats and fishing gear to the fishermen of Panama to recommence activities and help rebuild the community.

Sustainability Report



At Panama

The cost of advertising during Wesak is channelled into a house and self employment.

HNB saved the cost of sending greeting cards during the Wesak season and built a house and funded a self employment project for a young man, who tragically lost both his legs in a railway accident.

Support for Differently able persons

HNB undertook to upgrade the sanitation facilities at the boys' section of the Deaf and Blind School at Ratmalana.

Other Health Projects

The widespread HNB branch network plays a vital role in HNB's joint project with CIC Paints and National Stroke Association for raising funds for both child protection and the Stroke Association.

Annual Blood Donation Campaign

The first campaign was initiated in 1995, by a staff member Mr J M H Perera. During the past 10 years, through this campaign the bank staff volunteered to renovate the blood bank premises at the General Hospital and painting of the entire hospital premises at Piliyandala. Up to now the Bank has donated more than 1,000 pints of blood to the Hospitals. In 2005, the Bank exclusively carried out the campaign with the Blood Bank of the Cancer Hospital and this years 140 pints of blood collected from the staff of HNB Towers would be for the exclusive use of the cancer patients.

"I believe in Sri Lanka" (AIESEC) Project

HNB is associated with AIESEC on a Corporate Social Responsibility project titled "I believe in Sri Lanka". The project aims to impart new knowledge on Sri Lankan realities. The aim is to challenge young people and change their perception as Sri Lankans. The main activities under the project will be to conduct a lecture series at Jayawardenapura & Moratuwa Universities. The speakers will attempt to impress upon the final year students the opportunities available to Sri Lankans. Two national conferences will also be held during the year to create this awareness.

AIESEC also has a global exchange programme which gives us an opportunity to draw on a worldwide pool of talented professionals. The interns will spend a couple of months in our Bank and give us an opportunity for sharing experiences.

AIESEC has been in existence since 1948 and it is an international, independent, non-political youth association. Its objectives are to promote social understanding, entrepreneurship and youth leadership in the community. AIESEC is represented in 89 countries and works with 800 Universities. It is an international platform for young people to discover and develop their potential.

Affinity Card Program

HNB launched the Royal College Union (RCU) Affinity Card program in September 2000 the first of its kind in Sri Lanka. The enthusiasm and the substantial contribution towards the affinity partner prompted more affinity partners to join HNB to venture into such individual affinity programs. This resulted in Old Boys Unions/Past Pupils' Associations from 6 more schools launching their respective Affinity Cards in addition to the launch of 'Ranaviru Card' with the Sri Lankan Army. These affinity programs gave a unique identity to the cardholder and more importantly HNB made a substantial contribution of over Rs. 6 Mn to the affinity partners, which were used for worthy causes by the OBU/PPA of the respective schools and by the Sri Lankan Army to support our war heroes.



Affinity Cards

Support for Educational Infrastructure Development

Nena Pubuduwa School Library Project

HNB initiated a project to upgrade the libraries of the most deserving schools in the outstations, which in fact, involves 100 libraries in 100 schools, of which 50 have been completed by the end of 2005.

Bank Museum



Visitors at the Bank Museum

Sustainability Report

At the new Head Office of the Bank situated at T. B. Jayah Mawatha, Colombo 10, a museum was opened in 2005. This Museum depicts a collection of many items of historical value in banking relevant to HNB as well as banking throughout the country. Such historical data is of interest to students and others who are welcome to visit the Museum free of charge.

HNB's Commitment to Greener Landscape, Pollution Control and Waste Management

HNB had been environmentally conscious for a long period and it is displayed through many areas of our operations. HNB takes a proactive approach in ecological matters and hence we have undertaken the following;

It is mandatory that all new projects undertake an Environmental Impact Assessment and take whatever possible measures to reduce the impact and be within the guidelines stipulated by the Central Environmental Authority.

Our internal operations insist on waste management and recycling paper and metal takes place systematically.

All our branches and especially the new head office building, are encouraged to reduce the use of electricity and water. The Building Management System operational in our head office building controls the electricity usage by managing the lighting and temperature requirements.

Special training programs are conducted for our staff in energy, water and waste management, so that they will preserve the nature while at office as well as at their home.

Looking Ahead

We intend promoting responsible garbage disposal after segregation of recyclable products. We are evaluating a complete garbage management program to be implemented in a suitable location in Colombo, on a test basis with the help of few Non Government Organizations. HNB will take the role of the Promoter of the project by mobilizing the expertise and network.

We will commence a program to educate our clients on the necessity to protect the environment, by making optimum usage of our communication channels. Initially, the envelopes carrying statement of accounts, debit/credit advices, letters etc will have a slogan type of a message to create an awareness. This will be extended to other forms of communication to ensure that it reaches the target audience within a short space of time.

HNB intend publishing a booklet detailing the responsibilities of the citizens towards protecting the environment. We will convey to the public and especially to school children how they could contribute towards preventing exploitation and pollution of the environment.

We will encourage our corporate clientele to use environmentally friendly advertising materials and set an example by adhering to such methods ourselves.

Our long-term goal is to encourage the public to patronize companies and products, which meet Central Environmental Authority, specified environmental standards a method we think will compel the businesses to follow suit.

We intend having competitions and quiz programs amongst the staff at regular intervals and the contribution made by the employees towards achieving our environmental objectives will be also evaluated regularly. Our long-term goal is to implement community based projects in all the villages and towns, in order to sustain this program on clean environment. Employees who excel in this area of work will be selected to lead these community-based teams.

We appeal to you our valued stakeholders to join hands with us to have a cleaner environment and make our beautiful country and its cities free of garbage.

KEY INDICATORS

CUSTOMER

Complaints

360 complaints were received at Head Office out of which, action has been taken on almost all complaints.

Serving Different Customer Segments

The Bank continues to serve different segments in the country as indicated below:

	Advances	Deposits
Individuals	49%	64%
Private Companies	21%	5%
Public Companies	5%	1%
Other Business Entities	3%	1%
Others	22%	29%
	100%	100%

Royalty Points for Credit Cardholders

HNB Credit Cardholders were awarded "Royalty Points" under "Royalty 2005" at 1 point for every Rs. 100/- spent using the HNB Credit Card. Double the number of points was awarded whenever an HNB Credit Card was used at selected "Chosen Partner" outlets. The redemption of points commenced when the 500 threshold was reached by a cardholder and the cardholder was also simultaneously entered into a draw with one chance for every 250 points accrued.

Prizes on a quarterly basis and year-end Grand Draw totalling to over Rs. 5 Mn were awarded under this scheme.

Increasing Reach

The Bank being a "Partner in Progress" to more people in more places with its island wide branch network with 148 customer centres and 152 school units, which helps to inculcate the savings habit among school children.

Further, with an inter-linked ATM network, which consist of 143 machines, provides teller facilities 24 hr a day, 365 days a year.

With our representative offices in India and Pakistan and also with our staff working as representatives in some Middle Eastern countries the bank is catering to Sri Lankan's who are living abroad.

New Products and Promotions

As long term investment a 5 year fixed deposit was introduced in 2005. Our Bank's product range is designed to cater to different segments in the society, from newborn babies to senior citizens who are enjoying their retirement. The bank rewards a gold coin to new Singithi savings a/c's which are opened with an initial deposit of Rs. 10,000 for new born babies.

Senior citizens deposit scheme was relaunched with additional features.

Customer Training Programmes

The Bank conducted several specific educational seminars for the farmers on latest technology, for small entrepreneurs on business management and for corporate customers on International trade.

Brand Value

HNB's brand value has increased by 6% in 2005 to Rs 3,033 Mn according to the valuation performed by "Brand Finance (UK)". Further, "LMD - Voice of Business" ranked HNB as the number one brand in the financial sector.

PEOPLE

Training and Development - External

	Local	Overseas
No. of programmes	134	27
No. of participants	534	35

Pay and Conditions Compared with Local Averages

Two market surveys were carried out by the Bank and by an independent firm & necessary recommendations have been made to the management on the variation.

Training Cost

Rs16.5 Mn. has been spent on training and development.

Work/Life Balance

A comprehensive programme on this subject was conducted at our training centre where most of the Bank's executives participated.

Workplace Profile

Gender Analysis of Staff

	Female	Male	Total	Female % of total
Corporate Management Executives	6	14	20	30
Junior Executives	150	447	597	25
Banking Assistants	314	595	909	35
Trainees	409	1,154	1,563	26
Allied Grades	128	188	316	41
Minor Staff	424	12	436	97
	0	418	418	0
Total	1,431	2,828	4,259	34

Staff turnover

Staff turnover for year 2005 - 5%

Sustainability Report

Categorywise Analysis of Staff

	Number	% of total
Corporate Management	20	1
Executives	597	14
Junior Executives	909	21
Banking Assistants	1,563	37
Trainees	316	7
Allied Grades	436	10
Minor Staff	418	10
Total	4,259	100

SHAREHOLDER

Following are few indicators that depict the sustained growth of HNB.

	2000	2001	2002	2003	2004	2005
Earnings per Share (Rs)	10.9	4.1	8.0	13.7	12.5	15.1
Dividend Yield (%) - Voting	8.6	2.9	3.8	5.8	6.1	3.6*
Dividend Yield (%) - Non-Voting	10.9	4.2	6.4	10.9	10.7	9.6*
Asset Growth (Year on year %)	14.8	13.1	16.4	15.5	14.6	8.7
Holding Period Return - Voting (%)**	(42.2)	15.7	73.5	(7.6)	(10.3)	104.4
Holding Period Return - Non Voting (%)**	0.0	2.0	52.8	(13.3)	0.0	38.9
Operating Cost - Efficiency Ratio (%)	71.4	77.2	72.9	64.0	70.4	62.0
Share Price - Voting (Rs.)	46.25	52.00	79.00	69.00	57.00	112.50
- Non Voting (Rs.)	36.75	36.00	47.00	36.75	32.75	41.50
Dividend %	40	15	30	40	35	40*

* Inclusive of final dividends of 20% for year 2005 (To be approved at the AGM & payable in April 2006).

** No shares in year 2000 is assumed to be 1000

	2003	2004	2005
Market Value Addition (Rs. Bn.)***	(2.5)	(4.1)	0.2
Economic Value Addition (Rs. Bn.)	(0.2)	(0.7)	(0.6)

*** For market value addition the share price GDR is considered as equivalent to the local market price of shares.

COMMUNITY

Community Support

During the year the Bank has approved Rs.19.5 Mn for community support. This amount has been allocated mainly on:

Rehabilitation of tanks	Rs 5.0 Mn
School library project	Rs 13.3 Mn
Various other projects	Rs 1.2 Mn

Sustainability Report

Independent Review Report



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Independent review report to Hatton National Bank Limited ('HNB') on its Sustainability Report 2005

Introduction

We have been engaged by HNB to review selected performance data (the Performance Data) reported in the section titled "Key Indicators" on pages 43 and 44 of the Sustainability Report section ("Sustainability Report") in the Annual Report for the year ended 31 December 2005.

Scope

The Sustainability Report and management responsibility

The management of HNB are responsible for the preparation of the Sustainability Report and the information and assessments contained within it, for determining HNB's objectives in relation to sustainability performance, and for establishing and maintaining appropriate performance management and internal control systems from which the reported information is derived. Management's assertions about the effectiveness of the performance management and internal control systems are included in a separate letter we have received from management.

Review Approach

We have conducted an independent review of the Performance Data in the section titled "Key Indicators" on pages 43 and 44 of the Sustainability Report for the year ended 31 December 2005.

There are no generally accepted standards for the preparation, publication or review of sustainability performance data. HNB applies its own definitions for reporting the Performance Data ("the Criteria"). The selection and suitability of the Criteria is the responsibility of management and our review did not include an assessment of the adequacy of the Criteria. Further, the internal control structure which management has established and from which the Performance Data has been derived, has not been reviewed and no opinion is expressed as to its effectiveness.

Our review was conducted in accordance with the Sri Lanka Auditing Practicing Statement applicable to review engagements. We performed review procedures in order to state whether on the basis of the review procedures described, anything has come to our attention that would indicate the Performance Data has not been presented fairly in accordance with the Criteria established by management.

We formed our statement on the basis of the review procedures performed, which were limited primarily to:

- enquiries of company personnel; and
- analytical procedures applied to the Performance Data.

The procedures do not provide all the evidence that would be required in an audit, thus the level of assurance is less than given in an audit. We have not performed an audit and, accordingly, we do not express an audit opinion.

Statement

Based on our review, which is not an audit, we have not become aware of any matter that makes us believe the Performance Data reported in the section titled "Key Indicators" on pages 43 and 44 of the Sustainability Report section, in the Annual Report for the year ended 31 December 2005, has not been presented fairly in accordance with the Criteria established by management.

Ford Rhodes Thornton & Co.

CHARTERED ACCOUNTANTS

Colombo.
16 February 2006

KPMG Ford, Rhodes, Thornton & Co.,
a Sri Lankan partnership, is the Sri Lankan member
firm of KPMG International, a Swiss cooperative

R.N. Asirwatham FCA
S. Sirikanathan FCA
Ms. M.P. Perera FCA
C.P. Jayatilake FCA
W.W.J.C Perera FCA

A.N. Fernando FCA
M.R. Mihular FCA
P.Y.S. Perera FCA
T.J.S. Rajakarier FCA
Ms. S. Joseph ACA

Products & Services



A comprehensive portfolio that is structured to serve all segments of our society in the broadest spectrum: from constructing of an extension to a home building national infrastructure.

Products & Services

Personal Banking

- Savings Accounts • “Pathum Vimana” Savings Scheme
- “Singithi Pathum” Minors Savings Scheme • “Saubhagya” Planned Savings Scheme • Divi Shakthi Accounts • Senior Citizen Scheme • Current Accounts • Lifeline Scheme
- Certificates of Deposit • “Shareline” Current Account for HNB Shareholders • Term Deposit Accounts • “Shanthi” Housing Loans • Consumer Loans • Group Consumer Loans & Leasing Schemes • HNB “MasterCard” (Local & International) • HNB “VisaCard” (Local & International)
- “Hot-Shot” Credit Card for teenagers • “Subasiri” Personal Loans • Dream Drive Vehicle Loans • Lease Master • Consumer Leasing • “Wasi Leasing” Leasing Scheme • Finance Leasing • Pawning Services • HNB Graduateship Educational & Career Development Loans Scheme • Special Educational Loans for CIMA • “Danuma” Educational Loans exclusively for ETF members • “Teleline” Banking • Hatna-I • Hatna-SMS • “Cashline” ATM Facilities • Safe Deposit Lockers • HNB “Home Care” Accounts for utility bill payments
- Money Transfer Services • Insurance • Share Broking
- Sale of Gold

Development Banking

- Sarusara – Agricultural Loan Scheme • Animal Husbandry Loans • Inland & Marine Fisheries Loans • Loans for farm machinery, land development & irrigation systems • Long Term Loans for traditional plantations & perennial crops
- Short Term Loans for Cultivation of Cash Crops • Loans for agri business & enterprises • Gami Pubuduwa (Microfinance)
- Micro & Small Loans for Rural & Semi Urban population, specially unemployed youth • Group Loans in collaboration with Non-Governmental Organizations (NGOs) • State sponsored special self employment loans • Entrepreneur Development Programmes • Loans for unemployed women
- Mobilization of Rural Savings

Corporate Banking

- Letters of Credit • Bank Guarantee • Import & Export Finance
- Working Capital Finance • Commercial Paper Facility/Money Market Loans • Medium and Long Term Loans • Securitizations
- Cheque Purchase Facilities • Off-Shore Banking Facilities
- Loans Syndications

Project Financing

- Industrial Loans for Manufacturing, Processing etc
- Loans for Factory Re-location, Re-habilitation • Infrastructure Development Projects • Special Financing for Energy Projects under Re-finance Schemes • Real Estate & Property Development • Loans for Small & Medium Enterprises • Loans for Tourism & Leisure Industry • Loans for financing of Fixed Assets & Working Capital

International Banking

- Non Resident Foreign Currency “Singithi Surakum” Minor’s Savings Accounts • “Pathum Udanaya” Foreign Currency Savings & Fixed Deposits Scheme • Millennium Shield Life Cover • Non Resident Foreign Currency Accounts • Resident Foreign Currency Accounts • Resident Non-National Foreign Currency Accounts • Resident Guest Foreign Currency Accounts • Rupee Accounts for Non-Resident Sri Lankan Investment (RANSI) • Share Investment External Rupee Accounts • Exporters Foreign Currency Accounts • Indirect Exporters Foreign Currency Accounts • Foreign Currency Banking Unit • Export & Import Financing • Trade Information & Assistance • “Traveline” Foreign Travel Loan Scheme
- Foreign Currency Leasing • Shanthi Foreign Currency Housing Loans Scheme • Issue of International Guarantees
- Travellers Cheque Issues • Foreign Draft Issues • Inward/Outward Remittances • International Inward Remittances

Investment Banking

- Corporate Finance & Advisory; mergers & acquisitions, divestitures, restructuring & reorganizations, capital raising advisory.
- Equities; origination, structuring and transaction management of IPO’s, follow on issues, convertible issues and private placements, underwriting, global offerings, prime brokerage, sales & distribution, proprietary trading and research.
- Fixed Income; primary dealership of government securities, origination, structuring and placement of corporate bonds and commercial paper, proprietary trading, market making, interest rate products and research.
- Loan Syndications & Structured Finance; structuring and arranging of syndicated lending, management of loan syndications, acquisition & leveraged finance, project finance, origination and placement of asset backed and mortgage backed securities, collateralized loan obligations and collateralized debt obligations.
- Derivatives & Treasury Products; interest rate swaps, currency swaps and forward rate agreements.

Financial Services/Treasury Products

- Forward Contracts • Currency SWAPS • REPO • Reverse REPO • Money Market Loans • Options • Interest Rate Swaps (IRS) • Futures • Various Structured Products • LKR Bonds
- US Treasuries • Gilts • Bunds

Customer Centre Network



Our network covers the length and breadth of the country and is digitally linked to provide easier access, keeping the advantages of HNB Banking within reach of all.

Customer Centre Network

North Western Province

- Chilaw
- Dankotuwa
- Kuliypitiya
- Kurunegala
- Marawila
- Nawinne Ext-Kurunegala
- Puttalam
- Wennappuwa

Western Province

- Airport Office
- Aluthgama
- Aluthkade
- Apollo Hospitals
- Asha Central Hospital
- Athurugiriya
- Avissawella
- Bambalapitiya
- Biyagama
- Boralesgamuwa
- Borella
- Cinnamon Gardens
- City Office
- Dehiwela
- Delgoda
- Dematagoda
- Emirates
- Gampaha
- Grandpass
- Gunasinghepura
- Hanwella
- Head Office Branch
- Homagama
- Horana
- Hulftsdorp
- IWMI - Palawatta
- Ja-Ela
- Kadawatha
- Kaduwela
- Kalutara
- Kandana
- Katunayake
- Kiribathgoda
- Kirindiwela
- Kirullapone
- Kollupitiya
- Kollupitiya Extension Office
- Kotahena
- Kottawa
- Kotte

North Central Province

- Anuradhapura
- Nochchiyagama
- Polonnaruwa
- Thambuttegama

Northern Province

- Chunnakam
- Jaffna
- Jaffna Ext. Office
- Mannar
- Manipay
- Nelliya
- Vavuniya

- Maharagama
- Main Branch
- Malabe
- Maligawatte
- Maradana
- Marandaghamulla
- Minuwangoda
- Mirigama
- Mirihana
- Moratumulla
- Moratuwa
- Mt. Lavinia
- Mutwal
- Narahenpita
- Nawaloka Hospital
- Nawam Mawatha
- Negombo
- Negombo Extension Office
- Nittambuwa
- Nugegoda
- Overseas School of Colombo
- Padukka
- Panadura
- Panchikawatte
- Pettah
- Piliyandala
- Ports Authority
- Ragama
- Ratmalana
- Sea Street
- Seeduwa
- Sri Jayewardenepura Hospital
- SriLankan Airlines Administrative Complex
- Talangama
- Thalawathugoda
- Thimbrigasyaya
- Wattala
- Wellawatte
- Wijerama

Central Province

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

Southern Province

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

Eastern Province

- Akkaraipattu
- Ampara
- Batticaloa
- Kalmunai
- Kantalai
- Kattankudy
- Trincomalee
- Trincomalee - Extension Office

Uva Province

- Badulla
- Bandarawela
- Buttala
- Moneragala
- Welimada
- Wellawaya

HNB Customer Centres to be opened during the 1st quarter of the year 2006

- Jampettah Street

HNB Student Banking Centres - 152

HNB Gami Pubuduwa Banking Centres - 109

- Village Based - 23 ● Branch Based - 86

HNB Mobile Banking Centres - 2

- Hotel Culture Club - Dambulla
- Kandalama Hotel - Dambulla

Overseas Representative Offices

- Chennai - India ● Karachi - Pakistan

Global Presence



Wherever you go in the world, you'll find we have a correspondent Bank to meet your international needs.

Global Presence

Europe

- Austria
- Belgium
- Croatia
- Cyprus
- Czechoslovakia
- Denmark
- Finland
- France
- Germany
- Greece
- Hungary
- Ireland
- Italy
- Netherlands
- Norway
- Poland
- Portugal
- Romania
- Russian Federation
 - Spain
 - Sweden
- Switzerland
 - Turkey
- United Kingdom

Americas

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

Asia & Pacific

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

Middle East & Africa

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

Corporate Management



R Theagarajah

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



J M J Perera

F.C.I.B. (London)
Senior Deputy General Manager
Corporate Banking



G P Karunaratne

F.C.M.I.(UK)
Senior Deputy General Manager
International & Investment Banking



J D N Kekulawala

M.B.A. (Manchester), F.C.I.B.(London),
F.C.A.(England & Wales)
Chief Financial Officer



U A C Obeyesekere

F.I.P.M. (Sri Lanka)
Deputy General Manager
Human Resources & Administration



C P Abeywickrema

B.Com. (Special) Sri Lanka
Deputy General Manager
Personal Banking & Network Management



Ms I Goonesekera

Attorney-at-Law & Notary Public
Deputy General Manager
Legal / Board Secretary



Ms S N Wickramasinghe

Attorney-at-Law, F.C.M.I. (UK)
Deputy General Manager
Banking Services



C C Hemachandra

B.Sc. (Hons) London, M.B.C.S., M.A.C.S.
Deputy General Manager
Information Technology



N Hapuarachchy

M.B.A. (Sri J.), Dip. in Bank Mgmt.
Deputy General Manager
Credit Supervision & Recoveries



Ms A M Karunaratne

F.C.M.A.
Deputy General Manager
Corporate Banking



A S Ibrahim

B.Sc.(Hons) Colombo, F.C.I.B. (London)
Deputy General Manager
Treasury

Corporate Management



Ms L L C Thambiah
Assistant General Manager
Zone II



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 - Zone III



Ms D C Cooke
F.C.A.(Sri Lanka)
Head of Internal Audit



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



P Sridharan
Assistant General Manager
Personal Financial Services &
Business Development



Ms I R D Thenabadu
F.C.I.B. (London), F.C.M.A.
Assistant General Manager - Risk &
Compliance



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



D Rodrigo
M.B.A. (Cranfield), F.C.M.A., F.C.C.A.
Assistant General Manager - Credit Risk Management

Senior Management

B J Sinniah

Chief Manager - Risk & Compliance

Ms R P P Wickremasinghe

B.Dev.Studies (Hons) Colombo,
Dip. in Personnel Management (N.I.B.M.),
Dip. in Counselling (S.L.F.I.)
Chief Manager - Employee Relations

A P L Fernando

A.I.B. (SL), Dip. in Bank Mgmt.
Chief Manager - Credit Supervision &
Recoveries

V G P Vidyaratne

P.G.Dip.(Ind.Eng.), B.Sc. (Eng.)Cey.,
C.Eng., M.I.E. (SL)
Chief Manager - Premises & Engineering

R M P Ratnayake

M.B.A. (Fin. Sp.) Univ. of Southern
Queensland, P.G. Dip. Busi. & Fin.
Admin. (I.C.A.S.L. & Cranfield),
A.I.B. (SL), M.A.A.T.
Chief Manager - International Operations

V K A F Rajasekara

Chief Manager -South Western Region

A N J De Silva

Chief Manager - Business Development
- Subsidiaries

R H Abayasekara

Chief Manager - International & FCBU

M K Nambiyarooran

M.B.A.(Sri J.), F.C.M.A., F.S.C.M.A.,
F.I.B.(SL)
Chief Manager - Corporate Planning

K L Wijesooriya

LL.B
Chief Manager - Marketing

H N J Chandrasekera

Chief Manager - Colombo Region

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)
Chief Manager - Information Technology

A Ratnasabapathy

F.P.M.A.
Chief Manager - City Office

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 & Card Centre

N U Jumat

A.I.B. (SL)
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 - Balance Sheet
Management

R J Thambirajah

Chief Manager - Greater Colombo Region

I A Baduge

Dip.in Bank Mgmt., A.I.C.M.
Chief Manager - Head Office Branch

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 - North Western Region

S Wijayasinghe

B.Com. (Australia), F.C.M.A,
C.P.A. (Australia), A.C.I.B. (London)
Chief Manager - Finance

T M A Mutaliph

A.I.B.(SL), Dip. in Bank Mgmt.
Senior Manager - (Risk) Zone I

Ms N Y S Bodinagoda Rodrigo

A.I.B. (SL)
Senior Manager - (Risk) Zone III

N Premakumar

Senior Manager - Admin. & Trade
Services (City)

J J Namasivayam

Senior Manager - Currency Division

S Sivalingam

A.C.I.B. (London)
Senior Manager - Productivity

A Goonesekere

M.B.A. (Sri J.), A.C.A. (Sri Lanka),
A.S.C.M.A.
Senior Accountant

U N I Elapata

B.A. (Hons) - Univ. of Texas (Austin)
Senior Manager - Personal Financial
Services (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 - Uva/Eastern/
Sabaragamuwa 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), A.M.S.L.I.M.,
Dip. in Busi.Mgmt & Admin. (UK),
Dip. in Sales Mgmt & Marketing (UK)
Senior Manager

J T M Weeresinghe

Senior Manager - Credit Risk 1

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

HNB recognizes that the effective management of the various risks it is exposed to is vital for achieving and maintaining sustainable growth. Towards this end, HNB's risk management practices continue to evolve to meet the expectations of its various stakeholders.

During the year the bank took various initiatives to improve its risk management framework:

- Formed a Risk Management Committee chaired by the CEO & comprising the Heads of the various business units and operating departments to ensure an integrated approach to risk management across the bank.
- Intensified risk management training to inculcate a risk management culture at all levels.
- Enhanced the degree of independence of risk management & audit from the business.
- Began the transition to the Basel II framework in line with the directives of the CBSL.

Risk management is focused on the following six core areas

Credit Risk

The risk that a loss will be incurred if a counter party does not fulfill its financial obligations in a timely manner.

The underwriting of credit risk is a core activity of the bank and the related quantum of risk is greater than the total of all other risks undertaken by the bank. Accordingly HNB pays greatest attention to the management of this risk.

All credit decisions are guided by a credit policy, which has been approved by the Board of Directors and is reviewed at regular intervals to ensure that it meets the needs of the changing environment.

A credit rating system forms an integral part of the evaluation of a credit proposal and assists the approval authorities to assess the creditability of the borrowers. This risk rating system too is subject to periodic review and refinement

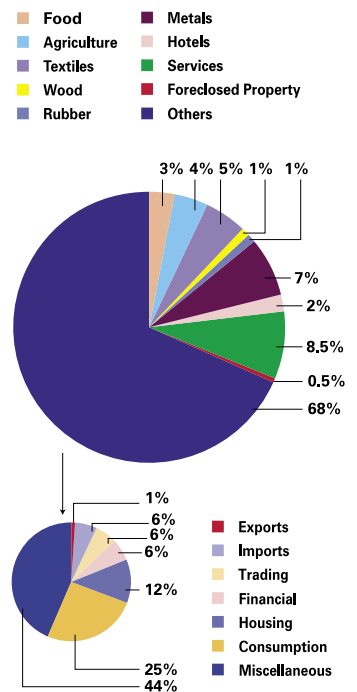
All credit risk exposure require approval by the appropriate credit committees with the

larger exposures being screened through the Risk and Compliance division which makes an independent assessment of the proposal. Ongoing reviews are carried out at frequent intervals, which focus on the usage and the performance of the facilities and the justification in continuing the relationship.

The credit approval process for consumer loans is a system based on -line approval with a built in risk evaluation, ensuring speedy assessment and disbursement. The system also permits the generation of management reports which give an accurate assessment on the current status of the portfolio.

The bank has a fully fledged Credit Supervision & Recoveries unit which is headed by a member of the Corporate Management and handles the restructuring of the sick industries and work related to the take over of assets of defaulting clients in which the bank has financial interests.

Analysis of Advances by Sector



Risk Management

The legal department works closely with the branches and the units handling the clients in order to expedite the loan disbursement and legal action when deemed necessary.

Liquidity Risk

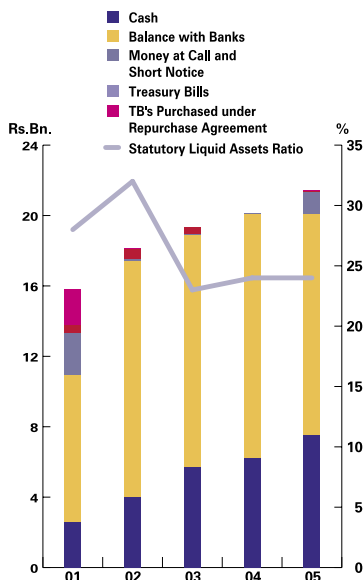
Liquidity risk arises from the mismatch of maturities across the balance sheet and contingent liabilities / commitments.

As a bank with a very large network of customer centres and a diverse product portfolio, management of liquidity is a challenging task. Monitoring of future cash flows and maintaining a mix of assets at all times is central to liquidity management. HNB like most other banks has mismatches in the contractual maturity profile of its assets and liabilities; however these mismatches are managed by periodically evaluating various scenarios and stress testing at regular intervals to analyse the potential impact and the need for corrective action.

The Treasury Division manages liquidity, funding requirements and related concentration risks daily with direction from

the Asset Liability committee (ALCO) which is chaired by the Chief Executive Officer (CEO). The committee meets fortnightly to review the banks assets and liability position in the light of past trends and future needs. It also reviews and readdresses policy

Cash, Short Term Funds & Government Securities



guidelines and ensures that regulatory requirements are complied with.

Market Risk

Market risk is defined as the potential loss in the value of a security arising from changes in market factors such as interest rates, exchange rates and equity prices.

The bank is exposed to this risk in its trading and treasury portfolios as the value of the positions is sensitive to changes in exchange and interest rates. ALCO and a Treasury Committee provide guidance to the Treasury Division in managing these risks.

Market Risk is managed by utilizing a combination of volume limits, intra day, overnight and stop loss limits.

Adherence to these limits and other policy guidelines is monitored by the Middle Office that has an independent reporting line. In addition to limit compliance, the Mid Office also prepares daily price risk reports and carries out sensitivity analyses on positions to alert management to the extent of the possible implications of the positions undertaken

Operational Risk

Operational risk arises when internal procedures, practices and systems are not rigorous or sophisticated enough to cope with frauds or human / technological errors. Although operational risk is not easy to identify or quantify as market or credit risk it has been implicated as a major factor in many of the recent highly publicized losses in the financial sector.

Risk Management

The Management has put in place a system of internal controls to minimize the risk of fraud and irregularities. Audit Department plays a major role in the internal control system by performing continuous audit of branches and business units to provide management with an assurance of the adequacy and efficacy of the controls in place. The independence of the Audit Department has been further strengthened by making it report directly to the bank's Board Audit Committee. Audit reports are also reviewed by the CEO. Head of the relevant department, audit department and risk management team which follows up the rectification and implementation of any recommendations.

It has now been made mandatory for all the core divisions in the bank to have a Business Continuity Plan (BCP), which is reviewed and discussed regularly at staff meetings to generate greater awareness of and readiness in case of an eventuality.

Legal Risks/Compliance

To minimize the legal risks, the branches are assisted by the Legal Department at Head Office or by the lawyers nominated by the bank to verify title deeds and in the preparation of mortgage bonds. The Legal Department also monitors the developments in the legal arena and observes the use of standard agreements to reduce documentation risks, where expedient, external counsel is chosen out of a pre-approved panel.

Reputation Risk

By practising transparent and socially responsible management, based on an ethical corporate culture we have

steadily established the foundation for progress as a leading financial institution in the country.

We believe that in order to be the best, all employees should abide by the code of ethics with a view to win the trust and confidence of our customers and the regulatory authorities.

We are fully conscious of the adverse impact on the image of the bank due to a lapse in any of the aforesaid and the resultant erosion of public confidence.

The bank has a well-equipped training department, which ensures that all employees are adequately trained in order to minimise the risks caused by mistakes or misconduct. The staff is also given opportunities to attend external programmes locally and abroad to improve skills and competencies.

All staff members dealing with clients are required to undergo training in Anti Money Laundering. KYC procedures are being evolved as an important part of this exercise.

As the bank operates in an environment that is subject to regulatory compliance requirements we have strengthened the Risk and Compliance Division, which is headed by a member of the corporate management supported by senior management staff having wide experience and banking knowledge.

Corporate Governance

At HNB we strive to maintain the highest standards of Corporate Governance. We are committed to ensuring the best interests of our customers, employees, our shareholders and the communities we serve. We are driven by our mission to provide excellence in financial services and thereby to remain at the forefront of best practice in Corporate Governance.

We are committed to continuously reviewing and improving our governance practices. The Board of Directors is central to Corporate Governance, and at HNB good governance is recognized as an essential ingredient in corporate success and sustainable economic growth. Several initiatives have been set up by the Board, our management and our employees to ensure that we live up to our core values and reach our shared goals.

Our Shared Responsibilities

- To protect our franchise by placing long-term shareholder value ahead of short term gains.
- To provide our customers with superior products and services, good advice and maintain the highest standards of integrity at all times.
- To be a responsible corporate and to play an active role in the communities in which we serve.
- To instill in our employees our culture of excellence, to promote mutual respect and provide an inspiring work environment with the right opportunities to outstanding achievers. This we believe is paramount to promoting the highest standards of integrity and professionalism throughout the Bank.
- To continuously review and strengthen our control environment and risk management strategies.

Board of Directors

The Board of Directors of HNB has consistently adopted strong Corporate Governance policies and practices. Director independence, the independence of the audit function, responsibilities in relation to financial reporting, and compliance with laws, rules and regulations are at the forefront of these policies.

Regular meetings of the Board are held to review the Bank's performance and to determine whether its strategies and business practices are aligned with shareholder expectations. Meetings of the Board are structured to allow open discussion. All directors receive accurate timely and clear information on all relevant matters. Any requests for further information are co-ordinated by the Board Secretary.

The number of meetings and attendance at meetings is given on page 62.

Composition of the Board

The Board consists of nine Directors. All Members are Non-executive while the CEO is the only Executive Member. The

profiles of the Directors are set out on page 8 Each of the Directors possess a wide range of skills, experience and a network of contacts. Each brings in independent judgment and considerable knowledge to perform their roles effectively.

The roles of the Chairman and Chief Executive Officer are distinct and separate with a clear division of responsibilities.

Board Role and Responsibility

The role and responsibilities of the Board are formalized in the Board Charter. The Charter also defines matters which are reserved for the Board and its Committees, and those which are delegated to management.

In summary, the Board is accountable to the shareholders for the Bank's overall performance and its responsibilities include:

strategy – providing strategic direction and approving corporate strategic initiatives;

board performance and composition – evaluating the performance of Non-executive Directors, and determining the size and composition of the HNB Board as well as making recommendations to shareholders on the appointment and removal of Directors;

leadership selection – evaluating the performance of and selecting the CEO and the CFO;

succession planning – planning for Board and executive succession;

remuneration – determining the remuneration of the CEO; and Non-executive Directors.

financial reporting – considering and approving quarterly and annual financial statements;

risk management – approving a risk management strategy and monitoring its effectiveness;

relationship with stock exchanges, regulators, and continuous disclosure – maintaining a direct and ongoing dialogue with the SEC and other exchanges where our securities are listed, ensuring that the market and our shareholders are continuously informed of material developments;

social responsibility – considering the social, ethical and environmental impact of our activities, setting standards and monitoring compliance with our social responsibility policies and practices; and

audit – selecting and recommending to Shareholders the appointment of the External Auditor. Determining the duration, remuneration and terms of appointment of the External Auditor, evaluating their performance and independence. Maintaining a direct and ongoing dialogue with the External Auditor.

Corporate Governance

The Board has delegated to management the responsibility for;

strategy – developing and implementing corporate strategies and making recommendations to the Board on significant strategic initiatives;

senior management selection – making recommendations for the appointment of senior management, determining terms of appointment evaluating performance, and developing and maintaining succession plans for senior management roles;

financial performance – developing the annual budget and managing day-to-day operations within the budget;

risk management – maintaining an effective risk management framework;

continuous disclosure – keeping the Board and market fully informed of material developments; and

social responsibility – managing day-to-day operations in accordance with standards for social, ethical and environmental practices, which have been established by the Board.

The selection and role of the Chairman

The Directors elect one of the independent Non-executive Directors to be Chairman. The Chairman's role includes:

- ensuring that, when all Board members take office, they undertake appropriate induction covering the terms of their appointment, their duties and responsibilities;
- providing effective leadership in formulating the Board's strategy;
- representing the views of the Board to the public;
- ensuring that the Board meets at regular intervals throughout the year, that minutes of meetings accurately record decisions taken and, where appropriate, the views of individual Directors;
- developing the agenda and conducting Board meetings; and
- reviewing the performance of Non-executive Directors.

Avoidance of Conflict of Interest by a Director

The Board is conscious of its obligations to ensure that Directors avoid conflicts of interest (both real and apparent) between their duty to HNB and their other interests. The Board has 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 their interest and unless the Board resolves otherwise, they do not participate

in boardroom discussions or vote on matters in which they face a conflict.

All related party transactions are disclosed from page 126 to 135.

Committees of the Board of Directors.

Nominations Committee

The composition of the Board is subject to continuous review and one of the responsibilities of the Board is identifying, evaluating and selecting candidates for suitable positions to ensure effective succession planning within the Bank. All new appointments as well as continuing directorships are reviewed by the nominations committee. Directors are required to report any substantial change in their professional responsibilities, occupation or business associations to the nominations committee, which will examine the facts and circumstances and make recommendations to the Board. In 2005 HNB added one new independent, Non-executive director to the Board

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 committee will consider their independence at that time and the proposed re-election of Directors is subject to prior review by the full Board.

Audit Committee

The Audit Committee of the Bank is comprised only of Non-executive Directors and meets regularly throughout the year. The CEO attends meetings on invitation. The committee reviews the Banks internal control and risk management systems with particular reference to internal controls over financial reporting.

The committee monitors the integrity of the Banks financial statements and formal announcements relating to the Bank's financial performance by reviewing the presentation of such reports and significant financial judgments/ estimates contained in them.

The committee monitors and reviews the effectiveness of the Banks internal audit function, the External Auditors' 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 by the External Auditor. The Audit Committee has the primary responsibility for making a recommendation on the appointment, reappointment or removal of the external auditor in-line with professional standards and regulatory requirements.

The Audit Committee also reviews issues relating to breach of ethics, such matters as fraud, accounting issues, employee wrong-doing and regulatory violations and the arrangements

Corporate Governance

by which the staff of the company may in confidence raise concerns about possible improprieties. The committee also ensures that the procedures for the independent investigations of such matters are appropriate.

A continuous review of the performance of the Audit Committee has been set up by retaining an independent consultant who is considered a financial expert, and has wide experience in audit and governance best practices. The consultant participates at all meetings of the committee and provides feedback. He also meets separately with the Corporate Management and makes recommendations to the committee in order to improve the effectiveness of the financial reporting process and control environment.

The report of the Audit Committee of the Bank for the year 2005 is given at page 86.

Credit Committee

The Credit Committee headed by the CEO and comprising of three Senior Officers of the Corporate Management approves facilities within its delegated authority. The Committee has regular meetings whilst credit papers for large facilities above the delegated authority of the CEO are also approved by circulation to the Directors.

All facilities approved by the Credit Committee within its delegated limit are reported to the Board of Directors at its monthly meetings.

The quality of the Banks loan portfolio, its NPA ratio, recovery process and bad debt provisions are closely monitored by the Credit Supervision and Recoveries group which is independent of the approval and disbursement process. Regular reports are submitted to the Board of Directors which closely monitors the Banks credit risk

Procurement Committee

Procurement within the Bank is centralized for effective management and control. All purchases in excess of the delegated authority are referred to a sub committee of the Board for further evaluation and negotiation. The Committee ensures that a transparent procedure is adopted and that contracts are fairly negotiated and concluded.

Human Resources / Remuneration Committee

The committee comprise of three Directors of the Bank including the CEO.

The responsibilities of the committee include:

- Executive remuneration and incentive policies
- Remuneration packages of senior management
- The Bank's recruitment, retention, termination, succession planning and career, planning policies for executive and senior management.
- Incentive and pension schemes.

The Committee is also responsible for assisting the Board with regard to the remuneration policy for Non-executive Directors and for making all relevant disclosures.

The Committee determines and agrees with the Board the broad policy framework for the remuneration of the CEO. The Director/CEO does not participate in such meetings.

Director Training and Orientation

Each new Director receives a formal induction. Existing directors undertake such professional development as they consider necessary in assisting them to carry out their duties as Directors. All Directors are encouraged, and are able if considered necessary to obtain independent professional/ expert advice at the Bank's expense.

Performance Evaluation

The performance of the Board and its Committees is evaluated by the Chairman who ensures that the Board functions effectively and efficiently. The performance of the CEO is reviewed by the full Board.

Board Secretary & Legal Officer

The Company Secretary & Legal Officer is responsible for:

- providing advice to Directors and officers in relation to the constitution, the requirements of the Companies Act, other regulatory requirements and the Stock Exchange listing rules.
- advising the Board and individual Directors on Corporate Governance principles and assisting in the implementation of Corporate Governance programs;
- functional responsibility for the management of the legal, compliance and company secretarial functions of the Bank.

All Directors have access to advice from the Board Secretary.

Controlled Entities

The activities of every company in the Group are overseen by their own Board of Directors.

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 its business and activities.

Confidence in the activities of a controlled entity Board is maintained through high quality controlled entity Boards and their commitment to group objectives.

Relations with Shareholders

The Bank communicates with its large shareholder base through the Annual Report and through the Annual General Meeting. Information is provided in advance of the AGM and shareholders can raise issues relating to their Shareholdings and the business of the group. Shareholders may also submit written questions in advance of the Annual General Meeting. The Chairmen of the Audit, Remuneration and Nominations Committees are present to answer questions.

Communication with its largest Institutional Shareholders is undertaken as part of the Bank's investor relations program. During the year the Directors review analysts reports which include analysis of share price movements, the Bank's performance in the sector, and brokers comments. Information regarding the Bank's activities and performance are also available on its website.

Other Corporate Governance Initiatives.

With a view to embedding in our culture the highest standards of integrity and professionalism, and to instill in our employees an appreciation of our core values, our shared responsibilities, and to provide them with the opportunities and the tools required to accomplish these goals the following initiatives have been introduced.

Continuing education is provided at different levels. Orientation is provided to all new Managers as well as to new employees. Manager training is provided to all existing Managers. We strive to develop our talent and help our Managers reach their potential through executive development programs and regular assessment and feed-back.

Code of Ethics

In order to secure a network wide commitment to integrity, our employees are required to review and abide by HNB's code of ethics. The code of ethics and other internal policies and guidelines are designed to support our core value of integrity as well as compliance with laws, rules and regulations that govern our business practices. During 2005 the Bank has reinforced its code of ethics and will be launching it on its intranet and e-learning platform as well.

A clear and consistent message of our values and culture is presented through improved communications. The CEO has regular meetings with business and regional heads, employee representatives and trade unions. Regular branch visits carried out by Senior Management improves dialogue with employees. Regional conferences are held as well as an annual conference for Managers. Regular information bulletins and corporate communications as well as the Banks intranet form part of an effective communications network.

Corporate Social Responsibility

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 25 to 44 in the Sustainability Report. The Bank has set up a Sustainability Committee which has three subcommittees addressing the social responsibility issues relating to our key stakeholders.

Compliance and Control

In our efforts to strengthen our control and compliance environment the following initiatives have been introduced during the year:

A Risk Management Committee was established according to a formally documented risk management charter. The committee is headed by the CEO and comprises of the divisional heads. Meetings are held on a monthly basis to identify, assess and address the risks relating to the numerous business units.

An independent risk and compliance function was established to support the business units to identify and manage their risks better. New and existing products are risk managed to ensure sustained and responsible business growth. The independent compliance function was strengthened to ensure that our businesses are compliant with applicable laws and regulations.

Control self - assessment is being used by the Bank over the last two years as a means to enhancing process discipline and internal control.

A fraud risk management strategy has been developed and is being implemented throughout the Bank by way of awareness programs and training for all managers. Arrangements are also in place for employees to raise concerns regarding control violations, compliance issues and other improprieties.

The allocation of resources for Compliance and Audit are reviewed by the Audit Committee as well as the CEO and strengthened from time to time. The key findings from Internal Audit Examinations are reviewed personally by the CEO together with the CFO and other divisional heads as appropriate. Continuing education and training is being provided to control and compliance professionals.

The Compliance report of the Bank is 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.

Corporate Governance

Meetings

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

	Board Meetings	Audit Committee	Nomination Committee	Remuneration Committee
Total no of meetings in 2005	14	03	01	05
Mr Rienzie T Wijetillake	14	*****	01	05
Dr V P Vittachi	14	*****	*****	*****
Mr R Theagarajah	14	*****	*****	05
Mr D H S Jayawardena	13	03	01	*****
Mr M V Theagarajah	12	*****	01	*****
Mr R K Obeyesekere	12	*****	01	04
Mrs P C Cooray	14	03	*****	05
Mr R Sivaratnam	10	03	*****	*****
Mr D R Ghazalli	2	*****	*****	*****

Mr D R Ghazalli was appointed to the board as a non executive director effective September 1st, 2005

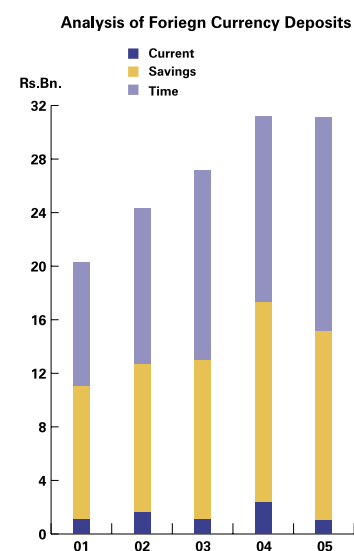
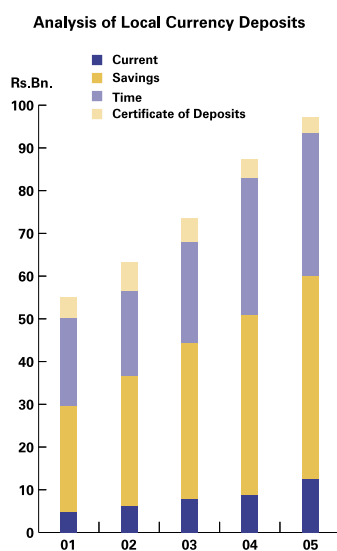
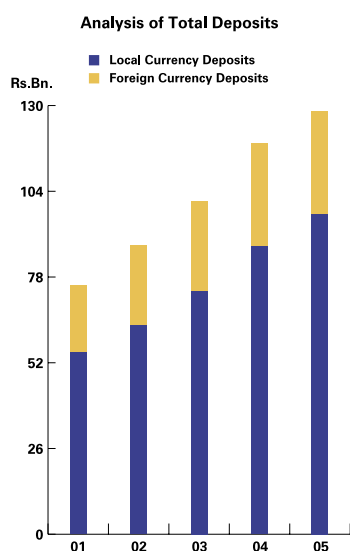
	Credit	Asset Disposal	Procurement Committee
Total no of papers approved in 2005	218	05	04
Mr Rienzie T Wijetillake	192	*****	*****
Dr V P Vittachi	10	*****	*****
Mr R Theagarajah	•217	05	04
Mr D H S Jayawardena	08	*****	*****
Mr M V Theagarajah	112	*****	03
Mr R K Obeyesekere	64	05	04
Mrs P C Cooray	126	05	*****
Mr R Sivaratnam	55	04	03
Mr D R Ghazalli	14	*****	*****

- Includes 06 papers approved by Mr J D N Kekulawela as the alternate director for Mr Theagarajah. Credit, Asset Disposal and Procurement Committees usually consider and approve proposals by circulation.

***** Not a member of committee

Analysis of Deposits

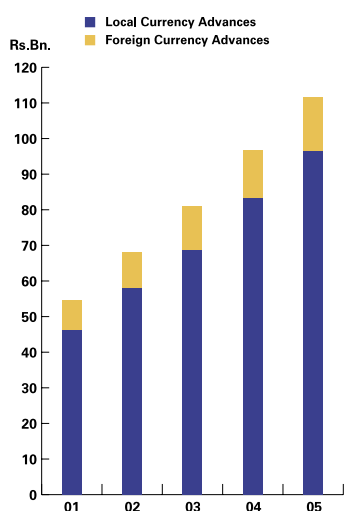
	2001 Rs.000	2002 Rs.000	2003 Rs.000	2004 Rs.000	2005 Rs.000
Local Currency Deposits					
Current	4,846,459	6,191,913	7,929,485	8,852,609	12,511,256
Savings	24,746,904	30,627,485	36,452,976	42,108,475	47,380,753
Time	20,603,261	19,872,255	23,502,610	31,920,537	33,587,699
Certificate of Deposits	4,944,472	6,677,438	5,861,618	4,448,095	3,634,393
	55,141,096	63,369,091	73,746,689	87,329,716	97,114,101
Foreign Currency Deposits					
Current	1,159,328	1,679,540	1,154,625	2,331,555	1,013,589
Savings	9,962,977	11,171,199	11,936,063	15,009,655	14,166,198
Time	9,335,857	11,664,587	14,188,135	13,853,008	15,989,793
	20,458,162	24,515,326	27,278,823	31,194,218	31,169,580
Total Deposits	75,599,258	87,884,417	101,025,513	118,523,934	128,283,681
Refinance	1,564,826	1,659,069	1,764,014	2,066,198	2,711,810
Total Deposits & Refinance	77,164,084	89,543,486	102,789,527	120,590,132	130,995,491



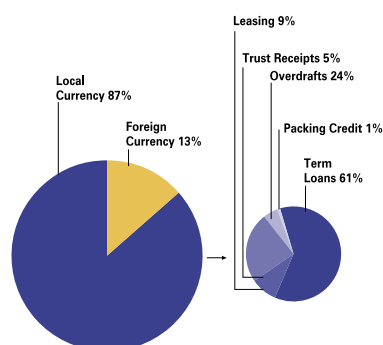
Analysis of Advances

	2001 Rs.000	2002 Rs.000	2003 Rs.000	2004 Rs.000	2005 Rs.000
Local Currency Advances					
Overdrafts	15,794,397	16,786,380	17,247,347	20,165,063	22,952,834
Trust Receipts	3,163,759	4,228,258	3,880,713	4,957,006	5,193,080
Packing Credit	483,248	329,217	557,260	521,945	523,517
Term Loans	23,786,022	32,757,990	41,880,705	50,714,867	58,978,155
	43,227,426	54,101,845	63,566,025	76,358,881	87,647,586
Leasing Facilities					
	2,898,214	4,032,043	5,084,773	6,838,367	8,864,351
Total	46,125,640	58,133,888	68,650,798	83,197,248	96,511,937
Foreign Currency Advances					
	8,649,230	10,195,368	12,314,964	13,702,580	15,060,895
Total	54,774,870	68,329,256	80,965,762	96,899,828	111,572,832

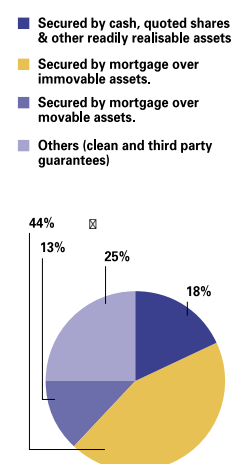
Analysis of Total Advances



Analysis of Advances



Analysis of Advances by Security

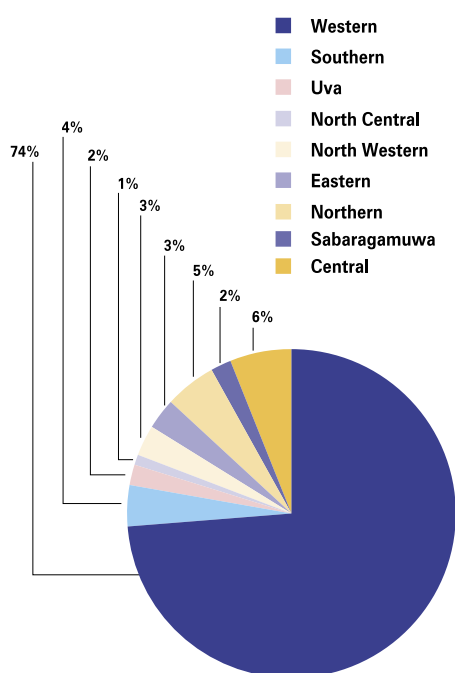


Provincewise Analysis of Deposits & Advances

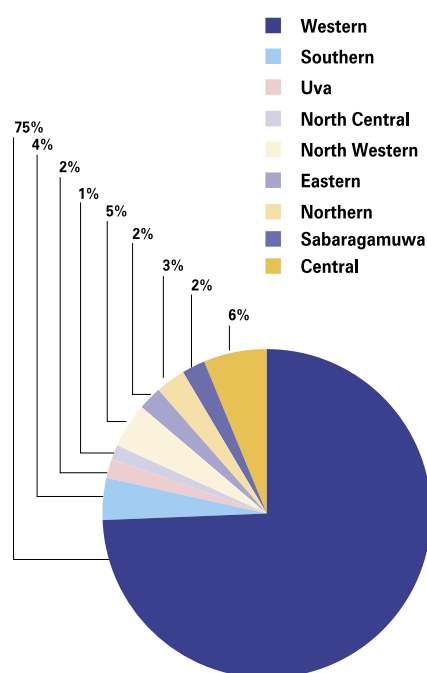
Provincewise Analysis of Deposits & Advances as at 31st December, 2005

Province	No of Customer Centres	Deposits (Rs.Mn.)	%	Advances Including Leasing (Rs.Mn.)	%	Deposit Utilisation %
Western	80	93,672	74	82,871	75	88
Southern	12	4,943	4	4,621	4	93
Uva	6	2,485	2	2,103	2	85
North Central	4	1,918	1	1,591	1	83
North Western	7	4,270	3	4,948	5	116
Eastern	8	4,255	3	2,603	2	61
Northern	7	5,784	5	3,291	3	57
Sabaragamuwa	9	3,134	2	2,569	2	82
Central	15	7,823	6	6,976	6	89
Total	148	128,284	100	111,573	100	87

Provincewise Deposits



Provincewise Advances



Sources & Utilisation of Income

Sources of Income

For the year ended 31st December,	2001 Rs.000	2002 Rs.000	2003 Rs.000	2004 Rs.000	2005 Rs.000
Interest	9,335,933	9,398,781	11,536,552	11,469,335	14,129,874
Exchange	516,176	382,272	506,436	662,176	646,460
Commission	615,179	755,384	1,241,588	1,519,924	1,663,545
Investments	84,424	303,507	356,830	288,193	329,322
Other	1,012,117	959,485	1,189,156	147,730	227,578
Total	11,563,829	11,799,429	14,830,562	14,087,357	16,996,779

Utilisation of Income

For the year ended 31st December,	2001 Rs.000	2002 Rs.000	2003 Rs.000	2004 Rs.000	2005 Rs.000
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Employees

Salaries and other payments to staff	1,626,189	1,778,250	2,320,427	2,414,137	2,741,656
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Suppliers

Interest paid	7,201,421	6,257,761	6,909,095	5,962,041	7,280,851
other expenses	2,307,849	3,004,516	4,440,289	4,418,999	4,922,800
Total	9,509,270	9,262,277	11,349,384	10,381,040	12,203,651

Net Income before Government Taxes & Levies

	428,370	758,902	1,160,751	1,292,180	2,051,472
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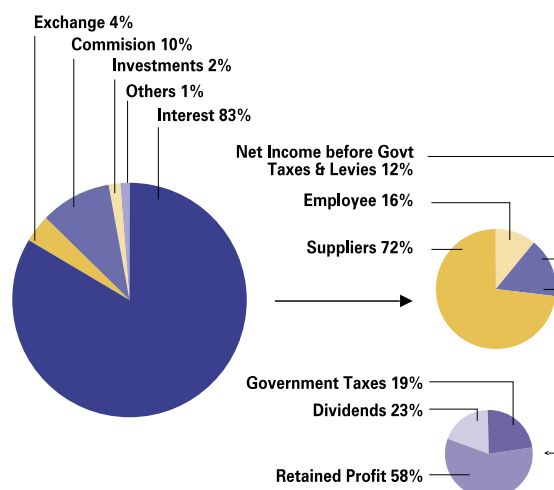
Government

Income tax, turnover tax, VAT, Debit Tax & defence levy/National Security levy	125,277	170,052	152,466	315,799	396,910
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Shareholders

Dividends	97,500	214,500	286,000	350,350	471,059
Retained Profit	205,593	374,350	722,285	626,031	1,183,503
Total	11,563,829	11,799,429	14,830,562	14,087,357	16,996,779

Sources & Utilization of Income



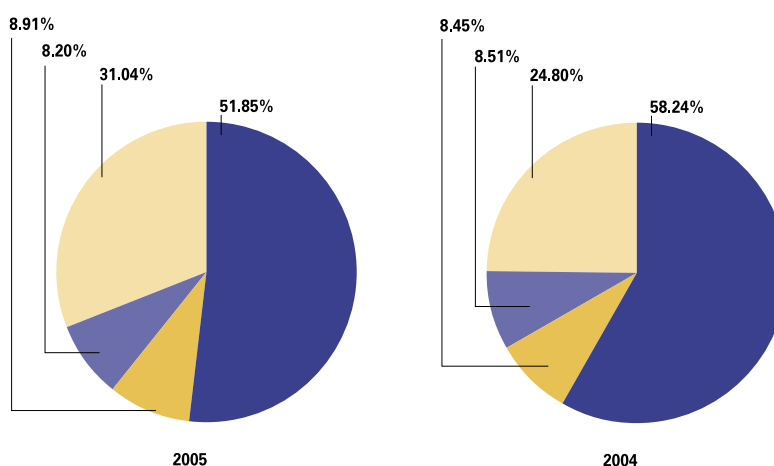
Within the context of the economy at large, the Bank acts as a financial intermediary with revenues from customers flowing to employees, depositors, the government and shareholders. The Bank retains part of the shareholder segment to support future growth and investment.

Value Added Statement

	2005 Rs.000	%		2004 Rs.000	%
Value added					
Income earned by providing banking services	16,581,974			13,755,323	
Cost of services	9,868,421			8,483,317	
<hr/>					
Value added by banking services	6,713,553			5,272,006	
Non-banking income	414,805			332,035	
Provision for bad debts	(1,840,909)			(1,459,066)	
	5,287,449			4,144,975	
<hr/>					
Value allocated to employees					
Salaries, wages & other benefits	2,741,656	51.85		2,414,137	58.24
<hr/>					
To providers of capital					
Dividends to shareholders	471,059	8.91		350,350	8.45
<hr/>					
To Government					
Value Added tax	194,000			336,692	
Income Tax	232,000			10,409	-
Debit tax	7,510	8.20		5,433	8.51
<hr/>					
To expansion and growth					
Retained income	1,183,503	22.38		626,031	15.10
Depreciation	494,321	9.35		438,658	10.58
Deferred taxation	(36,600)	(0.69)		(36,735)	(0.88)
	5,287,449	100.00		4,144,975	100.00

Analysis of Value Additions

- Value Allocated to Employees
- To Providers of Capital
- To Government
- To Expansion and Growth



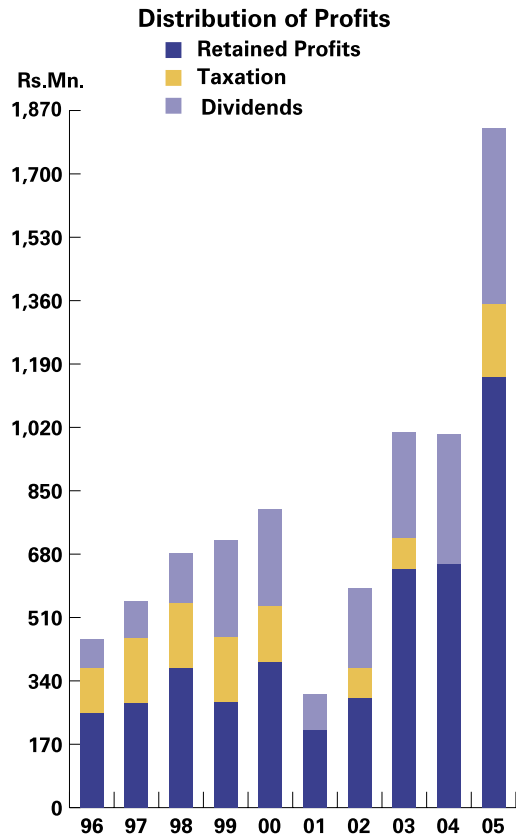
Quarterly Statistics

For the three months ended	2005				2004											
	December 31st	September 30th	June 30th	March 31st	December 31st	September 30th	June 30th	March 31st								
Balance Sheet Data																
(Rs. Million)																
Total Assets	166,012	160,493	158,944	155,653	152,780	144,617	135,943	133,112								
Loans, Leases & Bills	114,285	111,235	106,839	101,504	93,295	86,742	81,494	80,360								
Deposits	128,284	124,597	119,657	121,157	118,524	109,278	105,339	102,071								
Shareholders' Funds	11,239	10,895	10,470	9,149	9,052	7,516	7,364	7,031								
Average Assets	163,253	159,718	158,299	154,217	148,699	140,280	134,528	133,221								
Income Statement Data																
(Rs.000)																
Net Interest Income	1,888,511	1,801,941	1,655,938	1,502,633	1,590,924	1,508,690	1,225,058	1,182,622								
Foreign Exchange Profit	143,402	169,755	172,767	160,536	146,084	169,288	192,474	154,330								
Other Income	751,097	514,801	489,489	465,058	627,970	266,190	485,195	576,492								
Total Revenue	2,783,010	2,486,497	2,318,194	2,128,227	2,364,978	1,944,168	1,902,727	1,913,444								
Provision for Loan Losses	(636,299)	(372,122)	(387,666)	(363,357)	(597,876)	(320,632)	(345,929)	(302,056)								
Non-interest Expenses	(1,478,119)	(1,609,237)	(1,533,950)	(1,485,216)	(1,523,149)	(1,471,652)	(1,207,402)	(1,406,566)								
Provision for Income Tax	(35,400)	(80,000)	(48,000)	(32,000)	66,326	-	(16,000)	(24,000)								
Net Profit after Tax	633,192	425,138	348,578	247,654	310,279	151,884	333,396	180,822								
ORDINARY SHARE INFORMATION																
Market Price per share (Rs.)	V	NV	V	NV	V	NV	V	NV	V	NV	V	NV	V	NV	V	NV
High	148.00	65.75	119.00	64.00	85.50	46.00	62.50	45.00	60.00	35.00	71.00	41.00	74.00	44.00	80.00	47.00
Low	51.75	32.25	78.00	42.50	57.25	37.50	51.75	32.25	50.25	30.00	59.00	35.00	60.00	35.00	58.00	32.00
Closing	112.50	41.50	115.00	60.00	80.00	43.50	60.25	38.50	57.00	32.75	60.00	35.00	66.75	40.50	72.00	43.50
Book value per																
Ordinary Share	95.44		92.50		88.90		91.40		90.43		105.12		103.00		98.33	
	V - Voting NV - Non-Voting															
FINANCIAL MEASURES																
Profitability																
Return on average																
Shareholders' Equity	5.72%		3.98%		3.55%		2.72%		3.75%		2.04%		4.63%		2.58%	
Productivity																
Non-interest Expenses																
to Total Revenue	53.11%		64.72%		66.17%		69.79%		64.40%		75.69%		63.46%		73.51%	
Capital																
Risk weighted capital ratios (DBU)																
Tier 1	10.89%		9.87%		10.38%		9.59%		9.83%		7.42%		7.95%		8.00%	
Total (Tier 1 + 2)	11.57%		10.46%		11.85%		11.05%		11.26%		10.03%		11.27%		11.36%	
Asset Quality																
Provision for Credit losses																
to average loans	0.56%		0.34%		0.37%		0.37%		0.66%		0.38%		0.43%		0.38%	

Ten Year Statistical Summary

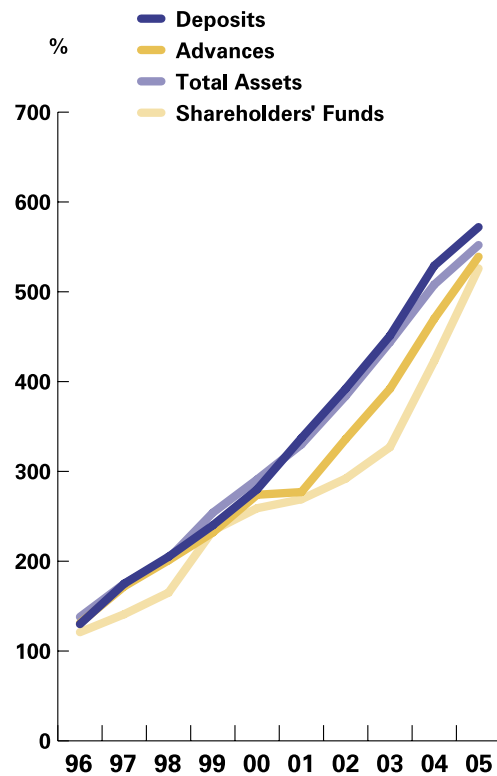
Year ended 31st December (Rs.Mn.)	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
OPERATING RESULTS										
Income	4,792	6,116	6,704	7,723	9,641	11,564	11,799	14,831	14,087	16,997
Interest Income	4,037	4,964	5,400	6,480	7,940	9,336	9,399	11,537	11,469	14,130
Interest Expenses	2,811	3,355	3,316	4,088	5,281	7,201	6,258	6,909	5,962	7,281
Exchange Income	215	395	428	313	364	516	382	506	662	646
Other Income	539	757	868	930	1,337	1,712	2,018	2,788	1,956	2,220
Operating Expenses	1,408	2,036	2,531	2,741	3,411	4,061	4,873	6,830	7,175	7,866
Profit before Income Tax	573	725	858	894	949	301	669	1,092	950	1,850
Income Tax on Profit	120	172	175	176	149	(2)	80	83	(26)	195
Profit after Taxation	453	553	683	718	800	303	589	1,008	976	1,655
SHAREHOLDERS' FUNDS										
Share Capital	200	200	300	650	650	650	715	715	1,001	1,178
Reserves	2,387	2,814	3,237	4,358	4,898	5,103	5,520	6,278	8,051	10,062
LIABILITIES										
Customer Deposits	29,234	39,303	46,032	53,858	62,758	75,599	87,884	101,026	118,524	128,284
Refinance Borrowings	913	954	1,129	1,636	1,655	1,665	1,659	1,764	2,066	2,712
Other Liabilities	8,592	9,243	13,805	15,732	17,540	15,999	19,354	23,161	22,788	23,463
Deferred Taxation	56	59	87	121	155	215	304	387	350	314
ASSETS										
Bills of Exchange	3,517	3,935	3,824	3,122	4,546	3,153	2,690	2,412	2,077	2,027
Loans and Advances	20,830	28,343	33,988	40,328	46,904	49,006	59,991	71,426	84,379	96,242
Lease Rentals Receivable	1,595	1,947	2,078	2,741	2,969	2,898	4,032	5,085	6,838	8,864
Cash, Short Term Funds and Statutory Deposits with Central Bank of Sri Lanka	9,124	10,585	14,495	17,325	15,212	18,844	23,640	25,019	29,228	29,766
Property, Plant & Equipment	1,261	1,437	1,675	1,914	2,273	2,509	2,781	3,414	3,387	3,370
Other Assets	5,055	6,327	5,003	10,924	15,752	22,722	22,301	25,975	26,870	25,743
RATIOS										
Return on Average Shareholders' Funds (%)	19	20	21	17	15	5	10	15	12	16
Income Growth (%)	34	28	10	15	25	20	2	26	(5)	21
Return on Average Assets (%)	1.3	1.2	1.2	1.0	1.0	0.3	0.6	0.8	0.7	1.0
Rate of Dividends (%)	40	50	45	40	40	15	30	40	35	40
Dividend Cover (times)	5.7	5.5	5.1	2.8	3.1	3.1	2.8	3.5	2.8	3.5
Gross Dividends (Rs.Mn.)	80	100	135	260	260	98	215	286	350	471
Advance to Deposits & Refinance (%)	86	85	85	82	84	71	76	77	77	82
Property, Plant & Equipment to Shareholders' Funds (%)	49	48	47	38	41	43	45	49	37	30
Total Assets to Shareholders' Funds (times)	16	17	18	15	16	17	19	19	17	15
(As specified in the Banking Act No. 30 of 1988)										
Capital Funds to Liabilities including Contingent Liabilities (%)	1.7	1.2	1.2	1.0	1.2	1.2	1.2	1.0	1.0	1.0
Liquid Assets to Liabilities (%)	23	23	27	25	25	28	32	27	25	24
SHARE INFORMATION										
Market Value per Share (Rs.)										
- Voting	260.00	225.00	174.00	87.00	46.25	52.00	79.00	69.00	57.00	112.50
- Non-Voting	-	-	-	-	36.75	36.00	47.00	36.75	32.75	41.50
Earnings per Share (Rs.)	6.15	7.51	9.27	9.75	10.86	4.11	8.00	13.69	12.51	15.09
Price Earnings Ratio	42.28	29.96	18.77	8.92	4.26	12.65	9.88	5.04	4.56	7.46
Net Assets per Share (Rs.)	129.35	150.70	117.90	77.05	85.35	88.51	87.20	97.81	90.43	95.44
OTHER INFORMATION										
No. of Employees	2,951	3,433	3,744	4,035	4,119	4,137	4,280	4,203	4,180	4,259
No. of Customer Centres	78	92	103	111	117	123	137	138	142	148
No. of other Financial Centres	56	61	72	95	104	110	110	110	110	113

Ten Year Graphical Review



The graph shows the distribution of before tax profit segregated into dividends, taxes and profits retained within the business.

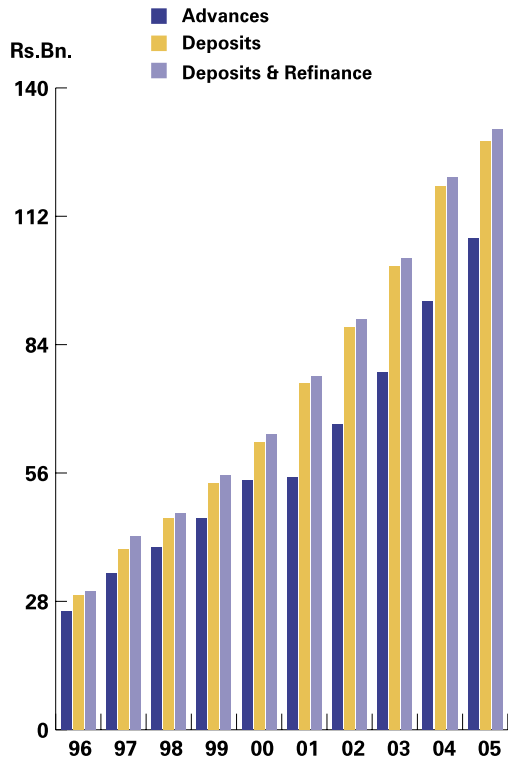
Balance Sheet Growth (Base Year 1995)



The graph shows the growth in deposits, advances, total assets and shareholders' funds. Year 1995 has been considered as the base year.

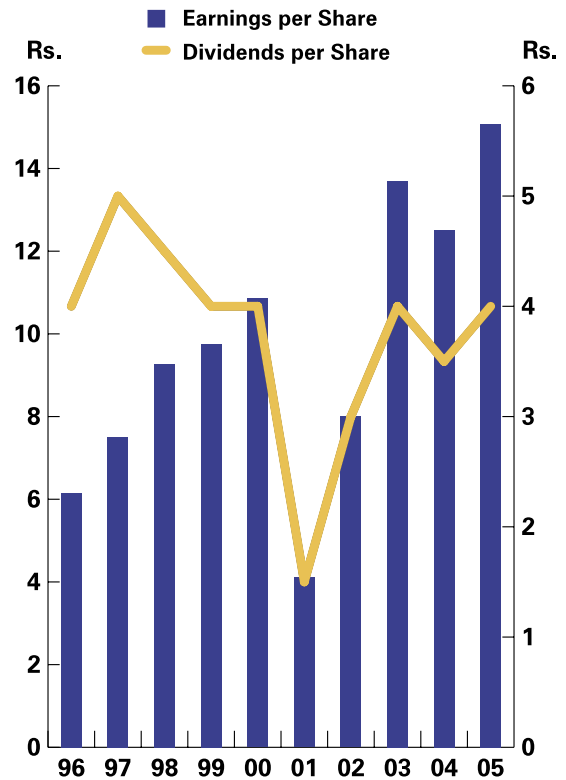
Ten Year Graphical Review

Advances, Deposits and Re-Finance Borrowings



The graph shows the growth in deposits and refinance borrowings compared with the volume of advances.

Earnings per Share & Dividends per Share

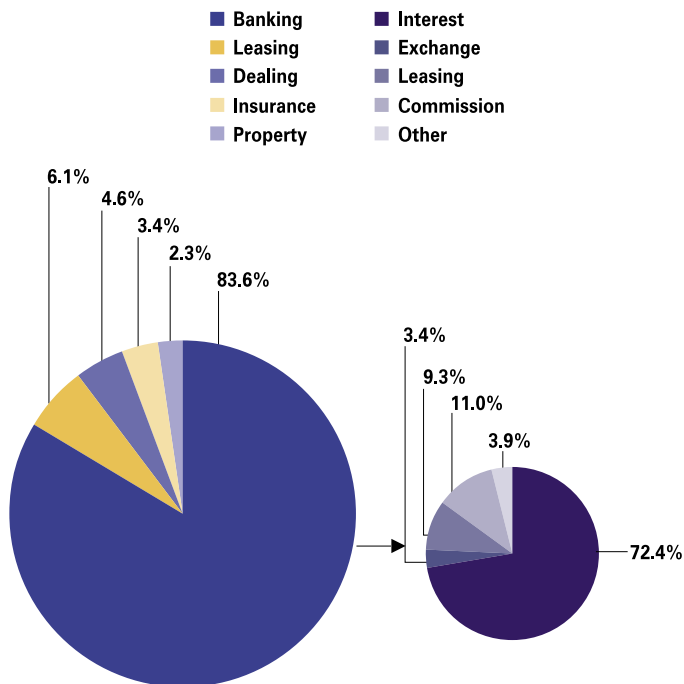


Segmental Analysis

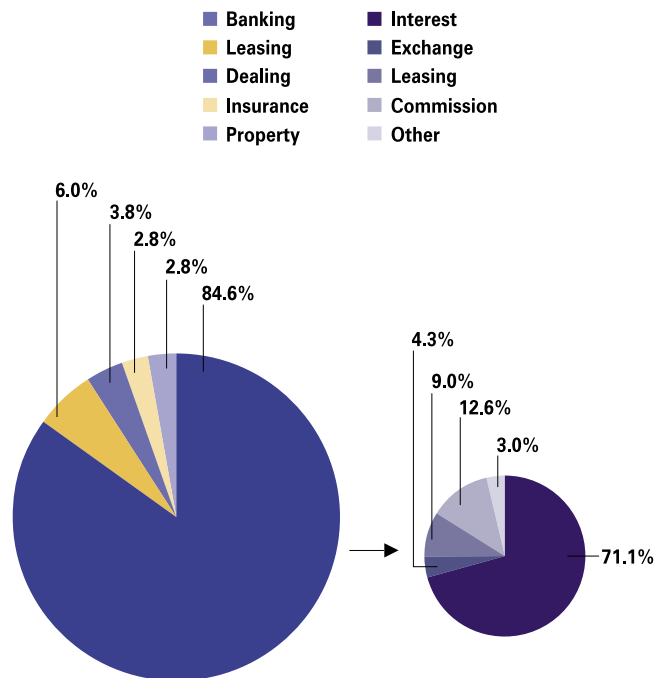
Business segments	Banking		Leasing		**Dealings		Property		Insurance		Total	
	2005 Rs. 000	2004 Rs. 000	2005 Rs. 000	2004 Rs. 000	2005 Rs. 000	2004 Rs. 000	2005 Rs. 000	2004 Rs. 000	2005 Rs. 000	2004 Rs. 000	2005 Rs. 000	2004 Rs. 000
Interest	12,967,419	10,539,437	-	-	680,325	465,359	52	238	64,989	43,296	13,712,785	11,048,330
Exchange	646,460	662,176	-	-	(294)	684	-	-	-	-	646,166	662,860
Lease/Premium/ Brokering Income	-	-	1,162,455	929,898	5,897	84,000	-	-	587,927	388,757	1,756,279	1,402,655
Commissions/Rent	1,663,545	1,519,924	-	-	-	-	432,904	434,835	-	-	2,096,449	1,954,359
Other	556,900	435,923	-	-	180,842	34,496	-	-	816	-	738,558	470,419
Total revenue	15,834,324	13,157,460	1,162,455	929,898	866,770	584,539	432,956	434,673	653,732	432,053	18,950,237	15,538,623

**Stock Broking & Securities Dealings

Segmental Analysis of Revenue-2005



Segmental Analysis of Revenue-2004



Share Information

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, 2005 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

As At 31st December 2005

Voting

	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 - 250	2,102	188,039	0.26	24	2,245	0.01	2,126	190,284	0.20
251 - 500	804	305,218	0.43	9	3,309	0.01	813	308,527	0.33
501 - 1,000	657	511,311	0.71	14	11,041	0.05	671	522,352	0.55
1,001 - 2,000	421	638,248	0.89	3	4,205	0.02	424	642,453	0.68
2,001 - 5,000	381	1,278,896	1.78	14	41,497	0.18	395	1,320,393	1.39
5,001 - 10,000	230	1,621,426	2.26	11	82,650	0.36	241	1,704,076	1.80
10,001 - 20,000	122	1,667,772	2.32	4	50,500	0.22	126	1,718,272	1.82
20,001 - 30,000	49	1,145,224	1.59	1	27,775	0.12	50	1,172,999	1.24
30,001 - 40,000	30	1,082,170	1.51	1	35,000	0.15	31	1,117,170	1.18
40,001 - 50,000	14	624,463	0.87	2	93,200	0.41	16	717,663	0.76
50,001 - 100,000	28	1,988,206	2.77	3	170,000	0.74	31	2,158,206	2.28
100,001 - 1,000,000	24	5,641,212	7.86	3	440,000	1.93	27	6,081,212	6.42
Over 1,000,000	9	55,123,790	76.76	2	21,887,303	95.79	11	77,011,093	81.35
	4,871	71,815,975	100.00	91	22,848,725	100.00	4,962	94,664,700	100.00

Analysis of shareholders

Resident/Non-Resident

	31/12/2005			31/12/2004		
	No of share holders	No of shares	%	No of share holders	No of shares	%
Resident	4,871	71,815,975	75.86	4,863	70,762,436	91.90
Non-Resident	91	22,848,725	24.14	78	6,237,564	8.10
Total	4,962	94,664,700	100.00	4,941	77,000,000	100.00

Individuals/Institutions

	31/12/2005			31/12/2004		
	No of share holders	No of shares	%	No of share holders	No of shares	%
Individuals	4,680	11,109,746	11.74	4,670	13,326,736	17.31
Institutions	282	83,554,954	88.26	271	63,673,264	82.69
Total	4,962	94,664,700	100.00	4,941	77,000,000	100.00

As

As per the rule No. 8.7(h) of the Colombo Stock Exchange, percentage of public holding as at 31st of December 2005 was 52.92 approximately.

Share Information

Non-Voting

	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 - 250	5,997	752,418	3.30	34	4,383	1.54	6,031	756,801	3.28
251 - 500	1,216	456,510	2.00	6	2,222	0.78	1,222	458,732	1.99
501 - 1,000	1,820	1,206,076	5.29	11	7,786	2.74	1,831	1,213,862	5.25
1,001 - 2,000	1,771	2,302,857	10.09	21	28,834	10.14	1,792	2,331,691	10.09
2,001 - 5,000	803	2,421,232	10.61	11	31,990	11.25	814	2,453,222	10.62
5,001 - 10,000	312	2,204,112	9.66	6	46,980	16.52	318	2,251,092	9.74
10,001 - 20,000	143	1,946,496	8.53	3	35,220	12.38	146	1,981,716	8.58
20,001 - 30,000	29	702,182	3.08	2	50,000	17.58	31	752,182	3.26
30,001 - 40,000	8	279,550	1.23	-	-	-	8	279,550	1.21
40,001 - 50,000	14	635,917	2.79	-	-	-	14	635,917	2.75
50,001 - 100,000	22	1,472,782	6.46	1	77,000	27.07	23	1,549,782	6.71
100,001 - 1,000,000	18	3,974,116	17.42	-	-	-	18	3,974,116	17.20
Over 1,000,000	1	4,461,337	19.55	-	-	-	1	4,461,337	19.31
	12,154	22,815,585	100.00	95	284,415	100.00	12,249	23,100,000	100.00

Analysis of shareholders

Resident/Non-Resident

	31/12/2005			31/12/2004		
	No of share holders	No of shares	%	No of share holders	No of shares	%
Resident	12,154	22,815,585	98.77	12,337	22,796,153	98.68
Non-Resident	95	284,415	1.23	93	303,847	1.32
Total	12,249	23,100,000	100.00	12,430	23,100,000	100.00

Individuals/Institutions

	31/12/2005			31/12/2004		
	No of share holders	No of shares	%	No of share holders	No of shares	%
Individuals	12,023	13,562,183	58.71	12,212	13,800,548	59.74
Institutions	226	9,537,817	41.29	218	9,299,452	40.26
Total	12,249	23,100,000	100.00	12,430	23,100,000	100.00

As at 31/1

As per the rule No. 8.7(h) of the Colombo Stock Exchange, percentage of public holding as at 31st of December 2005 was 95.55 approximately.

3 Share Trading

	2005	2004
Voting Shares		
Number of transactions	8,132	2,348
Number of shares traded (Mn.)	19.7	3.4
Rank(As per CSE)	46	90
Value of shares traded (Rs.Mn.)	2,019.8	224.4
Rank(As per CSE)	11	55
Non-Voting Shares		
Number of transactions	4,933	2,549
Number of shares traded (Mn.)	5.3	2.7
Value of shares traded (Rs.Mn.)	267.3	103.5

Share Information

4 Dividends

	2005	2004
Interim	20% paid in December 2005	20% paid in December 2004
Final	20% proposed in April 2006	15% paid in April 2005

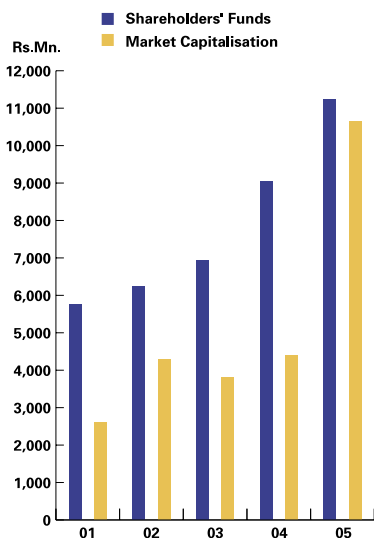
5 Earnings

	2005	2004
Earnings per share (Rs.)	15.09	12.51
Price earnings ratio(Times)	7.46	4.56

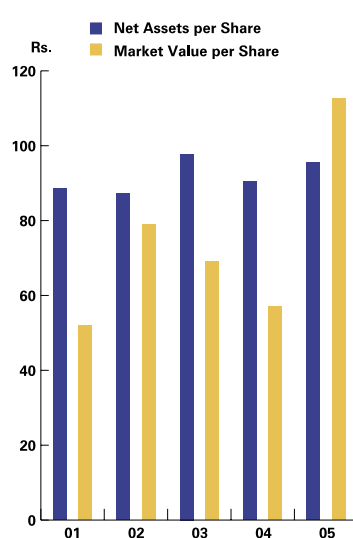
6 Market Value

	Highest Rs.	Lowest Rs.	Year End Rs.
2001 - Voting	64.00	31.00	52.00
- Non Voting	55.00	24.00	36.00
2002 - Voting	80.00	42.00	79.00
- Non Voting	48.50	28.25	47.00
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

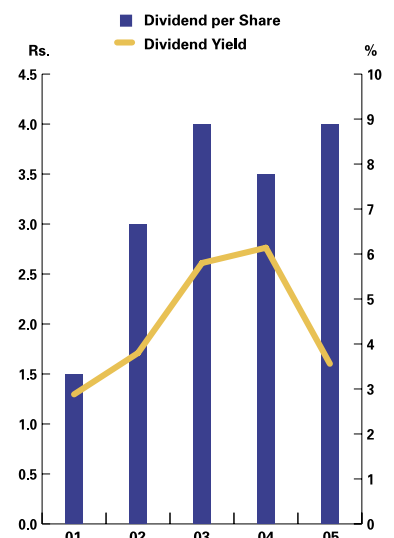
Shareholders' Funds & Market Capitalisation



Net Assets per Share & Market Value per Share



Dividend per Share & Dividend Yield



07 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
2001	5,753	2,600	124,000	2.10	10
2002	6,235	4,345	162,600	2.67	7
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

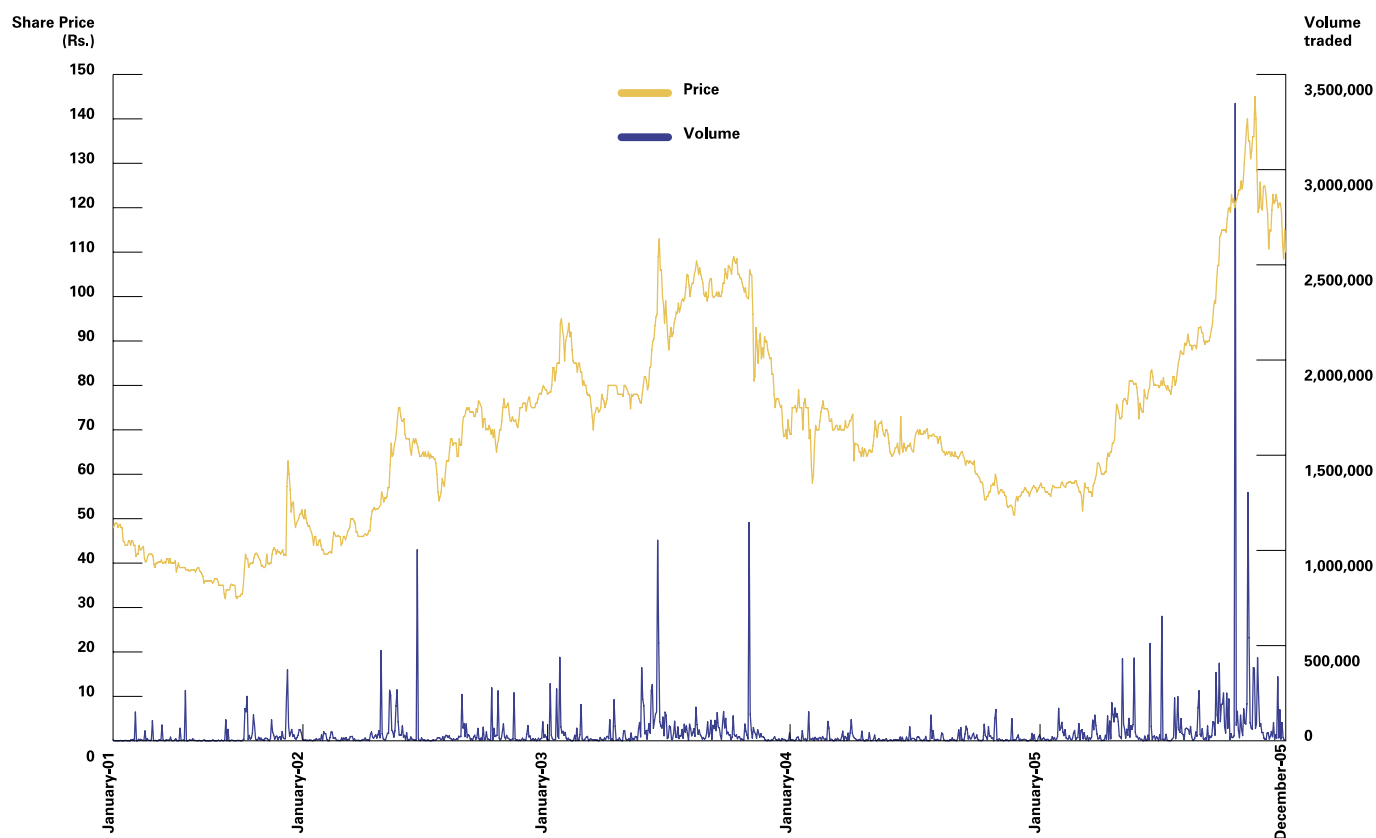
Share Information

9 Record of Scrip Issues

Year	Issue	Basis	No. of Shares	Increase in Share Capital (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	<u>1,177,647,000</u>
Total			117,764,700	1,177,647,000	

* Unsubscribed shares were issued to public

9 Price Volume Chart



Share Information

20 MAJOR VOTING SHAREHOLDERS – 31ST DECEMBER 2005

Name	% on total capital	No. of shares		
		2005	2004	
Deutsche Bank Trust Company Americas	15.00	17,664,700	-	
Brown & Co. Ltd	7.17	8,441,760	2,300,000	
CBD Exports Ltd	6.53	7,692,300	7,692,300	
Milford Exports (Cey) Ltd	6.53	7,686,525	7,686,525	
Stassen Exports Ltd	5.66	6,662,425	6,662,425	
Panchalingam Associates (Pvt) Ltd	5.19	6,116,471	6,116,471	
Sri Lanka Insurance Corporation Ltd - Life/Gen. Fund	4.88	5,749,566	5,749,566	
Standard Finance Ltd	4.77	5,620,360	11,252,020	
Taprobane Fund Management (Pvt) Ltd	3.98	4,685,193	-	
Sonetto Holdings Ltd	3.59	4,222,603	4,222,603	
Distilleries Co. of Sri Lanka Ltd	2.53	2,980,854	2,980,854	
Mr S V Somasundaram	0.59	692,000	-	
DPMC Financial Services (Pvt) Ltd A/c No.1	0.53	619,900	-	
Mr S Visuvanathan	0.38	448,832	448,832	
Masons Mixture Ltd	0.34	399,520	399,520	
Mr Y S H Indra Kumar Silva	0.34	397,990	-	
Associated Battery Manu (Cey) Ltd	0.26	300,902	300,902	
Asia Fort Asset Management (Pvt) Ltd	0.22	254,400	-	
Bank of Ceylon A/c Ceybank Unit Trust	0.18	209,003	679,600	
Mr Narhari Choonilal Bhatt	0.15	172,480	-	
Sub Total	68.80	81,017,784	56,491,618	
Balance Held By 4,942 Voting Shareholders	11.58	13,646,916	20,508,382	(4,928 V. sh)
Total Voting Shares	80.38	94,664,700	77,000,000	
Shares held by 12,249 Non Voting Shareholders	19.62	23,100,000	23,100,000	(12,430 NV. sh)
Total No. of Ordinary Shares	100.00	117,764,700	100,100,000	

20 MAJOR NON-VOTING SHAREHOLDERS

Name	% on total capital	No. of shares		
		2005	2004	
Legalink Trustee Services (Pvt) Ltd/HNB ESOP Trust	3.88	4,566,637	411,496	
Nawaloka Developments (Pvt) Ltd	0.61	715,000	715,000	
DFCC Bank A/c No.1	0.36	426,000	231,000	
Distilleries Co. of Sri Lanka	0.29	337,566	337,566	
Standard Finance Ltd	0.23	269,600	269,600	
Mr D F G Dalpethado	0.23	267,574	183,884	
Mr S Visuvanathan	0.19	220,000	220,000	
Mr D K Weeratunga & Mr D K A K Weeratunga	0.18	216,580	216,580	
Mr V P Paramalingam & Mrs S Paramalingam	0.17	196,510	208,150	
Hatton National Bank Ltd A/c No.2	0.14	169,319	169,319	
M C A Trading Co. (Pvt) Ltd	0.14	165,000	165,000	
A D Gunawardena	0.13	157,200	-	
Mr K V M Fernando & Mrs K W S H Fernando	0.13	156,600	-	
Ceylon Grain Elevators Ltd	0.12	137,500	137,500	
DP Capital Management (Pvt) Ltd/Mr K W S H Fernando	0.10	113,900	-	
Lanka Synthetic Fibre Co. Ltd	0.09	110,000	110,000	
Mr S F H Alexander	0.09	108,970	113,970	
Sri Lanka Insurance Corp. Ltd (Gen. Fund)	0.09	101,497	101,497	
Waldock Mackenzie Ltd /A H Udeshi	0.08	99,900	106,000	
Ms S A Fernando	0.08	94,000	-	
Sub Total	7.33	8,629,353	3,696,562	
Balance held by 12,229 Non Voting Shareholders	12.29	14,470,647	19,403,438	(12,414 NV. sh)
Total Non Voting shares	19.62	23,100,000	23,100,000	
Shares held by 4,962 Voting Shareholders	80.38	94,664,700	77,000,000	(4,927 NV. sh)
Total No. of Ordinary Shares	100.00	117,764,700	100,100,000	

Share Information

HNB DEBENTURES 2002

i) Market Value

	Highest Rs.	Lowest Rs.	Year End Rs.
5 year Fixed Rate (13.75% p.a.)	107.25	90.00	98.00
5 year Floating Rate (TB + 1.00% p.a.)	101.00	96.00	96.00
7 year Fixed Rate (14.00% p.a.)	100.00	100.00	100
7 year Floating Rate (TB + 1.10% p.a.)	99.75	99.75	N/T
10 year Fixed Rate (14.20% p.a.)	104.00	98.05	98.05
10 year Floating Rate (TB + 1.25% p.a.)	N/T	N/T	N/T

N/T – Not Traded for the period ended 31 December 2005

ii) Interest Income

Coupon Interest (Rs.)

	2005	2004
5 year Fixed Rate (13.75% p.a.)	13.75	13.75
5 year Floating Rate (TB + 1.00% p.a.)	12.00	12.00
7 year Fixed Rate (14.00% p.a.)	14.00	14.00
7 year Floating Rate (TB + 1.10% p.a.)	12.00	12.00
10 year Fixed Rate (14.20% p.a.)	14.20	14.20
10 year Floating Rate (TB + 1.25% p.a.)	12.00	12.00

For an investment of

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

	2005	2004
5 year Fixed Rate (13.75% p.a.)	15.07	14.66
5 year Floating Rate (TB + 1.00% p.a.)**	N/A	N/A
7 year Fixed Rate (14.00% p.a.)**	13.98	13.91
7 year Floating Rate (TB + 1.10% p.a.)**	N/A	N/A
10 year Fixed Rate (14.20% p.a.)	14.65	14.19
10 year Floating Rate (TB + 1.25% 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)

	2005	2004
5 year Fixed Rate (13.75% p.a.)	14.03	15.60
5 year Floating Rate (TB + 1.00% p.a.)	12.50	12.00
7 year Fixed Rate (14.00% p.a.)	14.00	13.97
7 year Floating Rate (TB + 1.10% p.a.)	12.03	12.03
10 year Fixed Rate (14.20% p.a.)	14.48	14.85
10 year Floating Rate (TB + 1.25% p.a.)	N/T	N/T

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

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

	2005	2004
5 year Treasury Bond	11.45	10.00
6 year Treasury Bond	11.50	10.25
10 year Treasury Bond	11.75	N/T

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

Share Information

HNB DEBENTURES 2003

i) Market Value	Highest Rs.	Lowest Rs.	Year End Rs.
5 year Fixed Rate (10.00% p.a.)	100.00	84.00	88.07
5 year Floating Rate (TB + 2.00% p.a.)	N/T	N/T	N/T

N/T – Not Traded for the period ended 31 December 2005

ii) Interest Income Coupon Interest (Rs.)	2005	2004
5 year Fixed Rate (10.00% p.a.)	10.00	10.00
5 year Floating Rate (TB + 2.00% p.a.)	12.24	9.40

For an investment

iii) Yield to Maturity of last trade done (% p.a)	2005	2004
5 year Fixed Rate (10.00% p.a.)	15.77	15.27
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)	2005	2004
5 year Fixed Rate (10.00% p.a.)	11.35	15.64.
5 year Floating Rate (TB + 2.00% p.a.)	N/T	N/T

N/T – Not Traded as at 31 December 2005

v) Yield on Equivalent Government Security (% p.a)	2005	2004
5 year Treasury Bond	11.45	10.00
6 year Treasury Bond	11.50	10.25
10 year Treasury Bond	11.75	N/T

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

Ratios	2005	2004
Debt to equity ratio (%)	36%	44%
Interest cover (Times)	4.92	2.96
Quick asset ratio (%)	61%	62%

Definitions

Debt to equity ratio (%)	$\frac{\text{Subordinated Debentures}}{\text{Shareholders Fund}}$
Interest cover (Times)	$\frac{\text{PBT+Debenture Interest}}{\text{Debenture Interest}}$
Quick asset ratio (%)	$\frac{\text{Liquid Assets}}{\text{Current Liabilities}}$

HATTON NATIONAL BANK LIMITED

479, T B Jayah Mawatha. Colombo 10, Sri Lanka.
www.hnb.lk

Subsidiary Companies

HNB ASSURANCE LIMITED

10, R A de Mel Mw. Colombo 03, Sri Lanka.
www.hnbassuarance.com

HNB STOCK BROKERS (PVT) LIMITED

479, T B Jayah Mawatha. Colombo 10, Sri Lanka.

HNB SECURITIES LIMITED

479, T B Jayah Mawatha. Colombo 10, Sri Lanka.
www.hnbsl.lk

SITHMA DEVELOPMENT (PVT) LIMITED

479, T B Jayah Mawatha. Colombo 10, Sri Lanka

Associate Companies

LANKA VENTURES LIMITED

46/12, Nawam Mawatha. Colombo 02, Sri Lanka.
www.lankaventures.lk

BROWNS ENGINEERING (PVT) LIMITED

481, T B Jayah Mawatha. Colombo 10, Sri Lanka

Report of the Directors

The Directors take pleasure in presenting to members their report and the audited accounts of the Company for the year ended 31st December 2005. This was approved by the Directors at a meeting held on 16th February, 2006.

Principal Activities

The principal activities of the Bank and the Group during the year were general banking, development banking, mortgage financing, lease financing, corporate financing, 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 Statement and the Managing Director's Review of Operations on Pages 10 to 17 of this Annual Report. These reports form an integral part of the Directors' Report.

New Product Development

During the year the Bank introduced value additions to the following existing product:

- 5 Year Fixed Deposit Scheme

Branch Expansion

During the year the Bank opened 6 Customer Centres at Kandana, Deniyaya, Mirigama, Wijerama, Manipay and second Customer Centre in Jaffna.

Internal Control

The Board of Directors has overall responsibility for the Bank's systems of internal financial control. Although no system of internal financial control can provide absolute assurance against material misstatement or loss, the Bank's internal control systems have been designed to provide the Directors with reasonable assurance that assets are safeguarded, transactions are authorised and properly recorded and material errors and irregularities are either prevented or detected within a reasonable period of time. The Board of Directors is satisfied with the effectiveness of the system of financial control for the period up to the date of signature of the accounts.

Corporate Governance

The main Corporate Governance practices of the Bank are given on pages 58 to 62 of the Annual Report.

Audit Committee

The members of the Audit Committee at the date of the Report of the Directors are :

- Mr R Sivaratnam (Chairman)
- Mr D H S Jayawardena
- Mrs P C Cooray
- Mr Ranjan Seevaratnam (Consultant)

All members of the committee are non-executive Directors and their report is contained on page 86 of this 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 accounts.

Code of Corporate Conduct

The Bank maintains the highest standards of Corporate Conduct in pursuance of the emphasis placed by the Management in this regard. Every staff member is required to subscribe to a Code of Ethics that is prescribed by the Bank which is intimated at the time of recruitment in the form of a document together with a letter of appointment enumerating several provisions on conduct. Aspects such as honesty, integrity and behaviour are highlighted in the performance of their duties which are in keeping with the Bank's objectives. Upholding of secrecy is enshrined in the Contract of Employment and Information Security Policy which prevents staff from disclosing information to unauthorized parties.

The dignity of every human being is recognized irrespective of religion, language, caste or creed and all customers are treated alike in the delivery of a high quality customer service. Promoting the image of the organization and the profession in the public eye is encouraged. Staff members are strictly obliged to desist from accepting or offering any improper gratification for personal gain. Those deviating from the norms, rules and regulations set by the Management in respect of discipline are dealt with in a just and equitable manner. Such stern actions, apart from acting as a deterrent, ensures the enforcement of discipline among staff.

Turnover/Gross Income

The Turnover/Gross Income of the Group for 2005 was Rs.18,298,191,000/- (2004 - Rs.14,502,961,000/-). An analysis of the net income is given in note 1 to the Accounts.

Profit	2005	2004
	Rs.000	Rs. 000
The Group Profit for the year ended 31st December 2005 after payment of all expenses of management and providing for depreciation and contingencies	2,008,350	746,771
Add/(Less)Taxation	(213,813)	15,114
Group Net Profit after taxation	1,794,537	761,885
Minority Interest	(24,116)	(6,279)
Unappropriate Profit Brought forward from previous year	642,660	778,133
On merger of subsidiaries	-	(27,879)
Transfer from Capital Reserve (revaluation surplus on property disposed)	19,251	-
Balance available for Appropriation	2,432,332	1,505,860
Appropriations	2005	2004
	Rs.000	Rs.000
Transfer to General Reserve	850,000	500,000
Transfer to Reserve Fund	55,000	20,000
20% Interim Dividend paid (20% - 2004)	235,529	200,200
Final Dividend 2004/2003	150,150	143,000
Balance carried forward as at 31.12.2005	1,141,653	642,660

Report of the Directors

The Directors recommend the payment of a final dividend for the year of 20% (15% - 2004) subject to tax from the balance carried forward as at 31.12.2005 (Note 24)

Taxation

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

Income tax rate applicable on the Bank's domestic operations and FCBU on-shore Banking Operations is 30%. The off-shore operations of the FCBU is taxed at 20%.

The Bank was also liable for Financial VAT at 15%.

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 20% (2004-15%) Final Dividend to be paid on 5th April 2006 to holders of Issued and paid up Ordinary shares of the Company as at the close of business on 24th March 2006. This Dividend together with the Interim Dividend of 20% (2004 - 20%) paid on 9th December 2005 amounts to a total dividend of 40% (2004- 35%) for the year 2005.

A part of the interim dividend paid for the year represents a redistribution of the exempt dividends received by the company and will therefore be free of income tax in the hands of the shareholders. On this basis 90.18% of the 20% Interim dividend paid for 2005 is subject to taxation.

Corporate Donations

During the year the Bank made donations amounting to Rs.19,641,891/- (2004 - Rs.155,000/-) 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.540,860/- (2004 - Rs.140,000/-).

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 recruitment and selection policy of the Bank is based on the needs of the organization. Recruitment levels are determined by the manpower plan which is prepared annually taking into consideration aspects including Information Technology, Profitability, Projected Growth, Overhead to Net Income Ratio, Optimum Utilization of Resources, Productivity, Work Volumes and Multiple Skills.

The organization is an equal opportunity employment company whereby males and females are recruited for employment from time to time as necessary. The island wide branch network of the Bank facilitates the recruitment of youth from the various districts irrespective of racial, religious and social differences. A consistent policy is in place to encourage recruitment of personnel from among external candidates as well as from within the organization.

The Bank endeavours to employ, train, develop and retain the best talent available. The recruitment process is carefully designed and involves the conduct of in-house exams, aptitude and psychometric tests and preliminary & structured interviews. Specific induction programmes are in place for new recruits and promotees. Placement of staff to fill vacancies is based on the needs of the Bank, the professional background and skills of the employee to ensure optimum utilization of human resources.

Capital Expenditure

The total capital expenditure incurred on the acquisition of fixed assets during the year amounted to Rs.545,656,000/- (2004 - Rs.701,865,000/-) details of which are given in Note 21 to the Accounts.

Property, Plant & Equipment

The details of the property, plant, and equipment of the company are shown in Note 21 on pages 116 to 121.

Market Value of Freehold Properties

The value of freehold properties owned by the Bank as at 31st December 2005 is included in the accounts at Rs.1,579,147,000/- (2004 - Rs.1,510,696,000/-). A panel of Chartered Valuers/Licensed Surveyors carried out a re-valuation of the Bank's freehold properties in December 1993. The details of freehold properties owned by the Bank are shown in Note 21.2 on pages 117 to 120.

Reserves

The Group Reserves consist of :

	2005 Rs.000	2004 Rs.000
Share Premium	2,704,096	1,962,246
Capital Reserve	306,639	325,890
Reserve Fund	624,707	569,707
Repairs & Renovation Reserve	6,700	6,700
Revenue Reserve	6,386,653	5,037,660
Total	10,028,795	7,902,203

The movement in these reserves is shown in the Statement of Changes in equity on page 90.

Share Capital

The total issued and fully paid up capital as at 31st December 2005 was Rs.1,177,647,000/- consisting of 94,664,700 ordinary shares of Rs.10/- each voting and 23,100,000 ordinary shares of Rs.10/- each non-voting.

Report of the Directors

Shareholding

As at 31st December 2005 there were 16,152 Registered shareholders. The distribution is indicated on pages 73 and 79.

Share Information

Information relating to earnings, dividend, net assets and market price per share is given in Financial Highlights on page 4 of the Annual Report. Information on share trading is given in Note 3 on page 74 of the Annual Report.

Major Shareholders

The twenty largest voting shareholders of the Bank as at 31st December 2005 are given on page 77 together with an analysis of the shareholding.

Future Developments

Information relating to the 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 Statement and Managing Director's Review of operations.

The Bank would continue implementing and reviewing strategies specified under its Business Plan. We will closely monitor the fiscal policy changes which may take place with the recent political changes and changes in macro economic conditions due to the large scale and rapid reconstruction and rehabilitation which will take place in tsunami affected areas and take prudent measures to achieve the set targets. 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 whilst leveraging on the new IT platform developed for transaction processing and management information.

Directors

The Board of Directors of Hatton National Bank Limited 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 8.

In accordance with the provisions of Article 87 of the Articles of Association, Dr. V P Vittachi who retires by rotation offers himself for re-election with the unanimous support of the Board, Special Notice having been given pursuant to Sections 138 and 182 of the Companies' Act No. 17 of 1982 of the intention to propose a Special Resolution for such re-election, notwithstanding the age limit of 70 years stipulated by section 181 of the Companies Act.

In accordance with the provisions of Article 93 of the Articles of Association, Mr. R Theagarajah and Mr R Ghazalli offer themselves for re-election with the unanimous support of the Board.

Directors' Interests

Directors' interests in contracts with the Company, both direct and indirect are referred to in Note 34 to the Accounts. These interests have been declared at the Directors' Meeting held on 26th January 2006. The Directors have no direct or indirect interest in any other contract or proposed contract with the company

Directors' Interest in Shares and Debentures

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

	As at 31/12/05	As at 31/12/04
Mr. R T Wijetilleke	3,913	14,914
Dr. V P Vittachi	5,005	5,005
Mr R Theagarajah	9,322	9,322
Mr D H S Jayawardena	5,005	5,005
Mr M V Theagarajah	120,974	73,874
Mr R K Obeyesekere	5,005	5,005
Mrs P C Cooray	12,505	3,300
Mr R Sivaratnam	5,040	5,040
Mr D R Ghazalli	—	—

No Director directly holds debentures of the Bank

There has been no change in their interests between 31st December 2005 and 16th February 2006 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.


Annual General Meeting

The 37th Annual General Meeting of the Bank is convened on Wednesday the 29th day of March 2006 at the Auditorium on Level 22 of "HNB Towers" at No: 479, T.B. Jayah Mawatha, Colombo 10, at 10.00 in the forenoon. The Notice of the 37th Annual General Meeting is on page 146 of this Report.

The Auditors

The retiring Auditors KPMG Ford, Rhodes, Thornton & Company have expressed their willingness to continue in office. In accordance with the Companies Act No: 17 of 1982, 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

DGM – Legal/Board Secretary

16th February, 2006

Colombo, Sri Lanka.

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Director's Responsibility for Financial Reporting

The Bank's Financial Statements for the year ended 31st December 2005 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. 17 of 1982. 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 has 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

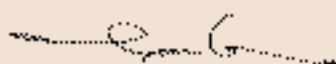
The Board of Directors oversee the management's responsibilities for financial reporting through their regular meeting reviews and the Audit Committee. The Audit Committee comprises three non-executive directors who are responsible for reviewing and approving financial information contained in the Annual Report and overseeing the management's responsibilities for the preparation and presentation of Financial Statements and the effectiveness of the internal control system in the Bank. With the demise of Mr Gemunu Gunatilleke, former Managing Partner, Ernst & Young, who functioned as a Consultant to the Committee, Mr R Seevaratnam former partner, KPMG Ford Rhodes Thornton & Co was appointed as a Consultant.

The Board of Directors also reviews 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.

The Bank Supervision Department of the Central Bank of Sri Lanka carries out periodical examinations of the records and the affairs of the Bank as deemed necessary to ensure conformity with the provisions of the Banking Act and the regulations formulated in accordance therewith. It also checks and ascertains whether certain financial ratios prescribed by it are being observed to ensure safety of the interests of depositors and shareholders in conformity with sound financial management.

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 87 of the annual report.

By Order of the Board



INDRANI GOONESEKERA
Deputy General Manager
(Legal)/Board Secretary

16th February, 2006
Colombo, SRI LANKA

Audit Committee Report

Membership

The membership currently comprises of three Non-executive Directors. During the year the Board appointed Mr. Ranjan Seevaratnam as the advisor to the Audit Committee and has determined him to be a 'financial expert' who has recent and relevant financial experience. The advisor attends all meetings of the Audit Committee and provides a continuous evaluation of its activities.

Meetings

The Committee met three times during the year. Attendance by Committee members at each of these meetings is given in the table on page 62. During the year the committee met with the CEO and with Senior Management. The Committee also met separately with the Banks External Auditors and the Head of Internal Audit.

The Committee monitors the integrity of the Banks annual and interim financial statements, including its disclosure policy, the procedures and systems of internal accounting control and financial reporting judgments. During 2005 the Committee reviewed the Annual Accounts for 2004 and interim results for 2005 before they were published.

The committee annually appraises the effectiveness of the External Auditors. During the year the committee met with the Banks External Auditors. The committee receives comprehensive reports from the auditors to assist them in improving the control environment of the Bank. The Audit Committee oversees the Banks relationship with the External Auditors taking into consideration the provision of audit and non-audit services. During the year the non-audit services provided by the External Auditors were confined to advisory services which did not fall within the category of restricted services. The lead- audit partner is rotated every five years. For the year ended 31st December 2005 the committee has concluded that the External Auditor remains independent and

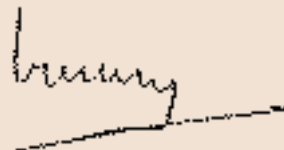
is effective. The Committee has recommended to the Board that they propose the re-appointment of the External Auditors to the shareholders at the 2006 AGM.

At the beginning of the year the committee received and approved the Internal Audit plan. The Committee monitors the effectiveness of the Internal Audit function and unresolved issues are specifically addressed for effective resolution. The Committee also discussed the resourcing of and succession planning for the Internal Audit function.

The Committee evaluates the Banks control environment. All unexpected losses resulting from frauds or operational failures are reported to the Committee on a quarterly basis. The Committee examined the procedures for staff to raise concerns about possible improprieties relating to the Banks operations.

The Committee reviewed the arrangements established by the management for compliance with the requirements of the regulator. A quarterly compliance statement is presented to the Audit Committee. During the year the Audit Committee also reviewed the Banks risk management processes including the key risks facing the Bank.

The Committee reports on its activities to the Board and the minutes of committee meetings are circulated to members of the Board.



R SIVARATNAM

Chairman

Thursday, February 16th, 2006

Auditors' Report



KPMG Ford, Rhodes, Thornton & Co.

(Chartered Accountants)
32 A, Sir Mohamed Macan Markar Mawatha,
P.O. Box 186,
Colombo 00300,
Sri Lanka.

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REPORT OF THE AUDITORS

TO THE MEMBERS OF HATTON NATIONAL BANK LIMITED

We have audited the balance sheet of Hatton National Bank Ltd as at 31st December 2005, the consolidated balance sheet of the Company and its subsidiaries as at that date, and the related statements of income, changes in equity and cash flows for the year then ended, together with the accounting policies and notes exhibited on pages 88 to 137 of the Annual Report.

Respective Responsibilities of Directors & Auditors

The directors are responsible for preparing and presenting these financial statements in accordance with the Sri Lanka Accounting Standards. Our responsibility is to express an opinion on these financial statements, based on our audit.

Basis of Opinion

We conducted our audit in accordance with the Sri Lanka Auditing Standards, which require that we plan and perform the audit to obtain reasonable assurance about whether the said financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the said financial statements, assessing the accounting principles used and significant estimates made by the directors, evaluating the overall presentation of the financial statements, and determining whether the said financial statements are prepared and presented in accordance with the Sri Lanka Accounting Standards. 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 books of account for the year ended 31st December 2005, and to the best of our information and according to the explanations given to us, the said balance sheet and related statements of income, changes in equity and cash flows and the accounting policies and notes thereto, which are in agreement with the said books and have been prepared and presented in accordance with the Sri Lanka Accounting Standards, provide the information required by the Companies Act No.17 of 1982 and the Banking Act No.30 of 1988 and give a true and fair view of the Company's state of affairs as at 31st December 2005 and of its profit and cash flow for the year then ended.

In our opinion, the consolidated balance sheet and related statements of income, changes in equity and cash flows and the accounting policies and notes thereto have been properly prepared and presented in accordance with the Companies Act No.17 of 1982, the Banking Act No. 30 of 1988 and the Sri Lanka Accounting Standards and give a true and fair view of the state of affairs as at 31st December 2005 and of its profit and cash flow for the year then ended of the Company and its subsidiaries dealt with thereby, so far as concerns the members of the Company.

Directors' Interest in Contracts with the Company

According to the information made available to us, the directors of the Company were not directly or indirectly interested in contracts with the Company during the year ended 31st December 2005 except as stated in Note 34 to these financial statements.

CHARTERED ACCOUNTANTS

Colombo
16th February, 2006

KPMG Ford, Rhodes, Thornton & Co.,
a Sri Lankan partnership, is the Sri Lankan member
firm of KPMG International, a Swiss cooperative

R.N. Asirwatham FCA
S. Sirikananathan FCA
Ms. M.P. Perera FCA
C.P. Jayatilake FCA
W.W.J.C Perera FCA

A.N. Fernando FCA
M.R. Mithular FCA
P.Y.S. Perera FCA
T.J.S. Rajakarier FCA
Ms. S. Joseph ACA

Income Statement

For the year ended 31st December		Bank		Group	
	Note	2005 Rs.000	2004 Rs.000	2005 Rs.000	2004 Rs. 000
INCOME	1	16,996,779	14,087,358	18,298,191	14,502,961
Interest income	2	14,129,874	11,469,335	14,740,829	11,579,556
Less: Interest expenses	3	7,280,851	5,962,041	8,069,768	6,361,766
Net interest income		6,849,023	5,507,294	6,671,061	5,217,790
Foreign exchange profit		646,460	662,176	646,166	662,860
Fee & commission income		1,663,545	1,519,924	1,639,249	1,574,282
Dividend income	4	65,050	166,406	65,866	75,317
Other income	5	491,850	269,517	1,206,081	610,946
		9,715,928	8,125,317	10,228,423	8,141,195
Less:					
OPERATING EXPENSES	6				
Personnel costs		2,415,295	2,169,689	2,535,274	2,274,277
Premises equipment & establishment expenses		1,861,421	1,620,796	1,664,923	1,409,430
Fee & commission expenses		116,611	122,894	117,571	117,396
Provision for staff retirement benefits		326,361	244,448	328,321	245,832
Bad debts written off		23,477	-	23,477	-
Provision for loan losses	7	1,759,444	1,566,493	1,759,444	1,566,493
Provision for /(writeback of) investments		81,465	(107,427)	82,699	(105,000)
Amortization of Goodwill/(Negative goodwill)	22	-	-	(353)	(353)
Other expenses		1,281,892	1,558,369	1,725,879	1,909,318
		7,865,966	7,175,262	8,237,235	7,417,393
PROFIT FROM OPERATIONS		1,849,962	950,055	1,991,188	723,802
Share of Associate Companies' profit before taxation		-	-	17,162	22,969
PROFIT BEFORE TAXATION		1,849,962	950,055	2,008,350	746,771
Add/(Less): Provision for taxation	8	(195,400)	26,326	(213,813)	15,114
PROFIT AFTER TAXATION		1,654,562	976,381	1,794,537	761,885
Less: Attributable to Minority Interest		-	-	24,116	6,279
NET PROFIT FOR THE YEAR		1,654,562	976,381	1,770,421	755,606
Attributable to Shareholders of the Bank		1,654,562	976,381	1,770,421	755,606
EARNINGS PER SHARE (Rs.)	9	15.09	12.51	16.14	9.68
DIVIDEND PER SHARE (Rs.)		4.00*	3.50	4.00*	3.50

The attached Accounting Policies and the Notes from Pages 92 to 137 form an integral part of these financial statements.

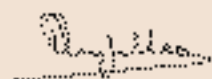
* Calculated on Interim Dividend paid and Final Dividend proposed, which is to be approved at the Annual General Meeting.

Balance Sheet

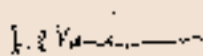
As at 31st December	Note	BANK		GROUP	
		2005 Rs.000	2004 Rs.000	2005 Rs.000	2004 Rs.000
ASSETS					
Cash & short term funds	10	21,200,074	20,107,785	21,193,935	20,113,310
Statutory deposit with Central Bank of Sri Lanka	11	8,565,629	9,120,391	8,565,629	9,120,391
Government Treasury Bills		139,340	-	2,001,340	744,282
Commercial papers		434,073	682,115	434,073	682,115
Securities purchased under re-sale agreements		-	-	3,881,251	5,650,256
Dealing securities	12	313,113	403,233	319,707	416,933
Investment securities	13	17,284,945	17,739,946	18,816,694	18,760,838
Bills of Exchange	14	2,026,977	2,077,466	2,026,977	2,077,466
Loans and advances	15	96,242,465	84,378,688	95,675,726	83,701,444
Lease rentals receivable within one year	16	3,112,469	2,564,267	3,112,469	2,564,267
Lease rentals receivable after one year	17	5,751,882	4,274,100	5,751,882	4,274,100
Investments in Associate Companies	18	132,326	132,326	170,592	168,588
Investments in Subsidiary Companies	19	2,293,663	2,293,663	-	-
Other assets	20	5,145,085	5,619,176	5,144,676	5,526,803
Property, plant & equipment	21	3,370,369	3,386,538	7,892,154	7,959,040
Goodwill on consolidation	22	-	-	-	813
Total Assets		166,012,410	152,779,694	174,987,105	161,760,646
LIABILITIES					
Deposits from customers	23	128,283,681	118,523,934	128,130,801	118,341,938
Dividends payable	24	50,291	108,299	50,291	108,299
Borrowings	25	3,940,111	4,213,891	3,940,111	4,213,891
Securities sold under re-purchase agreements		6,113,644	4,610,598	12,103,873	11,089,485
Bills payable		2,226,745	1,668,174	2,226,745	1,668,174
Other liabilities	26	9,838,930	10,414,757	10,282,275	10,752,874
Long-term insurance funds	27	-	-	300,818	169,493
Non life insurance reserves	28	-	-	267,020	210,611
Current tax liability		5,992	(162,195)	36,826	(157,981)
Deferred tax liability	29	313,756	350,356	316,317	352,529
Subordinated debentures	30	4,000,000	4,000,000	5,976,791	5,983,450
Total Liabilities		154,773,150	143,727,814	163,631,868	152,732,763
SHAREHOLDERS' FUNDS					
Share capital - Voting	31	946,647	770,000	946,647	770,000
Share capital - Non-Voting	31	231,000	231,000	231,000	231,000
Statutory Reserve Fund		624,707	569,707	624,707	569,707
Reserves		9,436,906	7,481,173	9,404,088	7,332,496
		11,239,260	9,051,880	11,206,442	8,903,203
MINORITY INTEREST		-	-	148,795	124,680
		11,239,260	9,051,880	11,355,237	9,027,883
Total Liabilities, Shareholders' Funds & Minority Interest		166,012,410	152,779,694	174,987,105	161,760,646
Commitments & Contingencies	32	44,763,208	45,246,343	44,763,208	45,246,343

The attached Accounting Policies and the Notes from pages 92 to 137 form an integral part of these financial statements.

For and on behalf of the Board



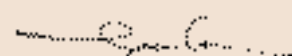
RIENZIE T WIJETILLEKE
Chairman



DR V P VITTACHI
Deputy Chairman



RAJENDRA THEAGARAJAH
Managing Director/
Chief Executive Officer



INDRANI GOONESEKERA
Deputy General Manager
Legal/Board Secretary

Thursday, 16th February 2006
Colombo, SRI LANKA.

Statement of Changes in Equity

For the year ended 31 December, 2005

Bank	Share Capital			Reserves					Total
	Voting Shares	Non-Voting Shares	Statutory Reserve Fund	Share Premium	Capital Reserve	General Reserve	Repairs & Renovation Reserve	Retained Profit	
	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	
Balance as at 31.12.2003	550,000	165,000	549,707	822,645	325,890	3,895,000	6,700	678,156	6,993,098
Rights issue of shares	220,000	66,000	-	1,139,601	-	-	-	-	1,425,601
Net profit for the year 2004	-	-	-	-	-	-	-	976,381	976,381
Final dividend for 2003	-	-	-	-	-	-	-	(143,000)	(143,000)
Interim dividend for 2004	-	-	-	-	-	-	-	(200,200)	(200,200)
Transfers during the year 2004	-	-	20,000	-	-	500,000	-	(520,000)	-
Balance as at 31.12.2004	770,000	231,000	569,707	1,962,246	325,890	4,395,000	6,700	791,337	9,051,880
Transfer of revaluation surplus on property disposed	-	-	-	-	(19,251)	-	-	19,251	-
Share issue as underlying for Global Depository Receipts	176,647	-	-	741,850	-	-	-	-	918,497
Net profit for the year 2005	-	-	-	-	-	-	-	1,654,562	1,654,562
Final dividend for 2004	-	-	-	-	-	-	-	(150,150)	(150,150)
Interim dividend for 2005	-	-	-	-	-	-	-	(235,529)	(235,529)
Transfers during the year 2005	-	-	55,000	-	-	850,000	-	(905,000)	-
Balance as at 31.12.2005	946,647	231,000	624,707	2,704,096	306,639	5,245,000	6,700	1,174,471	11,239,260

Group	Share Capital			Reserves					Total
	Voting Shares	Non-Voting Shares	Statutory Reserve Fund	Share Premium	Capital Reserve	General Reserve	Repairs & Renovation Reserve	Retained Profit	
	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	
Balance as at 31.12.2003	550,000	165,000	549,707	822,645	334,575	3,895,000	6,700	778,133	7,101,760
Rights issue of shares	220,000	66,000	-	1,139,601	-	-	-	-	1,425,601
Net profit for the year 2004	-	-	-	-	-	-	-	755,606	755,606
Final dividend for 2003	-	-	-	-	-	-	-	(143,000)	(143,000)
Interim dividend for 2004	-	-	-	-	-	-	-	(200,200)	(200,200)
On merger of Subsidiaries	-	-	-	-	(8,685)	-	-	(27,879)	(36,564)
Transfers during the year 2004	-	-	20,000	-	-	500,000	-	(520,000)	-
Balance as at 31.12.2004	770,000	231,000	569,707	1,962,246	325,890	4,395,000	6,700	642,660	8,903,203
Transfer of revaluation surplus on property disposed	-	-	-	-	(19,251)	-	-	19,251	-
Share issue as underlying for Global Depository Receipts	176,647	-	-	741,850	-	-	-	-	918,497
Net profit for the year 2005	-	-	-	-	-	-	-	1,770,421	1,770,421
Final dividend for 2004	-	-	-	-	-	-	-	(150,150)	(150,150)
Interim dividend for 2005	-	-	-	-	-	-	-	(235,529)	(235,529)
Transfers during the year 2005	-	-	55,000	-	-	850,000	-	(905,000)	-
Balance as at 31.12.2005	946,647	231,000	624,707	2,704,096	306,639	5,245,000	6,700	1,141,653	11,206,442

S

Share Premium shareholders.

Capital Reserve re ties. (Refer Note 21)

General Reserve comprises of the amounts appropriated by the Directors as a general banking reserve.

Repairs and Renovation Reserve includes the amounts allocated for repairs and renovation.

The attached Accounting Policies and the Notes from pages 92 to 137 form an integral part of these financial statements.

Cash Flow Statement

For the year ended 31st December	Bank		Group	
	2005 Rs.000	2004 Rs.000	2005 Rs.000	2004 Rs.000
Cash flows from operating activities				
Interest and commission receipts	15,793,419	12,989,259	16,380,078	13,153,838
Interest payments	(7,280,851)	(5,962,041)	(8,069,768)	(6,361,766)
Receipts from other operating activities	860,276	740,621	1,572,249	980,717
Cash payments to employees	(2,741,656)	(2,414,137)	(2,863,595)	(2,520,109)
Cash payments to suppliers	(1,367,100)	(1,182,138)	(1,070,864)	(871,889)
Payments for other operating activities	(1,404,849)	(1,743,315)	(1,831,088)	(1,886,053)
Operating profit before changes in operating assets and liabilities [Note (a)]	3,859,239	2,428,249	4,117,012	2,494,738
(Increase)/Decrease in operating assets:				
Treasury bills/commercial papers	108,702	202,966	(1,009,016)	(3,795,655)
Deposits held for regulatory or monetary control purposes	554,762	(3,057,946)	554,762	(3,057,946)
Funds advanced to customers	(14,898,628)	(17,069,462)	(14,769,828)	(18,224,688)
Other short-term assets	525,299	1,049,752	2,202,340	2,896,299
Increase/(Decrease) in operating liabilities:				
Deposits from customers	10,573,449	18,911,945	10,602,565	18,801,867
Negotiable certificates of deposit	(813,702)	(1,413,523)	(813,702)	(1,407,677)
Other liabilities	558,571	418,190	558,571	418,190
Net cash from operating activities before income tax	467,692	1,470,171	1,442,704	(1,874,872)
Income taxes (paid)/credit	-	-	(9,509)	(92,912)
Net cash generated from/(used in) operating activities	467,692	1,470,171	1,433,195	(1,967,784)
Cash flows from investing activities				
Income from dealing and investment securities	64,818	107,183	64,818	83,315
Income from unquoted investment securities	122,665	182,164	122,665	114,664
Proceeds from sales of securities	284,526	628,394	284,526	628,394
Proceeds from disposal of associate company	-	27,237	-	27,237
Net proceeds from investment securities	(496,038)	(1,548,251)	(1,042,139)	576,996
Purchase of property, plant & equipment	(496,611)	(516,281)	(545,656)	(701,865)
Proceeds from sale of property, plant & equipment	10,710	98,750	10,734	98,750
Net cash generated/(used in) investing activities	(509,930)	(1,020,804)	(1,105,052)	827,491
Cash flows from financing activities				
Increase in debentures	-	-	(6,659)	2,000,000
Increase of long-term borrowings	1,229,267	1,298,519	740,608	911,170
Net increase in other borrowings	(569,550)	(1,746,321)	(456,277)	(1,821,026)
Dividends paid	(443,687)	(275,658)	(443,687)	(275,658)
Proceeds from share issue	918,497	1,425,601	918,497	1,425,601
Net cash generated from financing activities	1,134,527	702,141	752,482	2,240,087
Net increase in cash and cash equivalents	1,092,289	1,151,508	1,080,625	1,099,794
Cash and cash equivalents at beginning of the year	20,107,785	18,956,277	20,113,310	19,013,516
Cash and cash equivalents at end of the year [Note (10)]	21,200,074	20,107,785	21,193,935	20,113,310
Note (a) Reconciliation of operating profit				
Operating profit before income tax	1,849,962	950,055	2,008,350	746,771
Income from dealing and investment securities	(64,818)	(107,183)	(64,818)	(83,315)
Income from investment securities	(122,665)	(182,164)	(122,665)	(114,664)
(Profit)/loss on sale of property, plant & equipment	7,749	(26,295)	7,749	(26,295)
Bad debts recovered	(142,095)	(103,888)	(142,095)	(103,888)
Depreciation	494,321	438,658	594,059	537,541
Provision for loan losses	1,759,444	1,566,493	1,759,444	1,566,493
Provision for diminution in value of investments	77,341	(107,427)	77,341	(27,552)
Goodwill amortization	-	-	(353)	(353)
	3,859,239	2,428,249	4,117,012	2,494,738

The attached Accounting Policies and Notes from Pages 92 to 137 form an integral part of these financial statements.

Significant Accounting Policies

GENERAL

Hatton National Bank Limited ("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 as at 31st December 2005 is 4,259 (2004 - 4,180).

The consolidated financial statements of the Bank for the year ended 31st December 2005 cover the Bank and its Subsidiaries, HNB Securities Limited, HNB Stockbrokers (Pvt) Limited, HNB Assurance Limited and Sithma Development (Pvt) Limited (together referred to as the "Group") and the Group's interest in its Associate companies M/s Lanka Ventures Limited and Browns Engineering (Pvt) Limited. The financial statements were authorised for issue by the Board of Directors on 16th February, 2006.

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 Limited and Sithma Development (Pvt) Limited are dealing in government securities as primary dealer, stock brokering, insurance services and property development respectively.

The principal activities of Lanka Ventures Limited and Browns Engineering (Pvt) Limited are providing venture capital services, construction and engineering respectively.

There were no significant changes in the nature of principal activities of the Bank and the Group during the financial year under review.

1 STATEMENT OF COMPLIANCE

The Balance Sheet, Income Statement, Statement of Changes in Equity and Cash Flow Statement have been prepared in accordance with generally accepted accounting principles and the Sri Lanka Accounting Standards laid down by the Institute of Chartered Accountants of Sri Lanka.

2. BASIS OF PREPARATION

The financial statements are presented in Sri Lanka rupees, rounded to the nearest thousand.

The financial statements are prepared under historical cost convention and applied consistently with no adjustments being made for inflationary factors affecting the financial statements, except that certain land and buildings, dealing securities and foreclosed properties are stated at valuation. Where appropriate, the policies are explained in the succeeding notes.

The accounting policies have been consistently applied by Group enterprises and any deviations disclosed accordingly.

3. MATERIALITY AND AGGREGATION

Each material item is presented separately in the financial statements. Immaterial amounts are aggregated with amounts of similar nature or function.

4. 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.

4.1 Subsidiaries

Subsidiaries are those enterprises controlled by the Bank. Control exists when the Bank has the power, directly or indirectly, to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities. 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 consolidated accounts are prepared to a common financial year end of 31st December. A list of subsidiaries within the group is provided in Note 19.

4.2 Associates

Associates are those enterprises in which the Group has significant influence, but not 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 on the equity method, from the date that significant influence effectively commences until the date that significant influence effectively ceases. A list of Associates within the group is provided in Note 18.

4.3 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 enterprise. Unrealised gains resulting from transactions with associates are eliminated 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.

Significant Accounting Policies

4.4 Goodwill

Goodwill arising on an acquisition represents the excess of the cost of the acquisition over the fair value of the net identifiable assets acquired. Goodwill is stated at cost less accumulated amortization. In respect of associates, the carrying amount of goodwill is included in the carrying amount of the investment in the associates. Goodwill is amortized over a period of 5 years from the date of initial recognition.

4.5 Negative Goodwill

Negative goodwill arising on an acquisition represents the excess of the fair value of the net identifiable assets acquired over the cost of acquisition. In respect of associates, the carrying amount of negative goodwill is included in the carrying amount of the investment in the associate. The carrying amount of other negative goodwill is deducted from the carrying amount of intangible assets until such excess is completely eliminated.

5. FOREIGN CURRENCY TRANSLATION

5.1 Transactions in foreign currencies are translated to Sri Lanka Rupees at the middle rate of exchange ruling at the date of the transaction.

Monetary assets and liabilities denominated in foreign currencies are stated at historical cost and are translated at the middle rate of exchange ruling on the date of the Balance Sheet. 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 fair value are translated to Sri Lanka rupees at the foreign exchange rates ruling at the dates that the values were determined.

5.2 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.

6. ASSETS AND BASES OF THEIR VALUATION

6.1 Cash and short term funds

Cash and short term funds 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. Interest is taken to profit when earned.

6.2 Statutory Deposit with Central Bank of Sri Lanka

The Monetary Law Act requires that all commercial banks operating in Sri Lanka shall maintain reserves against all deposit liabilities denominated in Sri Lanka Rupees. The reserve shall be an amount equal to 10% of the total of such rupee deposit liabilities.

6.3 Securities purchased under re-sale agreements

Securities purchased under re-sale agreements are recorded separately in the financial statements at cost. The difference between the purchase and sale price represents interest income and is recognized in the income statement over the period of the resale agreement.

6.4 Investments

6.4.1 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 the lower of cost or market value on an aggregate portfolio basis. Adjustment for fall in market value below cost, if relevant, is accounted for by charging the difference to the Income Statement.

6.4.2 Investment securities

These 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.

6.4.2(a) Amortization of premium/discount on foreign bonds

The Bank holds foreign treasury bonds as long term investments. The premium/discount on the bonds is amortized over the period to maturity.

6.4.3 Foreclosed properties (formerly classified as Investment Properties)

Foreclosed properties represent properties acquired in full or partial settlement of loans and advances and are yet to be disposed off. 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 Income Statement respectively. Foreclosed properties are recorded under loans and advances until they are disposed off.

Significant Accounting Policies

6.5 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

6.5.1 Non-performing Loans

Loans, advances and finance leases which are 90 days or more in arrears of due capital 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.

6.5.2 Provision for Loan Losses

Specific provisions for loan losses have been 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.

6.5.3 Revenue Recognition on Non-performing Loans

When an advance is classified as non-performing, interest income ceases to be recognized and is taken to income only on cash basis.

6.5.4 General Provision for Pawning and Shanthi Housing Loans

A general provision of 0.1% on total portfolio of pawning facilities and 0.2% on total portfolio of Shanthi housing loans is made in conformity with the industry practice.

6.6 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.

6.6.1 Provision for Lease Receivables

Specific provision has been made in relation to identified bad and doubtful leases as set out above. In addition a general provision of 2% of the lease receivables (net of specific provision) is made in conformity with industry practice.

6.7 Property Plant and Equipment

6.7.1 Property, Plant and Equipment are recorded at cost of purchase or construction or valuation together with any incidental expenses thereon. The assets are stated at cost less accumulated depreciation which is provided for on the basis specified in 6.7.2 below.

6.7.2 Depreciation is provided at the following rates on a straight line basis over the periods appropriate to the estimated useful lives of the different types of assets:

(i) Hatton National Bank			
Freehold Buildings	2.5%	per annum	
Leasehold Buildings	Lease period		
Motor Vehicles	25%	per annum	
Computer Equipment - Additions before 1.7.2000	25%	per annum	
- Additions after 1.7.2000	16.7%	per annum	
Office Equipment	20%	per annum	
Furniture and Fittings	10%	per annum	
Fixtures	10%	per annum	
(ii) Subsidiary Company - HNB Securities Ltd			
Office Equipment	Up to 31.12.2004	25%	per annum
Computer Equipment		33.33%	per annum
Furniture and Fittings		15%	per annum
			From 01.01.2005
			20% per annum
			16.7% per annum
			10% per annum
(iii) Subsidiary Company - Sithma Development (Pvt) Ltd.			
Freehold Buildings - Sithma Building	1%	per annum	
Smart Building	2.5%	per annum	
Generators, Generator Panels and associated power cables	2%	per annum	
Chillers, Cooling Towers and associated equipment	4%	per annum	
Lifts and escalator	4%	per annum	
Building Management System	4%	per annum	
Motor Vehicles	25%	per annum	
Plant & Machinery	20%	per annum	
Equipment	20%	per annum	

Significant Accounting Policies

6.7 Property Plant and Equipment (Contd.....)

Applicable to Bank, HNB Securities Ltd and Sithma Development (Pvt) Ltd

Year of Purchase:-

Assets purchased in the first half of the year 1/2 year depreciation

Assets purchased in the second half of the year No depreciation

Year of Disposal:-

Assets disposed in the first half of the year No depreciation

Assets disposed in the second half of the year 1/2 year depreciation

Depreciation is not provided on freehold land.

(iv) Subsidiary Company - HNB Stockbrokers (Pvt) Ltd	Up to 31.12.2004			From 01.01.2005
Furniture and Fittings	15%	per annum	10%	per annum
Office Equipment	25%	per annum	20%	per annum
Computer Equipment	33.33%	per annum	16.7%	per annum
Motor Vehicles	25%	per annum		
Improvements to leasehold property	20%	per annum		

Property plant and equipment are depreciated from the month of purchase to the month of sale.

(v) Subsidiary Company - HNB Assurance Ltd	Up to 31.12.2004			From 01.01.2005
Office Equipment and Machinery	20%	per annum	20%	per annum
Computer Equipment	25%	per annum	16.7%	per annum
Furniture and Fittings	10%	per annum		
Motor Vehicles	25%	per annum		

Full depreciation is provided in the month of purchase and no depreciation is provided in the month of disposal.

The depreciation rates of the subsidiaries have been ammended where applicable to conform with the rates applied by the Bank.

6.7.3 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 developments awaiting capitalization.

6.7.4 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.

7. LIABILITIES AND PROVISIONS

7.1 Deposits from Customers

Deposits include demand deposits, savings deposits, term deposits and certificate of deposits. They are brought to account at the gross value of the outstanding balance. Interest is charged to Income Statement.

7.2 Dividends Payable

Provision for dividends is recognised at the time the dividend is declared or recommended by the Directors and approved by the shareholders.

7.3 Borrowings

Borrowings include refinance borrowings, call and time deposits and borrowings from financial institutions. They are brought to accounts at the gross value of the outstanding balance.

7.4 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 and is recognized in the income statement over the period of the re-purchase agreement.

7.5 Bills Payable and Other Liabilities

Bills payable and Other liabilities include all other financial liabilities and include interest, fee and other expenses payable and securities purchased not delivered. These liabilities are recorded at the cash value to be realized when settled.

Significant Accounting Policies

7.6. Employee Benefits

7.6.1 Pensions and Retirement Benefits

The Bank operates an approved Pension Fund for the payment of pensions to retiring staff. 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 members of the permanent staff. The Bank carries out an actuarial valuation of the Pension Fund once in three years, or earlier where it deems appropriate to ascertain the full liability of the Fund.

An actuarial valuation of the pension fund was carried out as at 30th June 2005, 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)	10% p.a.
Salary increases (long term)	10% p.a.
Increase in Cost of Living Allowance (long term)	10% p.a.
Increase in Pension Payment	0% p.a.

The demographic assumptions underlying the valuation are retirement age (55 yrs.), early withdrawals from service, 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. 4,222.7 Mn and that the fair value of the fund assets is Rs. 2,336.8 Mn. resulting in a past service deficit of Rs. 1,885.9 Mn. in the Pension Fund due to the changes in actuarial assumptions that took place since the previous actuarial valuation as at 31st December 2002 as well as differences in experience compared to actuarial assumptions.

However, since Pension Fund is solvent on discontinuance basis (i.e. assuming that the Fund is terminated on the valuation date) the actuary recommended the amortization of the past service deficit by regular contributions over the full working life time of the current employees by incorporating it into the ongoing contribution rate.

Accordingly, the Bank increased the rate of contribution to the Fund commencing October 2005. Apart from this increase in the provision to the Fund, the Bank also introduced an optional scheme for pension to staff members, who are not covered by the Collective Agreement with a view to further reducing the burden on the Pension Fund.

The amount recognised as an expense for the current year is Rs. 326.3 Mn. (2004 – 244.4 Mn). The assets of the Fund, which are independently administered by the Trustees as per the provision of the Trust Deed are held separately from those of the Bank.

No additional provision has been made in the accounts 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 to its own non-contributory pension scheme, which is in force.

7.6.2 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 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 7.6.1 above.

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. 406 Mn. and that the fair value of the fund assets is Rs. 189.2 Mn. resulting in a past service deficit of Rs. 216.8 Mn. in the Widows, Widowers and Orphans Pension Scheme as at 30th June 2005.

However, since the Widows, Widowers and Orphans Pension Scheme is solvent on discontinuance basis the actuary has recommended similar course of action as recommended for the Pension Fund as detailed in Note 7.6.1 above.

With the introduction of the optional scheme for pension in June 2005, 477 members have opted out from the WWOP scheme thereby reducing the liability of the Fund.

The amount contributed by the members for the current year is Rs. 24.6 Mn. (2004 - Rs. 24.8 Mn.)

7.6.3 Defined Contribution Plans

Contributions to defined contribution plans are recognised as an expense in the Income Statement as incurred.

Provident fund

The Bank and employees contribute to the approved private Provident Fund. The total amount recognised as an expense for the current year is Rs. 180 Mn. (2004 - Rs. 171.5 Mn.).

Trust fund

The Bank contributes to the Employees' Trust Fund. The total amount recognised as an expense for the current year is Rs. 45 Mn. (2004 - Rs. 42.9 Mn.).

Significant Accounting Policies

7.6.4 ESOP

The Bank introduced an Employee Share Option Plan for its' Executives in January 2005. Under the plan, 626 employees were offered Non-voting shares of the Bank. The total number of shares allocated at Rs. 33/- (market value as at 31 December 2005 - Rs. 41.50) to the employees amounted to 4,566,633. The individual share allocation was based on the service and position of each employee.

7.6.5 HNB Securities Limited

Provision for retiring gratuity

Provision for retirement gratuity, payable under the Payment of Gratuity Act No. 12 of 1983 has been made for employees who have completed more than one year of continuous service with the Company. The gratuity liability is not externally funded.

Defined contribution plan

Obligations for contributions to Provident and Trust Funds covering all employees are recognised as an expense in the Income Statement.

7.6.6 HNB Stockbrokers (Pvt) Limited

Defined benefit plan for retirement

Provision has been made for retirement gratuities from the first year of service for all employees in conformity with SLAS - 16. However, under the Payment of Gratuity Act No. 12 of 1983, the liability to an employee arises only on completion of 5 years of continual service.

The gratuity liability is not externally funded.

Defined contribution plan

Obligations for contributions to Provident and Trust Funds covering all employees are recognised as an expense in the Income Statement.

7.6.7 HNB Assurance Limited

Defined benefit plan

Provision is made for retirement gratuities for employees who have completed more than one year's service with the Company, permitted as an allowed alternative in the Sri Lanka Accounting Standard - 16 "Retirement Benefit Cost". However under the Payment of Gratuities Act No. 12 of 1983, the liability to an employee arises only on completion of 5 years of continued service.

The gratuity liability is not externally funded.

Defined contribution plan

All employees of the Company are members of the Employee's Provident Fund (EPF) and Employee's Trust Fund (ETF) to which the Company contributes 12% and 3% respectively which are charged to the Statement of Income.

7.6.8 Sithma Development (Pvt) Limited

Defined benefit plan

No provisions have been made for gratuities as no employee has completed more than one year's service with the company.

Defined contribution plan

Obligations for contributions to Employee's Provident and Trust Fund are recognized as an expense in the Income Statement.

8. INCOME STATEMENT

8.1 Revenue Recognition

8.1.1 Interest income

Interest receivable is recognised on an accrual basis. Interest ceases to be accrued when the recovery of interest or principal is in arrears for three (3) months. 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 recognized on an accrual basis.

8.1.2 Dividend income

Dividend income from shares is recognised in the period in which it is declared.

8.1.3 Accounting for 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 three (3) months. Thereafter, such income is recognised on a cash basis.

8.1.4 Income on discounting of Bills of Exchange is recognised proportionately over the period of the instrument.

Significant Accounting Policies

8.1.5 Trading income

Gains or losses arising from the sale of investment securities, dealing securities, shares, units and property, plant and equipment are accounted for on the date of transaction in the Income Statement.

8.1.6 Fee and commission income

Fee and commission income are recognised in the Income Statement when the services are provided.

8.1.7 Profit/loss from sale of fixed assets

Profit/loss from sale of fixed assets are classified as other income.

8.2 Interest and Other Expenses

8.2.1 Interest expenses and other expenses

Interest payable is recognised on an accrual basis. Other expenses are recognised in the accounts as they are incurred, in the period to which they relate.

8.2.2 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 commitments on operating leases are shown in Note 32(c).

8.2.3 Fee and commission expenses

Fee and commission expenses are recognised on accrual.

8.3 Terminal Benefits

The Bank subscribes to a managed fund to provide pensions for all eligible salaried staff. Pension costs are charged to Income Statement in the year in which such costs are determined.

The actual amounts paid as pensions and retirement gratuities are charged to the Pension Fund as per 7.6.1 above.

8.4 Taxation

8.4.1 Income tax

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. 38 of 2000, as amended by subsequent legislation at the rates specified in Note No. 8 of the financial statement.

8.4.2 Deferred tax

Deferred tax is provided on the liability method and the balance of the deferred taxation account represents income tax applicable to the difference between the written down values for tax purposes of the assets on which depreciation allowances are claimed and the net book value of such assets.

No provision has been made for deferred taxation on assets leased to customers since timing differences on these assets are not expected to reverse for the next three years and is unlikely to reverse within a reasonable period or thereafter, in view of the bank maintaining or increasing its scale of leasing activity.

8.4.3. 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 company in the Group Financial Statements as a consolidation adjustment.

9. COMMITMENTS AND CONTINGENCIES

All discernible risks are accounted for in determining the amount of all known liabilities.

10 INSURANCE BUSINESS

10.1 Non-life (general) insurance business

10.1.1 Gross written premium

Premiums are generally recognised as written upon inception of the policy. Upon inception of the contract, premiums are recorded as written and are earned primarily on a pro-rata basis over the term of the related policy coverage. However, for those contracts for which the period of risk differs significantly from the contract period, premiums are earned over the period of risk in proportion to the amount of insurance protection provided.

10.1.2 Outward reinsurance

Premiums ceded to reinsurers is 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.

10.1.3 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 24ths basis in accordance with the Regulation of Insurance Industry Act No. 43 of 2000.

Significant Accounting Policies

10.1.4 Unexpired risk

Provision is made where appropriate for the estimated amount required over and above unearned premiums to meet future claims and related expenses on the business in force as at end of the year.

10.1.5 Deferred acquisition expenses

Deferred acquisition expenses represent net commissions relating to unearned premiums.

10.1.6 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 is reviewed on an ongoing basis. Debts, which are known to be uncollectible, are written off. A provision for doubtful debts is provided at 5% on total debts outstanding.

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.

10.1.7 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 provided as a defined percentage of claims incurred.

Whilst the Directors consider that the provision for claims are fairly stated on the basis of information currently available, the ultimate liability will vary as a result of subsequent information and events. This may result in adjustments to the amounts provided. Such amounts are reflected in the financial statements for that period. The methods used and the estimates made are reviewed regularly.

10.2 Life (long term) insurance business

10.2.1 Premiums (Revenue)

Premiums are accounted for as and when received and in the same period as the policy liabilities are created.

10.2.2 Reinsurance

Reinsurance premium expense is accrued on active policies on a monthly basis.

10.2.3 Benefits, losses and expenses

Expenses on the life insurance revenue account relate to the acquisition and maintenance of life insurance business and include investment expenses not treated as 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.

11. SEGMENT REPORTING

Segment information is presented in respect of the Group's business segments which is based on the group management and internal reporting structure. The Group comprise of following major business segments which are banking, leasing, dealing, property and insurance.

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 amortization costs.

12. CASH FLOW STATEMENT

The Cash Flow Statement has been prepared by using the "Direct Method" of preparing of Cash Flows in accordance with the Sri Lanka Accounting Standard 9 "Cash Flow Statements". Cash and Cash equivalents comprise cash in-hand, balances with banks, placements with banks, money at call and short notice and money market funds.

13. COMPARATIVE INFORMATION

Where necessary, comparative information has been restated to conform to the current year's presentation and classification.

14. DIRECTORS' RESPONSIBILITY STATEMENT

The Board of Directors is responsible for the preparation and presentation of these financial statements. Please refer page 85 for the statement of the Directors' Responsibility for Financial Reporting.

Notes to the Financial Statements

For the year ended 31st December	Bank		Group	
	2005	2004	2005	2004
	Rs.000	Rs.000	Rs.000	Rs.000
1. INCOME				
Interest income (Note 2)	14,129,874	11,469,335	14,740,829	11,579,556
Foreign exchange profit	646,460	662,176	646,166	662,860
Fees & commission income	1,663,545	1,519,924	1,639,249	1,574,282
Dividend income (Note 4)	65,050	166,406	65,866	75,317
Other income (Note 5)	491,850	269,517	1,206,081	610,946
	16,996,779	14,087,358	18,298,191	14,502,961
2. INTEREST INCOME				
Customer advances	12,670,259	10,225,782	12,668,067	9,902,188
Government securities	952,475	881,666	952,475	881,666
Placements with Banks	418,585	312,524	418,585	313,907
Other interest income	88,555	49,363	701,702	481,795
	14,129,874	11,469,335	14,740,829	11,579,556
Notional Credit for With Holding Tax on Government Securities on Secondary Market Transactions.				
Section 123 A of the Inland Revenue (Amendment) Act, No. 19 of 2003, provides that a company which derives interest income from the secondary market transactions in Government securities (on/after 1st April 2002) would 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, the net income earned from secondary market transactions in Government securities for the year, has been grossed up in the financial statements and the resulting notional tax credit amounts to Rs. 1.137 Mn. (2004 - Rs. 13.7 Mn.) for the Bank and Rs.7.91Mn. (2004 - Rs. 21.6 Mn.) for the Group.				
3. INTEREST EXPENSES				
Customer deposits	5,533,455	4,344,167	5,522,777	4,153,970
Refinance borrowings	109,798	102,221	109,798	102,221
Short term borrowings	900,399	821,397	900,399	923,618
Interest paid on debentures	472,405	484,042	472,405	476,047
Other interest expenses	264,794	210,214	1,064,389	705,910
	7,280,851	5,962,041	8,069,768	6,361,766
4. DIVIDEND INCOME				
Dealing securities	6,173	22,507	6,173	22,507
Investment securities - quoted	58,645	70,246	59,461	46,657
Investment securities - unquoted	232	73,653	232	6,153
	65,050	166,406	65,866	75,317
5. OTHER INCOME				
Income from dealing securities (quoted)	141,839	13,276	143,803	14,333
Income from investment securities	122,433	108,511	122,433	108,511
Bad debts recovered [Notes 15(a) & 17(a)]	142,095	103,888	142,095	103,888
Profit/(Loss) from sale of property, plant & equipment (net)	(7,749)	26,295	(7,749)	26,295
Profit from sale of foreclosed property	21,483	7,512	21,483	7,512
Gain on sale of government securities	4,179	90,238	19,433	90,237
Profit/(Loss) on gold/silver trading	19,026	(228,467)	19,026	(228,467)
Gain on interest rate Swaps	-	71,162	-	71,162
Gain/(Loss) on FCBU revaluation	28	42,990	28	42,990
Others	48,516	34,112	745,529	374,485
	491,850	269,517	1,206,081	610,946

Notes to the Financial Statements

For the year ended 31st December	Bank	Group		
	2005 Rs.000	2004 Rs.000	2005 Rs.000	2004 Rs.000
6. OPERATING EXPENSES				
Operating expenses, among other expenses, include the following:				
Legal expenses	14,430	6,215	14,430	6,215
Depreciation of property, plant and equipment	494,321	438,658	594,059	537,541
Directors' emoluments (Note 6.1)	8,911	12,597	8,911	12,597
Auditors' remuneration	2,600	2,600	3,560	3,385
Non audit fees	230	148	230	148
Donations	19,642	155	19,642	155
6.1 Directors' Emoluments				
Emoluments of Chairman (fee only)	168	79	168	79
Emoluments of highest paid Director	7,723	12,123	7,723	12,123
Emoluments of other Directors (fee only)	1,020	395	1,020	395
	<u>8,911</u>	<u>12,597</u>	<u>8,911</u>	<u>12,597</u>
7. PROVISION FOR LOAN LOSSES				
Specific provision for loans and advances	1,314,321	1,326,494	1,314,321	1,326,494
Specific Provision for foreclosed properties	315,865	95,317	315,865	95,317
Provision for Tsunami affected customers	-	60,000	-	60,000
General provision for pawning advances	8,250	3,000	8,250	3,000
General provision for housing advances	4,300	3,600	4,300	3,600
Provision for loans and advances [Note 15(a)]	1,642,736	1,488,411	1,642,736	1,488,411
Provision for bills of exchange	772	1,245	772	1,245
General provision for leases [Note 17(a)]	42,826	40,067	42,826	40,067
Specific provision for leases [Note 17(a)]	73,110	36,770	73,110	36,770
Total provision made during the year	<u>1,759,444</u>	<u>1,566,493</u>	<u>1,759,444</u>	<u>1,566,493</u>
8. TAXATION				
a) Charge to Taxation				
Income tax on profits for the year	(232,000)	(10,409)	(267,518)	(21,432)
Under/(over) provision during prior years	-	-	18,923	845
On Associate company's share of profit	-	-	(1,429)	(1,034)
Reversal from/(transfer to) deferred taxation	36,600	36,735	36,211	36,735
	<u>(195,400)</u>	<u>26,326</u>	<u>(213,813)</u>	<u>15,114</u>
b) Reconciliation of Accounting Profit and Taxable Income				
Net Profit as per the Income Statement	1,849,962	950,055	1,991,187	723,802
Disallowable expenses	5,163,131	850,653	5,221,949	1,139,539
Allowable expenses	(3,505,447)	(1,962,018)	(3,714,434)	(2,049,703)
Other income not chargeable with income tax	(2,159,340)	(166,406)	(2,188,206)	(159,089)
Losses applicable for Off Shore Banking Unit	-	313,393	-	313,393
Losses of prior periods set off against current year liabilities	(497,426)	(83,367)	(511,832)	(96,317)
Tax losses brought forward and not utilised	(3,614,574)	(3,972,974)	(3,717,506)	(4,025,361)
Tax losses not utilised and carried forward	3,624,465	4,112,000	3,891,881	4,229,338
Taxable Income	<u>860,771</u>	<u>41,336</u>	<u>973,039</u>	<u>75,602</u>
Income tax provision for the year is made up of the following:				
Income taxable at 30%	179,537	8,418	179,537	8,418
Income taxable at 20%	52,463	-	54,013	183
Income taxable at 32.5%	-	-	33,968	10,840
Income taxable at 15%	-	1,991	-	1,991
	<u>232,000</u>	<u>10,409</u>	<u>267,518</u>	<u>21,432</u>
Effective tax rate	<u>12.54%</u>	<u>1.10%</u>	<u>13.44%</u>	<u>2.96%</u>
c) The Bank's Domestic Banking Unit (DBU) is liable for income taxation on its income from banking operations at the rate of 30% (2004 - 30%) for the year. The non banking income of the Bank is liable for income taxation at the rate of 20% on Off Shore business income/profit and on sale of unquoted shares, (2004 - 30% on non banking income and 15% on profits from share trading activities). The taxable income of On Shore Operations of Foreign Currency Banking Unit (FCBU) is liable for income taxation at the rate 30% for the year (2004 - 30%). The taxable income from Off Shore Operations of FCBU is liable for income taxation at the rate of 20% with effect from 1st April 2004. The income of Off Shore Operations of FCBU was exempt from income taxation prior to that.				

Notes to the Financial Statements

8. TAXATION - (Contd.)

The Bank has recorded a taxable income of Rs.860.7 Mn. during the year 2005. The cumulative tax losses, which is available for setting off against future taxable income amounts to Rs.3,624 Mn. as at 31 December 2005 (31 December 2004 - Rs. 4,112 Mn.). The amounts reflected above are provisional.

Sithma Development (Pvt) Ltd. enjoys a tax holiday as per the agreement signed with the Board of Investment of Sri Lanka. As such no provision for income taxation has been made in the financial statements of the company.

HNB Stock brokers (Pvt) Ltd., is liable for income taxation at the rate of 32.5% (2004 - 32.5%) on its taxable profits. Provision has been made in the financial statements accordingly.

HNB Assurance Ltd., is liable for income tax at the rate of 30% (2004 - 30%) on its taxable profit and at the rate of 20% on its non business profits. Provision has been made in the financial statements accordingly.

HNB Securities Ltd., is liable for income taxation at the rate of 32.5% (2004 - 32.5%) on its taxable profits. Provision has been made in the financial statements accordingly.

Taxes Imposed with Retrospective Effect

The profits arising from the trading in the government securities were exempt from income tax in terms of section 15 (t) of the Inland Revenue Act, No. 38 of 2000. The Inland Revenue (Amendment) Act, No. 12 of 2004 withdrew this exemption with effect from 1st April 2002. The Fiscal Proposals included in the Government budget for 2005 intimated that the repeal of this section would be deferred to the year of Assessment 2003/2004.

The income tax liability on the profits arising from trading in Government securities as per the above, earned during the year 2003, amounting to Rs.71.6 Mn, which has been paid by HNB Securities Ltd, has been treated as a prior year adjustment and charged against the retained profits of 2003.

9. EARNINGS PER SHARE

Earnings per share (EPS) has been calculated by dividing the profit after taxation for the year attributable to ordinary shareholders, by the weighted average number of ordinary shares on issue (both Voting & Non-Voting) during the year ended 31st December 2005, calculated as per the requirements of Sri Lanka Accounting Standard 34 - "Earnings Per Share".

	Bank		Group	
	2005	2004	2005	2004
For the year ended 31st December				
Profit attributable to ordinary shareholders	(Rs.000) 1,654,562	976,381	1,770,421	755,606
Weighted average number of ordinary shares used as the denominator	('000) 109,682	78,054	109,682	78,054
Basic Earnings per Share	(Rs.) 15.09	12.51	16.14	9.68
As at 31st December	2005	2004	2005	2004
10. CASH AND SHORT-TERM FUNDS	Rs.000	Rs.000	Rs.000	Rs.000
Local currency in hand	1,946,367	1,693,161	1,940,228	1,698,686
Foreign currency in hand	138,042	258,132	138,042	258,132
Balances with local banks	15,107	19,440	15,107	19,440
Balances with foreign banks	9,930,384	13,529,169	9,930,384	13,529,169
Money at call and short notice	1,150,000	-	1,150,000	-
Money market funds	5,366,187	4,215,046	5,366,187	4,215,046
Placements with banks by FCBU	2,653,987	392,837	2,653,987	392,837
	21,200,074	20,107,785	21,193,935	20,113,310

11. STATUTORY DEPOSIT WITH CENTRAL BANK OF SRI LANKA

Statutory deposit with Central Bank of Sri Lanka	8,565,629	9,120,391	8,565,629	9,120,391
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A cash balance is maintained with the Central Bank of Sri Lanka according to statutory requirements. As at 31st December 2005, the minimum cash reserve requirement is 10% of the rupee deposit liabilities. There is no reserve requirement for deposit liabilities of the Foreign Currency Banking Unit.

Notes to the Financial Statements

12. DEALING SECURITIES

Bank

Quoted shares

As at 31st December

	No of Ordinary Shares of Rs.10/- each	2005 Cost of Investment Rs.000	% of Total Cost	Market Value Rs.000	No of Ordinary Shares of Rs.10/- each	2004 Cost of Investment Rs.000	Market Value Rs.000
Banks, Finance and Insurance							
Central Finance Co. Ltd.	-	-	-	-	30,000	3,913	8,100
Commercial Bank, Non-voting	-	-	-	-	229,900	24,161	20,691
Housing Development Finance Corporation Bank of Sri Lanka	16,600	3,828	1.11	3,171	-	-	-
Merchant Bank of Sri Lanka Ltd.	-	-	-	-	604,150	6,765	5,588
National Development Bank Ltd.	-	-	-	-	461,700	40,266	73,872
Nations Trust Bank Ltd.	-	-	-	-	588,300	14,907	10,737
Seylan Bank Ltd.	17,400	826	.24	639	297,300	14,417	8,919
Seylan Bank Ltd, Non-voting	839,300	20,446	5.91	13,639	-	-	-
The Finance Co Ltd.	-	-	-	-	131,180	2,880	2,492
Union Assurance Ltd.	335,400	23,689	6.85	32,198	-	-	-
		<u>48,789</u>	<u>14.11</u>	<u>49,647</u>		<u>107,309</u>	<u>130,399</u>
Chemicals and Pharmaceuticals							
Haycarb Ltd.	-	-	-	-	62	3	3
Construction & Engineering							
Colombo Dockyard Ltd.	100,000	3,543	1.02	2,225	-	-	-
Diversified Holdings							
Hayleys Ltd.	-	-	-	-	553,829	78,303	69,921
Hemas Holdings Ltd.	50,000	3,509	1.01	5,187	289,000	22,844	27,889
John Keells Holdings Ltd	150,000	21,348	6.17	19,388	436,793	45,824	48,047
		<u>24,857</u>	<u>7.18</u>	<u>24,575</u>		<u>146,971</u>	<u>145,857</u>
Footwear and Textile							
Veyangoda Textiles Ltd	-	-	-	-	5,000	122	-
Kuruwita Textiles Ltd	-	-	-	-	247,500	1,980	12,004
		<u>-</u>	<u>-</u>	<u>-</u>		<u>2,102</u>	<u>12,004</u>
Hotel and Travel							
Aitken Spence Hotel Holdings Ltd	54,500	5,738	1.66	3,706	-	-	-
Asian Hotels & Properties Ltd.	135,300	8,420	2.43	5,615	-	-	-
Galadari Hotel Lanka Ltd.	170,600	3,178	.92	1,919	55,000	972	880
Hotel Developers (Lanka) Ltd.	-	-	-	-	7,800	876	796
John Keells Hotels Ltd.	25,051	2,529	.73	2,029	25,051	2,529	2,186
Riverina Hotels Ltd.	32,300	1,046	.30	703	-	-	-
Trans Asia Hotels Ltd.	-	-	-	-	22,000	1,782	1,639
		<u>20,911</u>	<u>6.04</u>	<u>13,972</u>		<u>6,159</u>	<u>5,501</u>
Health Care							
Ceylon Hospitals Ltd.	-	-	-	-	10,800	273	248
Land and Property							
Ceylinco Housing and Real Estate Co. Ltd.	-	-	-	-	25	1	-
Collettes Ltd.	-	-	-	-	50	11	-
		<u>-</u>	<u>-</u>	<u>-</u>		<u>12</u>	<u>-</u>

Notes to the Financial Statements

12. DEALING SECURITIES - (Contd.)

As at 31st December

	No of Ordinary Shares of Rs.10/- each	2005 Cost of Investment Rs.000	% of Total Cost	Market Value Rs.000	No of Ordinary Shares of Rs.10/- each	2004 Cost of Investment Rs.000	Market Value Rs.000
Manufacturing							
ACL Plastics Ltd.	-	-	-	-	257,600	10,256	7,342
Caltex Lanka Lubricants Ltd	726,200	56,525	16.34	42,119	276,200	25,929	17,608
Dankotuwa Porcelain Ltd	1,207,400	30,230	8.74	18,111	390,700	11,670	6,154
Kelani Tyres Ltd	346,800	6,278	1.82	3,208	346,800	6,278	3,381
Lanka Cement Ltd	-	-	-	-	210,000	2,100	1,627
Lanka Ceramics Ltd	-	-	-	-	2,044,400	49,488	40,888
Pelwatte Sugar Industries Ltd	-	-	-	-	350,000	4,855	3,325
Richard Peiris and Co Ltd	374,700	34,546	10.00	25,386	-	-	-
Sierra Cables Limited (Rs.1 per share)	4,432,000	13,464	3.89	11,080	-	-	-
		<u>141,043</u>	<u>40.79</u>	<u>99,904</u>		<u>110,576</u>	<u>80,325</u>
Motors							
Lanka Ashok Leyland Ltd	-	-	-	-	1,000	141	97
Power & Energy							
Lanka IOC Ltd.	927,900	41,702	12.06	30,621	600,000	18,445	25,950
Plantations							
Balangoda Plantations Ltd	-	-	-	-	54,700	1,454	902
Kelani Valley Plantations Ltd	-	-	-	-	90,100	1,904	1,577
		<u>-</u>	<u>-</u>	<u>-</u>		<u>3,358</u>	<u>2,479</u>
Telecommunications							
Dialog Telekom (Rs.1 per share)	550,000	10,300	2.98	9,075	-	-	-
Sri Lanka Telecom Ltd.	2,334,800	54,604	15.78	38,524	408,900	7,883	6,338
		<u>64,904</u>	<u>18.76</u>	<u>47,599</u>		<u>7,883</u>	<u>6,338</u>
Trading							
Odd lots & delisted shares	-	135	0.04	-	-	1	-
Total		<u>345,884</u>	<u>100.00</u>	<u>268,543</u>		<u>403,233</u>	<u>409,201</u>
Less:							
Provision for diminution in Market Value b/f		-		-		(36,372)	-
Provision written back/(made)		(77,341)		-		36,372	-
		<u>268,543</u>		<u>268,543</u>		<u>403,233</u>	<u>409,201</u>
Government of Sri Lanka Treasury Bonds							
Face Value	Year of Maturity	Discounted Value (Rs. 000)					
Rs. 50 Mn.	2009	48,694		48,694		-	-
Less:							
Marked to market revaluation loss		(4,124)		-		-	-
		<u>44,570</u>		<u>44,570</u>			
Total for Bank		<u>313,113</u>		<u>313,113</u>		<u>403,233</u>	<u>409,201</u>

Notes to the Financial Statements

12. DEALING SECURITIES - (Contd.)

As at 31st December

	No of Ordinary Shares of Rs.10/- each	2005 Cost of Investment Rs.000	% of Total Cost	Market Value Rs.000	No of Ordinary Shares of Rs.10/- each	2004 Cost of Investment Rs.000	Market Value Rs.000
Subsidiaries							
Quoted Shares							
Commercial Bank of Ceylon Ltd. (Voting)	-	-	-	-	8,900	864	801
NDB Bank Ltd.	-	-	-	-	29,200	812	759
Nations Trust Bank Ltd.	-	-	-	-	108,900	2,502	1,987
Chemical Industries (Col.) Ltd.	-	-	-	-	13,587	1,990	1,699
Caltex Lanka Lubricants Ltd.	-	-	-	-	97,700	7,337	6,229
Grain Elevators Ceylon Ltd.	-	-	-	-	33,700	541	362
John Keells Hotels Ltd.	-	-	-	-	37	2	3
Lanka IOC Ltd.	25,000	1,265	12.07	819	-	-	-
Sri Lanka Telecom Ltd.	350,000	9,211	87.93	5,775	120,000	2,079	1,860
		<u>10,476</u>	<u>100.00</u>	<u>6,594</u>		<u>16,127</u>	<u>13,700</u>
Less: Provision for diminution in market value (made)		(3,882)		-		(2,427)	-
Total for Subsidiaries		<u>6,594</u>		<u>6,594</u>		<u>13,700</u>	<u>13,700</u>
Total for Group		<u>319,707</u>		<u>319,707</u>		416,933	422,901

13. INVESTMENT SECURITIES

For the year ended 31st December

	Bank		Group	
	2005 Rs.000	2004 Rs.000	2005 Rs.000	2004 Rs.000
13.1 Quoted - shares/units				
Balance b/f	633,969	667,744	641,377	674,994
Additions	-	-	-	158
Disposals	(16,200)	(36,951)	(16,358)	(36,951)
Transfers	-	(23,770)	-	(23,770)
Provision written back/(made)	-	26,946	(181)	26,946
Balance c/f (Note 13.4)	<u>617,769</u>	<u>633,969</u>	<u>624,838</u>	<u>641,377</u>
13.2 Unquoted - shares				
Balance b/f	25,956	25,956	25,956	25,956
Additions	-	-	-	-
Disposals	(250)	-	(250)	-
Balance c/f (Note 13.5)	<u>25,706</u>	<u>25,956</u>	<u>25,706</u>	<u>25,956</u>
13.3 Bonds and debentures				
Balance b/f	17,080,021	17,308,924	18,093,505	19,118,795
Additions	97,917	3,919,955	559,113	3,919,955
Redemptions	(536,468)	(4,148,858)	(486,468)	(4,945,245)
Balance c/f (Note 13.6)	<u>16,641,470</u>	<u>17,080,021</u>	<u>18,166,150</u>	<u>18,093,505</u>
Total Investment Securities	<u>17,284,945</u>	<u>17,739,946</u>	<u>18,816,694</u>	<u>18,760,838</u>

Notes to the Financial Statements

13. INVESTMENT SECURITIES (Contd.)

13.4 Quoted shares/units

Bank

As at 31st December

	No. of Ordinary Shares of Rs.10/- each	2005 Cost of Investment Rs.000	Market Value of Shares Rs.000	No. of Ordinary Shares of Rs.10/- each	2004 Cost of Investment Rs.000	Market Value of Shares Rs.000
Asha Central Hospital Ltd	120,000	1,578	2,850	120,000	1,578	1,830
Browns Beach Hotels Ltd	75,000	1,622	1,725	75,000	1,622	2,344
Commercial Bank of Ceylon Ltd	825,332	61,645	111,832	412,666	61,645	65,923
DFCC Bank	7,054,025	519,711	1,551,886	7,054,025	519,711	1,453,129
Distilleries Company of Sri Lanka Ltd (Rs.1/- per share)	1,481,500	11,158	51,853	1,481,500	11,158	42,223
Lanka Hospital Corporation Ltd	1,455,000	22,055	26,918	1,455,000	22,055	18,551
Magpek Exports Ltd	359,000	14,360	*	359,000	14,360	*
Metal Recyclers Colombo Ltd	69	3	*	69	3	*
Namal National Equity Fund (units)	-	-	-	1,629,450	16,200	22,144
		632,132	1,747,064		648,332	1,606,144
Provision for diminution in market value b/f		(14,363)				
Provision written back/(made)					(14,363)	-
Total Quoted - Shares / Units - Bank		617,769	1,747,064		633,969	1,606,144

*Shares delisted – Market value shown as Nil.

Subsidiaries

Commercial Bank of Ceylon Ltd. Cumulative Redeemable Preference Shares	725,000	7,250	7,069	725,000	7,250	7,250
Lanka IOC Ltd.	-	-	-	5,800	158	251
		7,250	7,069		7,408	7,501
Provision for diminution in value of investment		(181)				
Total Quoted - Shares / Units - Group		624,838	1,754,133		641,377	1,613,645

13.5 Unquoted Shares

	No. of Ordinary Shares of Rs.10/- each	Cost Rs.000	Directors' Valuation Rs.000	No. of Ordinary Shares of Rs.10/- each	Cost Rs.000	Directors' Valuation Rs.000
Bank and Subsidiaries						
Browns Group Motels Ltd	50,000	500	500	50,000	500	500
Credit Information Bureau of Sri Lanka (Shares of Rs.100/- each)	5,300	530	530	5,300	530	530
Fitch Rating Lanka Ltd	62,500	625	625	62,500	625	625
Janashakthi Insurance Co Ltd	-	-	-	25,000	250	250
Lanka Clear (Pvt) Ltd	2,200,000	22,000	22,000	2,200,000	22,000	22,000
S.W.I.F.T.	21	2,051	2,051	21	2,051	2,051
Total Unquoted Shares - Bank and Group		25,706	25,706		25,956	25,956

Notes to the Financial Statements

13. INVESTMENT SECURITIES (Contd.)

13.6 Bonds and debentures

As at 31 December

	2005		2004	
	Cost Rs.000	Directors' Valuation Rs.000	Cost Rs.000	Directors' Valuation Rs.000
Bank				
HNB Securities Ltd - Debentures	-	-	50,000	50,000
Long Term Non-negotiable Bonds maturing on 14.11.2016	489,000	489,000	489,000	489,000
Mercantile Leasing Ltd - Debentures	100,000	100,000	140,000	140,000
People's Leasing Co. Ltd. Securitised Notes Trust 04	39,791	39,791	78,601	78,601
People's Leasing- Securitised Notes Trust 10	137,500	137,500	187,500	187,500
People's Leasing - Securitised Notes Trust 14	187,500	187,500	250,000	250,000
People's Leasing - Securitised Notes Trust 20	97,917	97,917	-	-
Sri Lanka Development Bonds maturing on 25.06.2006	3,205,678	3,205,678	3,285,634	3,285,634
	4,257,386	4,257,386	4,480,735	4,480,735

Government of Sri Lanka Treasury Bonds

Face value	Year of Maturity	Discounted Value (Rs.000)				
Rs. 1,300.00 Mn	2006	1,331,294				
Rs. 2,717.80 Mn	2007	2,927,974				
Rs. 2,299.10 Mn	2008	2,538,932				
Rs. 2,740.00 Mn	2009	2,989,517				
Rs. 251.00 Mn	2013	266,239	10,053,956	10,053,956	10,172,974	10,172,974
			14,311,342	14,311,342	14,653,709	14,653,709

Foreign Currency Bonds	Face value	Year of Maturity	Value	Equivalent in SLR (Rs.000)	2005		2004	
					Cost of Investment (Rs. 000)	Market Value (Rs. 000)	Cost of Investment (Rs. 000)	Market Value (Rs. 000)
US\$ 5 Mn.		2009	US\$ 4,952,000*	505,599				
Foreign Investments			US\$ 17,870,018	1,824,529	2,330,128	2,330,128	2,426,312	2,426,312
Total Investment Securities - Bank					16,641,470	16,641,470	17,080,021	17,080,021

* Discounted value

Subsidiaries	Quoted Debentures	Commercial Bank of Ceylon Ltd-Debentures	72,500	2005		72,500	2004	
				No. of Debentures of Rs.100/- each	Cost of Investment Rs.000		No. of Debentures of Rs.100/- each	Cost of Investment Rs.000
					7,250		7,250	

Subsidiaries

Quoted Debentures

Commercial Bank of Ceylon Ltd-Debentures	72,500	7,250	72,500	7,250
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Government of Sri Lanka Treasury Bonds

Face value	Year of Maturity	Discounted Value (Rs.000)		
Rs. 82 Mn.	2006	82,000		
Rs. 1,075 Mn.	2007	1,123,618		
Rs. 250 Mn.	2009	246,531		
Rs. 67 Mn.	2010	65,281	1,517,430	1,056,234
Less: Investment in subsidiary by the Bank				
HNB Securities Ltd, 500,000 13% debentures of Rs. 100				(50,000)
Total Bonds and Debentures - Group			18,166,150	18,093,505

Notes to the Financial Statements

13. INVESTMENT SECURITIES (Contd.)

13.7 Investment Securities - Group

As at 31 December	2005	2004
	Cost	Cost
	Rs.000	Rs.000
Total cost of investment securities for Bank (as per Note 13.4, 13.5 and 13.6)	17,284,945	17,739,946
Subsidiaries - HNB Assurance Ltd / HNB Securities Ltd.		
Quoted shares	7,069	7,408
Quoted debentures	7,250	7,250
Government of Sri Lanka Treasury Bonds	1,517,430	1,056,234
Less: Investment in subsidiary debentures by the Bank	-	(50,000)
Total Investment Securities - Group	18,816,694	18,760,838

	Bank		Group	
	2005	2004	2005	2004
As at 31 December	Rs.000	Rs.000	Rs.000	Rs.000
14. BILLS OF EXCHANGE				
Inland bills	335,258	340,047	335,258	340,047
Import bills	222,831	276,727	222,831	276,727
Export bills	1,060,293	1,158,182	1,060,293	1,158,182
	1,618,382	1,774,956	1,618,382	1,774,956
Foreign Currency Banking Unit bills	696,639	591,273	696,639	591,273
	2,315,021	2,366,229	2,315,021	2,366,229
Less: Specific Loan loss provision [Note 15(b)]	288,044	288,763	288,044	288,763
	2,026,977	2,077,466	2,026,977	2,077,466

15. LOANS AND ADVANCES

Sri Lanka rupee loans and advances

Overdrafts	22,952,834	20,165,063	22,386,095	19,486,668
Trust receipts	5,193,080	4,957,006	5,193,080	4,957,006
Packing credit loans	523,517	521,945	523,517	521,945
Staff loans	4,104,142	3,634,411	4,104,142	3,635,562
Term loans	31,988,279	27,804,595	31,988,279	27,804,595
Housing loans	10,224,844	7,593,169	10,224,844	7,593,169
Pawning advances	12,521,666	11,432,733	12,521,666	11,432,733
Foreclosed properties [Note 15 (f)]	139,224	249,959	139,224	249,959
	87,647,586	76,358,881	87,080,847	75,681,637

Foreign currency loans and advances

Overdrafts	1,668,881	1,249,346	1,668,881	1,249,346
Trust receipts	1,423,649	1,424,943	1,423,649	1,424,943
Packing credit loans	812,883	895,731	812,883	895,731
Term loans	10,737,166	9,654,803	10,737,166	9,654,803
Foreclosed properties [Note 15 (f)]	418,316	477,757	418,316	477,757
	15,060,895	13,702,580	15,060,895	13,702,580

Total Sri Lanka rupee and Foreign currency loans and advances

	102,708,481	90,061,461	102,141,742	89,384,217
Less:				
Specific loan loss provision	5,099,566	4,488,324	5,099,566	4,488,324
Specific provision for foreclosed properties [Note 15 (f)]	420,451	138,727	420,451	138,727
General provision for pawning advances	16,473	11,020	16,473	11,020
General provision for housing loans	20,500	16,200	20,500	16,200
Total loan loss provision [Note 15(a)]	5,556,990	4,654,271	5,556,990	4,654,271
Loans & advances after loan loss provision	97,151,491	85,407,190	96,584,752	84,729,946
Less: Interest in suspense [Note 15(e)]	909,026	1,028,502	909,026	1,028,502
	96,242,465	84,378,688	95,675,726	83,701,444

Notes to the Financial Statements

15. LOANS AND ADVANCES (Contd.)

As at 31 December	Bank		Group	
	2005 Rs.000	2004 Rs.000	2005 Rs.000	2004 Rs.000
15(a) MOVEMENT IN LOAN LOSS PROVISION				
Balance brought forward	4,654,271	3,298,859	4,654,271	3,298,859
Reclassified to Bills of Exchange	-	42,418	-	42,418
Exchange rate variance on foreign currency provision	(55,550)	142,183	(55,550)	142,183
	4,598,721	3,483,460	4,598,721	3,483,460
Additional provision made (Note 7)	1,642,736	1,488,411	1,642,736	1,488,411
Fully provided debts written off	(549,337)	(216,458)	(549,337)	(216,458)
Recoveries made during the year	(132,334)	(101,142)	(132,334)	(101,142)
Reversals made from General Provision	(2,796)	-	(2,796)	-
	5,556,990	4,654,271	5,556,990	4,654,271

15(b) ANALYSIS OF PROVISION FOR LOAN LOSSES AND INTEREST IN SUSPENSE - BANK

As at 31 December	LOAN LOSS PROVISION			INTEREST IN SUSPENSE		
	2005 Rs.000	2005 Rs.000	2004 Rs.000	2004 Rs.000	2005 Rs.000	2004 Rs.000
Bills of Exchange (Note 14)	288,044		288,763			
Loans and advances (Note 15)	5,556,990	5,845,034	4,654,271	4,943,034	909,026	1,028,502
Lease rental receivable within 1 year (Note 16)	281,422		205,004			
Lease rental receivable after 1 year (Note 17)	115,727	397,149	85,997	291,001		
Total		6,242,183		5,234,035	909,026	1,028,502

15(c) ASSET QUALITY - BANK

As at 31 December	2005 Rs.000	2004 Rs.000
Non performing advances		
Bills of Exchange	300,081	326,540
Loans and advances	8,442,066	9,167,850
Foreclosed properties	557,540	727,716
Lease rental receivable	363,664	343,920
	9,663,351	10,566,026
Less: Specific provisions		
- Bills of Exchange	288,044	288,763
- Loans and advances	5,099,566	4,488,324
- Foreclosed properties	420,451	138,727
- Lease rental receivable	214,484	150,384
	6,022,545	5,066,198
Less: Interest in suspense	3,640,806	5,499,828
	909,026	1,028,502
Net non-performing advances	2,731,780	4,471,326

15(d) SECURITY WISE ANALYSIS OF GROSS NON-PERFORMING ADVANCES - BANK

As at 31 December	Amount Outstanding			
	2005 Rs.000	%	2004 Rs.000	%
Secured by immovable assets	4,960,486	51	5,388,673	51
Secured by movable assets	2,290,430	24	2,007,545	19
Secured by cash/shares	380,469	4	211,321	2
Other securities	1,522,389	16	1,584,904	15
Clean	509,577	5	1,373,583	13
	9,663,351	100	10,566,026	100

Notes to the Financial Statements

15. LOANS AND ADVANCES (Contd.)

15(e) MOVEMENT IN INTEREST IN SUSPENSE - BANK

	2005 Rs.000	2004 Rs.000
Balance brought forward	1,028,502	1,156,410
Interest suspended	352,025	579,693
Amounts recovered	(375,520)	(381,150)
Interest written off	(95,981)	(326,451)
	<u>909,026</u>	<u>1,028,502</u>

Bank, as a policy, seals off interest on non-performing advances which are in arrears over one year. However, at the time of recovery, further interest on such advances is calculated from the date on which interest is sealed off.

15(f) MOVEMENT IN FORECLOSED PROPERTIES

	2005 Rs.000	2004 Rs.000
Balance as 01st January	588,989	928,657
Additions during the year	-	3,331
Disposals during the year	(170,175)	(287,664)
Transfers during the year	-	(10,210)
Exchange translation	(1)	50,192
Provision for the year	(315,865)	(95,317)
Provision recoveries during the year	34,141	-
Balance as at 31st December	<u>137,089</u>	<u>588,989</u>

The net total of foreclosed properties has been included under

Sri Lanka rupee loans and advances	139,224	249,959
Foreign currency loans and advances	418,316	477,757
Specific provision for foreclosed properties	(420,451)	(138,727)
	<u>137,089</u>	<u>588,989</u>

15(g) PROVISIONS FOR DISCOUNT OF SECURITIES

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 can be 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 will 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 4 years should be reviewed on a regular basis, and discounted further at the discretion of the Management.

15(h) PROVISION FOR KABOOL LANKA (PVT) LTD.

The Bank continued to increase the provisions against the Kabool Lanka (Pvt) Ltd., (KLPL) liability of approximately Rs. 2.68 Bn., as a measure of

Several investors have been evaluating the project for revival, however as at Balance Sheet date no formal agreement has been entered into for the sale of the assets jointly owned by Hatton National Bank Ltd. and Bank of Ceylon, acquired through the legal process.

A total provision of Rs. 2.4 Bn., has been made by the Bank up to 31st December 2005 leaving an exposure of Rs. 0.28 Bn, covered by assets.

Notes to the Financial Statements

	Bank		Group	
As at 31 December	2005	2004	2005	2004
	Rs.000	Rs.000	Rs.000	Rs.000
16. LEASE RENTALS RECEIVABLE WITHIN ONE YEAR				
Total Lease rentals receivable [Note 16(a)]	11,337,968	8,635,918	11,337,968	8,635,918
Lease rentals receivable after one year from Balance Sheet date	(6,817,535)	(5,001,262)	(6,817,535)	(5,001,262)
Lease rentals receivable within one year from Balance Sheet date	4,520,433	3,634,656	4,520,433	3,634,656
Unearned lease income	(1,126,542)	(865,385)	(1,126,542)	(865,385)
Provision for lease receivables - Specific [Note 17 (a)]	(214,484)	(150,384)	(214,484)	(150,384)
- General [Note 17 (a)]	(66,938)	(54,620)	(66,938)	(54,620)
	<u>3,112,469</u>	<u>2,564,267</u>	<u>3,112,469</u>	<u>2,564,267</u>
16(a)TOTAL LEASE RENTALS RECEIVABLE				
Cost of equipment	14,365,569	10,792,259	14,365,569	10,792,259
Unearned lease income	4,587,847	3,516,769	4,587,847	3,516,769
Total lease rentals receivable	18,953,416	14,309,028	18,953,416	14,309,028
Initial rentals received (prepaid)	(137,873)	(124,617)	(137,873)	(124,617)
Lease rentals received	(7,477,575)	(5,548,493)	(7,477,575)	(5,548,493)
Lease rentals receivable	<u>11,337,968</u>	<u>8,635,918</u>	<u>11,337,968</u>	<u>8,635,918</u>
17. LEASE RENTALS RECEIVABLE AFTER ONE YEAR				
Lease rentals receivable after one year from Balance Sheet date	6,817,535	5,001,262	6,817,535	5,001,262
Unearned lease income	(949,926)	(641,165)	(949,926)	(641,165)
Provision for lease receivables - General [Note 17 (a)]	(115,727)	(85,997)	(115,727)	(85,997)
	<u>5,751,882</u>	<u>4,274,100</u>	<u>5,751,882</u>	<u>4,274,100</u>
There were no lease rentals receivable beyond 5 years.				
17(a)MOVEMENT IN PROVISION OF LEASE RECEIVABLES				
For the year ended 31 December	2005	2005	2004	2004
Bank	Rs.000	Rs.000	Rs.000	Rs.000
	Specific	General	Specific	General
Balance brought forward	150,384	140,617	116,360	100,468
Exchange rate variance on foreign currency provision	-	(27)	-	82
	<u>150,384</u>	<u>140,590</u>	<u>116,360</u>	<u>100,550</u>
Additional provision made (Note 7)	73,110	42,826	36,770	40,067
Recoveries made during the year	(9,010)	(751)	(2,746)	-
	<u>214,484</u>	<u>182,665</u>	<u>150,384</u>	<u>140,617</u>
Group				
Balance brought forward	150,384	140,617	116,360	100,468
Exchange rate variance on foreign currency provision	-	(27)	-	82
	<u>150,384</u>	<u>140,590</u>	<u>116,360</u>	<u>100,550</u>
Additional provision made (Note 7)	73,110	42,826	36,770	40,067
Recoveries made during the year	(9,010)	(751)	(2,746)	-
	<u>214,484</u>	<u>182,665</u>	<u>150,384</u>	<u>140,617</u>

Notes to the Financial Statements

17(b) ANALYSIS OF LOANS AND ADVANCES AND LEASES BY SECTOR

Sector/Type of Loan	Overdrafts	Short Term Loans	Medium Term Loans	Long Term Loans	Pawning	Total
Bank - 2005	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000
Food, beverages and tobacco	772,303	1,210,154	1,034,262	482,100	-	3,498,819
Agriculture, agro business and fisheries	1,063,720	1,373,757	1,545,722	842,548	-	4,825,747
Textile and wearing apparel	1,363,807	1,311,776	1,569,483	1,535,139	-	5,780,205
Wood and paper products	177,822	216,582	285,091	150,130	-	829,625
Rubber and leather products	353,902	795,298	118,226	247,894	-	1,515,320
Metals, chemicals and engineering	1,894,105	1,222,324	1,685,961	3,383,443	-	8,185,833
Hotels	444,224	28,032	640,918	808,628	-	1,921,802
Services	2,022,454	1,311,845	3,094,082	3,110,230	-	9,538,611
Foreclosed properties	-	-	-	557,540	-	557,540
Others	16,529,378	10,094,855	17,999,786	20,247,262	12,521,666	77,392,947
Total	24,621,715	17,564,623	27,973,531	31,364,914	12,521,666	114,046,449
Loans and Advances (Note 15)						102,708,481
Leases (Note 16(a))						11,337,968
						114,046,449

The "others" category comprises the following advances:

Exports	207,751	235,096	87,909	335,869	-	866,625
Imports	1,115,525	2,749,100	303,541	485,202	-	4,653,368
Trading	3,299,676	127,768	578,999	698,638	-	4,705,081
Financial	1,117,581	260,263	1,536,820	1,747,281	-	4,661,945
Housing	-	66,944	723,083	8,269,358	-	9,059,385
Consumption	4,867,381	3,222,888	6,940,532	4,715,741	-	19,746,542
Miscellaneous	5,921,464	3,432,796	7,828,902	3,995,173	12,521,666	33,700,001
Total	16,529,378	10,094,855	17,999,786	20,247,262	12,521,666	77,392,947

Bank - 2004

Food, beverages and tobacco	862,376	1,351,291	1,154,885	538,326	-	3,906,878
Agriculture, agro business and fisheries	1,317,152	1,701,055	1,913,990	1,043,285	-	5,975,482
Textiles and wearing apparel	1,377,810	2,306,168	2,161,002	2,113,715	-	7,958,695
Wood and paper products	337,007	410,464	540,304	284,525	-	1,572,300
Rubber and leather products	516,206	1,160,033	172,448	361,582	-	2,210,269
Metals, chemicals and engineering	819,388	528,776	729,345	1,463,673	-	3,541,182
Hotels	714,498	45,088	1,030,865	1,300,613	-	3,091,064
Services	1,222,423	792,917	1,870,143	1,879,903	-	5,765,386
Foreclosed properties	-	-	-	727,716	-	727,716
Others	14,247,550	7,742,476	13,089,272	17,436,376	11,432,733	63,948,407
Total	21,414,410	16,038,268	22,662,254	27,149,714	11,432,733	98,697,379

Loans and Advances (Note 15)						90,061,461
Leases (Note 16(a))						8,635,918
						98,697,379

The "others" category comprises the following advances:

Exports	599,643	678,570	253,735	969,437	-	2,501,385
Imports	906,561	2,234,130	246,681	394,312	-	3,781,684
Trading	4,411,394	228,769	1,886,700	1,897,606	-	8,424,469
Financial	1,007,899	234,720	1,385,993	1,575,799	-	4,204,411
Housing	-	65,441	706,848	8,083,690	-	8,855,979
Consumption	3,737,939	1,647,797	2,548,552	2,161,716	-	10,096,004
Miscellaneous	3,584,114	2,653,049	6,060,763	2,353,816	11,432,733	26,084,475
Total	14,247,550	7,742,476	13,089,272	17,436,376	11,432,733	63,948,407

Notes to the Financial Statements

17(b) ANALYSIS OF LOANS AND ADVANCES AND LEASES BY SECTOR (Contd.)

Sector/Type of Loan	Overdrafts	Short Term Loans	Medium Term Loans	Long Term Loans	Pawning	Total
Group - 2005	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000
Food, beverages and tobacco	772,303	1,210,154	1,034,262	482,100	-	3,498,819
Agriculture, agro business and fisheries	1,063,720	1,373,757	1,545,722	842,548	-	4,825,747
Textile and wearing apparel	1,363,807	1,311,776	1,569,483	1,535,139	-	5,780,205
Wood and paper products	177,822	216,582	285,091	150,130	-	829,625
Rubber and leather products	353,902	795,298	118,226	247,894	-	1,515,320
Metals, chemicals and engineering	1,894,105	1,222,324	1,685,961	3,383,443	-	8,185,833
Hotels	444,224	28,032	640,918	808,628	-	1,921,802
Services	2,022,454	1,311,845	3,094,082	3,110,230	-	9,538,611
Foreclosed properties	-	-	-	557,540	-	557,540
Others	15,962,639	10,094,855	17,999,786	20,247,262	12,521,666	76,826,208
Total	24,054,976	17,564,623	27,973,531	31,364,914	12,521,666	113,479,710
Loans and Advances (Note 15)						102,141,742
Leases (Note 16(a))						11,337,968
						<u>113,479,710</u>

The "others" category comprises the following advances:

Exports	207,751	235,096	87,909	335,869	-	866,625
Imports	1,115,525	2,749,100	303,541	485,202	-	4,653,368
Trading	3,299,676	127,768	578,999	698,638	-	4,705,081
Financial	1,117,581	260,263	1,536,820	1,747,281	-	4,661,945
Housing	-	66,944	723,083	8,269,358	-	9,059,385
Consumption	4,867,381	3,222,888	6,940,532	4,715,741	-	19,746,542
Miscellaneous	5,354,725	3,432,796	7,828,902	3,995,173	12,521,666	33,133,262
Total	15,962,639	10,094,855	17,999,786	20,247,262	12,521,666	76,826,208

Group - 2004

Food, beverages and tobacco	862,376	1,351,291	1,154,885	538,326	-	3,906,878
Agriculture, agro business and fisheries	1,317,152	1,701,055	1,913,990	1,043,285	-	5,975,482
Textiles and wearing apparel	1,377,810	2,306,168	2,161,002	2,113,715	-	7,958,695
Wood and paper products	337,007	410,464	540,304	284,525	-	1,572,300
Rubber and leather products	516,206	1,160,033	172,448	361,582	-	2,210,269
Metals, chemicals and engineering	819,388	528,776	729,345	1,463,673	-	3,541,182
Hotels	714,498	45,088	1,030,865	1,300,613	-	3,091,064
Services	1,222,424	792,917	1,870,143	1,879,903	-	5,765,387
Foreclosed properties	-	-	-	727,716	-	727,716
Others	13,570,305	7,742,476	13,089,272	17,436,376	11,432,733	63,271,162
Total	20,737,166	16,038,268	22,662,254	27,149,714	11,432,733	98,020,135

Loans and Advances (Note 15)	89,384,217
Leases (Note 16(a))	8,635,918
	<u>98,020,135</u>

The "others" category comprises the following advances:

Exports	599,643	678,570	253,735	969,437	-	2,501,385
Imports	906,561	2,234,130	246,681	394,312	-	3,781,684
Trading	4,411,394	228,769	1,886,700	1,897,606	-	8,424,469
Financial	1,007,899	234,720	1,385,993	1,575,799	-	4,204,411
Housing	-	65,441	706,848	8,083,690	-	8,855,979
Consumption	3,737,939	1,647,797	2,548,552	2,161,716	-	10,096,004
Miscellaneous	2,906,869	2,653,049	6,060,763	2,353,816	11,432,733	25,407,230
Total	13,570,305	7,742,476	13,089,272	17,436,376	11,432,733	63,271,162

Notes to the Financial Statements

18. INVESTMENTS IN ASSOCIATE COMPANIES

As at 31st December	BANK		GROUP	
	2005	2004	2005	2004
	Rs.000	Rs.000	Rs.000	Rs.000
Balance as at 1st January	132,326	157,582	168,588	190,309
Disposal	-	(68,149)	-	(19,548)
Transfer to Dealing Securities	-	(1,216)	-	-
Provision Written Back	-	44,109	-	-
Consolidation Adjustment	-	-	2,004	(2,173)
Balance as at 31st December	132,326	132,326	170,592	168,588

As at 31st December	2005			2004			
	Principal Activity	% Holding	Balance Rs.000	Market Value Rs.000	% Holding	Balance Rs.000	Market Value Rs.000
18.1 Bank							
Quoted							
Lanka Ventures Ltd (10,036,250 shares of Rs.10/- each)	Venture Capital	20.07	132,326	122,944	20.07	132,326	97,853
			<u>132,326</u>	<u>122,944</u>		<u>132,326</u>	<u>97,853</u>
Unquoted							
Browns Engineering (Pvt) Ltd. (2,056,000 ordinary shares of Rs.10/- each)	Engineering	32.63	20,560		32.63	20,560	
Less: Provision for diminution in value			<u>(20,560)</u>			<u>(20,560)</u>	
Total for the Bank			<u>132,326</u>			<u>132,326</u>	

Browns Engineering (Pvt) Limited is under liquidation and the Bank's investment has been fully provided for.

18.2 Group

Quoted Investments

Investment in associate companies (at cost)	132,326	132,326
Negative goodwill on acquisition	5,830	5,830
Group share of associate company retained profits		
Balance as at 1st January	31,598	34,992
Current year's share of profits after tax	15,734	21,531
Dividends received during the year	(14,896)	(24,925)
Balance as at 31st December	<u>32,436</u>	<u>31,598</u>
Group share of associate company net assets	170,592	169,754
Unamortized negative goodwill carried forward [Note 18.2(a)]	-	(1,166)
Group investment in associate companies (equity basis)	<u>170,592</u>	<u>168,588</u>
18.2(a) Negative goodwill on acquisition	<u>5,830</u>	<u>5,830</u>
Amortization of negative goodwill		
Balance as at 1st January	(4,664)	(3,498)
Amortized during the year	(1,166)	(1,166)
Balance as at 31st December	<u>(5,830)</u>	<u>(4,664)</u>
Unamortized negative goodwill	<u>-</u>	<u>1,166</u>

Notes to the Financial Statements

19. INVESTMENTS IN SUBSIDIARY COMPANIES

	Bank							
As at 31 December	2005	2004						
	Rs.000	Rs.000						
19.1 Quoted								
Balance as at 1st January	<u>149,965</u>	149,965						
Balance as at 31st December	<u>149,965</u>	<u>149,965</u>						
Unquoted								
Balance as at 1st January	2,143,698	1,193,698						
Additions	-	900,000						
On merger of subsidiaries (Net)	-	50,000						
Balance as at 31st December	<u>2,143,698</u>	<u>2,143,698</u>						
Total	<u>2,293,663</u>	<u>2,293,663</u>						
As at 31st December	2005			2004				
	Principal Activity	% Holding	Balance Rs.000	Market Value Rs.000	% Holding	Balance Rs.000	Market Value Rs.000	
19.2 Quoted								
HNB Assurance Ltd. (14,996,500 shares of Rs. 10/- each)	Insurance	60	<u>149,965</u>	<u>191,205</u>	<u>60</u>	<u>149,965</u>	<u>187,456</u>	
19.3 Unquoted								
Bank								
Sithma Development (Pvt) Ltd (106,000,000 ordinary shares of Rs.10/- each/Rs.9/- each called up, 100,000,000 ordinary shares of Rs. 9/- each called up as at 31 December 2003)	Property Development	100	1,973,000	1,973,000	100	1,973,000	1,973,000	Directors' Valuation
HNB Securities (Pvt) Ltd (15,000,000 ordinary shares of Rs.10/- each)	Primary Dealer in Government Securities	100	150,000	150,000	100	150,000	150,000	Directors' Valuation
HNB Stock brokers (Pvt) Ltd (3,600,000 ordinary shares of Rs.10/- each)	Share Broking	100	20,698	20,698	100	20,698	20,698	
			<u>2,143,698</u>	<u>2,143,698</u>		<u>2,143,698</u>	<u>2,143,698</u>	
Total for Bank			<u>2,293,663</u>	<u>2,143,698</u>		<u>2,293,663</u>	<u>2,143,698</u>	

20. OTHER ASSETS

	Bank		Group	
As at 31 December	2005	2004	2005	2004
	Rs.000	Rs.000	Rs.000	Rs.000
Deposits and prepayments	2,191,046	2,115,150	2,191,046	2,126,800
Items in transit	1,583,030	2,053,362	1,583,030	2,053,362
Claims receivable	170,476	130,692	170,476	130,692
Other debtors	1,200,533	1,319,972	1,200,124	1,215,949
	<u>5,145,085</u>	<u>5,619,176</u>	<u>5,144,676</u>	<u>5,526,803</u>

Notes to the Financial Statements

21. PROPERTY PLANT AND EQUIPMENT

	Leasehold Buildings	Freehold Land and Buildings	Computer Equipment	Equipment Furniture and Fixtures	Motor Vehicles	Capital Work-in Progress	2005 Total	2004 Total
	Note 21.3 Rs.000	Note 21.2 Rs.000	Note 21.1 Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000
Bank								
Cost/Valuations as at 31.12.2004	579,314	1,624,754	1,787,119	1,651,972	86,881	60,043	5,790,083	5,509,502
Additions for the year	42,695	58,940	134,081	121,090	1,830	137,975	496,611	516,281
Disposals	(10,274)	-	(29,644)	(42,896)	(1,117)	-	(83,931)	(203,526)
Adjustments	-	-	-	-	-	-	-	427
Capitalized during the year	11,521	30,870	51,924	15,877	-	(110,192)	-	-
Write-down/Deletions	-	-	-	-	-	-	-	(32,601)
Cost/Valuation as at 31.12.2005	<u>623,256</u>	<u>1,714,564</u>	<u>1,943,480</u>	<u>1,746,043</u>	<u>87,594</u>	<u>87,826</u>	<u>6,202,763</u>	<u>5,790,083</u>
Accumulated Depreciation as at 31.12.2004	231,240	114,058	1,083,958	908,014	66,275	-	2,403,545	2,095,958
Charge for the year	64,702	21,359	226,925	172,065	9,270	-	494,321	438,658
On disposals	(9,553)	-	(21,193)	(33,609)	(1,117)	-	(65,472)	(131,071)
Accumulated Depreciation as at 31.12.2005	<u>286,389</u>	<u>135,417</u>	<u>1,289,690</u>	<u>1,046,470</u>	<u>74,428</u>	<u>-</u>	<u>2,832,394</u>	<u>2,403,545</u>
Net book Value as at 31.12.2005	<u>336,867</u>	<u>1,579,147</u>	<u>653,790</u>	<u>699,573</u>	<u>13,166</u>	<u>87,826</u>	<u>3,370,369</u>	
Net book Value as at 31.12.2004	<u>348,074</u>	<u>1,510,696</u>	<u>703,161</u>	<u>743,958</u>	<u>20,606</u>	<u>60,043</u>		<u>3,386,538</u>
Group								
Cost/Valuation as at 31.12.2004	579,314	4,213,846	1,846,139	3,775,458	98,468	60,043	10,573,268	10,107,103
Additions for the year	42,695	66,539	162,952	133,577	1,918	137,975	545,656	701,865
Disposals	(10,274)	-	(29,644)	(42,896)	(1,514)	-	(84,328)	(203,526)
Adjustments	-	-	-	-	-	-	-	427
Capitalized during the year	11,521	30,870	51,924	15,877	-	(110,192)	-	-
Write downs/Deletions	-	-	-	-	-	-	-	(32,601)
Cost/Valuation as at 31.12.2005	<u>623,256</u>	<u>4,311,255</u>	<u>2,031,371</u>	<u>3,882,016</u>	<u>98,872</u>	<u>87,826</u>	<u>11,034,596</u>	<u>10,573,268</u>
Accumulated Depreciation as at 31.12.2004	231,240	174,936	1,102,332	1,030,953	74,767	-	2,614,228	2,207,758
Charge for the year	64,702	52,940	237,365	228,852	10,200	-	594,059	537,541
On disposals	(9,553)	-	(21,193)	(33,609)	(1,490)	-	(65,845)	(131,071)
Accumulated Depreciation as at 31.12.2005	<u>286,389</u>	<u>227,876</u>	<u>1,318,504</u>	<u>1,226,196</u>	<u>83,477</u>	<u>-</u>	<u>3,142,442</u>	<u>2,614,228</u>
Net Book Value as at 31.12.2005	<u>336,867</u>	<u>4,083,379</u>	<u>712,867</u>	<u>2,655,820</u>	<u>15,395</u>	<u>87,826</u>	<u>7,892,154</u>	
Net Book Value as at 31.12.2004	<u>348,074</u>	<u>4,038,910</u>	<u>743,807</u>	<u>2,744,505</u>	<u>23,701</u>	<u>60,043</u>		<u>7,959,040</u>

There were no significant changes in the Bank's or Group's property, plant and equipment during the year. The market value of land does not differ substantially from the book value.

The Bank had a valuation carried out on all its freehold properties during the year 1993, excluding the Pettah Branch premises which was under construction, and the land in Jaffna, by a panel of Chartered Valuers/Licensed Surveyors and one half of the increase in the valuation of properties amounting to Rs.152,575,000/- was written up in the book value of the freehold properties in 1993 and the balance of Rs.152,575,000/- was written up in 1994. The Bank has obtained the necessary approval of the Monetary Board for the increase in the valuation.

A freehold property situated at No. 455/1 Buddhaloka Mawatha, Colombo 8 was disposed of in the financial year 2004 and the revaluation surplus realised on disposal amounting to Rs. 19.251 Mn. was transferred from the Capital Reserve to Retained Profit.

Notes to the Financial Statements

21. PROPERTY PLANT AND EQUIPMENT (Contd.)

21.1 COMPUTER EQUIPMENT - BANK

	Additions Prior to 1.7.2000 Rs.000	Additions After 1.7.2000 Rs.000	2005 Total Rs.000	2004 Total Rs.000
Rate of depreciation Cost/Valuations as at 01.01.2005	(25%)	(16.67%)		
	661,529	1,125,590	1,787,119	1,641,151
Additions for the year	-	186,005	186,005	97,107
Transfers	-	-	-	103,197
Disposals during the year	(15,482)	(14,162)	(29,644)	(54,336)
Cost/Valuation as at 31.12.2005	<u>646,047</u>	<u>1,297,433</u>	<u>1,943,480</u>	<u>1,787,119</u>

21.2 FREEHOLD LAND AND BUILDINGS - BANK

	Buildings Sq.ft.	Extent (perches)	Cost of Land Rs.000	Cost of Buildings Rs.000	Total Value Rs.000	Accumulated Depreciation Rs.000	Net Book Value Rs.000
Within Colombo City Limits							
Borella 53/1 D. S. Senanayake Mawatha Borella	7,530	28.00	21,702	37,232	58,934	1,011	57,923
Colombo 12 property 11, Mohandiram's Road Colombo 12	4,835	37.53	28,411	7,948	36,359	1,306	35,053
Bambalapitiya Branch 285, Galle Rd, Colombo 4	12,786	20.00	10,000	27,763	37,763	5,703	32,060
City Office 16, Janadhipathi Mawatha Colombo 1 25, Chatham Street Colombo 1	28,900	84.00	100,800	85,053	185,853	21,603	164,250
Head Office Property 479, T B Jayah Mawatha Colombo 10	Land	100.00	75,781	-	75,781	-	75,781
Centralized Operations Bldg. 90 Vidyalkara Mawatha Colombo 10	92,008	249.00	145,599	31,776	177,375	393	176,982
Main Branch 10, R A De Mel Mawatha Colombo 3	36,379	40.00	32,000	80,848	112,848	19,749	93,099
Independence Avenue 23 & 23 1/1 Independence Avenue Colombo 7	9,975	60.40	37,081	47,729	84,810	4,366	80,444
* Pettah Branch 88, Main Street, Colombo 11	3,708	7.60	9,099	14,842	23,941	3,060	20,881
Sea Street Branch 60, Sea Street Colombo 11	3,652	6.93	8,200	52,640	60,840	8,723	52,117

Notes to the Financial Statements

21. PROPERTY PLANT AND EQUIPMENT (Contd.)

21.2 FREEHOLD LAND AND BUILDINGS - BANK (Contd.)

	Buildings Sq.ft.	Extent (perches)	Cost of Land Rs.000	Cost of Buildings Rs.000	Total Value Rs.000	Accumulated Depreciation Rs.000	Net Book Value Rs.000
Janadhipathi Mawatha property 21 21A, 23 & 25 Janadhipathi Mawatha Colombo 1	39,410	26.62	34,889	-	34,889	-	34,889
Wellawatte Property 102 Galle Road Wellawatte	18,040	36.05	29,854	64,082	93,936	5,383	88,553
Grandpass Property 182 St. Joseph Street Colombo 14	9,325	24.00	9,359	22,051	31,410	1,659	29,751
Colombo Central 149-151 Main Steet Colombo 11	9,732	7.56	30,000	80,868	110,868	5,199	105,669
			<u>572,775</u>	<u>552,832</u>	<u>1,125,607</u>	<u>78,155</u>	<u>1,047,452</u>

* Condominium property

Outside Colombo City Limits

Akkaraipattu Property 1, Main Street, Akkaraipattu	7,700	19.32	3,351	20,748	24,099	233	23,866
Ambalangoda Branch 94/1, New Road Ambalangoda	4,950	29.90	3,129	8,801	11,930	1,926	10,004
Badulla Branch No:15, 151/1, Udayaraja Mawatha,Badulla	3,584	28.44	2,418	11,374	13,792	2,493	11,299
Boralesgamuwa Branch 24, Maharagama Road Boralesgamuwa	3,500	30.34	5,048	15,057	20,105	1,384	18,721
Dambulla Branch 622, Anuradhapura Road Dambulla	6,600	100.00	14,565	14,911	29,476	-	29,476
Galle Branch 3, Wakwella Road Galle	4,988	13.80	11,000	11,095	22,095	2,126	19,969
Gampola Branch 12, Kandy Road Gampola	5,604	11.88	8,319	3,221	11,540	1,042	10,498
Hatton Branch 78, Dimbulla Rd Hatton	5,500	53.50	1,075	4,736	5,811	752	5,059
		2.72	989	-	989	-	989
		13.80	8,392	-	8,392	-	8,392
"Mount Bungalow" 7, Mount Road Hatton	4,200	160.00	3,620	5,018	8,638	1,060	7,578
Jaffna Property 181/5C, Ponnambalam Road Jaffna	Under Development	80.00	1,994	30	2,024	2	2,022

Notes to the Financial Statements

21. PROPERTY PLANT AND EQUIPMENT (Contd.)

21.2 FREEHOLD LAND AND BUILDINGS - BANK (Contd.)

	Buildings Sq.ft.	Extent (perches)	Cost of Land Rs.000	Cost of Buildings Rs.000	Total Value Rs.000	Accumulated Depreciation Rs.000	Net Book Value Rs.000
Kandy Branch 1, Dalada Veediya Kandy	10,600	78.90	38,627	16,031	54,658	3,507	51,151
Kurunegala Branch 6, St. Anne's Street Kurunegala	9,600	16.25	3,250	8,177	11,427	1,669	9,758
Nawalapitiya Branch 92, Gampola Road Nawalapitiya	2,324	46.00	875	7,783	8,658	1,201	7,457
Negombo Branch 18, Rajapakse Broadway Negombo	3,504	8.88	1,776	14,930	16,706	3,353	13,353
Nittambuwa Branch 22, Kandy Road Nittambuwa	4,000	14.50	687	10,162	10,849	2,006	8,843
Nochchiyagama Branch 10, Puttalam Rd Nochchiyagama	1,800	40.00	320	10,986	11,306	1,711	9,595
Wattala Property 270, 270/1 Negombo Road Wattala	6,400	53.00	10,399	19,813	30,212	2,461	27,751
Kuliyapitiya (Additional property) 225 Madampe Road Kuliyapitiya	3,795	8.80	883	-	883	-	883
Kurunegala (New premises) 34/16 St. Anne's Street Kurunegala	Bare Land	20.00	6,759	-	6,759	-	6,759
Monaragala (New premises) Kumaradola Road Monaragala	Bare Land	20.00	1,455	-	1,455	-	1,455
Nugegoda Branch 181, High Level Road Nugegoda	11,639	19.50	7,550	27,719	35,269	6,094	29,175
Nuwara Eliya Branch/Bungalow 42, Queen Elizabeth Drive Nuwara Eliya	7,150	64.36	11,504	23,934	35,438	2,192	33,246
Trincomalee Branch 59, Ahambaram Rd Trincomalee	6,802	20.51	1,451	16,214	17,665	2,996	14,669
Anuradhapura Branch 30, Maithripala Senanayake Mawatha, Anuradhapura	2,000	25.59	5,337	12,979	18,316	2,436	15,880
Maskeliya Branch 9, New Town Maskeliya	1,900	20.32	1,948	2,571	4,519	460	4,059
Mannar Branch 68, Main Street Mannar	4,200	23.00	619	5,221	5,840	799	5,041
Ratnapura Branch 21 & 23 Senanayake Mawatha Ratnapura	3,048	21.01	12,479	10,777	23,256	1,765	21,491

Notes to the Financial Statements

21. PROPERTY PLANT AND EQUIPMENT (Contd.)

21.2 FREEHOLD LAND AND BUILDINGS - BANK (Contd.)

	Buildings Sq.ft.	Extent (perches)	Cost of Land Rs.000	Cost of Buildings Rs.000	Total Value Rs.000	Accumulated Depreciation Rs.000	Net Book Value Rs.000
Ja-Ela Branch 73, Old Negombo Road, Ja-Ela	4,300	19.00	2,729	9,623	12,352	1,674	10,678
Matale Branch 660, Trincomalee Road Matale	7,615	22.08	3,459	11,814	15,273	2,352	12,921
Kuliyapitiya Branch 225, Main Street, Kuliyapitiya	2,750	24.00	3,483	5,561	9,044	1,592	7,452
Mount Lavinia Branch 100, Galle Road Mount Lavinia	12,674	28.46	10,294	26,651	36,945	3,501	33,444
Marawila Branch 534, Chilaw Road, Marawila	4,640	23.30	3,916	} 8,372	14,715	1,827	12,888
Marawila Staff Quarters	1,733	23.30	2,427				
Matara Branch 29, Anagarika Dharmapala Mw Matara	6,988	26.00	5,136	21,361	26,497	2,648	23,849
Narammala Property Hewankumbura Narammala	Bare Land	40.00	4,159	-	4,159	-	4,159
Kegalle Property Main Street, Kegalle	Bare Land	48.70	15,600	-	15,600	-	15,600
Kahawatte Property Main Street, Kahawatte	Bare Land	-	2,265	-	2,265	-	2,265
Total freehold land and building outside Colombo city limits			<u>223,287</u>	<u>365,670</u>	<u>588,957</u>	<u>57,262</u>	<u>531,695</u>
Total freehold land and building as at 31st December 2005			<u>796,062</u>	<u>918,502</u>	<u>1,714,564</u>	<u>135,417</u>	<u>1,579,147</u>

21.3 LEASEHOLD BUILDINGS

As at 31 December	Bank 2005		Group 2005		Bank 2004		Group 2004	
	Cost of Buildings Rs.000	Accumulated Depreciation Rs.000	Cost of Buildings Rs.000	Accumulated Depreciation Rs.000	Net Book Value Rs.000	Net Book Value Rs.000	Net Book Value Rs.000	Net Book Value Rs.000
Lease Period								
Up to 1 year	-	-	-	-	-	10,586	-	10,586
1 - 05 years	120,259	96,166	120,259	96,166	24,093	45,330	24,093	45,330
6 - 10 years	121,690	78,927	121,690	78,927	42,763	18,785	42,763	18,785
11 - 15 years	48,753	24,444	48,753	24,444	24,309	4,795	24,309	4,795
16 - 20 Years	332,554	86,852	332,554	86,852	245,702	268,578	245,702	268,578
	<u>623,256</u>	<u>286,389</u>	<u>623,256</u>	<u>286,389</u>	<u>336,867</u>	348,074	<u>336,867</u>	<u>348,074</u>

21.4 FREEHOLD LAND AND BUILDINGS - SUBSIDIARIES

As at 31 December	Buildings		Cost of		Total Accumulated		2005		2004	
	Sq.ft.	Buildings Rs.000	Buildings Rs.000	Buildings Rs.000	Value Rs.000	Depreciation Rs.000	Net Book Value Rs.000	Net Book Value Rs.000	Net Book Value Rs.000	Net Book Value Rs.000
Smart Building 21, 21A, 23, 25, Janadhipathi Mawatha Colombo 1	42,765	128,115	128,115	128,115	128,115	19,072	109,043	112,246		
Sithma Building 479 T B Jayah Mawatha Colombo 10	499,554	2,468,576	2,468,576	2,468,576	2,468,576	73,387	2,395,189	2,415,968		
		<u>542,319</u>	<u>2,596,691</u>	<u>2,596,691</u>	<u>2,596,691</u>	<u>92,459</u>	<u>2,504,232</u>	<u>2,528,214</u>		

Notes to the Financial Statements

21. PROPERTY PLANT AND EQUIPMENT (Contd.)

21.5 IDLE PROPERTY, PLANT AND EQUIPMENT

	Buildings Sq.ft.	Extent (perches)	Cost of Land Rs.000	Cost of Buildings Rs.000	Total Value Rs.000	Accumulated Depreciation Rs.000	Net Book Value Rs.000
Building at No. 88, Main Street (Pettah Branch) Kurunegala (New premises) 34/16 St. Anne's Street	3,708	7.60	9,099	14,842	23,941	3,060	20,881
Kurunegala Kegalle Property	-	20.00	6,759	-	6,759	-	6,759
Main Street, Kegalle Kahawatte Property	-	48.70	15,600	-	15,600	-	15,600
Main Street, Kahawatte Monaragala	-	-	2,265	-	2,265	-	2,265
Land at No. 67/11, Kumamadola Road, Monaragala Narammala	-	40	4,159	-	4,159	-	4,159
Land at No. 118A, Negombo Road Narammala	-	20	1,455	-	1,455	-	1,455
			<u>39,337</u>	<u>14,842</u>	<u>54,179</u>	<u>3,060</u>	<u>51,119</u>

21.6 FULLY DEPRECIATED PROPERTY

The gross value of fully depreciated plant, machinery and equipment as at 31 December 2005 was Rs. 399,116,705.

As at 31st December

2005

2004

Goodwill Rs.000	Negative Goodwill Rs.000	Goodwill Rs.000	Negative Goodwill Rs.000
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22. GOODWILL ON CONSOLIDATION

Group

Balance brought forward	2,600	1,787	5,200	3,574
Arising during the year	-	-	-	-
Less: Amortization during the year	2,600	1,787	2,600	1,787
Balance c/f	-	-	2,600	1,787
Goodwill arising on acquisition	13,000	8,935	13,000	8,935
Less: Amortization as at 31st December	13,000	8,935	10,400	7,148
	-	-	2,600	1,787
C/F in Balance Sheet	-	-	813	-
Goodwill on Consolidation charged to Income Statement				
Acquisition of Subsidiaries	2,600	1,787	2,600	1,787
Investment in Associate companies	-	1,166	-	1,166
	2,600	2,953	2,600	2,953
Net charge to Income Statement		(353)		(353)

Notes to the Financial Statements

As at 31st December	Bank		Group	
	2005 Rs.000	2004 Rs.000	2005 Rs.000	2004 Rs.000
23. DEPOSITS FROM CUSTOMERS				
Local Currency Deposits				
Current account deposits	12,511,256	8,852,609	12,369,491	8,809,217
Savings deposits	47,380,753	42,108,475	47,373,887	42,080,321
Time deposits	33,587,699	31,920,537	33,583,449	31,810,087
Certificates of deposit	3,634,393	4,448,095	3,634,393	4,448,095
Foreign Currency Deposits				
Current account deposits	1,013,589	2,331,555	1,013,589	2,331,555
Savings deposits	14,166,198	15,009,655	14,166,199	15,009,655
Time deposits	15,989,793	13,853,008	15,989,793	13,853,008
	128,283,681	118,523,934	128,130,801	118,341,938
23(a) ANALYSIS OF DEPOSITS				
Deposits From Non-Bank Customers	127,577,487	118,072,406	127,428,685	117,890,410
Deposits From Banks	462,778	90,078	462,778	90,078
Deposits From Finance Companies	243,416	361,450	239,338	361,450
	128,283,681	118,523,934	128,130,801	118,341,938
24. DIVIDENDS PAYABLE				
Balance as at 1st January	108,299	40,757	108,299	40,757
Dividends declared during the year	385,679	343,200	385,679	343,200
Dividends settled	(443,687)	(275,658)	(443,687)	(275,658)
Balance as at 31st December	50,291	108,299	50,291	108,299
<p>The 20% interim dividend paid on 9th December 2005 included a re-distribution of tax exempt dividends of Rs. 23,120,368/- (2004 - Rs.37,618,955/-) received by the Bank. 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.</p> <p>Directors have recommended the payment of a final dividend of 20% for the year ended 31st December, 2005 (2004 - 15%), which will be approved at the Annual General Meeting to be held on 29th March , 2006. 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, 2005.</p>				
25. BORROWINGS				
Call and time deposits from banks	510,517	1,104,650	510,517	1,104,650
Refinance borrowings	2,711,810	2,066,198	2,711,810	2,066,198
Foreign bank borrowings	717,784	1,043,043	717,784	1,043,043
	3,940,111	4,213,891	3,940,111	4,213,891

Notes to the Financial Statements

	Bank		Group	
	2005 Rs.000	2004 Rs.000	2005 Rs.000	2004 Rs.000
As at 31 December				
26. OTHER LIABILITIES				
Cheques sent on clearing	2,395,504	1,836,378	2,395,504	1,836,378
Accrued expenditure and interest	3,389,960	3,396,237	3,389,960	3,404,282
Claims payable	183,323	642,288	183,323	642,288
Margins	1,004,758	854,777	1,004,758	907,102
Pension fund	745,715	289,546	745,715	289,546
Widows'/widowers' & orphans' pension fund	225,119	188,588	225,119	188,588
Employees provident fund	1,004,823	2,227,254	1,004,023	2,227,254
Gold Investment Account	2,103	3,235	2,103	3,235
Other creditors	887,625	976,454	1,331,770	1,254,201
	9,838,930	10,414,757	10,282,275	10,752,874

27. LONG TERM INSURANCE FUND

Long Term Insurance Fund balance represents the Life Fund of the subsidiary, HNB Assurance Ltd., 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 2005 was made by Mr M Poopalanathan, AIA, of M/s Actuarial and Management Consultants (Pvt) Ltd. for and on behalf of HNB Assurance Ltd. The life fund stands at Rs. 300.818 Mn. as at 31st December 2005 (2004 - Rs 169.493 Mn) and in the opinion of the Actuary this amount is adequate to cover the liabilities pertaining to long term insurance business of HNB Assurance Ltd., as per the Actuary's Report dated 2nd February 2006.

28. NON LIFE INSURANCE RESERVES

Non Life Insurance Reserves represents the following which are included in the financial statements of HNB Assurance Ltd., subsidiary of the Bank, as required by the statement of recommended practice of Institute of Chartered Accountants of Sri Lanka (ICASL) and in accordance with the regulation of Insurance Industry Act No. 43 of 2000.

	Group			
	2005 Rs.000	2005 Rs.000	2004 Rs.000	2004 Rs.000
As at 31 December				
Unearned premium - Gross		237,059		164,792
- Reinsurance		(57,152)		(42,734)
- Net		179,907		122,058
Deferred acquisition expenses		(7,283)		(4,027)
Unexpired Risk Reserve		1,365		-
		173,989		118,031
Claims outstanding - Gross	78,061		80,128	
Claims incurred but not reported - Gross	14,970		12,452	
Claims reserve - Gross		93,031		92,580
Total		267,020		210,611

	Bank		Group	
	2005 Rs.000	2004 Rs.000	2005 Rs.000	2004 Rs.000
As at 31 December				
29. DEFERRED TAXATION				
Balance brought forward	350,356	387,091	352,529	389,375
Add/(Less): Charge/(Reversal)during the year	(36,600)	(36,735)	(36,212)	(36,846)
	313,756	350,356	316,317	352,529

Provision has not been made for deferred taxation on assets leased to customers as explained in the significant accounting policy 8.4.2.

30. SUBORDINATED DEBENTURES

	Bank		Group	
	2005 Rs.000	2004 Rs.000	2005 Rs.000	2004 Rs.000
Balance as at 1st January	4,000,000	4,000,000	5,983,450	3,983,450
Debentures issued	-	-	-	2,000,000
Debentures held by Group Companies	-	-	6,659	-
Balance as at 31st December (a)	4,000,000	4,000,000	5,976,791	5,983,450

Notes to the Financial Statements

30. SUBORDINATED DEBENTURES (Contd.)

- (a) i. 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:

	<u>5 year</u>	<u>7 year</u>	<u>10 year</u>
Fixed	13.75%	14.00%	14.20%
Effective annual yield	14.22%	14.49%	14.70%
Floating	TB + 1%	TB + 1.1%	TB + 1.25%

The floating rate is based on the 6 month treasury bill rate with a cap of 17% and a floor of 12%. Based on the duration, the debentures are redeemable on September 11th, 2007 September 11th, 2009 or September 11th, 2012. These debentures are listed on the Colombo Stock Exchange.

- ii. Consists of twenty million unsecured, subordinated, redeemable debentures of Rs. 100/- each. The two types of debentures have fixed or floating interest rate options as follows:

	<u>5 Year</u>
Fixed	10.00%
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.

As at 31 December	2005	2004
	Rs.000	Rs.000

31. SHARE CAPITAL - GROUP AND BANK

AUTHORISED

1Billion ordinary shares of Rs.10/- each	<u>10,000,000</u>	<u>10,000,000</u>
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ISSUED AND FULLY PAID - VOTING ORDINARY SHARES

As at 1st January

77Mn. (2004 - 55Mn.) voting ordinary shares of Rs.10/- each	770,000	550,000
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Rights issue of 2:5

22Mn. voting ordinary shares of Rs.10/- each	-	220,000
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New share issue

17,664,700 voting ordinary shares of Rs. 10/- each	<u>176,647</u>	-
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As at 31st December

94,664,700 (2004 - 77Mn.) voting ordinary shares of RS.10/- each	<u>946,647</u>	<u>770,000</u>
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ISSUED AND FULLY PAID - NON-VOTING ORDINARY SHARES

As at 1st January

23.1Mn. (2004 - 16.5Mn.) non-voting ordinary shares of Rs.10/- each	231,000	165,000
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Rights issue of 2:5

6.6Mn. non-voting ordinary shares of Rs.10/- each	-	66,000
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As at 31st December

23.1Mn. non-voting ordinary shares of Rs.10/- each	<u>231,000</u>	<u>231,000</u>
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17,664,700 Voting shares were issued on 17 June 2005 as underlying shares for the 1,766,470 Global Depository Receipts (GDR) listed at Luxembourg Stock Exchange. This represents 15% of the issued capital of the Bank.

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 a dividend for three consecutive years, these shares automatically convert into voting ordinary shares.

Notes to the Financial Statements

32. COMMITMENTS AND CONTINGENCIES - GROUP AND BANK

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.

As at 31 December	2005	2004
	Rs.000	Rs.000
a) Contingent Liabilities		
Acceptances	3,983,731	3,038,626
Documentary credits	6,306,610	6,682,773
Guarantees	14,710,250	13,845,805
Bills for collection	6,147,266	5,118,633
Interest rate Swap	1,761	24,500
	31,149,618	28,710,337
Forward Exchange Contracts	13,613,590	16,536,006
Total Commitments and Contingencies Group and Bank	44,763,208	45,246,343

b) Irrevocable Commitments - Bank

Commitments that cannot be revoked at the discretion of the Bank without the risk of incurring significant penalty or expense amounted to Rs. 21.016 Mn. (2004 - Rs. 20.529 Mn).

c) Future commitments on operating leases - Bank

1 - 5 years	3,294	3,458
6 - 10 years	3,510	3,667
11 - 15 years	705	572
16 - 20 years	200	132
	7,709	7,829

d) Taxes 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 & VATFS/U6/0405/05 against which the Bank has duly appealed. The Bank is of the view that these assessments will not have any material impact on the financial statements.

e) Litigation against the Bank

1. Six claims for damages made by customers in Cases Nos. 24440/MR, 9030/M, 9272/M, 1773/M, 23897/MR and 7638 in the DCs/HC (Civil) and two claims in Cases Nos. 17343/MR and 23434/MR in Court of Appeal in respect of cheques dishonoured/debits to Accounts
2. DC Case No. 5383/Land - guarantor challenging signature on a Mortgage Bond over immovable property
3. HC(Civil) Case No. 132/2001 (i) a depositor's action against Habib Bank AG Zurich Sri Lanka Branch (HBZ) challenging the Bank setting-off a customer liability with the deposit and claiming damages – the Bank substituted with acquisition of HBZ business
4. Labour Tribunal Cases Nos. 08/2674/96, 13/42/98, 03/148/99, 13/609/99, 18022, 08/2114/2002, 08/2115/2002, 08/2176/2002, 23/7957/2002, 26/02/2004, 26/122/2004, 26/06/2005, 9/11/2005, 13/42/2005, 21/Add/489/05, 21/9313/99, 42/237/2005, 3/149/2005 and LT Appeal Cases Nos. HCA/66/2004, HCA 74/2005

Based on the available information and current status of the above cases, the Bank is not in a position to quantify the financial impact if any, as at the Balance Sheet date. Further, the Bank confirms that there is no case which is not disclosed above would have a material impact on the financial position of the Bank.

Notes to the Financial Statements

33. CAPITAL COMMITMENTS

Capital expenditure approved by the Board of Directors for which provision has not been made in the accounts amount to approximately, Rs. 19.9 Mn.

As at 31st December	2005 Rs.000	2004 Rs.000
Approved and contracted for	19,957	93,910
Approved but not contracted for	<u>-</u>	<u>26,384</u>
	<u>19,957</u>	<u>120,294</u>

34. DIRECTORS' INTEREST IN CONTRACTS WITH THE BANK

(a) Trading transactions

The Bank carries out transactions in the ordinary course of business on an arm's length basis with companies in which there is an interest by Directors of the Bank, the details of which, are reported below:

Name of Related Party	Name of Director (Relationship)	2005 Amount Rs.Mn.	2004 Amount Rs. Mn.	Nature of Transactions
Brown & Co. Ltd.	Mr M V Theagarajah (Chairman)	13.795	10.592	Payment for purchase of fixed assets, office equipment, repairs to assets & service agreements.
		26.250	21.000	Payment for purchase of generators and generator service agreements.
		-	9.648	Purchase of advertising material.
		-	0.156	Payment for rental of office space at No. 481, T B Jayah Mw., Colombo 10. Vacated on 01.12.04.
		0.042	0.063	Payment for lease of residential premises at Hatton. Three premises were rented in 2004. Two were vacated in June 2005.
Browns Tours Ltd.	Mr M V Theagarajah (Chairman)	-	1.960	Rent received for premises rented at No. 479, T B Jayah Mw. Premises vacated on 31.12.04.
BG Air Services (Pvt) Ltd.	Mr M V Theagarajah (Chairman)	-	1.200	Rent received for premises rented at No. 479, T B Jayah Mw. Premises vacated on 31.10.04.

Notes to the Financial Statements

34. DIRECTORS' INTEREST IN CONTRACTS WITH THE BANK (Contd...)

Name of Related Party	Name of Director (Relationship)	2005	2004	Nature of Transactions
		Amount Rs.Mn.	Amount Rs. Mn.	
Madulsima Plantations Ltd.	Dr V P Vittachchi (Chairman) Mr D H S Jayawardena (Managing Director) Mr R K Obeyesekere (Director)	0.720	0.720	Payment for lease of holiday bungalow at Bogawantalawa.
Lanka Bell (Pvt) Ltd. (from June 2005)	Mr D H S Jayawardena (Chairman)	1.360 1.811 1.163	- - -	Payment for voice communication charges. Payment for data communication charges. Telephone charges paid.
Sri Lanka Insurance Corporation Ltd.	Mr D H S Jayawardena (Chairman) Mr R K Obeyesekere (Deputy Chairman)	49.052	50.650	Insurance premiums paid, inclusive of taxes.
Stassen Exports Ltd.	Dr V P Vittachi (Chairman) Mr D H S Jayawardena (Managing Director) Mr R K Obeyesekere (Director)	0.906	1.966	Payment for purchase of promotional material.

The details of the lending transactions with companies in which there is an interest by Directors of the Bank, are disclosed in note No. 35, "Related Party Transactions".

(b) Accommodation Granted to Directors for Credit Cards

	Limit Rs. Mn.	Outstanding as at 31.12.05 Rs. Mn.
Mr R T Wijetilleke (Chairman)	1.00	0.54 (a)
Dr V P Vittachi (Deputy Chairman)	0.50	0.02
Mr D H S Jayawardena	12.50	2.01 (b)
Mr M V Theagarajah	0.50	0.02
Mr R K Obeyesekere	0.50	0.01
Mrs P Cooray	0.50	Nil
Mr R Sivaratnam	1.24	0.07 (b)
Mr R Theagarajah	0.40	Nil

(a) Rs. 0.5 Mn clean and the balance is secured by immovable property.

(b) Rs. 0.5 Mn clean and the balance is secured by cash deposits.

(c) Facilities Granted to Directors

Name of Director	Aggregate Amount of Accommodation		Security
	Limit Rs.Mn.	Outstanding as at 31.12.05 Rs.Mn.	
Mr R T Wijetilleke	13.58	12.68	- Immovable property/cash deposits
Mr M V Theagarajah	4.60	1.66	- Cash deposits
Mr R Sivaratnam	1.50	-	- Quoted company shares/cash deposits
Mr R Theagarajah	5.00*	4.45	- Provident Fund balance

*(Original amount of loan)

Notes to the Financial Statements

35. RELATED PARTY TRANSACTIONS

The Bank carries out transactions in the ordinary course of its business on an arm's length basis with its subsidiaries, shareholders and companies in which such persons have substantial shareholdings and or significant influence by representation on the Board of Directors of such companies. The pricing applicable to such transactions is based on the assessment of risk and the pricing model of the bank and is comparable with what is applied to transactions between the bank and its unrelated customers.

These companies, names of directors, their relationship and the nature of transaction entered into are listed below:

(a) Transactions with Subsidiaries

35.a (i) Sithma Development (Pvt) Ltd.

Sithma Development (Pvt) Ltd. is a wholly owned subsidiary of Hatton National Bank Ltd. (HNB).

Sithma Development (Pvt) Ltd. operates an overdraft facility with HNB and the outstanding balance at the end of 2005 is Rs. 565 Mn. (2004 - Rs. 618 Mn.). The Company also maintains a debenture to the value of Rs. 2 Bn. which was placed in 2004 with Sri Lanka Insurance Corporation.

The details of the overdraft facility with HNB are as follows:

Type of Facility	Rate of Interest	Limit Rs.Mn.	Outstanding as at 31/12/05 Rs.000	Security	Review
Overdraft	2% above the one year TB. To be reviewed every 6 months.	800	565,796	Registered primary floating mortgage for Rs. 1,800 Mn. over land & building at No. 479, TB Jayah Mw., Colombo 10.	October 2006

A summary of transactions with HNB and other group companies are given below.

	HNB SECURITIES Rs. 000	HNB STOCK BROKERS Rs. 000	HNB ASSURANCE Rs. 000	HNB Rs. 000
Rent income received	5,685	7,131	-	398,176
Rent income receivable	-	2,129	-	-
Rent advance received (as at 31.12.2005)	569	375	-	22,066
Refundable deposit received	3,000	3,000	-	500,000
Insurance premium paid	-	-	185	-
Interest received	52	-	-	-
Interest paid	-	-	-	54,738
Overdraft balance	-	-	-	565,796
Ground rent paid	-	-	-	3,753

35.a (ii) HNB Securities Limited

HNB Securities Ltd., is a fully owned subsidiary of Hatton National Bank Ltd.

The company maintains a current account with the bank and the balance as at December 2005 amounts to Rs. 23.2 Mn. (2004- Rs.10.10 Mn.). The Bank had invested in debentures issued by the Company to the value of Rs. 50 Mn. as at December 2004 which was redeemed in 2005 and the company paid Rs. 3.1 Mn. as interest (2004 - Rs. 6.5 Mn.) to the Bank

A summary of HNB Securities transactions with HNB and other group of companies are given below:

	SITHMA Rs. 000	HNB STOCK BROKERS Rs. 000	HNB ASSURANCE Rs. 000	HNB Rs. 000
Rent paid	5,685	-	-	-
Rent advance paid (as at 31.12.2005)	569	-	-	-
Refundable deposit paid	3,000	-	-	-
Insurance premium paid	-	-	97	-
Interest received	-	-	-	54,900
Interest paid	52	-	8,413	3,152
Overdraft balance	-	-	-	237
Current account balances	-	-	-	23,200
Re-purchase balances	-	-	101,554	600,000

35. RELATED PARTY TRANSACTIONS (Contd.)

35.a (iii) HNB Assurance Limited

HNB Assurance Ltd., is a subsidiary of Hatton National Bank Ltd.

The Company held deposits with the Bank amounting to Rs. 43.7 Mn. (2004 - Rs. 145.4 Mn.) as at 31.12.2005. The Bank has paid Rs. 10.4 Mn. (2004 - Rs.6.5 Mn.) as interest to the Company for the deposits held by the Company.

A summary of HNB Assurance transactions with HNB and other group of companies are given below:

	SITHMA Rs. 000	HNB STOCK BROKERS Rs. 000	HNB SECURITIES Rs. 000	HNB Rs. 000
Rent paid	-	-	-	13,297
Premium received	185	326	97	14,101
Commission paid	-	-	-	30,192
Interest received	-	-	8,413	10,469
Current account balances	-	-	-	43,707
Re-purchase balances	-	-	101,554	-

35.a (iv) HNB Stockbrokers Limited

HNB Stockbrokers Limited is a wholly owned subsidiary of Hatton National Bank Ltd.

The Company held deposits with the Bank and the balance as at 31.12.2005 amounts to Rs. 78.9 Mn. (2004 - Rs 9.5Mn.)

A summary of HNB Stockbrokers transactions with HNB and other group of companies are given below:

	SITHMA Rs. 000	HNB ASSURANCE Rs. 000	HNB SECURITIES Rs. 000	HNB Rs. 000
Rent paid	7,131	-	-	-
Rent payable	2,129	-	-	-
Rent advance paid (as at 31.12.2005)	375	-	-	-
Refundable deposit paid	3,000	-	-	-
Commission paid	-	-	-	27,652
Interest paid	-	-	-	1,958
Premium paid	-	326	-	-
Current account balances	-	-	-	78,907

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 with effect from 15 December 2004, is also a Director of the four companies mentioned above.

Mr Yeo Took Keat alternate to Mr D R Ghazalli, Director of the Bank is also a Director of HNB Assurance Ltd.

Notes to the Financial Statements

35. RELATED PARTY TRANSACTIONS (Contd.)

35(b) Transactions with other related parties

Name of Related Party	Name of Director (Relationship)	Nature of Transaction	Aggregate Amount of Accommodation			Security
			Limit (Rs.Mn.)	Outstanding as at 31.12.05 Direct Indirect		
Stassen Exports Ltd	Dr V P Vittachi (Chairman/Shareholder) Mr D H S Jayawardena (Managing Director/ Shareholder)	Overdraft	313.50	560.56	-	Cash Deposits Quoted Company Shares Inventories
		Standby Overdraft	200.00		-	
		Temp Overdraft	300.00		-	
	Mr R K Obeysekere (Director/Shareholder)	Letters of Guarantee	50.00	-	59.92	
		Letters of Credit	2.00	-	1.07	
			<u>865.50</u>	<u>560.56</u>	<u>60.99</u>	
Stassen International Ltd	Dr V P Vittachi (Chairman) Mr D H S Jayawardena (Managing Director) Mr R K Obeysekere (Director)	Letter of credit	70.00	-	112.67	Cash Deposits Quoted Company Shares Inventories
		Overdraft	20.00	0.29	-	
		Letters of Guarantee	50.00	-	102.24	
		<u>140.00</u>	<u>0.29</u>	<u>214.91</u>		
Stassen Natural Food (Pvt) Ltd	Dr V P Vittachi (Chairman) Mr D H S Jayawardena (Managing Director) Mr R K Obeysekere (Director)	Temp. Letters of Guarantee	-	-	15.00	Quoted Company Shares
		Temp. Letters of Credit	-	-	2.64	
			<u>-</u>	<u>-</u>	<u>17.64</u>	
Madulsima Plantations Ltd	Dr V P Vittachi (Chairman) Mr D H S Jayawardena (Managing Director) Mr R K Obeysekere (Director)	Overdrafts	157.00	127.72	-	Cash Deposits Quoted Company Shares Mortgage over leasehold property.
		Letters of Guarantee	1.00	-	-	
			<u>158.00</u>	<u>127.72</u>	<u>-</u>	
Distilleries Co. of Sri Lanka Ltd	Dr V P Vittachi (Chairman) Mr D H S Jayawardena (Managing Director) Mr R K Obeysekere (Director)	Letters of Credit	2.81	-	2.81	Cash Deposits
		Temp. Letters of Credit	-	-	101.25	
		Letters of Guarantee	2.87	-	2.87	
			<u>5.68</u>	<u>-</u>	<u>106.93</u>	

Notes to the Financial Statements

35. RELATED PARTY TRANSACTIONS (Contd.)

Name of Related Party	Name of Director (Relationship)	Nature of Transaction	Aggregate Amount of Accommodation			Security
			Limit (Rs.Mn.)	Outstanding as at 31.12.05 Direct	(Rs.Mn.) Indirect	
Lanka Dairies (Pvt) Ltd	Dr V P Vittachi (Chairman) Mr D H S Jayawardena (Managing Director) Mr R K Obeyesekere (Director)	Overdraft	30.00	4.54	-	Quoted Company Shares
		Letters of Credit	10.00	-	-	
			40.00	4.54	-	
Lanka Milk Foods (CWE)Ltd	Dr V P Vittachi (Chairman) Mr D H S Jayawardena (Managing Director) Mr R K Obeyesekere (Director)	Letters of Credit	270.00	-	178.29	Quoted Company Shares Immovable Property (Leasehold)/Plant & Machinery
		Letters of Guarantee	14.08	-	3.61	
		Overdraft	150.00	74.17	-	
		434.08	74.17	181.90		
Milford Exports (Cey.) Ltd	Dr V P Vittachi (Chairman) Mr D H S Jayawardena (Managing Director) Mr R K Obeyesekere (Director)	Temp. Letters of Credit	-	-	0.50	Quoted Company Shares Inventories
		Overdraft	0.50	-	-	
		Letters of Guarantee	24.00	-	31.54	
		24.50	-	32.04		
Danish Dairy Products Lanka (Pvt) Ltd.	Dr. V P Vittachi (Chairman) Mr D H S Jayawardena (Managing Director) Mr R K Obeyesekere (Director)	Overdraft	10.00	0.39	-	Quoted Company Shares
			10.00	0.39	-	
Balangoda Plantations Ltd.	Dr V P Vittachi (Chairman) Mr D H S Jayawardena (Managing Director) Mr R K Obeyesekere (Director)	Letters of Guarantee	1.41	-	1.41	Immovable Property (Leasehold) Cash Deposits
		Temp. Overdraft	-	0.13	-	
		Development Loan	20.00	17.07	-	
		21.41	17.20	1.41		
Ambewela Livestock Co. Ltd	Dr. V P Vittachi (Chairman) Mr D H S Jayawardena (Managing Director) Mr R K Obeyesekere (Director)	Overdraft	50.00	26.15	-	Quoted Company Shares
		Letters of Credit	10.00	-	2.09	
		60.00	26.15	2.09		

Notes to the Financial Statements

35. RELATED PARTY TRANSACTIONS (Contd.)

Name of Related Party	Name of Director (Relationship)	Nature of Transaction	Aggregate Amount of Accommodation			Security
			Limit (Rs.Mn.)	Outstanding as at 31.12.05 (Rs.Mn.)		
				Direct	Indirect	
Pattipola Livestock Co. Ltd	Dr. V P Vittachi (Chairman) Mr D H S Jayawardena (Managing Director) Mr R K Obeyesekere (Director)	Overdraft	50.00	4.77	-	Quoted Company Shares
		Letters of Credit	10.00	-	1.55	
			<u>60.00</u>	<u>4.77</u>	<u>1.55</u>	
Periceyl (Pvt) Ltd	Mr D H S Jayawardena (Chairman) Mr R K Obeyesekere (Director)	Temporary Overdraft	-	0.03	-	Cash Deposits
			<u>-</u>	<u>0.03</u>	<u>-</u>	
Trade & Investment Lanka (Pvt) Limited	Mr D H S Jayawardena (Director) Mr R K Obeyesekere (Director)	Temp. Letters of Guarantee	-	-	5.00	Quoted Company Shares
			<u>-</u>	<u>-</u>	<u>5.00</u>	
Browns Beach Hotels Ltd.	Dr V P Vittachi (Director) Mr D H S Jayawardena (Director) Mr R K Obeyesekere (Director)	Temp. Letters of Credit	-	-	1.06	Inventories Cash Deposits
		Temp. Overdraft	-	5.76	-	
		Import bills	-	-	0.60	
		<u>-</u>	<u>5.76</u>	<u>1.66</u>		
CBD Exports Ltd.	Dr V P Vittachi (Director) Mr R K Obeyesekere (Director)	Temp. Letters of Guarantee	-	-	10.00	Quoted Company Shares
			<u>-</u>	<u>-</u>	<u>10.00</u>	
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 - Accommodation granted to Falcon Commodities (Pvt) Ltd. continues to be classified as non-performing. The outstanding of Rs. 326.0 Mn. as at 31.12.05 is fully covered by cash and capital provisioning of Rs. 276.0Mn. made during the previous years. Increase in exposure is due to a facility at Habib Bank AG Zurich Ltd taken over with a full provision.
		Overdraft (Habib Bank AG Zurich Ltd.)		13.20	-	
			<u>Nil</u>	<u>98.05</u>	<u>228.36</u>	
Texpro Industries Ltd.	Mr D H S Jayawardena (Chairman)	Letters of Credit	1.60	-	1.05	Immovable Property/ Machinery Cash Deposits Inventories
		Export Loans	(1.60)	0.52	-	
		Term Loan	0.75	0.75	-	
		Term Loan	0.61	0.61	-	
		Term Loan	0.02	0.02	-	
		Term Loan	0.04	0.04	-	
		Overdraft	0.05	-	-	
	<u>3.07</u>	<u>1.94</u>	<u>1.05</u>			

Notes to the Financial Statements

35. RELATED PARTY TRANSACTIONS (Contd.)

Name of Related Party	Name of Director (Relationship)	Nature of Transaction	Aggregate Amount of Accommodation			Security
			Limit (Rs.Mn.)	Outstanding as at 31.12.05 (Rs.Mn.)		
				Direct	Indirect	
Kandalama Hotels Ltd.	(Subsidiary of Aitken Spence Hotels Ltd.)	Letter of Guarantee	0.36	-	0.36	Title to goods imported
		Letter of Credit	16.00	-	15.55	
			<u>16.36</u>	<u>-</u>	<u>15.91</u>	
Elpitiya Plantations Ltd	(Subsidiary of Aitken Spence Plantation Management Ltd.)	Overdraft	25.00	60.83	-	Inventories Immovable Property Absolute ownership of the equipment/vehicles leased.
		Temp. Overdraft	35.00		-	
		Overdraft/Commercial Paper/Money Market Loan	100.00	100.00	-	
		Standby Overdraft	(100.00)		-	
		Term Loan	11.48	11.48	-	
		Term Loan	11.56	11.56	-	
		Revolving Loan	0.75	0.75	-	
		Packing Credit	1.00	-	-	
		Leases	6.88	6.88	-	
		<u>191.67</u>	<u>191.50</u>	<u>-</u>		
Aitken Spence Hotels Ltd.	(Subsidiary of Aitken Spence & Co. Ltd.)	Temp. Letters of Credit	-	-	0.01	Title to goods imported
			<u>-</u>	<u>-</u>	<u>0.01</u>	
Aitken Spence Travels Ltd.	(Subsidiary of Aitken Spence & Co. Ltd.)	Foreign Drafts & Travellers Cheque Purchase	2.00	-	-	Cash Deposits
			<u>2.00</u>	<u>-</u>	<u>-</u>	
Aitken Spence Hotel Holdings Ltd.	Mr D H S Jayawardena (Director)	Letters of Credit	140.00	-	139.52	Title to goods imported
			<u>140.00</u>	<u>-</u>	<u>139.52</u>	
Aitken Spence (Garments) Ltd	(Subsidiary of Aitken Spence & Co. Ltd.)	Letters of Credit	1.50	-	0.19	Immovable Property Quoted Company Shares
		Export Loan	(1.50)	0.42	-	
		Overdrafts	0.25	0.03	-	
		Overdraft (Rs.Mn.)	(25.00)	(Rs.Mn.) 1.73	-	
		Letter of Guarantee	(Rs.Mn.) 0.01	-	(Rs. Mn.) 0.01	
			(US\$ Mn)	<u>1.75</u>	<u>0.45</u>	
	(Rs. Mn)	<u>0.01</u>	<u>1.73</u>	<u>0.01</u>		
Cowrie Investments (Pvt) Ltd	(Subsidiary of Aitken Spence Hotel Holdings Ltd.)	Term Loans	5.93	3.80	-	Immovable Property (leasehold)
		Temp. Overdraft	1.00	1.01	-	
			(US\$ Mn)	<u>6.93</u>	<u>4.81</u>	

Notes to the Financial Statements

35. RELATED PARTY TRANSACTIONS (Contd.)

Name of Related Party	Name of Director (Relationship)	Nature of Transaction	Aggregate Amount of Accommodation			Security
			Limit (US\$.Mn.)	Outstanding as at 31.12.05 Direct Indirect		
Ace Power Generation Horana (Pvt) Ltd	Mr D H S Jayawardena (Director)	Standby Letters of Credit	0.39	-	0.39	} Immovable Property Machinery Bank Guarantee Inventories
		Term Loan	0.62	0.62	-	
		Term Loan	1.68	1.68	-	
		Overdraft	1.20	0.29	-	
		Standby Letters of Credit (Rs.Mn.)	100.00	-	(Rs.Mn.) 100.00	
		Overdraft (Rs.Mn.)	(120.00)	(Rs.Mn.) 80.19	-	
			(US\$.Mn)	3.89	2.59	
	(Rs.Mn)	100.00	80.19	100.00		
Ace Power Generation Matara (Pvt) Ltd	Mr D H S Jayawardena (Director)	Term Loan	0.45	0.45	-	} Immovable Property (Leasehold)/Plant & Machinery Bank Guarantee
		Term Loan	1.55	1.55	-	
		Standby Letters of Credit	0.43	-	0.43	
		Overdraft	1.20	0.16	-	
		Standby Letters of Credit (Rs.Mn.)	100.00	-	(Rs.Mn.) 100.00	
		Letter of Guarantee (Rs.Mn.)	(0.08)	-	(Rs.Mn.) 0.08	
		Overdraft (Rs.Mn.)	(120.00)	(Rs.Mn.) 82.51	-	
	(US\$.Mn)	3.63	2.16	0.43		
	(Rs.Mn)	100.00	82.51	100.08		
Ace Power Generation Embilipitiya (Pvt) Ltd.	(Subsidiary of Aitken Spence & Co. Ltd.)	Term Loan	0.44	0.44	-	} Immovable Property Machinery
		Term Loan	1.86	1.86	-	
		Overdraft	0.62	3.31	-	
		Overdraft	2.63	-	-	
		Standby Letter of Credit	0.12	-	0.12	
			(US\$.Mn)	5.67	5.61	
		Limit (Rs.Mn.)	Outstanding as at 31.12.05 Direct	(Rs.Mn.) Indirect		
Brown & Co. Ltd.	Mr M V Theagarajah (Chairman)	Letters of Credit		-	26.90	} Immovable property Absolute ownership of the leased assets Inventories
		Import Loan	315.00	24.81	-	
		Letters of Guarantee		-	20.47	
		Overdraft		188.81	-	
		Term Loan	395.84	395.84	-	
		Term Loan	146.00	146.00	-	
		Lease	0.06	0.06	-	
				856.90	755.52	
Browns Group Industries Ltd.	Mr M V Theagarajah (Chairman)	Letters of Credit	15.00	-	27.74	} Immovable Property Absolute ownership of the leased assets. Inventories Cash Margin
		Letters of Credit	10.00	-	-	
		Once off Letter of Credit	25.00	-	25.00	
		Lease	0.24	0.24	-	
		Letters of Guarantee	0.73	-	0.73	
				50.97	0.24	
I.G. Browns Rubber Industries Ltd	Mr M V Theagarajah (Chairman)	Letter of Credit	2.50	-	-	} Immovable Property
		Overdraft	0.40	0.01	-	
			2.90	0.01	-	
Browns Dimo Industrial Products (Pvt) Ltd.	Mr M V Theagarajah (Chairman)	Letters of Credit	4.00	-	2.66	} Cash Deposits
		Overdraft	1.00	-	-	
			5.00	-	2.66	

Notes to the Financial Statements

35. RELATED PARTY TRANSACTIONS (Contd.)

Name of Related Party	Name of Director (Relationship)	Nature of Transaction	Aggregate Amount of Accommodation			Security
			Limit (Rs.Mn.)	Outstanding as at 31.12.05 Direct Indirect		
Engineering Services Ltd.	Mr M V Theagarajah (Director)	Letters of Credit	2.00	-	-	Quoted Co. Shares
		Once off Letter of Credit	18.80	-	-	
		Import Loans	(25.80)	21.93	-	Cash Margin Absolute ownership of the leased assets.
		Overdraft	3.00	2.04	-	
		Letter of Guarantee	5.00	-	8.92	
		Letters of Guarantee	2.80	-	-	
		Lease	0.83	0.83	-	
	<u>32.43</u>	<u>24.80</u>	<u>8.92</u>			
Walker & Greig Ltd.	Mr M V Theagarajah (Chairman)	Letters of Credit	10.00	-	6.13	Inventories Absolute ownership of the leased assets.
		Overdraft	15.00	19.84	-	
		Term Loan	16.40	16.40	-	
		Lease	0.79	0.79	-	
			<u>42.19</u>	<u>37.03</u>	<u>6.13</u>	
Browns Tours Ltd.	Mr M V Theagarajah (Chairman)	Letters of Guarantee	10.00	-	9.22	Quoted Company Shares Absolute ownership of the leased assets.
		Lease	0.23	0.23	-	
			<u>10.23</u>	<u>0.23</u>	<u>9.22</u>	
Snowcem Products Lanka (Pvt) Ltd.	Mr M V Theagarajah (Chairman)	Letters of Credit	0.80	-	-	Cash Deposits Corporate Guarantee of Brown & Co. Ltd.
		Trust Receipt	(0.80)	-	-	
		Overdraft	2.50	2.31	-	
			<u>3.30</u>	<u>2.31</u>	<u>-</u>	
Ceylon Biscuits Ltd.	Mr R T Wijetilleke (Director)	Letters of Credit	50.00	Not disbursed	-	Negative pledge of stocks
		Overdraft	50.00	Not disbursed	-	
		Once off letters of Credit	184.50	-	184.50	
			<u>284.50</u>	<u>-</u>	<u>184.50</u>	
Nawaloka Hospitals Limited	Mr R T Wijetilleke (Director)	Temporary Overdraft	-	15.46	-	Clean
			<u>-</u>	<u>15.46</u>	<u>-</u>	
New Nawaloka Hospitals Limited	(Subsidiary of Nawaloka Hospitals Limited)	Loan I	124.66	124.66	-	Immovable Property Equipment Title to goods imported
		Loan II	91.66	69.99	-	
		Standby Overdraft	10.00	24.90	-	
		Letters of Credit	10.00	-	7.92	
			<u>236.32</u>	<u>219.55</u>	<u>7.92</u>	

Notes to the Financial Statements

36. MATURITY ANALYSIS - BANK

An analysis of the total assets & 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	3-12 Months Rs.000	1-3 Years Rs.000	3-5 Years Rs.000	More Than 5 Years Rs.000	Total 2005 Rs.000
Interest earning assets						
Cash and short term funds	9,185,281	-	-	-	-	9,185,281
Balances with Foreign Banks which are interest bearing	9,930,384	-	-	-	-	9,930,384
Government Treasury Bills	139,340	-	-	-	-	139,340
Commercial paper	434,073	-	-	-	-	434,073
Investment securities-Bonds & Debentures	-	4,536,972	3,392,765	7,956,494	755,239	16,641,470
Bills of Exchange	1,592,548	386,611	41,164	-	6,654	2,026,977
Loans & advances	17,086,800	31,308,961	19,921,362	12,429,682	15,495,660	96,242,465
Lease rentals receivable	397,355	696,610	2,856,964	4,762,370	151,052	8,864,351
	38,765,781	36,929,154	26,212,255	25,148,546	16,408,605	143,464,341
Non interest earning assets						
Cash and short term funds	2,084,409	-	-	-	-	2,084,409
Statutory deposit with CBSL	8,565,629	-	-	-	-	8,565,629
Dealing securities	313,113	-	-	-	-	313,113
Quoted shares	617,769	-	-	-	-	617,769
Unquoted shares	25,706	-	-	-	-	25,706
Investment in Associate companies	-	-	-	-	132,326	132,326
Investment in Subsidiary companies	-	-	-	-	2,293,663	2,293,663
Property, plant & equipment	-	-	-	-	3,370,369	3,370,369
Other assets	5,145,085	-	-	-	-	5,145,085
	16,751,711	-	-	-	5,796,358	22,548,069
Total assets	55,517,492	36,929,154	26,212,255	25,148,546	22,204,963	166,012,410
Percentage - 31/12/2005	33.44	22.24	15.79	15.15	13.38	100
Percentage - 31/12/2004	40.09	11.94	20.03	15.72	12.22	100
Interest bearing liabilities						
Deposits from customers	72,380,919	27,937,007	7,324,296	4,060,444	3,056,170	114,758,836
Borrowings - Money at call	510,517	-	-	-	-	510,517
Borrowings - Refinance	2,016,632	6,258	41,839	97,961	549,120	2,711,810
Borrowings - Foreign Banks	717,784	-	-	-	-	717,784
Repo agreements	6,113,644	-	-	-	-	6,113,644
Subordinated Debentures	-	-	3,759,148	127,628	113,224	4,000,000
	81,739,496	27,943,265	11,125,283	4,286,033	3,718,514	128,812,591
Non Interest bearing liabilities						
Deposits from customers	13,524,845	-	-	-	-	13,524,845
Dividend payable	50,291	-	-	-	-	50,291
Bills payable	2,226,745	-	-	-	-	2,226,745
Current tax liability	5,992	-	-	-	-	5,992
Deferred tax liability	313,756	-	-	-	-	313,756
Other liabilities	9,838,930	-	-	-	-	9,838,930
Shareholders' funds	-	-	-	-	11,239,260	11,239,260
	25,960,559	-	-	-	11,239,260	37,199,819
Total liabilities and shareholders' funds	107,700,055	27,943,265	11,125,283	4,286,033	14,957,774	166,012,410
Percentage - 31/12/2005	64.87	16.83	6.70	2.58	9.02	100
Percentage - 31/12/2004	62.75	16.79	8.11	4.37	7.98	100

* "Up to 3 months" deposits include the Bank's Savings Deposit Base of Rs. 61.5 billion (2004 - Rs. 57.1 billion).
2004 percentages are calculated by restating comparatives in to the current format.

Notes to the Financial Statements

37. SEGMENT REPORTING

Business segments - Group

	Banking		Leasing		**Dealing		Property		Insurance		Eliminations/Unallocated		Consolidated	
	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004
	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000	Rs. 000
Revenue from external customers :														
Interest	12,907,337	10,372,081	-	-	624,931	400,219	-	238	46,106	33,358	1,162,455	773,660	14,740,829	11,579,556
Exchange/Premium	646,460	662,176	-	-	(294)	684	-	-	573,218	357,165	-	-	1,219,384	1,020,025
Lease/Brokerage	-	-	1,162,455	929,898	5,897	56,904	-	-	-	-	(1,162,455)	(929,898)	5,897	56,904
Commissions/Rent	1,633,352	1,517,378	-	-	-	-	20,378	18,886	-	-	-	-	1,653,730	1,536,264
Other	496,693	376,649	-	-	180,842	34,496	-	-	816	-	-	(100,933)	678,351	310,212
Total revenue from external customers	15,683,842	12,928,284	1,162,455	929,898	811,376	492,303	20,378	19,124	620,140	390,523	-	(257,171)	18,298,191	14,502,961
Inter-segment revenue	150,482	229,176	-	-	55,394	92,236	412,578	415,549	33,592	41,530	(761,670)	(1,121,190)	-	-
Total revenue	15,834,324	13,157,460	1,162,455	929,898	866,770	584,539	432,956	434,673	653,732	432,053	(761,670)	(1,378,361)	18,298,191	14,502,961
Segment result	1,772,032	812,712	677,193	576,001	142,756	20,269	37,250	65,510	74,422	26,880	(8,830)	(240,029)	2,694,823	1,261,343
Unallocated expenses													703,635	537,541
Profit from operations													1,991,188	723,802
Income from associates													17,162	22,969
Income tax expense													(213,813)	15,114
Minority interests													(24,116)	(6,279)
Net profit for the year													1,770,421	755,606
Segment assets	128,035,145	118,110,642	8,864,351	6,846,944	7,597,672	7,440,812	4,884,220	5,002,102	1,106,409	745,188	(2,358,209)	(1,949,750)	148,129,588	136,195,938
Investment in associates													170,592	168,588
Unallocated assets													26,686,925	25,396,120
Total Assets													174,987,105	161,760,646
Segment liabilities	121,646,075	113,353,741	8,864,351	6,846,944	6,973,851	6,940,425	3,125,967	3,193,161	734,421	433,490	(1,975,521)	(1,562,128)	139,369,144	129,205,633
Unallocated liabilities													24,262,724	23,527,130
Total liabilities													163,631,868	152,732,763
Cash flows from operating activities	460,214	819,785	7,478	650,386	38,022	(6,924)	30,075	(70,345)	127,256	74,355	770,150	(3,435,041)	1,433,195	(1,967,784)
Cash flows from investing activities	(509,930)	(1,020,804)	-	-	3,116	47,791	17,986	(158,343)	(120,901)	(60,901)	(495,323)	2,019,748	(1,105,052)	827,491
Cash flows from financing activities	1,134,527	702,141	-	-	(53,386)	(81,518)	-	500,000	(356)	-	(328,303)	1,119,464	752,482	2,240,087
Capital Expenditure	495,638	516,057	973	224	7,743	5,552	7,599	163	34,034	30	(331)	179,839	545,656	701,865
Depreciation	493,991	436,576	330	2,082	4,058	6,200	83,600	68,107	12,411	10,586	(331)	13,990	594,059	537,541
Amortisation	-	-	-	-	-	-	4,303	-	-	-	-	-	4,303	-

**Stock Broking & Securities Dealings

38. EVENTS OCCURRING AFTER THE BALANCE SHEET DATE

There are no events occurring after the Balance Sheet date, which requires adjustment to or disclosure in the financial statements.

Capital Adequacy

The principal objective of the Central Bank of Sri Lanka's Capital Adequacy requirements is to ensure that an adequate level of capital is maintained to withstand any losses which may result from the risks in a Bank's Balance Sheet, in particular, "credit risk". Our risk based capital adequacy requirements are consistent with the international standards of Basle Committee on Banking Regulations and Supervisory Practices. The framework has three basic aspects - the capital base elements; the required capitalisation level; and the risk-weighting.

The capital base is comprised of two elements namely Tier 1 and Tier 2 capital after certain deductions.

Tier 1 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 2 capital includes 50% of asset revaluation reserves, general provision for doubtful debts, hybrid debt/equity instruments and approved subordinated term debts.

Equity investments in un-consolidated banking and financial subsidiaries and investments in capital of other banks/financial associates, are deducted from total Tier 1 and 2 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. Tier 1 capital must be at least 50% of the minimum capital requirements.

In orde

There are five risk weightings (0%, 10%, 20%, 50%, 100%) and the assets to which those weightings apply are described below. Off-balance sheet transactions are converted to credit equivalents, using a credit conversion factor, before being allocated a risk weighting.

Off-balance sheet items are categorised as follows:

- * Direct Credit Substitutes
- * Transaction-related contingencies
- * Short-term self liquidating Trade- Related Contingencies
- * Sale and Repurchase Agreements & Assets Sale with recourse where the credit risk remains with the Bank
- * Obligations under an On-going Underwriting Agreement
- * Other Commitments with an original maturity of up to one year or which can be unconditionally cancelled at any time
- * Other commitments with an original maturity of over one year
- * Foreign Exchange & Interest Rate Contracts

The total of the risk weighted assets plus the risk assessed off-balance sheet items is then related to the capital base and the resultant risk ratio is used as a measure of capital adequacy.

The following table provides details of Tier 1 & Tier 2 capital position and risk adjusted assets and off-balance sheet exposure.

Capital Adequacy

Capital Base as at 31st December,	2005	2004
Rupees Million		
TIER 1		
Voting ordinary shares	947	770
Non-Voting ordinary shares	231	231
Share Premium	2,704	1,962
Statutory Reserve Fund	625	570
Published Retained Profits	1,174	791
General & other reserves	5,252	4,402
Total Tier 1 Capital	10,933	8,726
TIER 2		
Approved assets revaluation reserves (1)	153	163
General provisions	219	167
Debentures	2,119	2,837
Total Tier 2 Capital	2,491	3,167
Total Tier 1 & Tier 2 Capital	13,424	11,893
Less: Holdings in other Banks/Financial Associates (2)	(1,808)	(1,893)
Capital Base	11,616	10,000
Risk Adjusted Capital Ratios		
Tier 1 (Statutory minimum ratio required is 5%)	10.87	9.83
Tier 2	0.68	1.43
Total (Statutory minimum ratio required is 10%)	11.55	11.26

ADJUSTED ASSETS AND OFF-BALANCE SHEET EXPOSURE

As at 31st December	Balance		Risk Weights %	Risk Adjusted Balance	
	2005	2004		2005	2004
Rupees Million					
ASSETS					
Cash, Treasury Bills, statutory reserves with Central Bank	24,138	25,161	-	-	-
Loans secured by cash and guaranteed by Central Bank of Sri Lanka	26,204	22,212	-	-	-
Guaranteed by OECD Central gov./Central banks	1,176	-	10	118	-
Due from Local/Foreign Banks/Financial Institutions	17,023	18,608	20	3,405	3,722
Loans secured by residential properties and guaranteed by external agencies	28,906	24,224	50	14,452	12,112
Loans and advances secured by other form of securities	56,222	50,854	100	56,222	50,854
Other assets	10,809	10,076	100	10,809	10,076
Total assets	164,478	151,135		85,006	76,764

Capital Adequacy

OFF-BALANCE SHEET EXPOSURE

Rupees Million	Amount of Off-Balance Sheet Items	Credit Equivalent Amount	Risk Weights	Risk Weighted Balance	
As at 31st December	2005	2005	%	2005	2004
Financial guarantees, Bank acceptances and other guarantees	14,549	14,549	0-100	15,061	11,691
Performance related guarantees and warranties, stand by credit lines	5,187	2,594	0-100	212	340
Shipping guarantees, Documentary Letters of Credit	5,074	1,015	0-100	-	-
Undrawn term and overdraft facilities < 1 year	13,008	-	0-100	-	-
> 1 year	467	234	0-100	-	-
Foreign Exchange Contracts	13,614	272	0-100	-	-
Foreign Interest Rate Contracts	7,453	522	0-100	261	-
Total off-balance sheet exposures	59,352	19,186		15,534	12,031
Total risk adjusted assets				85,006	76,764
Total risk adjusted assets and off-balance sheet exposure				100,540	88,795

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 in other Banks/Financial Associates	2005 Rs.Mn.	2004 Rs.Mn.
Sithma additional investment	900	900
Employee Share Option Plan	135	147
Others	773	846

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

Income Statement in US Dollars

For the year ended 31st December	Bank		Group	
	2005	2004	2005	2004
In thousands of US\$				
INCOME	166,472	134,614	179,218	138,585
Interest income	138,393	109,597	144,376	110,650
Less: Interest expenses	71,311	56,971	79,038	60,791
Net interest income	67,082	52,626	65,338	49,859
Foreign exchange profit	6,332	6,328	6,329	6,334
Fee & commission income	16,293	14,524	16,055	15,043
Dividend income	637	1,590	645	720
Other income	4,817	2,575	11,813	5,838
	95,161	77,643	100,180	77,794
Less:				
OPERATING EXPENSES				
Personnel costs	23,656	20,733	24,831	21,833
Premises equipment & establishment expenses	18,231	15,488	16,307	13,468
Fee & commission expenses	1,142	1,174	1,151	1,122
Provision for staff retirement benefits	3,197	2,336	3,215	2,248
Bad debts written off	230	-	230	-
Provision for loan losses	17,233	14,969	17,233	14,969
Provision for /(writeback of) investments	798	(1,026)	810	(1,004)
Amortization of Goodwill/(Negative Goodwill)	-	-	(3)	(3)
Other expenses	12,555	14,891	16,904	18,245
	77,042	68,565	80,678	70,878
PROFIT FROM OPERATIONS	18,119	9,078	19,502	6,916
Share of Associate Companies' profit before taxation	-	-	168	220
PROFIT BEFORE TAXATION	18,119	9,078	19,670	7136
Add/(Less): Provision for taxation	(1,914)	252	(2,094)	144
PROFIT AFTER TAXATION	16,205	9,330	17,576	7,280
Less: Attributable to Minority Interest	-	-	236	60
NET PROFIT FOR THE YEAR	16,205	9,330	17,340	7,220
Attributable to Shareholders of the Bank	16,205	9,330	17,340	7,220
EARNINGS PER SHARE (US\$)	0.15	0.12	0.16	0.09
DIVIDEND PER SHARE (US\$)	0.04*	0.03	0.04*	0.03

Exchange rate of 1 US\$ was Rs. 102.10 as at 31.12.2005 (Rs. 104.65 as at 31.12.2004).

* Calculated on Interim Dividend paid and Final Dividend proposed, which is to be approved at the Annual General Meeting.

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

Balance Sheet in US Dollar

As at 31st December	2005	Bank	2004	2005	Group	2004
In thousands of US\$						
ASSETS						
Cash & short term funds	207,640		192,143	207,580		192,196
Statutory deposit with Central Bank of Sri Lanka	83,895		87,151	83,894		87,151
Government Treasury Bills	1,365		-	19,602		7,112
Commercial papers	4,251		6,518	4,251		6,518
Securities purchased under re-sale agreements	-		-	38,014		53,992
Dealing securities	3,067		3,853	3,131		3,984
Investment securities	169,294		169,517	184,297		179,272
Bills of Exchange	19,853		19,852	19,853		19,852
Loans and advances	942,629		806,294	937,079		799,823
Lease rentals receivable within one year	30,485		24,503	30,485		24,503
Lease rentals receivable after one year	56,336		40,842	56,336		40,842
Investments in Associate Companies	1,296		1,264	1,671		1,611
Investments in Subsidiary Companies	22,465		21,918	-		-
Other assets	50,393		53,695	50,389		52,812
Property, plant & equipment	33,010		32,361	77,298		76,054
Goodwill on consolidation	-		-	-		8
Total Assets	<u>1,625,979</u>		<u>1,459,911</u>	<u>1,713,880</u>		<u>1,545,730</u>
LIABILITIES						
Deposits from customers	1,256,451		1,132,575	1,254,954		1,130,836
Dividends payable	493		1,035	493		1,035
Borrowings	38,591		40,266	38,591		40,266
Treasury bills sold under re-purchase agreements	59,879		44,057	118,549		105,967
Bills payable	21,809		15,940	21,809		15,940
Other liabilities	96,366		99,520	100,708		102,751
Long term insurance funds	-		-	2,946		1,620
Non life insurance reserves	-		-	2,615		2,013
Current tax liability	59		(1,550)	361		(1,510)
Deferred tax liability	3,073		3,348	3,098		3,369
Subordinated debentures	39,177		38,223	58,539		57,176
Total Liabilities	<u>1,515,898</u>		<u>1,373,414</u>	<u>1,602,663</u>		<u>1,459,463</u>
SHAREHOLDERS' FUNDS						
Share capital - Voting	9,272		7,358	9,272		7,358
Share capital - Non-Voting	2,262		2,207	2,262		2,207
Statutory Reserve Fund	6,119		5,444	6,119		5,444
Reserves	92,428		71,488	92,107		70,067
	110,081		86,497	109,760		85,076
MINORITY INTEREST	-		-	1,457		1,191
	110,081		86,497	111,217		86,267
Total Liabilities, Shareholders' Funds & Minority Interest	<u>1,625,979</u>		<u>1,459,911</u>	<u>1,713,880</u>		<u>1,545,730</u>
Commitments & Contingencies	438,425		432,359	438,425		432,359

Exchange rate of 1 US\$ was Rs. 102.10 as at 31.12.2005 (Rs. 104.65 as at 31.12.2004).

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

Glossary of Financial/Banking Terms

BIS Surplus

The total Capital 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.

Dividend Cover

Profit after tax divided by gross dividends. This ratio measures the number of times dividend is covered by current year's distributable profits.

Documentary Letters of Credit (L/C's)

Written undertakings by a bank on behalf of its customer (typically an importer), authorising a third party (e.g. an exporter) to draw drafts on the bank up to a stipulated amount under specific terms and conditions. Such undertakings are established for the purpose of facilitating international trade.

Earnings Per Share (EPS)

Profit attributable to ordinary shareholders divided by the number of ordinary shares in issue.

Economic Value Addition (EVA)

This is an internal managerial performance measure which monitors whether managers of divisions are increasing shareholder value (measured as MVA) or not.

Foreign Exchange Profit

Profit earned on foreign currency transactions arising from the difference in foreign exchange rates between the transaction date or last balance sheet date and the settlement date or current balance sheet date. Also included are gains from trading in foreign currencies.

General Provisions

Are established for leasing transactions, housing loans and for pawning advances for anticipated losses on aggregate exposures where credit losses cannot yet be determined on an individual facility basis.

Glossary of Financial/Banking Terms

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 its financial obligations to third parties. Certain other guarantees represent non-financial undertakings such as bid and performance bonds.

Holding Period Return

The total return received from holding an asset.

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.

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, treasury bills.

Provision for Bad and Doubtful Debts (please refer Provision for Loan Losses)

Market Capitalisation

Number of ordinary shares in issue multiplied by the market value of each share at the year end.

Market Value Addition (MVA)

This is an external measure of how much better off the shareholders are as a consequence of management's performance.

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

A loan placed on a cash basis (i.e. interest income is only recognised when cash is received) because, in the opinion of management, there is reasonable doubt regarding the collectability of principal or interest. Loans are automatically placed on cash basis when a payment is 90 days past due. 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 Loan Losses

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.

Glossary of Financial/Banking Terms

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.

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.

Shareholders' Funds

Shareholders' funds consist of issued and fully paid ordinary share capital plus capital and revenue reserves.

Sustainability Report

The section of the annual report that focuses on our commitment to the stakeholders i.e. Corporate Social Responsibility (CSR).

Swaps (Foreign Exchange)

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 of Meeting

Notice is hereby given that the Thirty Seventh (37th) Annual General Meeting of the Hatton National Bank Limited is convened on Wednesday the Twenty Ninth (29th) day of March 2006 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/Special Business will be transacted.

ORDINARY BUSINESS

To receive and consider the Report of the Directors and the Statement of Accounts and Balance Sheet of the Company for the year ended 31st December 2005 with the Auditors' Report thereon.

To declare a final dividend of 20% as recommended by the Directors, to the shareholders.

To re-elect Dr. V P Vittachi who retires by rotation at the Annual General Meeting in terms of Article 87 of the Articles of Association of the Company, as a Director of the Company, Special Notice having been given pursuant to Sections 138 and 182 of the Companies' Act No. 17 of 1982 of the intention to propose the following resolution.

Resolution

"That Dr Vijaya Perera Vittachi (a Director retiring by rotation) who has attained the age of 70 years on 2nd December 1992 and is of the age of 83 years be and is hereby re-elected as a Director of the Company and it is hereby declared that the age limit of 70 years referred to in Section 181 of the Companies' Act No. 17 of 1982, shall not apply to the said Director".

To re-elect Mr. R Theagarajah in terms of Article 93 of the Articles of Association of the Company, as a Director of the Company.

To re-elect Mr R Ghazalli in terms of Article 93 of the Articles of Association of the Company as a Director of the Company

To re-appoint Auditors for the ensuing year and to authorise the Directors to fix their remuneration.

To authorise the Directors to determine payments for the year 2006 for charitable and other purposes set out in the Companies Donations Act (Cap. 147).

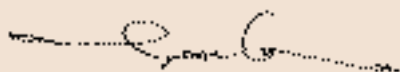
SPECIAL BUSINESS

To pass the following resolution as a Special Resolution:

"THAT the Articles of Association of the Company be altered as follows :-

- (1) By deleting Article 75
- (2) By deleting the words **"and any Nominee director appointed under the provisions of Article 73 or 75"** in line 2 in Article 86.
- (3) In Article 106 –
 - (i) by deleting the words **"(not being a nominee director)"** in line 1 within brackets
 - (ii) by deleting sub-clause (iii)
 - (iii) by deleting sub-clause (iv)
 - (iv) by deleting the words **"and to an alternate to a nominee director"** in line 2 in sub-clause (v)
 - (v) by deleting the words **"and an alternate to a nominee director"** in line 1 of sub-clause (v) (a)
 - (vi) by deleting the words **"and every alternate to a nominee director"** in line 1 and the words **"An alternate to a nominee director shall be entitled to attend and vote at any such meeting at which the nominee director in whose place he was appointed is (and for so long as he is) not personally present and he may also generally perform all the functions of a director in the absence of the nominee director or if the nominee director shall have so authorised him, as to which a declaration by the alternate for the nominee director shall be sufficient without any further proof."** - the last sentence in sub-clause (v) (b).
 - (vii) by deleting the words **"or an alternate to nominee director"** in line 1 of sub-clause (v) (c)."

By Order Of The Board



INDRANI GOONESEKERA

DGM-LEGAL/BOARD SECRETARY

Colombo. Sri Lanka.

Thursday, February 16th, 2006

Notes :

1. A member entitled to attend and vote at the meeting is entitled to appoint a proxy to attend and vote 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 27th March, 2006.

Notes

Notes

Form of Proxy

I/We
of
being a member/members of the Hatton National Bank Ltd, hereby appoint Rienzie Theobald Wijetilleke, or failing him Vijaya Perera Vittachi, or failing him Rajendra Theagarajah, or failing him Don Harold Stassen Jayawardena, or failing him Manickam Vallipuram Theagarajah, or failing him Rajpal Kumar Obeyesekere, or failing him Pamela Christine Cooray, or failing her Ratna Sivaratnam, or failing him Rasheed Ghazalli or failing him
.....of
as my/our proxy, to represent me/us and to vote for me/us on my/our behalf at the Thirty Seventh (37th) Annual General Meeting of the Company to be held at the Auditorium on Level 22 of "HNB Towers" at No. 479, T B Jayah Mawatha, Colombo 10 on the 29th of March, 2006 at 10.00 in the forenoon and at any adjournment thereof and at every poll which may be taken in consequence thereof to vote :

	In favour	To declare a final dividend of 20%
	Against	
	In favour	To re-elect Dr. V P Vittachi, Director who retires by rotation
	Against	
	In favour	To re-elect Mr. R Theagarajah as a Director of the Company.
	Against	
	In favour	To re-elect Mr R Ghazalli as a Director of the Company
	Against	
	In favour	To re-appoint Auditors for the ensuing year/authorise the Directors to fix their remuneration.
	Against	
	In favour	To authorise the Directors to determine payments for charitable and other purposes
	Against	
	In favour	Special Resolution - Alteration of the Articles of Association
	Against	

Signed this day 2006.

Signature/s

Please provide the details :

Shareholder's NIC No./

Folio No./Number of Shares held

Proxy holder's NIC No. (if not a Director)

Notes :

i) In terms of Article 67 of the Articles of Association of the Company –

This instrument appointing a proxy shall be in writing and

- (a) in the case of an individual shall be signed by the appointor or by his attorney, and
- (b) in the case of a company or corporate body shall either be under its Common Seal or signed by its attorney or by an officer on behalf of the Company or corporate body in accordance with the Articles of Association of that Company or corporate body.

The Company may, but shall not be bound to, require evidence of the authority of any such attorney or officer.

In terms of Article 68 of the Articles of Association of the Company –

The instrument appointing a proxy shall be lodged, and the Power of Attorney (if any) under which it is signed or a notarially certified copy thereof shall if required be deposited for inspection at the office, in each case not less than forty eight hours before the time appointed for holding the meeting or adjourned meeting, or in the case of a poll before the time appointed for taking of the poll at which the person named in the instrument proposes to vote, and in default the instrument of proxy shall not be treated as valid.

In terms of Article 62 of the Articles of Association of the Company –

In the case of joint-holders of a share the vote of the senior who tenders a vote, whether in person or by proxy or by attorney or by representative, shall be accepted to the exclusion of the votes of the other joint-holders, and for this purpose seniority shall be determined by the order in which the names stand in the Register of Members in respect of the joint-holding.

The first joint-holder thereby has power to sign the proxy without the concurrence of the other joint-holders.

- ii) The full name and the registered address of the shareholder appointing the proxy should be legibly entered in the form of proxy.
- iii) To be valid the completed form of proxy should be deposited with the Board Secretary, at the Registered Office of the Company at No: 479, T B Jayah Mawatha, Colombo 10, before 10.00 in the forenoon on 27th March, 2006.
- iv) Every alteration or addition to the Form of proxy must be duly authenticated by the full signature of the shareholder signing the form of proxy. Such signature should as far as possible be placed in proximity to the alteration or addition intended to be authenticated.