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HOW IT  
WORKS  
9



**HNB**

ANNUAL REPORT 2009

2  
HOWIT  
WORKS  
9

STRATEGISING PROACTIVELY and building resilience through challenging times  
SETTING THE TONE AT THE TOP and embracing best practices  
INTEGRATING BUSINESS FOCUS WITH THE NEEDS and expectations of our stakeholders  
KEEPING COUNT OF EVERYTHING WITH TRANSPARENCY and continuous disclosures  
THAT IS HOW IT WORKS



**HNB**

## Vision

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

## Mission

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

## Financial Goals and Performance

For the Year ended 31st December	2005	2006	2007	2008	2009	Medium Term
						Goals
Return on Average Assets (%)	1.0	1.2	1.4	1.3	1.6	Over 1.5
Return on Average Shareholders' Funds (%)	16.3	18.4	19.3	16.5	19.6	Over 20.0
Cost / Net Income Ratio (Excl. Financial VAT) (%)*	60.3	57.8	56.2	54.2	54.4	Below 50.0
Dividend per Share (Rs)	4.00	5.00	3.50	4.00	6.50	Over 4.00
<b>Capital Adequacy</b>						
Tier 1 Capital Ratio (%) (Statutory Minimum Ratio Required is 5%)	10.87	10.23	10.32	9.25	11.10	9.00
Total Capital Ratio (%) (Statutory Minimum Ratio Required is 10%)	11.55	11.32	12.08	11.40	13.16	12.50

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

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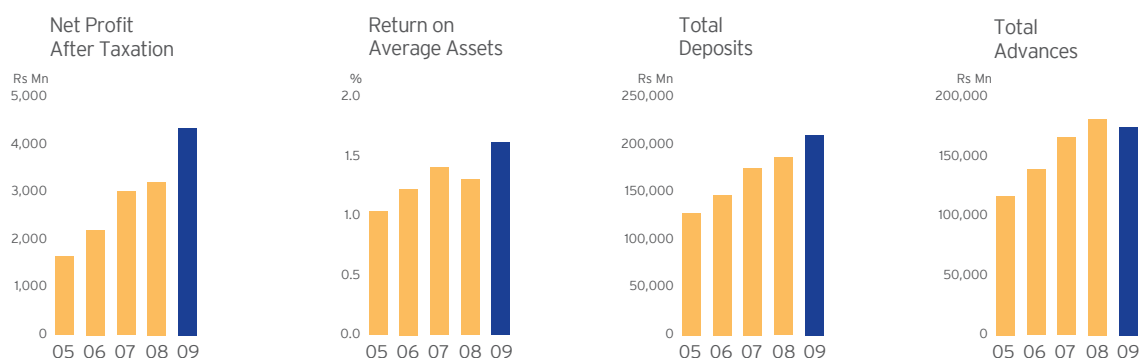
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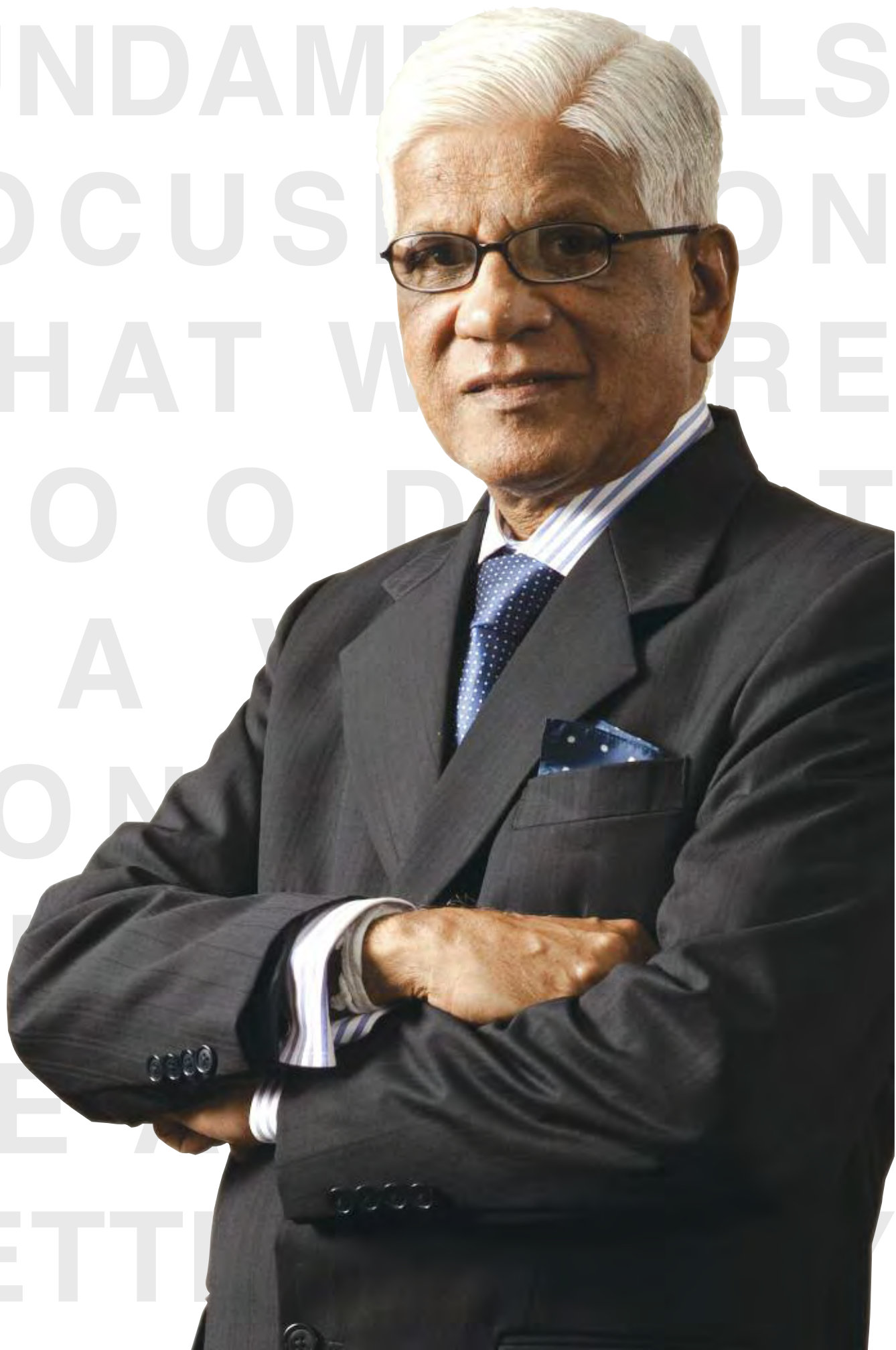
## Financial Highlights

	Bank			Group		
	2009 Rs. Mn	2008 Rs.Mn	% Change	2009 Rs.Mn	2008 Rs.Mn	% Change
<b>Results For the Year</b>						
Income	39,374	37,151	+ 6.0	41,317	38,711	+ 6.7
Net Profit Before Income Tax	5,918	4,785	+ 23.7	6,167	4,485	+ 37.5
Income Tax on Profits	1,566	1,566	+ 0.0	1,613	1,599	+ 0.9
Net Profit After Taxation	4,352	3,219	+ 35.2	4,553	2,886	+ 57.8
Gross Dividends	1,533	942	+ 62.7	1,555	961	+ 61.8
Profit Available After Appropriation	2,819	2,277	+ 23.8	2,998	1,925	+ 55.8
<b>At the Year End</b>						
Shareholders' Funds (Capital and Reserves)	23,900	20,581	+ 16.1	26,374	22,921	+ 15.1
Deposits from Customers	210,507	186,770	+ 12.7	210,363	186,615	+ 12.7
Advances to Customers Including Leasing, Bills of Exchange and Commercial Paper (Gross)	177,195	184,425	- 3.9	174,476	182,594	- 4.4
Total Assets	280,592	256,711	+ 9.3	287,511	263,431	+ 9.1
<b>Information per Ordinary Share</b>						
Earnings (Rs)*	18.47	13.67	+ 35.2	19.03	12.02	+ 58.3
Dividends (Rs)	6.50	4.00	+ 62.5	6.50	4.00	+ 62.5
Dividend Yield (%)	3.82	5.73	- 33.4	3.82	5.73	- 33.4
Net Asset value (Rs)	101.37	87.38	+ 16.0	111.86	97.22	+ 15.1
Market Value (Rs) - Voting	170.25	69.75	+ 144.1	170.25	69.75	+ 144.1
Market Value (Rs) - Non voting	104.75	32.00	+ 227.3	104.75	32.00	+ 227.3
<b>Ratios</b>						
Return on Average Shareholders' Funds (%)	19.57	16.51	+ 18.5	18.19	12.80	+ 42.1
Price Earning (Times)	9.22	5.10	+ 80.6	8.95	5.80	+ 54.1
Dividend Cover (Times)	2.84	3.42	- 16.9	2.93	3.00	- 2.5
<b>Capital Adequacy Ratios</b>						
Tier 1 (%) (Statutory minimum ratio required is 5%)	11.10	9.25	+ 20.0	10.85	8.93	+ 21.5
Tier 1 & 2 (%) (Statutory minimum ratio required is 10%)	13.16	11.40	+ 15.4	12.92	11.08	+ 16.6

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



STICKING TO  
FUNDAMENTALS  
FOCUS ON  
WHAT WORKS  
GOOD  
HAPPY  
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WE  
WE  
GETTING



It gives me great pleasure to welcome all of you, our shareholders, to the forty first Annual General Meeting of Hatton National Bank PLC and to present to you the Audited Financial Statements and Annual Report for the year 2009. Our shareholders will be equally pleased to note that this year, your Bank celebrates 120 years of service to the nation's financial and banking industry and more so to the people of Sri Lanka from our humble beginnings as the Hatton Bank. Our legacy by far establishes us not only as a pioneer in the industry but also as a revolutionary force in shaping the future of Sri Lanka's commercial intent.

In May 2009, as terrorism was quelled and Sri Lanka united as one nation, the foundations were laid for the future economic prosperity of the nation. However, with thousands whose lives have been repressed due to the effects of the raging conflict, there remains a dire need for rehabilitation of lives and livelihoods before Sri Lanka is able to stand on a firm footing.

#### **Global economy expected to recover in 2010**

The global economy in 2009 continued to grapple with one of the worst depressions in modern times. In a severe recession inflicted by a massive financial crisis and an acute loss of confidence, the year witnessed the adoption of a wide-

as India and China. This turnaround will nevertheless depend on how decisively financial authorities will act towards the restoration of financial stability and to what degree fiscal and monetary policies in the world's major economies will work towards sustaining strong support for aggregate demand.

#### **Local economy sustains in the face of growing challenges**

The Sri Lankan economy in 2009 faced both internal and external challenges. Whilst in the first half of the year the economy lagged under the dual pressures of the escalated war on terror, and the recessionary pressures of the global economy, in the second half of the year economic developments were more favourable

# CHAIRMAN'S MESSAGE

#### **2009 brings hope to a united Sri Lanka**

The year under review has no doubt been a turning point in the history of modern Sri Lanka. We have witnessed the end to a conflict that had blighted our country and its prospects of future prosperity. For over three decades, Sri Lankans across the nation suffered from the debilitating effects of an internal conflict, terrorised and traumatised by personal loss. Despite the economy remaining resilient in the face of adversity, its potential for accelerated development remained in check.

ranging and often unorthodox policy responses towards making progress in stabilising financial markets and restoring consumer and investor confidence. By late 2009, these responses marginally contributed towards the arrest of negative feedback between weakening activity and intense financial strains. While the rate of contraction moderated significantly from the second quarter onward, it is projected that the global economy will post a marginal growth of 0.5% during 2009. In 2010, the International Monetary Fund (IMF) forecasts the global economy to recover with the growth being driven by emerging economies such

than previously forecasted. Confidence improved and output growth indicated an upward movement. Foreign investor enthusiasm remained strong in the face of post conflict development. Garment exports fared better than expected despite speculation on the termination of the GSP+ preferential tariff for Sri Lanka's garments. Import expenditure during the year witnessed a significant drop mainly due to the decline in crude oil prices. Despite challenges in the global economy remittances improved during the year resulting in expectations to post a positive current account balance in 2009 after 33 years. The decline in policy

## > Chairman's Message

rates as stipulated by the Central Bank of Sri Lanka is expected to support higher growth in 2010 with the banks' lending rates reducing by 5-6% per annum during the last quarter of 2009. At the beginning of 2009 Sri Lanka's economy experienced a dramatic plunge in foreign reserves. However with the approval and release of two tranches of the IMF's USD 2.6 Bn loan facility, the economy's foreign reserves were boosted to a record USD 5 Bn by November 2009, thus comfortably offering a cushion equivalent to approximately 6 months of imports. Economic growth for the third quarter of 2009 stood at 4.2% depicting a gradual recovery from the previous two quarters, whilst the annual average inflation declined to 3.4% by December 2009.

Going forward, it is expected that this improved and optimistic economic situation will provide adequate leeway for the Government to carry out policy reforms that will address the economy's vulnerabilities, accelerate reconstruction and resettlement, and lay a strong basis for future growth.

### The need of the hour

The recently concluded Presidential elections gave the Head of State a clear new mandate for economic development. The outcome of the election was by far an indication of the people's gratitude for the successful conclusion of the conflict and their expectations for the future. However, the elections clearly demonstrated that the need of the hour is in essence economic governance led through both private and public sector reforms. To achieve accelerated economic progress, the State has to give leadership to the creation of a just

and equitable society where merit is recognised and people are held accountable for their actions. As a nation Sri Lanka has to overcome its cancerian reputation for corruption to achieve an economic renaissance where FDI plays an active role in propagating growth. It is essential then that professionals, the business community, civil society and academics facilitate collective action towards these goals.

Sri Lanka now stands on the threshold of economic prosperity. As a nation its leaders and its people must grasp this opportunity to realise our vision for the nation. Let us not allow this opportunity to slip through our fingers; we must all focus on contributing towards a stated national development plan. We must all contribute towards the creation of a corruption free, transparent and well-governed state. Once again Sri Lanka as a nation needs to reposition itself as the "heaven of peace and harmony", a position it proudly held in the past.

### The role of the Bank

Hatton National Bank has always been a leader and proponent of national priorities. In much the same way, it will continue to play a catalytic role in achieving the economic objectives of this new Sri Lanka. Through the conceptualisation of new products and services which target growth sectors and which will contribute towards the achievement of national priorities, the Bank will continue to align its business strategy with the national aspirations for economic growth and prosperity. It will continue to accelerate its efforts towards socially mobilising rural Sri Lanka with special focus on the people of the Northern and Eastern provinces who need to be

empowered towards the achievement of self-sustenance. At Hatton National Bank we are confident of what our nation can achieve and committed towards playing a vital role in achieving economic success.

### New Appointments to the Board

During the year Mr N G (Tanki) Wickramaratne was appointed to the Board w.e.f. 1st July 2009. Mr Wickramaratne brings a tremendous wealth of experience having dedicated his entire professional career to the Hayleys Group where he retired as Group Chairman / Chief Executive Officer.

Your Board has today appointed Mrs Rose Cooray to the Board. Mrs Cooray was a career Central Banker who spent more than 30 years with the Central Bank of Sri Lanka and served in the capacity of Deputy Governor and Secretary to the Monetary Board of Sri Lanka at the time of her retirement.

On behalf of the shareholders I welcome Mrs Cooray and Mr Wickramaratne to our Bank and wish them a long and meaningful association.

### Appreciations

I would like to take this opportunity to thank my fellow Directors who have at all times extended their fullest support and shared their valued expertise towards the betterment of the Bank. The Management and Staff have worked tirelessly to post exceptional results despite the difficult conditions faced by all of us. I take this opportunity to thank all members of management and staff led by the Managing Director / Chief Executive Officer for



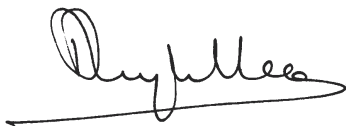
their unstinted loyalty, commitment and focus.

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

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

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

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



**Rienzie T. Wijetilleke**  
Chairman

Colombo, Sri Lanka  
15th February 2010

STICKING TO  
FUNDAMENTALS  
FOCUSING ON  
WHAT WE ARE  
GETTING  
HOLDING ON  
SUPPORTING  
GETTING READY  
FOR THE  
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### How it works: *External triggers shape challenging times*

The financial year 2009 was by far, one of the most challenging years in recent times. Overall, global commerce continued to be contained within the confines of a trough with only modest indications of a revival witnessed in the last quarter of 2009. As another decade ended, the global economic downturn remained unabated with cascading effects of depressed demand stifling growth of emerging and export dependent economies such as Sri Lanka.

In the first half of the year, the Sri Lankan economy continued to slide exacerbated by a multitude of factors. At the height of the war against terror, strained domestic liquidity, a “wait and see” approach towards investment and

remained depressed. The International Monetary Fund (IMF) bail out loan facility negotiations remained at a standstill, a detriment to the country's worsening external reserves.

However, in the second half of the year, heralded by the end of a conflict that ravaged Sri Lanka for over three decades, the prospects for the economy brightened. Optimistic expectations for economic revival in the long term were followed through with tangible outcomes towards an improved economy in the short term. As the final two quarters of the year progressed, an apparent uptake in economic activity was evidenced through improvements in economic indicators. Fourth quarter GDP growth tipped at 6%, inflation (as reflected in provisional estimates) decelerated to

### How it works: *Financial and Operational Performance*

At Hatton National Bank PLC, challenges have never been an impediment to our growth. Challenges and trying times have only motivated us to look beyond the conventional to innovation and inspired action. In 2009, we resolved towards finding optimised solutions to how it works. As in the past, by strategising proactively, setting the tone at the top, by integrating business focus with needs of stakeholders and by being consistently transparent through continuous disclosures, the Bank was able to augment its operation to one of enhanced wealth creation.

Thus, agility and acceleration of strategy implementation paved the way for greater growth in 2009.

# CHIEF EXECUTIVE OFFICER'S REVIEW

a high interest rate scenario compounded the deceleration of credit by financial institutions. As an outcome of the global financial crisis, the banking sector effectively adopted tighter processes and procedures of compliance. The unexpected and severe collapse of one of the largest financial services groups in Sri Lanka during the early part of 2009 further propagated an attitude of risk aversion. Whilst in the short term this approach paid dividends, it is likely that in the long term, calculated measures and risk aversion will only contribute towards constraining overall growth of the Sri Lankan economy. From an industry perspective, growth sectors such as Tea, Tourism, Trade and Industrial Exports as well as Construction

3.4% in December 2009, whilst the infusion of the finalised IMF loan facility helped to boost external reserves to an all time high of USD 5 Bn. in November 2009. The optimism for Sri Lanka's economy was further demonstrated in the oversubscription (by 13 times) of the USD 500 Mn, sovereign bond issued in October 2009. The Government of Sri Lanka in the last quarter of the financial year reduced domestic interest rates through a direction to the State banks with the intention of precipitating post conflict development. However, financial institutions grappled with the dilemma of balancing re-pricing of assets whilst liabilities partly remained contracted to pre-agreed rates.

Despite the adversities, our financial performance proved to be exceptional with the Bank posting a pre tax profit growth of 24% and post tax profit growth of 35%. The Bank posted an after tax profit of Rs 4.3 Bn, whilst Group after tax profit stood at Rs 4.5 Bn, remarkably above the performance averages for the Banking industry in 2009.

Solid contributions from core banking activities served towards the expansion of financial performance during the year. Group performance was enhanced considerably during the year with a majority of the subsidiaries posting commendable returns. The Insurance subsidiary - HNB Assurance PLC - posted returns of Rs 201.6 Mn (after tax) and assisted towards

## > Chief Executive Officer's Review

sustaining the performance excellence of the Group. Acuity Partners (Pvt) Ltd., which was formed in the preceding financial year as a Joint Venture with DFCC Bank, demonstrated early signs of progress towards delivering the full potential in the medium term with a profit after tax of Rs 16.8 Mn. Sithma Development (Pvt) Ltd. too performed well during the year with an after tax profit of Rs 68 Mn as a direct outcome of reduced funding costs.

The Bank, during the year, worked towards the achievement of a significantly reduced NPA portfolio. Its strategies towards this end enabled the Bank to successfully constrain NPAs to barely over 6% for the year, a noteworthy achievement given that the Bank's NPAs stood at 8.1% in the 3rd quarter of the year. Moreover, from an industry perspective, the industry norm for Non Performing Advances remains at over 8%. Thus, the Bank's diligent and relentless pursuit of portfolio quality paid dividends in 2009.

During the first three quarters of the year, loan growth witnessed a considerable contraction. However, in the final quarter, stimulated by revisions to interest rates by the Central Bank of Sri Lanka, a visible turnaround in loan growth was evident. Deposit growth on the other hand witnessed exponential momentum during the year, with over Rs. 20 Bn., in new deposits garnered over the course of the period under review. Of these, a commendable growth in low cost deposits facilitated the Bank towards balancing the cost of funds. Chiefly, the modest growth in assets over the year helped meet pre-agreed terms to depositors despite alterations to the interest rate scenario in the third quarter of the year.

The potential of Treasury operations, during 2009 remained largely untapped. Despite having tremendous potential for growth, forex contributed a modest Rs 920 Mn to the bottom-line. Corrective measures were initiated during the course of the financial year in a bid to convert this potential profitability. Capacity building initiatives in Treasury aimed at the further exploitation of opportunities afforded through trading of foreign exchange, fixed income and structured products, are expected to realise the full potential of the trading room going forward. To this end the Bank has recruited a new Head of Treasury as a member of the Bank's corporate management.

The Bank's remittance products and exchange houses continued to deliver consistent value during the year. A mix of owned / managed exchange houses, money transfer businesses and correspondent banks located across strategic global locations has formed the backbone of the inward remittance business. The owned / managed exchange houses have served towards the formation of critical remittance partnerships with an array of remittance directed countries apart from Sri Lanka, including Nepal, India, Bangladesh, Pakistan and Philippines. In the medium and long term, the Bank will continue to invest in remittance products and services given the significant contribution of inward remittances towards the development of the national economy.

Investment banking operations showed signs of promise during the second half of 2009. This business was re-launched into the market in early 2009 as Acuity Partners (Pvt) Ltd (Acuity), which aspires to be positioned as the largest full service investment bank in Sri Lanka. In the upcoming financial year, steps have been initiated towards melding the

business of venture capital under the service portfolio of Acuity. This will no doubt widen the spectrum of investment banking offerings through a single window.

Risk management and corporate governance took centre-stage during the year, driven by the heightened necessity for stringent processes and compliance procedures, greater transparency and disclosure as well operational prudence. Enhancements towards the implementation of BASEL II road map included the commitment to progressively embrace the Internal Rating Based (IRB) approach, in which risk weightings are deemed a function of the Bank's internal assessment of borrowers. The formalisation of the Board Integrated Risk Management Committee will further the Bank's tone at the top towards Risk and Governance by greater facilitation of Board oversight of Risk Management initiatives. In addition, the Bank is steadfastly pursuing the adoption of Sri Lanka Accounting Standards 44 - "Financial Instruments: Presentation" and Sri Lanka Accounting Standards 45 - "Financial Instruments: Recognition and Measurement" by 2011. Towards this end an internal Gap Analysis was conducted which will be validated by an external consultant in 2010, to authenticate the outcomes of the analysis.

### **How it works: Policy reforms to stimulate economic development**

Taxation has in the past and continues to be in the present a contentious issue for the Banking industry. The sector faces an effective rate of taxation that stands at approximately 60% - the highest amongst similar economies in the Asian region - and is an undisputed dissuasion to capital formation. Going forward, the Bank will continue to lobby for tax reforms,

purely based on its belief that a more progressive and empowering taxation policy will propel economic and social development at an accelerated pace. Thus, Sri Lanka's taxation policy in the future needs to achieve equilibrium between the dual needs of fiscal revenue and capital formation. It is hoped that the National Taxation Commission will give leadership towards this end.

Small and Medium Enterprises (SMEs) are undoubtedly Sri Lanka's engines of growth. Whilst Hatton National Bank PLC enjoys the first mover advantage after having been at the forefront of serving the SME community for many decades, it perceives further opportunity to grow the SME sector in the newly liberated Northern and Eastern provinces under the Sri Lankan Government's development programme for the region. However, the Bank recognises that impediments to the development of the region exist in the form of effective access to markets and logistical constraints. The Bank however, has the ability to introduce its corporate clients to SMEs to form win-win alliances that can further commercial enterprise. These forms of commercial linkages have already been established with partnerships formed. The Bank looks forward to further replicating this model in the coming year.

Over the past few years the Bank has continuously managed its thirst for capital through a consistent plough back of profits predominantly due to the prohibitive cost of capital and the level of uncertainty on the economic front, which inhibited raising of debt. However, in the face of a potential resurgence of the economy and with the Government's vision to double per capita income within the next five years, the Banking sector needs to appropriately gear itself to play a

critical role in the realisation of this vision.

Unfortunately, there exists a mismatch between vision and reality, i.e. the anticipated capital requirement and the available capital within the industry. For the Banking sector to truly and actively participate in furthering economic development it is essential that in future bigger and stronger banks be formed. Thus, consolidation and pooling of capital seems the most appropriate solution whereby the local banking industry is positioned to be competitive. It is hoped that the proposed amendments to the Banking Act will pave the way for consolidation as an avenue of growth for the sector.

#### **How it works: Recognition of excellence**

In 2009, the Bank received numerous accolades for its outstanding performance and service excellence. In this review, I wish to make mention of only a few of these recognitions as these alone vividly portray the successes of the Bank in diverse areas of operational and performance excellence.

Hatton National Bank PLC was the winner for the "Best Retail Bank in Sri Lanka 2008" presented by "The Asian Banker" in The Asian Banker Excellence in Retail Financial Services Awards 2009 for the second consecutive year. Likewise, Euromoney Finance Magazine recognised the Bank as the "Best Bank in Sri Lanka" at the Euromoney Awards for Excellence 2009 whilst at the Institute of Chartered Accountants of Sri Lanka (ICASL) Annual Report Awards 2008, Hatton National Bank PLC was awarded the Overall Winner of the Gold Award for the Best presented Annual Report amongst all sectors,

the Gold Award for Best presented Annual Report in the Banking sector and the Silver Award in the best presentation of Management Discussion and Analysis.

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

#### **Appreciations**

I would like to extend my sincere appreciation to the Governor of the Central Bank of Sri Lanka and his able staff for their tremendous support throughout this financial year. My deepest gratitude to the Chairman and my fellow Board Directors for their continuous and consistent support, encouragement, wisdom, input and guidance. To the HNB team, thank you for your perseverance and passion - you have been the reason for our Bank's successes. We have many more great things to achieve for the future, and I am confident that we will leave Hatton National Bank's indelible mark on Sri Lanka's future prosperity.



**Rajendra Theagarajah**  
Managing Director / CEO

Colombo, Sri Lanka  
15th February 2010

## The Board of Directors



### 1 CHAIRMAN

#### **MR RIENZIE T. WIJETILLEKE**

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

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

### 2 MANAGING DIRECTOR/CHIEF EXECUTIVE OFFICER

#### **MR RAJENDRA THEAGARAJAH**

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

Appointed Director / General Manager / Chief Executive Officer in December

2004. He was appointed Managing Director in December 2005. Member of the Corporate Management of HNB since 1997. He counts over 25 years in Banking including overseas assignments. He is a Director of HNB Assurance PLC, Acuity Partners (Private) Ltd, Acuity Securities Ltd, Acuity Stockbrokers (Pvt) Ltd and Sithma Development (Pvt) Ltd. He is the Chairman of Lanka Financial Services Bureau Ltd, Sri Lanka Banks' Association (Guarantee) Ltd and Financial Ombudsman Sri Lanka (Guarantee) Ltd and Vice Chairman of the Asian Bankers Association.

### 3 DIRECTOR

#### **MR D H S JAYAWARDENA**

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

He is also the Consul-General for Denmark in Sri Lanka. He was former Chairman of Sri Lankan Airlines Ltd and Sri Lanka Insurance Corporation PLC and a former Director of the Board of Investment of Sri Lanka.

### 4 DIRECTOR

#### **MR M V THEAGARAJAH**

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

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

### 5 DIRECTOR

#### **MR R K OBEYESEKERE**

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



**6 DIRECTOR**  
**MS PAMELA C. COORAY**  
*LL.B.*

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

**7 DIRECTOR**  
**MR RANJEEVAN SEEVARATNAM**  
*B.Sc (London), F.C.A. (England & Wales), F.C.A. (Sri Lanka)*

Appointed Director in March 2007. Former Partner of KPMG Ford Rhodes Thornton & Company - Chartered Accountants. He is a Director of Haycarb PLC, Dipped Products PLC, Diesel & Motor Engineering PLC, Acme Printing & Packaging PLC, Tea Factories Small Holders PLC, Hayleys Management PLC, Shaw Wallace & Hedges PLC, Shaw

Wallace Marketing PLC, Kelani Valley Plantations PLC, Lanka Aluminium Industries PLC, Colombo Fort Land & Building Co PLC, Tokyo Cement PLC, Metecno Lanka (Pvt) Ltd, Classic Teas (Pvt) Ltd, Green Farms (Pvt) Ltd, Acme Packaging Solutions (Pvt) Ltd.

**8 DIRECTOR**  
**MR N G WICKREMERATNE**  
*B.Sc (University of Ceylon, Peradeniya)*

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

He had chaired the Sri Lanka Association of Manufacturers and Exporters of Rubber Products, served as a Committee Member of the Ceylon

Chamber of Commerce and had been its representative on the National Labour Advisory Council. He is past President of the Sri Lanka-France Business Council.

**9 BOARD SECRETARY**  
**MS INDRANI GOONESEKERA**  
*ATTORNEY-AT-LAW*

Appointed Board Secretary in April 2001. She is the Deputy General Manager (Legal) of the Bank and is a member of the Corporate Management of the Bank for over 13 years. She is also the Board Secretary of HNB Assurance PLC, Acuity Securities Ltd (formerly known as HNB Securities Ltd) and Sithma Development (Pvt) Ltd.



## Corporate Management



- 1 R Theagarajah**  
*M.B.A. (Cranfield), F.C.M.A., F.C.A. (Sri Lanka)*  
Managing Director/Chief Executive Officer
- 2 J M J Perera**  
*F.C.I.B. (London)*  
Senior Deputy General Manager - Business Development & International Relations
- 3 J D N Kekulawala**  
*M.B.A. (Manchester), F.C.I.B. (London), F.C.A. (England & Wales)*  
Chief Financial Officer
- 4 C P Abeywickrema**  
*B.Com. (Special) Sri Lanka*  
Deputy General Manager (Marketing & Retail Banking)
- 5 Ms I Goonesekera**  
*Attorney-at-Law & Notary Public*  
Deputy General Manager (Legal) / Board Secretary
- 6 Ms D C Cooke**  
*F.C.A. (Sri Lanka)*  
Deputy General Manager - Operations & Systems





**7 Ms I R D Thenabadu**

*F.C.I.B. (London), F.C.M.A.*

Deputy General Manager - Corporate Banking

**8 J R P M Paiva**

*B.A. (Hons) Ceylon*

Deputy General Manager - Human Resources & Administration

**9 Ms L L C C Thambiah**

Deputy General Manager - Network Management

**10 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)*

Deputy General Manager - Services

**11 P Sridharan**

Assistant General Manager - Personal Financial Services

**12 D P N Rodrigo**

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

Assistant General Manager - Risk & Compliance

**13 H N J Chandrasekera**

Assistant General Manager - Network Relations

## > Corporate Management



**14 R H Abayasekara**

Assistant General Manager - Correspondent Banking & International Operations

**15 A Ratnasabapathy**

*F.P.M.A.*

Assistant General Manager - Corporate Banking

**16 M Asokan**

*F.C.A. (Sri Lanka), A.C.M.A, C.I.S.A. (USA), C.I.A.(USA)*

Head of Internal Audit

**17 A P L Fernando**

*M.B.A (Colombo), F.I.B. (SL),*

*Dip. in Bank Mgmt*

Assistant General Manager - Recoveries & Credit Quality Management

**18 D A de Vas Gunasekara**

*A.C.A, F.S.C.M.A*

Assistant General Manager - Finance

**19 D St E Fernando**

Assistant General Manager - Operations

**20 N U Jumat**

*F.I.B. (SL)*

Assistant General Manager - Trade Services

# Senior Management

- 1 **R M P Ratnayake**  
M.B.A. - Finance (Southern Queensland - Aus.), P.G. Dip. Busi. & Fin. Admin. (I.C.A.S.L. & Cranfield), F.I.B. (SL), M.A.A.T., F.C.P.M.  
Chief Manager - International Operations / Chief AML Officer
- 2 **K L Wijesooriya**  
LL.B (Sri Lanka)  
Chief Manager - Remittances
- 3 **V Vijayakumar**  
M.Sc. (I.T.) UK, A.I.B. (SL), M.I.M.I.S. (Lond.), A.M.I.A.P. (Lond.), M.A.A.T. (SL), M.B.C.S.  
Chief Manager - Information Technology
- 4 **T Govinthadas**  
M.B.A. (Colombo), B.Sc. (Hons) (P.F.T.) (Cey.), A.C.I.B.(Lond.)  
Chief Manager - Pawning & Development Banking
- 5 **B K Wijeratne**  
B.Sc. (Physical Science) Colombo  
Chief Manager - Leasing
- 6 **P G Wilson**  
B.Sc. (Kelaniya), Dip. In IT (N.I.B.M)  
Chief Manager - Business Continuity Planning
- 7 **R J Thambirajah**  
Chief Manager - Colombo Region & Corporate Branches
- 8 **I A Baduge**  
Dip.in Bank Mgmt., A.I.C.M.  
Chief Manager - Corporate Banking
- 9 **R M P Dayawansa**  
M.B.A. (Sri J.), F.I.B. (SL), M.C.I.M. (UK), M.S.L.I.M.,  
Chief Manager - Greater Colombo Region
- 10 **S Sivalingam**  
A.C.I.B. (London)  
Chief Manager - Procurement & Logistics
- 11 **T M A Mutaliph**  
Attorney-at-Law, A.I.B.(SL), Dip. in Bank Mgmt., LL.B (Sri Lanka)  
Chief Manager - Operational Risk
- 12 **A Goonesekere**  
M.B.A. (Sri J.), F.C.A. (Sri Lanka), F.C.M.A.  
Chief Accountant
- 13 **R B Warnakulasuriya**  
M.B.A (Sri J.), B.Com. (Special) Kelaniya, M.A.A.T, A.I.C.M.  
Chief Manager - North Western Region
- 14 **V Ratnasabapathy**  
A.C.I.B. (London)  
Chief Manager - Credit Risk
- 15 **U N I Elapata**  
B.A. (Hons) - Univ. of Texas (Austin)  
Senior Manager - Card Centre
- 16 **Ms N M C P Wettasinha**  
Attorney-at-Law & Notary Public  
Senior Manager - Legal
- 17 **E C Alles**  
B.Sc. (Bangalore)  
Senior Manager - Special Projects (International)
- 18 **S Udayakumar**  
D.B.A (UK), B.Sc. (AM), M.C.M.I. (Lond), M.S.L.I.M, Dip. In Busi. Mgmt & Admin (UK), M.C.P.M.(SL), Dip. In Sales Mgmt & Marketing (UK), A.I.T.D. (SL)  
Senior Manager - Operational Risk
- 19 **J T M Weeresinghe**  
Senior Manager - Credit Risk
- 20 **N Premarajah**  
Higher Diploma in Institute of Business Mgmt - Chennai  
Senior Manager - Consumer Banking & Housing Finance
- 21 **Ms M K Rambukwella**  
M.B.A. (Sri J.), M. Sc. (Pera.), B.A (Hons) Pera., A.C.I.M. (UK), M.S.L.I.M., A.M.I.T.D. (SL)  
Senior Manager - Training & Development
- 22 **Ms R Prabhakaran**  
A.I.B. (SL)  
Senior Manager - Treasury Operations
- 23 **A G Gomez**  
Senior Manager - Treasury
- 24 **Ms K Balasubramaniam**  
LL.B (Sri Lanka)  
Senior Manager (Human Resource Management)
- 25 **H J A Fernando**  
Senior Manager (Centralised Operations)
- 26 **L S C L R Fernando**  
A.I.B (Sri Lanka)  
Senior Manager - Central Region
- 27 **N M Kulatunga**  
M.B.A. (Sri J), A.I.B. (Sri Lanka)  
Senior Manager - Credit Administration
- 28 **W J T Fernando**  
M.B.A. (Sri J), A.I.B. (Sri Lanka)  
Senior Manager - Uva Sabaragamuwa Region
- 29 **D S L Ferdinando**  
Senior Manager - Corp. Account Relationship
- 30 **A R Uduwela**  
M.B.A. (Sri J), B.Sc. Special (Pera),  
Senior Manager - City Office
- 31 **P H K S C Ranasinghe**  
B.Sc. (Eng) Moratuwa, ACMA  
Chief Information Officer
- 32 **W M C O Panditharatne**  
Senior Manager (Employee Remuneration & Benefits)
- 33 **L S Sameera**  
CEng. MBCS, CITP,MCS (SL),  
Senior Manager (IT Software Dev.)
- 34 **B K Achan**  
M.Sc. (Bombay), B.Sc. (Hons) (Calcutta),C.A.I.I.B.(India)  
Chief Representative Officer - Chennai
- 35 **Kausar Ali**  
B.Com.  
Chief Representative Officer - Karachi

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# MANAGEMENT DISCUSSION

STRATEGISING PROACTIVELY and building resilience through challenging times  
THAT IS HOW IT WORKS

## Management Discussion



### Corporate Banking

How it worked in 2009:  
strategic business innovation maintains  
momentum despite industry slack.

As the effects of the global financial crisis permeated into the Sri Lankan economy, a perceptible sluggishness in the financial services sector was evident throughout the year. This was further exacerbated as repercussions of financial fall-outs in the local industry were disclosed in the early part of 2009.

Given the industry slack, Hatton National Bank's (Bank) Corporate and Project Finance Division opportunely utilised the year under review to revisit and reinforce business processes. In an attempt to further strengthen the existing governance and risk assessment processes the Bank analysed every facet of the Corporate and Project Finance business to improve and incorporate best practices along the procedural system.

With the market contraction witnessed during the year, Corporate and Project Finance activities were duly focused on consolidation of existing business through enhanced customer relations. Extensive customer portfolio evaluations were carried out during the year to determine viable customer relationships in the long term. However, the development of strategic growth drivers was given precedence during the year. As such a series of market and sector based analysis were conducted to determine a conclusive and strategic way forward, in the immediate future.

#### Corporate Banking

As the year progressed strategic business innovation allowed the Bank to

maintain performance momentum through proactive implementation of market-based strategies. In the Corporate Banking arena, the Bank spearheaded the entry of private sector financing of large-scale Infrastructure projects such as utilities and road development. Despite the low appetite for corporate funding in 2009, the portfolio was retained whilst aggressive recovery strategies were put in place which resulted in the maintenance of a healthy portfolio.

#### Project Financing

Project Financing activities continued to focus on power generation and renewable energy projects. In view of the growing global, socio-economic debate on the need for green energy, the Bank placed emphasis on garnering a greater level of involvement in the energy sector given the strategic importance of the sector especially in the long-term. As such, for the first time, the Bank undertook the project financing of an energy project in an international market with the strategic intention of gaining entry into new emerging markets for energy based projects in the years ahead. Hatton National Bank continued to play an integral role in the financing of a number of energy based projects in Sri Lanka, with financing extended for the first time to a wind power generation plant. Leisure based projects in Sri Lanka and the Maldives continued to generate commendable revenue during the year.

From a performance perspective, Project Financing contributed significantly to the overall profitability of the Bank. The Project Financing portfolio was successfully retained during the year whilst the Bank also made its first entry into the African continent to further diversify its exposure to overseas markets.

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

#### Small and Medium Enterprise (SME)

The Bank continued to support small and medium category enterprises out of its own funds as well as donor sponsored refinance credit lines.

The SMILE II Revolving Fund Credit Scheme that was commissioned in the latter part of the year 2008 subsequent to the exhaustion of the SMILE I Revolving Fund Credit Scheme in July 2008 met equal measures of demand. The Fund was utilised to extend assistance to entrepreneurs in the Northern peninsula as well, in the post conflict scenario.

Whilst the Bank over the past three decades had supported entrepreneurs of the North and Eastern provinces through its strategically positioned branch network and long standing

presence in the region, in mid 2009, it further reinforced its service offering through further extension of credit facilities and re-finance programmes. This was ably demonstrated when the Bank remained the sole active participant of the KfW DFCC - V credit scheme for SMEs in the North and East. With a view to actively participating in the development efforts of the Northern and Eastern provinces, the Bank also undertook a series of initiatives aimed at increasing awareness of the Bank's numerous credit facilities and products.

The tea industry was a key area of focus for the Bank during the year. The year 2009 proved to be yet another

challenging year for the industry, which experienced comparatively low international prices in the first few months as an outcome of the effects of the global recession. This was further exacerbated by adverse weather conditions constraining the total productive output of the industry. In view of this, the Bank continued with the series of relief measures proactively afforded to bought leaf factory operators. The Bank's initiative towards this end was in line with the offer of relief packages to the Tea Sector by the Government of Sri Lanka through the Sri Lanka Tea Board. Being an active participant of this Interest Subsidy Loan

Scheme the Bank approved facilities totaling Rs 493.6 Mn.

### Future Outlook

Going forward, Corporate and Project Finance will continue to consolidate its service delivery and introduce innovative products and services in a bid to enhance convenience to clients with a view to be positioned as the preferred banker for corporates. In the year ahead, the Bank will continue to conduct a series of customer development programmes with a view to sharing skills and know-how with the Corporate, Project Finance and SME sectors whilst also popularising the SME concept amongst the rural population.



## Personal Financial Services

How it worked in 2009:  
Portfolio Quality and Sustainable Business Practices stabilise a strong growth momentum.

Hatton National Bank's retail banking services comprise a portfolio of products that covers a wide spectrum of personal financial services. In 2009, the Bank persisted towards its strategic objectives by focusing on the realisation of strong penetration of retail banking services across the nation whilst preserving the lending portfolio quality.

Throughout its operational history, the Bank has strived to cater to the people of Sri Lanka - across every stratum of demography and geography - by providing solutions that empower and enhance livelihoods. The ability to empathise with the people of the nation has earned it the recognition of being a financial institution that goes beyond mere banking to being an undisputed partner in the progress of people's lives.

In the year under review, this recognition was further enhanced and reinforced when the Bank was awarded the Best Retail Banker of the Year by "The Asian Banker" for the second consecutive year. HNB remains the only Bank in Sri Lanka to have retained the Award consecutively in the history of the Retail Banker Award scheme. In addition to this, the Bank also received the accolade of being recognised by the prestigious Euromoney Magazine as the Best Bank in Sri Lanka for 2009. The Bank's role in precipitating personal financial services within the periphery of sustainable business practices has been a key to its success in the year.

### Developing accessibility with convenience through Customer Centres

In 2009 the Bank expanded its customer centre network to 186 customer centres across Sri Lanka. During the year 9 new customer centres were added to the network whilst 5 relocations provided greater access to customers.

Towards the latter half of the year a significant focus was made on strengthening the existing branch network in the Northern and Eastern provinces with enhanced resources. In addition, new customer centres at pre-identified areas of the region are in the pipeline for inauguration in 2010.

## > Management Discussion

The Bank's very first Micro Banking Unit commenced operations in Kurunduwatte, Nawalapitiya to cater to the needs of SMEs and micro finance customers in the area.

### Automated Teller Machine (ATM) Penetration enhanced

The Bank, during the year under review, remained committed to its strategy of facilitating accessibility by aggressively expanding the Bank's electronic delivery channels, specifically through enhanced penetration of the ATM network. The Bank is well regarded as having the widest reach of ATMs within Sri Lanka. The network caters not only to the Bank's own debit and credit card holders, but for all VISA, and MasterCard credit and debit cardholders.

In 2009, the network reached a milestone with the commissioning of the 300th ATM at the Sinhalese Sports Club in Colombo. During the year, 50 new ATM locations enhanced the network to 310 locations as at the end of 2009.

During the year the Bank also introduced several value additions to the ATM enabled services ranging from the facility to change ATM PIN (Personal Identification Number), cheque book request, display of un-cleared effects and mini statement of the last 10 transactions, to the transfer of funds to any HNB account. The value additions to and expansion of the ATM network in the year 2009 coincided with the Bank introducing its VISA International Debit Card, which replaced the proprietary ATM card.

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

Hatton National Bank recognises the need to look beyond traditional delivery channels in an era when consumers are gaining sophistication in the manner in which they transact and interact with service providers. Whilst the Bank's traditional brick and mortar service delivery - the branch network, micro banking infrastructure etc - reaches out to the majority of the Bank's customer

base, a growing demand for alternate delivery channels has driven the growth of Bank's E-banking solutions. With the growth of Internet and mobile telephony penetration in Sri Lanka, this trend is expected to grow.

The Bank's Internet Banking Service, "Virtual Branch" continued to garner increased traffic and transactions during the year with a large number of financial transactions exceeding Rs 1.72 Bn completed during the year. This resulted in a 36% increase over the previous year. The integration of the Virtual Branch to the Bank's Core Banking Platform in 2009 facilitated the incorporation of a number of value additions to the service, thereby enhancing the service through lowered transaction costs, greater flexibility and greater security in transactions.

The usage of SMS and Mobile Banking reflected a growth of 14% during the year.

### Deposit Mobilisation

The year 2009 proved to be one of the most successful years in terms of the quantum of deposits mobilised. With a newly garnered deposit base of approximately Rs 20 Bn, the Bank's deposit mobilisation drive during the year under review was further enhanced by the prevalence of a stimulating interest rate scenario during the first 3 quarters of the year. Therefore, the Year On Year (YOY) deposits growth was a commendable 13.4% from that of 2008, a growth trend that is indicative of the accomplishments of deposit mobilisation during the year.

HNB Pathum Vimana, the Bank's flagship mobilisation tool for the past 16 years played a critical role in garnering a greater share of the savings deposits during the year. Targeted at the Bank's entire customer base across the spectrum of geo-demographics, Pathum Vimana effectively attracted a significant flow of funds into the Bank through low interest cost savings accounts. During the year, as a result of the successful appeal of Pathum Vimana

scheme to our customer base, the Bank posted a 13% growth.

Capital Savings, introduced into the market place in 2008 to stimulate the lackluster savings environment, performed commendably to post a 100% growth in the deposit base. With a greater affinity towards urban markets, Capital Savings, though beneficial to the customer are less cost effective to the Bank due to high cost of capital incurred by high interest rates. The Capital Savings base grew during the year by 156%.

Fixed Deposits, though stifled by intense industry competition also registered a sound growth trend of 7% in 2009. Savings products - Singithi Kirikatiyo and Singithi Lama - aimed at inculcating the habit of thrift amongst children effectively drew in over Rs 680 Mn during the year. The Student Banking Units continued to play a critical role in this regard. These units have successfully instilled a strong savings habit amongst children and have served as a source of inspiration to countless children across the nation who in turn have preached the benefits of a savings culture to their peers and parents, thus shaping beliefs and changing behaviours.

Foreign Currency deposits witnessed 10% growth during the year despite the instability in the global economy. NRFC and RFC accounts attracted new savings deposits by virtue of the success of the HNB Pathum Udanaya promotional drive.

### Pawning

Pawning as a product has emerged as a focal line of business in the retail sector. It is a significant contributor to the profitability of the Bank whereby its influence on the bottom-line has consistently grown sharper over the past years. However, in the year 2009, the cumulative effects of a sluggish economy and increased competition in the industry led to a somewhat subdued growth of business YOY from 2008.



Despite the challenges faced during the year, the Bank defended its market share, enhancing the competitiveness of the product via a dual pronged strategy of competitive scale of finance and interest rates together with the differentiation of offer through a promotional campaign.

During the final quarter of 2009, the pawning portfolio witnessed a significant increase aiding in the achievement of a net growth of about Rs 785 Mn in business for the year. However, this remained below the target expectations outlined at the commencement of the year.

The Bank's pawning portfolio is characterised by its quality. Whilst aggressively marketing the product, the Bank is conscious of the need for responsible lending and concertedly follows a series of quality evaluations prior to lending. This lack of compromise on the quality of the portfolio is evident in that the Bank enjoys a Non Performing Advances (NPA) ratio of around 2%. As a result, capital losses have been very low. These factors have firmly established pawning as a main product in the retail product line.

### Leasing

The leasing industry in 2009 contracted sharply due largely to a decline in the motor vehicle market, which plummeted consequent to revisions to import taxation. This market shrinkage affected the entirety of the leasing industry. Nevertheless, the Bank performed above average due to the quality of the leasing portfolio wherein effective monitoring and credit evaluations rendered low NPA levels. The consistent

focus on portfolio quality and recoveries enabled the Bank to overcome the challenges posed by the external environment whilst setting a sound foundation for further growth in the year ahead.

Enhanced customer relations and a series of tactical promotions worked hand in hand to strengthen the brand and to consolidate the business. Unique promotions were conducted by the Bank in the form of "town storming" leasing fairs in over 40 locations across Sri Lanka in association with vehicle dealers.

### Housing Loans

A scenario of high interest rates coupled with the impact of the recession impeded the Shanthi home loan product. The momentum of growth slackened in the year. However, the bank was able to sustain the portfolio despite adverse conditions. The priority for the year, therefore, remained the maintenance of the portfolio quality with many control measures undertaken to contain the NPA levels.

### Personal Loans

The personal loan portfolio showed a slight decline during the year with credit issuance at reduced levels due to decrease in demand arising from the high interest rates prevalent in the first three quarters of the year. As a result, the Bank concentrated on portfolio quality and reduction of NPAs.

### Credit Card Services

The growth of credit cards services during the year 2009 was intentionally constrained due in part to challenges

posed by the global financial crisis and as a risk mitigation strategy in the aftermath of the incidents that marred the stability of the Sri Lankan financial services industry during the year. Therefore, the key objective for the year was to consolidate the existing credit card base whilst generating revenue through incentivised usage. Focused promotions at a variety of merchant locations aided in maintaining card profitability despite the challenging market environment. Stringent control measures enabled the Bank to maintain portfolio quality, a commendable achievement from an industry perspective.

Efforts to increase merchant acceptance paid dividends during the year with the Bank increasing its share to 40%, enabling the Bank to become the largest Visa card acquirer in the Sri Lankan market. The main focus during the latter part of the year was the launch of the Visa Platinum credit card, the exclusive product offering for the Bank's premier customers. The card was launched initially at "The Club" priority banking centre.

The Bank renewed its marketing focus to aggressively promote its Visa Debit card from the first quarter of the year with the objective of converting existing proprietary ATM cardholders to the Visa Debit card. By the end of the financial year under review, the debit card base posted a 300% volume growth.

## > Management Discussion



### Development Banking

How it worked in 2009:  
Corporate collaboration and customised services augment the future of micro-finance.

Hatton National Bank prides itself as the premier private sector commercial bank in Sri Lanka to have been actively involved in rural development during the last four decades. The Bank commenced its development banking activities almost from its inception. By 1972 the Bank recognised the need for focused resource allocation to further develop services to the rural community and thereafter established the Development Division with a vision to be the foremost development banking unit among commercial banks whilst positively contributing towards the economic development of the nation by providing credit and other social banking services. Since then, the Bank has made significant inroads to the rural population of the country.

#### Rural / Agri Lending and Micro Finance

The Bank through its established funding programmes catered to agriculture / agro based SMEs and microfinancing sectors during the year. It also continued to promote a number of rural sector refinance and non-refinance credit lines and provided a comprehensive package of financial services for the development of the rural economy. As an active 'Participating Credit Institution' for almost all credit lines funded by the Asian Development Bank, World Bank, International Fund for Agricultural Development, Japanese Bank for International Cooperation as well as concessionary credit lines introduced by

the Government of Sri Lanka, the Bank has acted as a catalyst of change to Sri Lanka's rural community.

In the year under review the rural and micro financing portfolio grew by 9% to Rs 6.4 Bn with disbursement of loans amounting to Rs 2.9 Bn during the year to a total of 9,200 rural entrepreneurs. The portfolio quality remained a key consideration in loan disbursement in 2009.

The Bank's 'Gami Pubuduwa' (village awakening) programme, during the year, continued to extend financial services to self employment projects and other micro enterprises in the rural and semi-rural areas. The primary objective of the programme has been achieved over the past two decades of operations, with the Bank successfully establishing a closer linkage with the rural communities to whom financial services had hitherto been less accessible. To reinforce its commitment, the Bank currently deploys in excess of 120 field officers including microfinance / agricultural experts to assist the rural sector banking operations. Through the implementation of "Gami Pubuduwa" the Bank has not only placed confidence in the capability of the rural community but also assisted them towards the achievement of self-reliance.

Micro Financing for Small and Medium Enterprises (SME) in 2009 gathered further momentum with renewed accessibility to enterprises in the Northern and Eastern Provinces. The Bank viewed this geographic area as a

viable growth market in the first half of the year. Subsequently in the post conflict era, consistent and sustained emphasis in the development of this market through financial accessibility has led to the establishment of strong relations with SMEs.

#### Spearheading Corporate Collaboration

In the year under review, the Bank pioneered a concept for long term surety of farmer produce through corporate collaboration. By establishing linkages and partnerships that allow for the optimisation of farmer produce, the Bank networked with corporates to assure long-term market viability for rural farmers.

The Bank has been at the forefront of providing financial services to the rural community covering a wide and extensive area focusing on agriculture, agri processing, animal husbandry, fisheries, trading and other self employment projects. It pioneered this collaboration in an effort to stabilise the long term revenue avenues for farmers, who are otherwise jeopardised by crop price variations due to external factors.

Over the years the Bank has gained wide exposure in serving the rural community and has gone beyond the normal engagement of providing financial assistance by finding markets for the products that are produced through the rural sector. To facilitate this process the Bank organised and conducted a number of trade fairs in the

rural hamlets of Sri Lanka. The Bank also actively promoted the use of modern technology by linking the rural community to technically savvy organisations to improve the quality and standards of the products manufactured by them.

During the year, the Bank selected two major corporate partners; Chemical Industries (Colombo) PLC and Hayleys PLC who are established household names among communities in the rural sector, to build and strengthen new linkages with these communities with a view to generate new employment opportunities in the agricultural sector and related fields, create awareness for entrepreneurs to move towards new technology, techniques and market opportunities, and provide opportunities to entrepreneurs to move from substance level to commercial level.

The programme envisages that the corporate partners will identify prospective farmers and entrepreneurs who are eligible to be linked with their out grower network in sectors such as paddy, livestock, fisheries, fruit and vegetables etc; supply agri input and advisory services; assist in agro technologies and implement buy back agreements with farmers to purchase their produce. The Bank in turn will focus on providing financial assistance by promoting credit and drive the approach of building financial literacy and technical know-how among the farmer community through its branch managers, agricultural officers and micro finance officers serving in rural areas.

### **Micro Banking Units**

During the year 2009, the Bank pioneered a new delivery channel for development banking through the inauguration of the Micro Banking Unit with the intention of bringing financial inclusion to rural Sri Lanka. The concept behind this initiative is to offer a comprehensive package of services including financial assistance, technical know-how and marketing arrangements to the rural community. This will significantly contribute to the development of the rural agricultural economy, whilst bringing banking to its doorstep. As such, the first ever Micro Banking Unit was opened at Kurunduwatte, Nawalapitiya on 15th September 2009.

Kurunduwatte is a newly awakened town and is an area that has a growing demand for banking services, particularly in the agricultural sector as well as commercial sectors. The Micro Banking Unit at Kurunduwatte, Nawalapitiya has a fully equipped IT infrastructure and provides ATM facilities to the community. It also serves as a focal point for the dissemination of financial literacy to the people of the area.

### **Micro Insurance**

The Bank's Micro Insurance product launched in partnership with its subsidiary HNB Assurance PLC posted a significant growth during the year with an increase of 45% in policy holders from 2008. Volume wise the product garnered 4,082 policies as against 2,796 policies in 2008. The growth

momentum of the product during the year indicates a strong market potential for the product in the years ahead.

### **Future Outlook**

In a post conflict era, Sri Lanka stands at a critical stage in precipitating the nation's economic development, especially in respect of areas that have, hitherto, remained neglected. Thus, stimulation of the national economy through the creation of Micro Entrepreneurs and acceleration of rural development will remain key national priorities for the next couple of decades.

Therefore, in the medium and long term, the Bank envisages opportunities to further strengthen the Development Banking sector in the Northern and Eastern provinces. It foresees its role as a catalyst in infusing sustainable business practices to the communities of these provinces thereby precipitating development of the socio-capital and the livelihoods of the people. Hatton National Bank, with decades of experience and expertise in the field of microfinance, with all the resources at its disposal is well placed and will have a distinct advantage over its competitors to create a major impact on financial inclusion.

## > Management Discussion



# International Operations

How it worked in 2009:  
Volume expansion in Remittances propels growth

### Remittance enlarge in post-conflict scenario

Despite the Global Banking downturn in many developed countries, inward remittances from expatriate Sri Lankans routed through Hatton National Bank continued to grow in 2009 recording an increase of 12% over the previous year. In absolute terms such inward remittances totaled USD 515 Mn during 2009 as against USD 462 Mn in 2008.

Another factor that supported volume expansion of inward remittances was the direct consequence of a foreseeable post-conflict development scenario in Sri Lanka.

Within the Sri Lankan banking industry, Hatton National Bank is the holder of the second largest foreign currency base and in 2009 the bank further augmented stature by enhancing its infrastructure to facilitate delivery of inward remittances. To this end, a series of initiatives both within the Sri Lankan as well as international markets was commenced.

The cumulative effects of the interest scenario globally, and the initiatives offered by the Central Bank of Sri Lanka to Non-Resident Foreign Currency (NRFC) and Resident Foreign Currency (RFC) account holders in the form of bonus on interest, were deemed to have further propelled the growth of these categories of foreign currency deposits in 2009.

Hatton National Bank sought to further benefit from the opportunities for

inward remittances through the strategic establishment of two remittance houses in Abu Dhabi and Toronto during the year 2009. These two exchange houses supplement the Bank's existing operations in Oman which commenced in November 2008. These exchange houses which are managed by Hatton National Bank are considered strategic to the future growth of the Bank's international business especially in the sphere of remittances, a subject which now commands recognition across the globe. These initiatives complement the inward remittance business which has been nurtured through strategic alliances with a portfolio of Exchange Houses and Money Transfer Agencies in key "Send Countries".

### Infrastructure development drives International Operations portfolio

International operations portfolio, particularly the services for Letters of Guarantee related to infrastructure development projects contributed significantly, recording a fee based income increase of 19% in 2009 over the previous financial year.

### MoneyGram

In Sri Lanka Hatton National Bank PLC operates as the super agent since April 2008 for MoneyGram, a leading provider of money transfer services from over 180,000 agent locations in 190 countries and territories.

### Future Outlook

In 2009 the Bank exercised its super agent authority by appointing a Sub-Representative with a 34 customer centre network increasing the points at which beneficiaries could collect the proceeds of their moneygram remittances. A further Sub-Representative with a good network of outlets is expected to be appointed in 2010.

The focus lies in strengthening the operations of the international network of owned and managed exchange houses with the foremost objective being to break even as early as possible in 2010.

Plans are a foot to reach finality on ground work already carried out for the extension of Exchange House activity to Australia in the ensuing year.

The bank is fully committed and focused towards expanding remittance activity in anticipated markets of growth such as Israel, South Korea and Italy through mutually beneficial relationships and models ensuring speed of delivery while simultaneously minimising operational risk and cost.

### TRADE SERVICES

International trade operations witnessed a marginal decline from that of the year 2008, the result of the global economic downturn and reduction in cross border trade impositions. Consequently, import financing revenue declined by 1.6% and

export financing revenue declined by 7%. The challenging environment constrained the Bank's fund and non fund income from trade services with the annual income declining to Rs 2.1 Bn from Rs 2.2 Bn in 2008.

The Bank's Trade Services operations are ISO 9001:2000 certified. During the year, the operations were upgraded to the new Standard, ISO 9001:2008 version. This image enhancement is expected to augment marketability of the division's services in the years ahead.

### Future Outlook

In the immediate future, trade services envisages a turnaround in international trade activity as the global recession bottoms out towards the second quarter of 2010. As a result, the division targets a 15-20% growth in the year ahead. From a domestic economic perspective, the infrastructure, agriculture and commercial activity in the Northern and Eastern provinces are expected to drive the economy to higher levels of growth in the upcoming financial year. The scope for international trade operations is therefore expected to grow in parallel to the surge in economic growth.

The full implementation of the Finacle core banking system in 2009 will, no doubt, garner greater returns due to synergies arising from a uniform platform. The Bank will look to exploit the Free Trade Agreements (FTA) with India and Pakistan through its representative offices in these nations.



## Treasury Operations

How it worked in 2009:

Prudent and proactive management of risk, abiding by fundamentals facilitates overcoming challenges

The year 2009 was expected to bring stability to local and overseas forex and money markets, due mainly to the easing of the sub-prime mortgage crisis. However, what transpired during the year was contrary to expectations and fresh challenges began to emerge, particularly from the Middle East.

Locally, the Central Bank of Sri Lanka lifted restrictions on forward exchange transactions. Restrictions to net overnight exposures, imposed in 2008 too were lifted during the year. The USD/LKR hit record highs of around Rs 120.30 and plummeted subsequently, mainly due to the receipt of two IMF loan tranches. The Central

Bank managed to reduce volatility by holding the USD/LKR at certain levels for extended periods of time.

Local interest rates also plummeted as the market got saturated with funds. The Benchmark Repurchase and Reverse Repurchase Rates dropped from 10.5% and 12% at the beginning of the year to 7.5% and 9.75% respectively by November 2009.

Although the first half of the year was relatively calm and compared to 2008, forex and commodity markets continued to experience turbulent times during the second half of the year, with the greenback weakening throughout the

year. Major economies demonstrated initial signs of economic revival although the U.S. economy continued to face major structural and cyclical problems, with speculation mounting on the possible replacement of the greenback as the world's reserve currency.

Through prudent and proactive risk management policies and by focussing on fundamentals, the Treasury Division managed to successfully negotiate the majority of challenges posed during the year.

## > Management Discussion



# Information Technology

How it worked in 2009:  
proactive IT supports business growth

### The Role of Information Technology

Information Technology (IT) continued to be used at Hatton National Bank to support its business objectives. A keen IT orientation has enabled the Bank to be at the forefront of product development, enhanced market infrastructure and the implementations of reliable techniques for control of risks and has assisted in effectively bridging the divide between geographically distant and diversified markets. Thereby, technology has changed the contours of the major functions performed by the Bank; access to liquidity, transformation of assets and monitoring of risks.

The benefits of Information Technology to the operations of the Bank are numerous. As a support to the core banking function, IT has transformed the Bank's service offering to both internal and external customers. In 2009 as in previous years, proactive IT solutions supported business growth through improvements in business intelligence and cross selling, product development capability and time to market, thus achieving significant advancement in competitive advantage.

Transaction processing costs have been better managed through improved operational efficiency and increased productivity. Standardisation of services has resulted in customer service across the network becoming uniform.

### Banking Made Easy

#### *HNB Virtual Branch:*

Implemented in 2003, the Bank's Online Banking solution to date serves a cross section of its customer base. During the year 2009, a 40% growth in the online banking community was evident from that of the previous year, demonstrating the degree at which customers migrate from traditional to virtual banking. The increased ICT literacy and penetration across Sri Lanka is expected to propagate an increased demand for virtual banking needs in the next five years.

#### *HNB Mobile Banking:*

Introduced in the year 2006, the Bank's mobile banking solution allows customers access to the HNB Virtual Branch through the use of a GPRS/3G enabled mobile phone in three languages. The solution aims to empower customers through greater accessibility to banking services, by fragmenting the confines of traditional banking.

#### *SMS Banking:*

Mobile telephony penetration in Sri Lanka has increased rapidly over the last decade with significant usage in rural Sri Lanka as an alternative to fixed telephony. Research indicates that approximately 12.6 Mn subscribers in Sri Lanka have access to mobile phones and are familiar with the functionalities of SMS, MMS and other supplementary services offered by mobile telephony service providers. This rapid volition of

the mobile phone has created a conducive platform for penetration of banking services with ease and speed. Hatton National Bank's SMS banking system has seen a rapid growth during the past years.

#### *Cash Xpress:*

HNB's own remittance system is deployed in a number of exchange houses in the Middle East, Canada, Malaysia, Australia and the UK. This has empowered a large number of migrant workers to be able to instantly and securely transfer funds to Sri Lanka either in the form of an Account Credit or payment on identification.

#### *Automated Teller Machine (ATM) Network:*

ATM services through the Bank's Cashline Card and Visa Debit Cards are available to customers having Current / Savings accounts and / or Visa / Master Credit Card accounts. The Bank has 310 ATMs networked across the nation including its drive-through ATMs.

#### *Visa Debit Card:*

The Bank's Visa Debit Card allows customers to access their primary bank accounts directly for purchases. The card allows for customers who may not necessarily wish to use credit cards the opportunity to shop securely with their own money irrespective of their location, be it in Sri Lanka or overseas. The card can also be used to withdraw cash from any ATM that accepts Visa Cards in Sri Lanka and overseas.

### The Next Step: Emerging Technologies

Hatton National Bank recognises that banking is undergoing a rapid transformation in the world of today. Value added services are slowly but steadily emerging with significant evidence pointing towards consumer willingness to utilise such services in view of the convenience they offer.

A major challenge faced by financial services companies is the impact of

competition from Telcos and other service providers offering low cost options.

The solution, therefore, appears to lie in increasing volumes well beyond a critical mass so as to achieve better economies of scale. This is best achieved by exploiting the benefits of technology which facilitate handling increased volumes at higher levels of efficiency. It is in this context that Hatton National Bank envisages the imperative need for integrating

technology with every aspect of its service offering. Innovation through the application of emerging technologies will allow the Bank to optimise its service offering whilst minimising its costs in the years to come.

### Pipeline

The Bank will persist with the strategy of introducing greater innovations through cutting edge technology in the coming years as well.



## Marketing

How it worked in 2009:  
Strategic Marketing and Integrated Marketing Communications sustain business performance despite industry slow-down

Strategic marketing and marketing communications together proved to be key contributors to the performance excellence of Hatton National Bank during the year 2009. Consumer confidence suffered in totality during the year, due to the cumulative effects of upheavals in the local financial services industry compounded by the multiplier effects of the global financial crisis.

The Bank employed a dual strategy aimed at enhancing its corporate image whilst concurrently generating consumer interest in the Bank's products and services through a series of tactical promotions, thereby motivating consumers to convert their brand awareness and interest into action.

### Strategic Corporate Communications maintain corporate brand image

As events in the Sri Lankan and Global financial services industry unfolded in the first quarter of 2009, general confidence amongst consumers plummeted. To ascertain the true impact of the fall-out, Hatton National Bank commissioned a series of research to determine consumer understanding of the situation and the level of confidence amongst retail banking consumers. The findings pointed towards a sharp decline in the overall confidence of consumers in financial institutions mainly due to the collapse of two key financial service institutions.

Consumer insight therefore dictated the need for the Bank to communicate its strength, stability and long standing

reputation as an icon in the financial services industry of Sri Lanka. Thus, a corporate brand communications strategy was formulated with the intention of instilling the core values of the HNB brand. In February 2009, the corporate communications campaign was launched across all "above the line" media vis-a-vis TV, Press and Radio, with below the line activities supplementing the core campaign. As a fully integrated marketing communications campaign, a concurrent internal communication aimed at employees reinforced awareness, educated and imparted the core values of the brand whilst simultaneously acting as a confidence building exercise at branch level.

Post testing of the campaign validated the effectiveness of the campaign in negating perceptual inconsistencies and

## > Management Discussion

demonstrated a high level of consumer belief in the brand values of heritage and strength.

### **Integrated Marketing Communications translate interest to action**

As in previous years, the Bank unveiled a series of promotions to activate specific sub-brands. Whilst many of the promotions were ones held in preceding years and therefore activity that is inherently part and parcel of certain sub-brands, others were conceptualised during the year to stimulate consumer action.

#### ***HNB Pathum Vimana:***

Held for the sixteenth consecutive year, the Pathum Vimana promotion holds the distinction of being the biggest deposit draw in the financial services and banking industry in Sri Lanka, to provide customers with incentives to not only save regularly, but also build substantial savings accounts and thereby be eligible to win prizes. The prize scheme is multi-pronged allowing customers multiple chances of winning.

#### ***HNB Pathum Udanaya:***

The Bank's deposit draw for Sri Lankan expatriates and Resident Foreign Currency holders, was held during the year, through two mega draws.

Pathum Udanaya was first introduced with the objective of encouraging Sri Lankans working overseas to save their foreign earnings with a trusted bank back home. The Bank prides itself in the knowledge that by encouraging people to save through minimum savings criteria, it is assisting people to save for long-term wealth creation.

#### ***HNB Singithi***

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

Singithi Lama is a savings account that can be opened for any child below 12 years of age. The Singithi Lama account holder was eligible to choose from a range of exclusive gifts during the year 2009. Similarly, the Bank initiated a number of linkages with selected merchants in Sri Lanka to offer account holders a wider choice of gifts through redeemable gift vouchers.

To complement its Singithi Lama product, the Bank organised and sponsored for the second consecutive year, an all island inter school competition titled "Lowa Dinana Singitho" in association with the Ministry of Education. The final prize presentation coincided with World Children's Day in October 2009. This competition provided some 9,700 schools across the country an opportunity to participate.

HNB Singithi is the first branded financial product aimed at children in Sri Lanka, which was introduced in 1991. Singithi heralded a new culture in savings particularly among school going children. Today the bank operates more than 150 school units through which school going children are continuously encouraged to develop and adopt the savings habit. Branding remains a major area of focus for the Bank, and will continue to play a focal role in broad basing the relationship with school children in the years ahead. The brand was promoted aggressively during the year in mainstream television programmes such as "Punchi Pahe Mung" and coupled with a series of activation programmes including six Regional Student Manager Conferences conducted by the Bank.

#### ***HNB Singithi Kirikatiyo***

The Bank successfully marketed the savings scheme for newborns during the year. The scheme, termed "Singithi Kirikatiyo" has a number of promotional offers including gifts on birth days and higher interest rates etc. During the course of the year, the Bank initiated this scheme island-wide to include all key hospitals and nursing homes.

#### ***HNB Shanthi***

Acknowledged as a leader among housing finance brands in Sri Lanka, HNB Shanthi Home Loans was actively promoted in media and through strategic sponsorships during the year. The Bank continued to sponsor the Construct 2009 exhibition for the 9th Consecutive year with high levels of brand activation at the site.

#### ***Introducing New Brands***

During the year the Bank introduced its Niche Brand "The Club HNB" targeting the high networth customer segment through the specially set up Priority Banking Centre at Green Path in the exclusive Colombo 7 neighbourhood. Unlike the typical premier banking product which targets the mass affluent segment, The Club is clearly positioned and caters to a smaller population of Higher Networth Individuals.

The HNB Teen brand was introduced during 2009 with a number of value additions and 'targeted' promotions. The bank's flagship micro finance Gami Pubuduwa brand was further strengthened by the introduction of the HNB Divisaviya Brand, focusing on providing financial literacy programmes in semi urban and rural Sri Lanka to uplift financial literacy, transfer modern technology, enhance managerial skills and promote good health habits among people.

#### ***Other Brands***

The HNB Pawning brand was active throughout the year with a promotional drive to maintain high brand visibility and brand re-call. The HNB Leasing brand was kept active throughout the year with a number of activation programmes and promotions with reputed vehicle agents despite the downturn in the automobile industry. The HNB credits cards were promoted with seasonal promotional campaigns focusing on increasing card usage. The Visa Platinum Credit card was launched with the theme "Exclusivity has dawned" during the year. Likewise, participation at educational fairs and educational institutes with specific



promotions that targeted graduates drove the momentum of HNB's Graduate-ship Loan programme.

### **Striving for excellence in Customer service**

During the year under review, the Bank also undertook a series of initiatives to enhance customer service, and accessibility of the Bank's services to a greater number of potential and existing customers.

From the perspective of customer service orientation, the Bank continued to focus on striving towards higher levels of customer service excellence. To this end it employed a series of customer service measures and audits to better understand short-falls in the service philosophy and levels. As such, a branch-wide customer satisfaction survey was conducted during the year to determine quantifiable data

pertaining to customer satisfaction levels whilst a "mystery shopper" concept was implemented in parallel to ascertain a qualitative "feel" for the service levels. Analysis of findings and customer input is expected to generate more rigorous criteria in laying out the customer service thresholds in the year ahead.

Whilst accessibility to the Bank's branch network increased significantly during the year, the quality of interaction with the Bank was further enhanced in 2009 through the adoption of a "team orientation" at branch level, thereby creating one of the largest teams in the financial services and banking industry in Sri Lanka. Subsequently during the year this was communicated as a credible advantage in customer service excellence in a series of communications coinciding with branch openings and re-locations.

### **Future Outlook**

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

## > Management Discussion



# Subsidiary Operations

## HNB Assurance PLC

Performance Highlights for 2009:  
Above industry growth in Life and Non Life

### Overall Performance for the Year

HNB Assurance continued to demonstrate commendable growth in the year under review. Persisting with excellence in financial performance through the execution of strategic plans, prudent actions towards risk mitigation and good governance, the Company achieved a turnover growth of 15% and a profit growth of 23% recording a pre-tax profit of Rs 231 Mn and a post tax profit of Rs 202 Mn by the end of the 2009 financial year. Despite the evidence of a sluggish trend in the overall Insurance industry and a probable decline in the market during the year, HNB Assurance achieved above-industry growth in both the Life and Non Life sectors.

With a network of 47 branches across Sri Lanka, HNB Assurance increased its penetration to the masses during the financial year with the inauguration of four branches in Mannar, Horana, Avisawella and Kuliypitiya. From a business continuity perspective, HNB Assurance undertook a major upgrade of IT systems in 2009 with the intention of increasing management transparency through the availability of greater information across the organisation's decision makers.

### Review of Operations: Life Insurance

Product innovation in 2009 drove the success of the Life Insurance segment of the business. By taking advantage of the prevalent high interest rate scenario in the first half of the year, the Company

introduced a single premium investment plan garnering high demand for the product and in effect a total mobilisation in excess of Rs 160 Mn in premium by the end of the financial year. However, due to the sharp decline in interest rates in the fourth quarter of the year, the Company made a prudent decision to defer the continuity of the product indefinitely.

During the year HNB Assurance perceptively filled a market gap by launching a product exclusively for youth. 'My Life' is the first and only insurance product in Sri Lanka that targets the youth consumer. Tailored to fit the needs of its target audience, the product capitalises on its affordability factor. In the first six months since its launch over 2,400 'My Life' policies were sold.

### Review of Operations: Non Life Insurance

In the Non Life segment, HNB Assurance positively benefited from the general uncertainty and turbulence that characterised the Insurance industry during the year. A significant shift of business to the Company, especially large policies, demonstrated HNB Assurance's capabilities of underwriting large risks and the support and strength of the Company's re-insurers.

Prudent management of claims and expenses was key to HNB Assurance's ability to maintain a satisfactory growth

momentum in profit, thereby ensuring a satisfactory rate of return to investors.

### Recognition

During the year Fitch Ratings upgraded HNB Assurance's National Long-term rating to 'A(Ika)' from 'A-(Ika)' with a stable outlook. Concurrently, Fitch re-affirmed HNB Assurance's National Insurer Financial Strength (IFS) rating at 'A(Ika)'.

HNB Assurance garnered international recognition in 2009 for its Financial Reporting and disclosures at the South Asian Federation of Accountants (SAFA) Awards by being placed second runner up in the Non Banking Financial Sector category. SAFA is an apex body of the South Asian Association for Regional Co-operation (SAARC) and a regional grouping of the International Federation of Accountants (IFAC). The aim of the awards is to promote a high degree of financial disclosure and good corporate governance among the organisations in the member countries.

Further recognising the Company's commitment towards the maintenance of good governance principles and practices and the full financial disclosure in reporting, HNB Assurance won the joint Silver Award for Corporate Governance and the Bronze Award in the Insurance sector at the ICASL Annual Report Awards 2009. It was also placed first in the Small Scale Category at the ACCA Sri Lanka Sustainability Reporting Awards 2009.

### Future Outlook

In the immediate future HNB Assurance looks to further affirm its engagement with the people of the Northern and Eastern provinces to increase the penetration of insurance. As a Company that has had a significant presence in these regions despite the conflict, its

association with the people is one that has been built on trust. Going forward, HNB Assurance plans to garner the benefits of these relationships and the strength of its brand equity to create further mutually beneficial opportunities.

The Company will also look towards the maintenance of its present growth momentum by overcoming the constant challenges that characterise the local and global economic and market conditions.



## Subsidiary Operations Sithma Development (Pvt) Limited

Performance Highlights for 2009:  
Profitability through cost and interest containment

### Performance Review

Sithma in 2009 demonstrated returns that forecast a strong performance capacity for the year 2010. This is evident from signs of a healthy performance witnessed during the year in review with profitability exceeding Rs 68 Mn for the year. Containment of operational costs combined with a favourable interest rate scenario culminated in a commendable profitability outlook for 2009.

HNB Towers, Sithma's flagship project continued to be an icon of modern construction for Colombo. Reputed to be one of the few energy efficient buildings in Sri Lanka, HNB Towers is expected to obtain the Leadership in Energy and Environmental Design (LEED) certification in the year 2010. LEED is a third-party certification

programme and an internationally accepted benchmark for the design, construction and operation of high performance green buildings.

Demand for Spathodea Residencies, Sithma's ongoing condominium development project followed the trajectory of upward momentum in the condominium industry. With over 30% of apartment units sold in 2009, Sithma Developments expect the revival of the industry to propel the sale of all units in 2010, especially as Spathodea Residencies is considered a prestigious and high quality construction in Colombo.

Reflecting the high quality and concern for excellence in construction, Nawaloka Construction Company which is the main civil contractor for Spathodea Residencies won a National Award of

Construction Merit from the Ministry of Construction and The Institute for Construction Training and Development (ICTAD) in 2009.

### Future Outlook

In the immediate future, Sithma will concentrate its efforts to maximise its returns from Spathodea Residencies. Sri Lanka's condominium industry emerged from a trough during the year under review and is expected to witness a steady recovery during the course of 2010. Confidence in the industry is further elevated subsequent to the end of hostilities in the Northern and Eastern provinces and with the conclusion of the conflict in May 2009.

Optimising the space utilisation at HNB Towers will be a key focus in the year ahead.

## > Management Discussion



### Exchange Houses

Performance Highlights for 2009:  
Market expansion promises  
sound future returns

#### MAJAN EXCHANGE LLC (OMAN)

Established in Oman in 2008, Majan Exchange LLC became operational in November of that year, initially targeting the Sri Lankan expatriate community in Oman. During the latter part of its 14 months in operation up to December 2009, remittances to other corridors such as India, Pakistan, Nepal, Bangladesh and the Philippines have been added. As an agent for MoneyGram, XpressMoney and EzRemit, Majan Exchange LLC cater to many other corridors.

A further capital infusion of Oman Riyal 40,000/- was made in the latter part of 2009 for expansion in terms of a new branch in Gobra.

Majan Exchange LLC is expected to break even during 2010.

#### DELMA EXCHANGE - CANADA (Division of Commercial Interlink Services Inc)

Recognising Canada as an important corridor for inward remittances to Sri Lanka from an estimated half a million former Sri Lankans, Delma Exchange Canada commenced operations in August 2009.

The focus of Delma Exchange - Canada is On line remittances following FINTRAC regulations to ensure Best Practices throughout operations.

Delma Exchange - Canada will shortly commence remittances to other destinations such as India, Nepal, Bangladesh and the Philippines.

Delma Exchange Canada is expected to break even towards the latter part of 2010.

#### DELMA EXCHANGE (UAE)

Established in January 2009 and based in the heart of the financial city of Abu Dhabi UAE, Delma Exchange UAE commenced operations in April of that year. Initially serving the Sri Lankan expatriate community, it subsequently commenced catering to Nepalese, Indian, Pakistani and Phillipino Nationals.

Abu Dhabi has remained resilient economically, thus affirming the Bank's resolve for the establishment of an Exchange House in UAE.

Two new branches are to commence operations in 2010; one in Al Quoz City and another in Mussafah City which are located in close proximity to Industrial Zones. Delma Exchange UAE is expected to break even in 2010.



## Joint Venture Operations Acuity Partners (Pvt) Limited

Performance Highlights for 2009:  
Optimisation through consolidation

### Re-alignment delivers greater returns

Operationally, the year under review was one of consolidation for Acuity Partners. The year witnessed a series of operational changes that collectively enhanced the business and financial performance of the Company.

In early 2009, HNB Stockbrokers, Acuity Stockbrokers, the Corporate Finance Division, and HNB Securities were integrated into one centralised operational location. Exploiting the synergies arising from this rationalisation, the Company took one step further to garner greater economies of scale through the consolidation of the two brokering firms. The potency of the consolidation was evident during the surge of the Colombo Stock Exchange's indices from May 2009 onwards, as a result of the successful completion of the war. In October 2009, subsequent to an expression of interest to purchase the stock brokering license of HNB Stockbrokers (Pvt) Limited, the License of HNB Stockbrokers was sold to DNH Financial (Private) Limited.

HNB Securities Limited too performed commendably and was in line with the post consolidation performance expectations for the Company.

Furthermore, in a bid to strengthen the brand equity of the Company, the primary dealership was renamed and re-launched into the market in 2009 as Acuity Securities Limited.

### Enhancement of Service Portfolio

During the year under review, the Company converged personnel from DFCC Bank and Hatton National Bank to develop a formidable Corporate Finance team with the intention of extending the Acuity Partners service portfolio to one that offers a basket of key financial services under one roof. The successful development of Corporate Finance Services during the year enabled Acuity Partners to be at the forefront of the financial services industry. This leadership was evident in promoting and managing a listing of the first Unit Trust on the Colombo Bourse, through an Initial Public Offering of Namal Acuity Value Fund in September 2009.

Acuity Partners during the year undertook numerous mandates for the restructuring of companies, and assisted in the raising of private equity and debt.

### Future Outlook

From a performance perspective, pointed reference must be made to the fact that Acuity Partners though

incorporated in 2008 was only operationally active from early 2009. Therefore, within this time frame the Company has performed commendably and registered significant growth realising the vision of the promoters of Acuity Partners. During the year under review, the group posted a pre-tax profit of Rs 135 Mn and a post tax profit of Rs 62 Mn. Foresight and good business acumen together were the pivots for investment into Acuity Partners and its incorporation. Going forward, this same sense of foresight and commercial spirit will spur the Company towards greater heights. In January 2010, the Company took control of Lanka Ventures Limited a listed venture capital firm through which it now brings in unlisted / private equity financing also as part of the portfolio of investment banking offerings.

Optimistic, and excited about its future prospects, the Company together with its partners will continue to operate in the quest for excellence, journeying towards leadership in the financial services sector. A conducive post conflict scenario wherein prospects for economic development are promising, further heightens the future outlook for Acuity Partners and its many stakeholders.

## > Management Discussion



# Associate Operations

## Lanka Ventures PLC

Performance Highlights for 2009:  
Diversification of Core Business

### Strategic shift in business focus

The year 2009 has been a year of strategic change for Lanka Ventures. A macro review of the Company's operations in the past years vis a vis that of the year under review has validated the case for a strategic shift in the core business drivers. Whilst historically Lanka Ventures has predominantly relied on the venture capital business as a core driver, in 2009 the need to diversify the Company's operational portfolio was evident, especially in the light of favourable returns from strategic Joint Ventures formed in recent years.

In view of this strategic shift, the Company prudently exited from three venture capital investments during the year at a profit of Rs 14 Mn. However, Lanka Ventures further renewed its venture capital partnerships with formidable corporates in two key growth industries - Healthcare and Energy. The volatility and the level of risk in Sri Lanka's venture capital industry necessitates the highest levels of risk mitigation; Lanka Ventures therefore assesses the reputation of each of its venture partners and the industry potential prior to investment.

### Overall Performance for the Year

In terms of cost the Company's venture capital investment portfolio net of provisions, redemptions and disposals amounted to Rs 397 Mn at year end 2009. New investments made during the year amounted to Rs 65 Mn.

The Company's fully owned subsidiary LVL Energy Fund (Private) Limited (LEF) - which focuses on investments in the energy sector - expanded its investments by a Rs 40 Mn by year end 2009, increasing its portfolio size to Rs 217 Mn. The total generation capacity of the mini-hydro power projects funded by LEF amounts to 14.4 MW or 60 GWH of electricity per year. The three mini hydropower plants that were commissioned in 2008 are expected to create significant shareholder value in the medium term.

### Key Value Drivers

Power generation remains a key identified value driver for the future success of Lanka Ventures. As such, the Company is hopeful of establishing its own mini hydro power generation plants in the near future without the added risks associated with a collaborator.

As a result of the experience gained through LEF's involvement in the energy sector, the Company is confident of its ability to succeed. Renewable energy - hydropower and wind power - is bid to be a key contributor to the long term wealth of the Company.

Lanka Ventures continued to reaffirm its commitment to the healthcare sector during the year. As a direct outcome of this commitment, the Company expanded its investments into the sector, thereby enhancing the investment portfolio for the healthcare sector to Rs 140 Mn.

### Future Outlook

The Company is confident of the future growth potential of both the healthcare and energy sectors and thus intends to commit greater resources towards the development of projects in these sectors in the years ahead. Post conflict development in the Northern and Eastern provinces is expected to open up opportunities for investment in other sectors as well.



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## **Associate Operations**

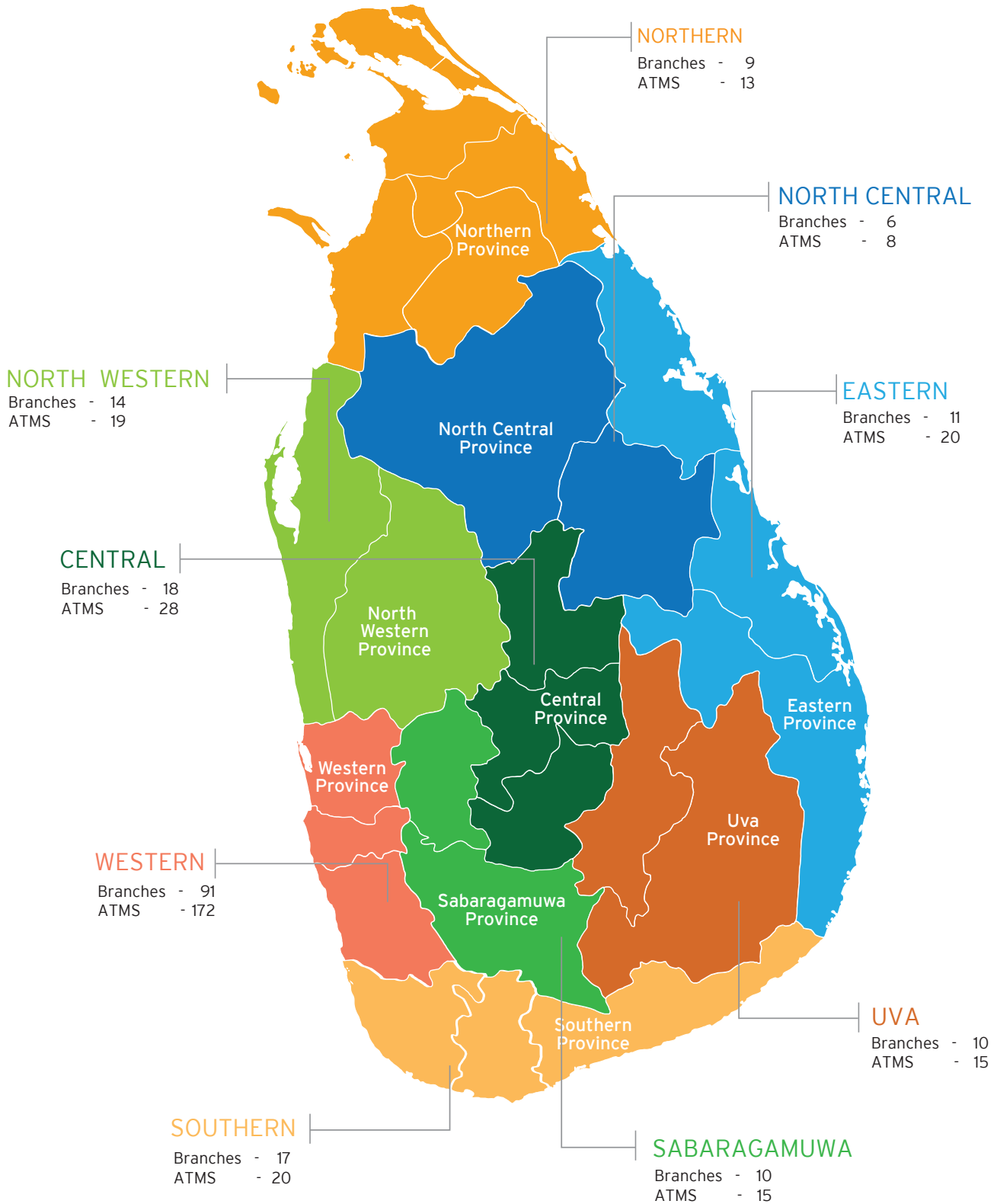
### **Browns Engineering (Pvt) Limited**

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HNB has invested Rs 20.6 Mn in the ordinary shares of Browns Engineering (Pvt) Ltd. However this company is

under liquidation and the Bank's investments in this company have been fully provided for.

## Customer Centre Network





HNB Customer Centres to be opened during the 1st quarter of the year 2010  
Medawachchiya

Customer Centres – 186  
HNB Student Banking Centres – 153  
Mico Banking Units - 1

HNB Gami Pubuduwa Banking Centres - 110  
Village Based - 18      Branch Based - 92

HNB Mobile Banking Centres – 2  
Hotel Culture Club and Kandalama Hotel - Dambulla

Overseas Representative Offices  
Chennai - India and Karachi - Pakistan

### Western Province

Airport Office  
Aluthgama  
Aluthkade  
Apollo Hospitals  
Asha Central Hospital  
Athurugiriya  
Avissawella  
Bambalapitiya  
Biyagama  
Boralesgamuwa  
Borella  
Cinnamon Gardens  
City Office  
Dehiwela  
Delgoda  
Dematagoda  
Divulapitiya  
Ekala  
Gampaha  
Ganemulla  
Grandpass  
Green Path  
Gunasinghepura  
Hanwella  
Head Office Branch  
Hendala  
Homagama  
Horana  
Hulftsdorp  
IWMI - Pelawatta  
Ja-ela  
Jampettah Street  
Kadawatha  
Kaduwela  
Kalutara  
Kandana  
Katunayake  
Kelaniya  
Kiribathgoda  
Kirindiwela  
Kirullapone  
Kochchikade  
Kohuwala  
Kollupitiya  
Kotahena  
Kottawa  
Kotte  
Maharagama  
Malabe  
Maligawatte  
Maradana

Marandagahamula  
Mathugama  
Minuwangoda  
Mirigama  
Mirihana  
Moratumulla  
Moratuwa  
Mt. Lavinia  
Mutwal  
Narahenpita  
Nawala  
Nawaloka Hospital  
Nawam Mawatha  
Negombo  
Negombo Extension Office  
Nittambuwa  
Nugegoda  
Overseas School of Colombo  
Padukka  
Panadura  
Panchikawatte  
Pettah  
Pettah - 2nd Office  
Piliyandala  
Ports Authority  
Ragama  
Ratmalana  
Sea Street  
Seeduwa  
Sri Jayawardenapura  
Hospital  
Sri Lankan Airlines  
Administration Complex  
Talangama  
Thalawathugoda  
Thimbirigasyaya  
Wattala  
Weliweriya  
Wellawatte  
Wellawatte Extension Office  
Wijerama  
World Trade Centre

### North Western Province

Alawwa  
Chilaw  
Dankotuwa  
Galgamuwa  
Hettipola  
Kuliyapitiya  
Kurunegala  
Marawila

Nikaweratiya  
Norochchole  
Nawinne - Kurunegala  
Puttalam  
Wennappuwa  
Wariyapola

### Northern Province

Chavakachcheri  
Chunnakam  
Jaffna  
Jaffna - 2nd Office  
Mannar  
Manipay  
Nelliyady  
Point Pedro  
Vavuniya

### North Central Province

Anuradhapura  
Anuradhapura Ext. Office  
Kekirawa  
Nochchiyagama  
Polonnaruwa  
Thambuttegama

### Eastern Province

Akkaraipattu  
Ampara  
Batticaloa  
Chenkaladi  
Kalmunai  
Kantalai  
Kattankudy  
Sammanthurai  
Trincomalee  
Trincomalee - Courts Road  
Thirukkovil

### Central Province

Akurana  
Bogawantalawa  
Dambulla  
Digana  
Gampola  
Geli Oya  
Hatton  
Kandy  
Katugastota  
Maskeliya

Matale  
Nawalapitiya  
Nuwara Eliya  
Peradeniya  
Pilimathalawa  
Pussellawa  
Ragala  
Thalawakelle

### Sabaragamuwa Province

Balangoda  
Embilipitiya  
Godakawela  
Kahawatte  
Kegalle  
Mawanella  
Pelmadulla  
Pinnawela  
Ratnapura  
Warakapola

### Southern Province

Agunakolapelassa  
Akuressa  
Ambalangoda  
Ambalantota  
Deniyaya  
Elpitiya  
Galle  
Karapitiya  
Kataragama  
Hambantota  
Koggala  
Matara  
Middeniya  
Pitigala  
Suriyawewa  
Tangalle  
Tissamaharama

### Uva Province

Badulla  
Bandarawela  
Bibile  
Buttala  
Haputale  
Mahiyangana  
Moneragala  
Passara  
Welimada  
Wellawaya

## Correspondents Worldwide



### Americas

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



### Middle East & Africa

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



### Europe

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



### Asia & Pacific

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

# Financial Review

How it worked in 2009:  
Best practices in Corporate Governance, Risk Management, Financial Astuteness & Innovation assure the sustainability of business

The financial year 2009 was wrought with uncertainties. As the year began, the nation's economy confronted a multitude of challenges both on the internal and external fronts. The acceleration of the war on terror during the first quarter of the year saw a focus of State resources towards defence requirements. The domestic economy, till the beginning of the second half of the year, remained sluggish whilst investors and the business community deliberated over the outcome of the conflict.

The combined effects of the global financial crisis and the instability witnessed in the local financial sector fanned doubts in the minds of consumers on the state and security of the financial services industry. A scenario of high interest rates in the first half of the year compounded the deceleration of demand for financial services which resulted in a contraction in loan growth. In the final quarter of 2009, a steep decrease in interest rates directed by the State towards Government owned banks brought about a new challenge for the industry as private sector banks too experienced pressure on interest margins.

Nevertheless, true to the spirit of Hatton National Bank (Bank), these adversities fuelled a renewed enthusiasm to prevail. Best practices in corporate governance, effective risk management, the relentless pursuit of portfolio quality combined with innovation across every function of the Bank, and the strict alignment of strategies with its overall vision have been the cornerstones of the Bank's success in past years. In 2009, these principles further strengthened the Bank's position and image as a sustainable business.

## Financial Performance

Despite the challenging macro economic climate, the Bank continued to perform commendably in the financial year 2009.

The Bank's financial performance exceeded expectations for the year with Pre-Tax Profit for 2009 growing by as much as 23.7% from that of 2008.

Likewise, surmounting the growth momentum of the previous year, the Bank was successful in surpassing Post Tax Profit of Rs 4 Bn for the first time in its history. The Bank recorded a growth in Post Tax Profit of 35.2% for the year, up from a growth rate of 6.5% in 2008, positing a Profit After Tax of Rs 4.35 Bn at the end of the financial year.

## Income

Total interest income in 2009 stood at Rs 34.6 Bn, up by 6.8% from 2008.

Interest expenses for the year increased by 1.5% to stand at Rs 20 Bn. The resultant Net Interest Income (NII) grew by 15% to Rs 14.6 Bn in 2009.

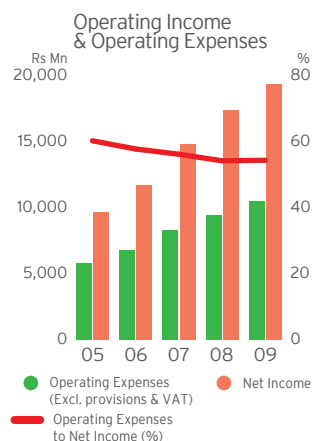
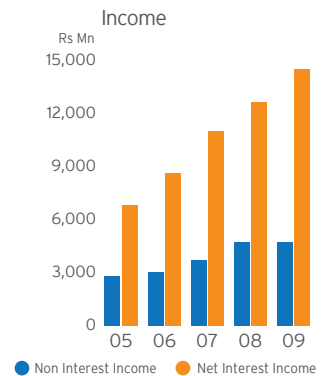
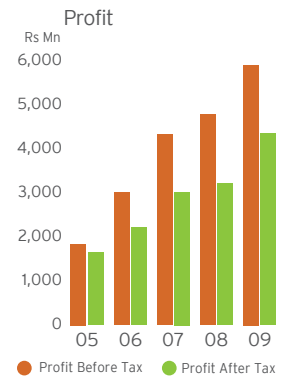
The exchange income witnessed a fall of 21.2% while fee and commission income recorded a drop of 2.3% over 2008. The cumulative effects of a decline in trade finance business, static exchange rates and a decline in the forward exchange bookings contributed to this drop.

As a result of restructuring of subsidiaries in the last financial year, dividend income showed an exceptional growth in 2008. The non recurring nature of the above gain was reflected in 2009, with the dividend income recording a decline of 59.6% to Rs 217.4 Mn.

The increase of 101% in other Income to Rs 1.3 Bn was primarily as a result of provision reversals on account of Kabool Lanka (Pvt) Ltd. and Cross Staff Aquila USD Plus (Aquila) Funds. The total non interest income improved marginally by 0.7% in 2009.

## Operating Expenses

The overall operating expenses for the year increased by a mere 6.4% to stand at Rs 13.4 Bn, with staff expenses and salaries in particular contributing to the rise. The newly negotiated collective agreement with Ceylon Bank Employees Union came into force during the year, increasing staff expenses by as much as 14.9% due to an upward revision of salaries. The effective



## > Financial Review

cost of the revision for the clerical and junior executive grades stood at 18%.

However, the Bank continued its efforts towards cost management and productivity improvements as it managed to reduce headcount by 2.1% despite the expansion of operations by opening 9 new customer centres during the year.

The cost income ratio (excluding financial VAT) stood almost flat at 54.4% in 2009 compared to 54.2% in 2008 despite the surge in salary expenses. The Bank will continue its pursuit of achieving the medium term goal of containing the cost income ratio to below 50%.

Despite the slowdown in the economy, the Bank managed to reduce its Non Performing Loans & Advances (NPA) ratio from 6.7% in 2008 to 6.2% by end 2009 as a result of responsible lending policies, aggressive collections and recovery made on account of Kabool Lanka (Pvt) Ltd. The specific provision for loan losses increased in 2009 by 11.7% for the financial year to Rs 665.8 Mn.

Bank's general provisioning declined as a result of the contraction in loans and advances. In line with the provisioning mandate of the Central Bank of Sri Lanka, the Bank continued to maintain and meet the 1% general provisioning requirement. The Bank's provision cover (total provisions to non performing loans) was maintained at 52.8%. The net NPA (net of Interest in suspense and provisions) was 2.9%, which is one of the lowest among local commercial banks.

Taxation continued to be a heavy burden to the banking and financial services industry. As emphasised in previous years the Taxation regime remains grossly non-conducive for industry vigour and capital formation. In 2009, as in previous years, taxation imposed considerable strain on the Bank's bottom line.

The inclusion of Nation's Building Tax (NBT) during the year 2009 added to the tax burden comprising of Income Tax and Value Added Tax (VAT). During the year Financial VAT accounted for 27% whilst Corporate Tax too accounted for 19.3% of Profit before

Financial Services VAT and Corporate Tax. The total charge to the Income Statement in 2009 from taxation stood at Rs 3.8 Bn, accounting for a staggering 46.3% of the Profit before Financial Services VAT and Corporate Tax.

Sri Lanka's taxation regime is reputed to be one of the most regressive in South Asia. In order to rectify the impact of taxation on industry growth, the national taxation commission is believed to have made some pragmatic recommendations for a more sustainable taxation policy which will be supportive of capital formation in the banking sector.

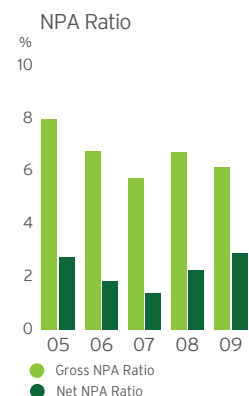
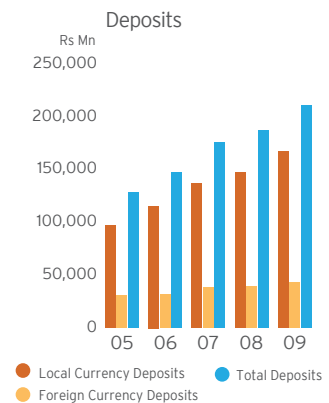
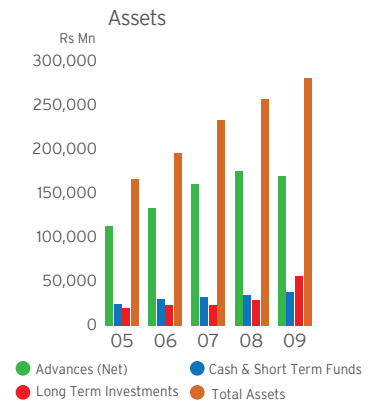
### Balance sheet

The Bank's balance sheet in the year under review, continued to reflect strength and stability, proving that sound fundamentals, astute financial policies and strategies are the core to sustainable business.

### Asset growth

The Bank's total asset value increased by 9.3% to a value of Rs. 280.6 Bn in comparison to Rs 256.7 Bn in 2008. In 2009 the Bank reinforced its status as having one of the highest asset bases amongst commercial banks in Sri Lanka. The Bank successfully managed its asset mix to optimise asset growth and stability. With loans and advances distributed across the spectrum - from Retail, Micro, SME to Corporate - the Bank focused on the management of a quality portfolio as opposed to growth. Despite the contraction of the advances portfolio during the year, the Bank balanced its interest margins to effectively overcome a scenario of deterioration in net interest income. These actions enabled the Bank to effectively sustain the business irrespective of external forces.

The total net advances and leasing portfolio during the period under review declined by 2.6% from Rs 172.6 Bn in 2008 to Rs 168.1 Bn in 2009 with overall lending across the product spectrum declining due to the high interest rates experienced over much of the year. However, the net interest income increased due to the Bank's skillful management of its margins and deposit mix.



**Liability growth**

Deposit mobilisation in the first half of the year proved to be less complex predominantly due to the high interest rates and in part due to conditions within the industry wherein customers migrated their funds to more financially stable deposit taking institutions. Thus, the LKR deposit portfolio witnessed a growth of 13.4% from the previous year to settle at Rs 167.2 Bn from Rs 147.4 Bn in 2008. However, in the final quarter the downward spiraling of deposit rates led by the State banks created a climate where customers sought more lucrative returns for deposits. Nevertheless, the character and composition of the client mix enabled the Bank to effectively defend its savings deposit base.

Demand deposits grew by 18.4% YOY to Rs 15.1 Bn in 2009. Time deposits and Certificates of Deposit continued to be the highest contributors to the overall composition of deposits accounting for over 51% of the LKR base. However growth mainly stemmed from savings accounts in the LKR deposit base which expanded by 21.1% to Rs 66.1 Bn, up from Rs 54.5 Bn in the previous year. This resulted in LKR deposit mix, consisting of current and savings accounts which are relatively low cost, improving to 49% compared to 46% in 2008.

Perceptible signs of recovery of the global economy from the financial crisis together with an inflow of foreign exchange into post conflict Sri Lanka created a conducive environment for growth in foreign currency deposits. This resulted in an increase of 10% in foreign currency deposits to an equivalent of Rs 43.3 Bn in 2009 over the previous year.

Total liabilities at the end of the year recorded at Rs 256.7 Bn in comparison with Rs 236.1 Bn in 2008.

**Shareholders' funds**

Shareholders' funds grew by 16.1% in the financial year, enhanced primarily by retained profits from 2009. The fund base grew from Rs 20.6 Bn to Rs 23.9 Bn during the year. The Bank declared an interim

dividend of Rs 1.50 per share on the 2009 profits amounting to Rs 353.4 Mn. The Bank proposes a final dividend of Rs 5.00 per share on profits for the year under review, which will amount to a total dividend payout of Rs 1.5 Bn.

**Capital adequacy**

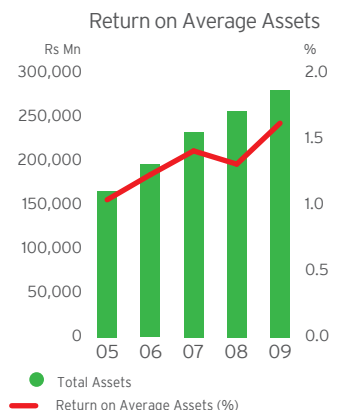
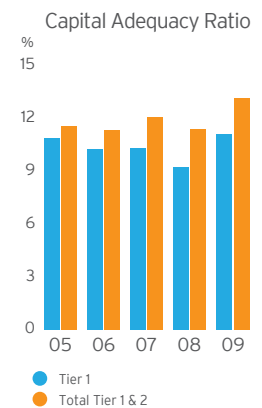
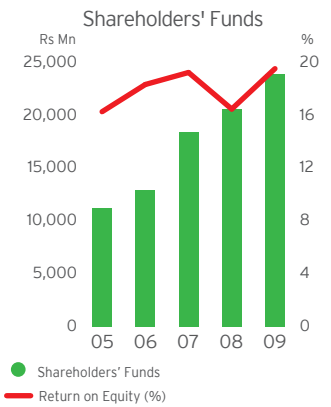
The Bank's total capital adequacy ratio in 2009 improved to 13.2% from 11.4%, while Tier 1 ratio stood at 11.1% compared to 9.2% in 2008. During 2009, the Bank did not look at new core or supplementary capital generation due to high interest rates and a continued sluggishness which prevailed in capital markets during most part of the year. Business growth was, instead, funded through retained profits.

**Return on Average Assets (ROAA)**

The Return on Average Assets (ROAA) in 2009 increased to 1.6% from 1.3% in 2008 reaching the medium term goal while the Return on Average Equity (ROAE) increased to 19.6% from 16.5% in 2008.

**Future Outlook**

In the current post conflict scenario, the Bank expects to play a key role in the reconstruction and development of the Northern and Eastern provinces of Sri Lanka. As one of the few private sector banks to have had a concerted and prolific presence in the two regions even during the time of the war, Hatton National Bank will look to reinforce its relationship, which extends to 4 decades, with the people of these areas. As such in 2010, the financial outlook for the Bank will be shaped and defined to a considerable degree by its actions and initiatives in these two regions. The Bank is also optimistic that the growth rate of the nation's economy will accelerate in 2010. However, HNB's prudent strategies and financial acumen will continue to steer the Bank towards sustainable growth even if economic circumstances continue to pose challenges in the year ahead.



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# CORPORATE GOVERNANCE

SETTING THE TONE AT THE TOP and embracing best practices  
THAT IS HOW IT WORKS

# Risk Management

## Vision and Strategy for Risk Management

Risk is an integral part of banking business and HNB aims at delivering superior shareholder value by achieving an appropriate trade-off between risk and returns. Our Risk management strategy is based on a clear understanding of various risks, disciplined assessment, measurement and continuous monitoring of such risks. The policies and procedures established for this purpose are continuously reviewed in our quest to benefit from a blend of local and international best practices.

The Board is principally responsible for establishing risk tolerance, approving related strategies and policies, monitoring and assessing the activities of management, overseeing policy compliance and the effectiveness of the risk framework to meet the requirements of applicable regulations and the interests of all stakeholders.

The Board Integrated Risk Management Committee (BIRMC) regularly oversees development of policies in relation to various risks, including Credit, Market, Operational, Regulatory and Strategic risk to ensure that risk appetite is in line

with strategy and that controls and limits are in place to mitigate losses to the Bank.

HNB's Integrated Risk and Compliance Division, reports to BIRMC and Chief Executive Officer. The function comprises of six units; whilst retaining its independence, effectively integrates with business functions to ensure Risk Management is truly ingrained in HNB's culture.

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

## Organisational Control and Board Governance

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

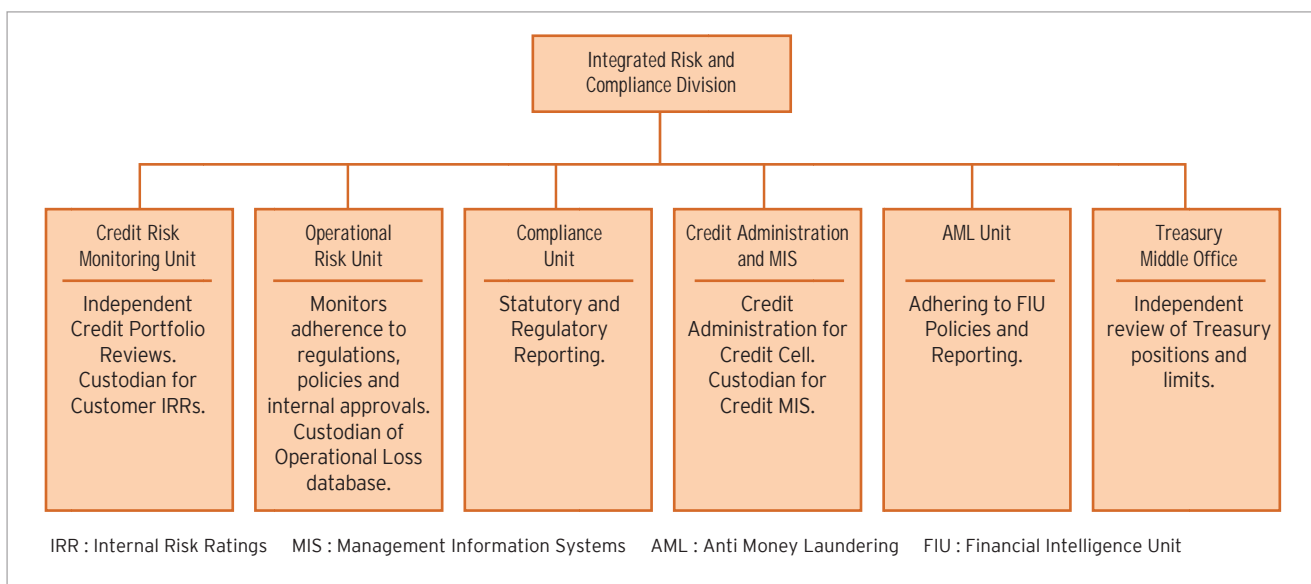
The Audit Committee assists the Board in overseeing internal audit and the

adequacy of HNB's accounting policies and financial reporting.

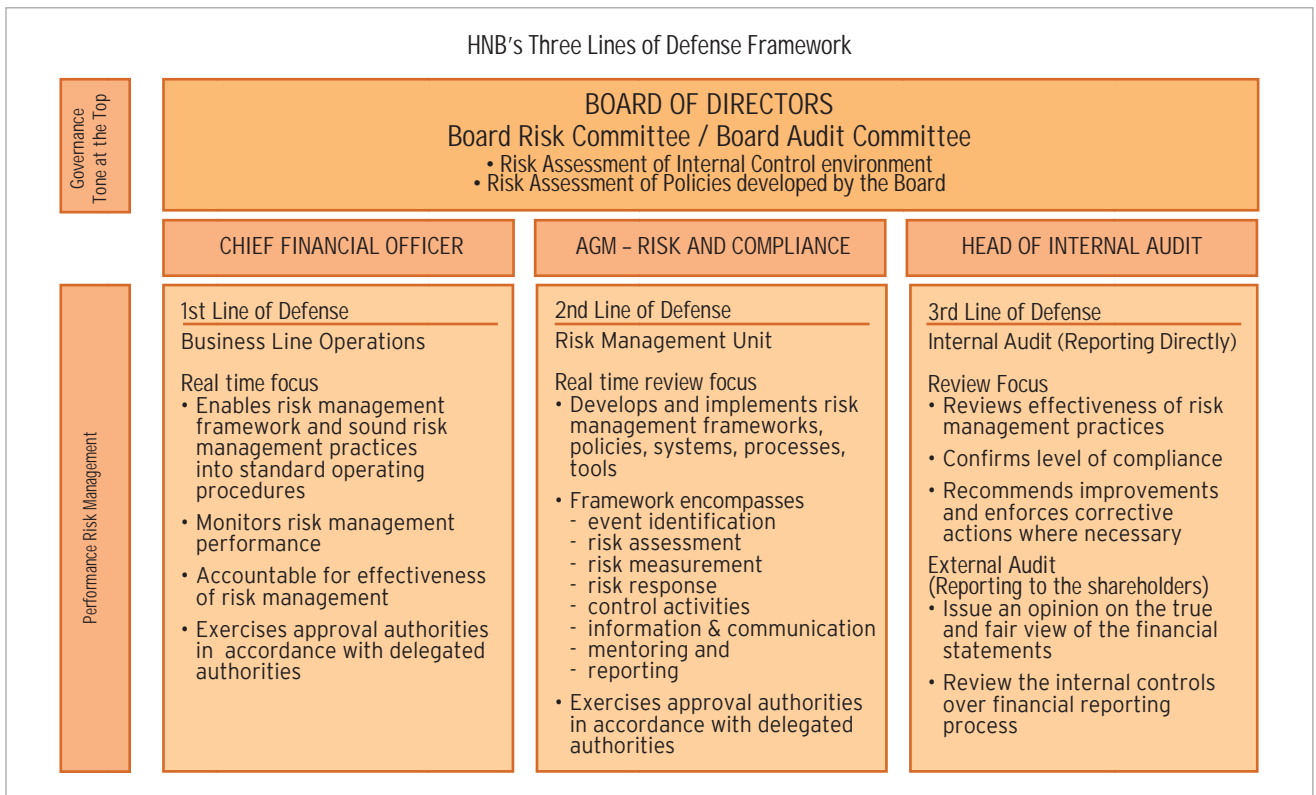
The BIRMC assists the Board in fulfilling its responsibilities relating to the oversight of HNB's risk management strategies, policies and processes that have the potential to impact significantly on earnings performance, reputation and capital protection. BIRMC also assists the Board to assess and to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

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

- Asset and Liability Committee (ALCO)
- Credit Policy Committee
- Operational Risk Committee
- IT Steering Committee
- Corporate Social Responsibility Committee (CSR)







### HNB's Approach to Managing Key Risks

#### Credit Risk

Credit risk is the risk that a borrower is unable to meet its financial obligations to the lender. HNB has a well diversified credit portfolio in terms of concentration, business segments and industry accounting for over 60% of its Asset base, consequently safeguarding portfolio quality is of paramount importance.

The credit approval structure broadly sets out HNB's Credit Strategy and discretionary lending limits. This document is reviewed at least annually and approved by the Board. A monthly Credit Policy Meeting chaired by Chief Executive Officer, drives policy decisions and implementation.

We adopt a committee based approval structure, where all approval signatories carry equal responsibility for credit risk. Individual credit facilities beyond a threshold, includes an independent risk signatory with no revenue targets in respective committees. The structure

ensures business development and credit administration functions are clearly separated.

Our Credit Risk Monitoring unit periodically reviews conformance with internal risk parameters based on credit portfolio reviews.

An internally developed online MIS (known as 'KPI Wizard') is in place to evaluate credit risk indicators at branch, regional, zonal and bank level. Accountability for Credit Risk performance is driven by regular meetings at each level. At corporate level an Executive Risk Committee is in place with balanced representation of business managers and risk managers to review performance against a predefined risk charter.

We measure, monitor and manage credit risk for each borrower and also at the portfolio level. We have standardised credit approval processes, which include a well-established procedure of comprehensive credit appraisal and rating. We have implemented internal credit rating methodologies for Large Corporate, Middle Market and Small and Medium customers.

The rating factors include quantitative and qualitative issues and credit enhancement features specific to the transaction. The rating for every borrower is reviewed at least annually. Industry knowledge is constantly updated through field visits and interactions with clients, regulatory bodies and industry experts.

The rating serves as an input in the approval as well as post-approval credit processes. Credit rating, as a concept, is being internalised within the Bank.

At a portfolio level the bank's loan book is comfortably financed by deposits, therefore reliance on interbank market is minimal. The non existence of long term borrowing instruments results in some maturity mismatch in the asset book (borrow short and lend long) however, this is considerably mitigated by a large stable and growing low cost deposit base.

At a transaction level, almost the entire credit portfolio is secured by collateral and bank guarantees with adequate (internally defined) margins in our favour (see page 239).

## > Risk Management

### Operational Risk

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

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

HNB has a comprehensive Loss tracking database analysed by business function and loss incidents as per BASEL requirements. A high level Operational Risk Dashboard was developed during the year to keep BIRMC and Senior Management apprised of key operational losses on a monthly basis. Furthermore, an effective feedback loop is in place to ensure that learning from loss incidents, is regularly disseminated across the network to prevent/minimise recurrence.

HNB's Operational Risk is also mitigated by Insurance. The consequent adequacy and effectiveness of insurance was evaluated during the year and suitable recommendations made to the BIRMC.

### Market Risk

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

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

The Treasury Middle Office monitors the asset-liability position under the

supervision of the ALCO. It also oversees Treasury Front Office activities and adherence to regulatory / internal policy guidelines.

HNB's Treasury did very little trading on own account, did not offer derivative products and only carried a small equity trading portfolio during 2009.

Consequently the relative exposure to market risk from these areas was low. Our exposure to exchange rate risk was managed by stipulating position limits. Consequently, the focus was mainly on interest rate risk arising from conduct of normal business. Given the criticality of this area in the current environment a key priority is to further improve our infrastructure to ascertain re-pricing gap analysis and duration analysis with a view to ensuring adequate liquidity at all times through systematic funds planning and maintenance of liquid investments. We remain committed to augment the Market Risk Infrastructure

in terms of skills, systems and controls to support Treasury's expansion plans.

### Compliance Risk

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

The Compliance Unit is accountable for designing a compliance programme that allows HNB to meet its regulatory obligations (see Table 1) and each division has responsibility for embedding the compliance framework into its business operations.

Key principles of the Compliance Framework are to foster an integrated approach where staff are responsible and accountable for compliance, within their job role and in their sphere of influence.

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

#### Mandatory Regulations

Obtaining Know Your Customer ("KYC") Data from customers (August 2008 update)  
- New Customers  
- Existing

Already Compliant  
New KYC form implemented, data collection in progress

Directions on Financial Derivatives Products (July '09)

Compliant

Develop a 1% General Provision on Total Advances net of cash backed and fully provided accounts by March '09 (Sep '06)

Compliant

Directions on Risk Management relating to Forex Business (Sep '09)

Significantly Compliant, Treasury Policy amended to reflect where necessary and internal timelines developed with a view to full compliance by end 2010

Identifying, Reporting, Transferring and Maintaining Abandoned Property of Licensed Commercial Banks (Sep '09)

Compliant

Adoption of SLAS 44 and 45 for adoption by Jan. '11

Internal Gap Analysis forwarded to Regulator and a consultancy firm identified to assist in implementation process with a view to ensuring compliance by end '10.

Mandatory Lending to Agricultural Sector - achievement of 10% of Total Advances by end Dec '09

Compliant

#### Guidelines

AML Risk Profiling of all Customers (May '07) (AML - Anti Money Laundering)

Following the decision to procure a common AML system for participating banks, its implementation will be a pre-requisite for this exercise. Accordingly we expect to commence the process for Risk Profiling of our customers by end 2010.

Draft Guidelines on Integrated Risk Management Systems in Banks (Sep '09)

An Internal Gap Analysis is in place with plans to bridge the identified gaps. This analysis is part of HNB's BASEL Advanced Risk Management Implementation Roadmap

### Our Journey towards Implementing Best Practices in Risk Management

The contagion effect of the global economic crisis continues to depress business activity in the country and overshadows the positive impact from the end of the three decade military conflict. The Risk Management Initiatives taken in 2009 served to create an increased appreciation of key risk areas to focus and consequently galvanized action across the network to address these risks.

The Risk Management Initiatives undertaken in 2009 were with the twin objectives of creating an internal monitoring framework to assess areas of vulnerability primarily arising from the Global Economic Crisis and building capacity to take advantage of country's improving development and economic prospects in the medium term.

### Stress Testing

The bank is in the process of formulating a Stress Testing framework.

The following stress tests have been computed to assess the impact of key credit, equity and exchange risk variables on the banks capital adequacy ratio based on 31st December 2009 data as per CBSL Risk Management guidelines issued in Sep '09.

#### Base Data (All figures in Rs. Million)

Capital Adequacy Ratio (CAR)	13.17%	Total NPA	12,467
Capital as at Dec '09	23,179	Equity Market Value	4,698
Risk Weighted Assets	176,181	Net Open Position	423

#### A. Credit Risk

##### i) Increase in Non Performing Advances

The 3 scenarios explain the impact of 5%, 10% and 20% increase in NPLs directly downgraded to loss category having 100% provision requirement

	Scenario 1	Scenario 2	Scenario 3
Magnitude of shock	5%	10%	20%
Total NPA's	12,467	12,467	12,467
Increase in NPL	623	1,247	2,493
Revised capital	22,556	21,932	20,686
Revised RWA	175,558	174,934	173,688
Revised CAR %	12.85%	12.54%	11.91%

##### ii) Negative Shift in NPL Categories

The 3 scenarios explain the impact of 50%, 80% and 100% downward shift in NPA categories and the resultant impact on provisioning

	Scenario 1	Scenario 2	Scenario 3
Magnitude of shock	50%	80%	100%
Total NPL	12,467	12,467	12,467
Weighted NPA's	7,037	7,037	7,037
Weighted NPA's after shift in categories	8,036	8,633	9,033
Increase in Provisions	999	1,596	1,996
Revised Capital	22,180	21,583	21,183
Revised Risk Weighted Assets	175,182	174,585	174,185
Revised Capital Adequacy	12.66%	12.36%	12.16%

Note : Composition of NPA categories Special Mention, Substandard, Doubtful and Loss are 23%, 18%, 12% and 47% respectively)

#### B. Equity Price Risk

##### Fall in Stock Market Prices

The stress test for equity price assesses the impact of a fall in the stock market index.

	Scenario 1	Scenario 2	Scenario 3
Magnitude of shock	5%	10%	15%
Net exposure in stock market	4598	4598	4598
Fall in value of stock	230	460	690
Revised capital	22,949	22,719	22,489
Revised RWA	175,951	175,721	175,491
Revised CAR %	13.05%	12.94%	12.82%

#### C. Exchange Rate Risk

##### Adverse movement in Exchange Rate

The stress test for exchange rate assesses the impact of change in exchange rate on the value of equity. To model direct foreign exchange risk only the net open position of the bank including on and off balance sheet exposures are given adverse shocks.

	Scenario 1	Scenario 2	Scenario 3
Magnitude of shock	5%	10%	15%
Net open position	423	423	423
Loss on exchange Rate change	21	42	63
Revised capital	23,158	23,137	23,116
Revised RWA	176,160	176,139	176,118
Revised CAR %	13.15%	13.14%	13.13%

### Developing an Internal Monitoring Framework

A 'Crisis Prevention Committee' was set up with representation from key line management functions to assess the 'health' of key stakeholders comprising shareholders, customers, correspondent banks, suppliers and outsourced partners. The main outcomes of this committee were to institute regular reviews of suppliers / outsourcing partners, overseas buyers (trading partners of our export customers) and revisit / develop fresh placement and trade limits to correspondent banks.

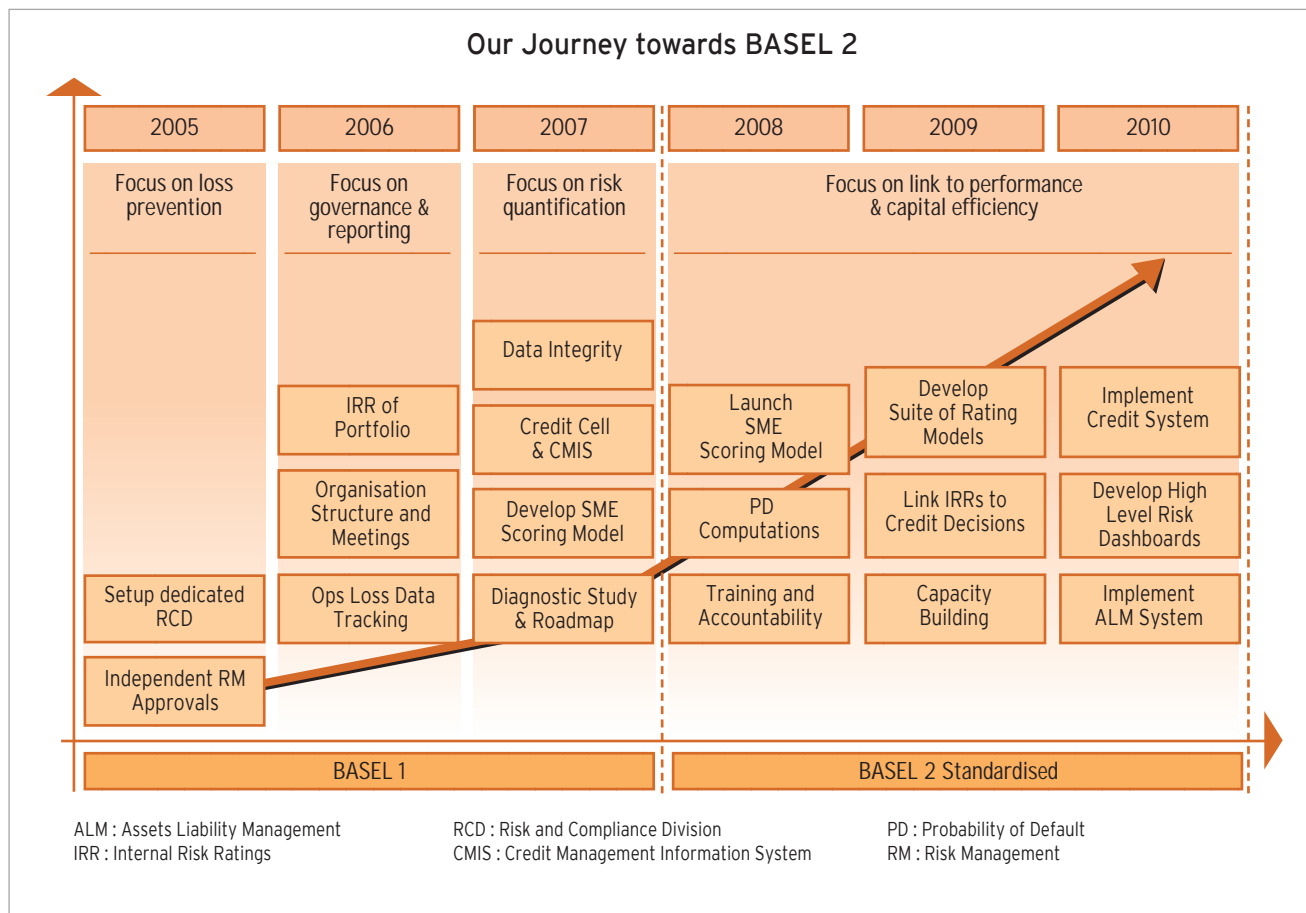
Policy documents developed during the year include Operational Risk Policy and Overseas Agency Operational Risk Policy, whilst a number of policy documents viz. Treasury Policy and AML Policy were updated to reflect a medium term perspective.

### Capacity Building for the future

HNB views BASEL 2 Risk Management Practices as an opportunity to embrace best in class Risk Management Practices in our continuing quest of Learning, applying, Growing and developing Winning Strategies to achieve Sustainable Profits. We completed a diagnostic study with the assistance of external consultants in 2007 followed by a gap analysis of where we are against where we want to be and developed a 5 year implementation roadmap to build the requisite Risk Infrastructure ahead of the Regulatory deadline of 2013.

HNB successfully transitioned from BASEL 1 to BASEL 2 basis of Capital Adequacy from January 1, 2008. The methodology for Capital allocation for Credit Risk is the Standardised Approach. Operational Risk requires a capital allocation based on the Basic Indicator Approach whilst Market Risk remains unchanged from Basel 1.

## > Risk Management



### Key Risk Management Initiatives implemented during 2009

Development of a suite of Internal Rating Models	We were successful in developing a suite of rating models for Corporate and Retail segments. The Corporate Models were developed to cater to three distinct segments within Corporate Banking namely Large Corporate, Middle Market and Financial Institutions to supplement the SME Model developed last year. These models were duly implemented with requisite training of credit cell staff. The robustness of these models are being regularly assessed through quarterly PD computations. Retail models developed include Housing, Personal Loans and Credit Cards. The priority is to ensure a supportive risk infrastructure in place in terms of structure and systems prior to roll out.
Link IRR's to Credit Decisions	This initiative was incorporated in the updated Credit Approval Structure commencing with SME and Corporate Segments. Industry specific structural issues prevent us from full application. However the bank is committed to initiatives such as Risk based pricing for progressive implementation.
Capacity Building - Talent and Systems	A comprehensive programme on Risk Management was conducted for Risk Management Staff in two phases in Dec '09 and Jan '10 by a team of foreign trainers. Successfully completed Credit Risk Modular training for second batch of Credit Relationship Managers and accordingly 25 associates have successfully completed Omega Credit Skills programme. Developed full day Risk Management Programme for Assistant Managers and rolled out across the network. Amendments were made to the KPI Wizard system during the year with a view to improving presentation layouts, performance benchmarking and security controls.

### Priorities for 2010

Implement / Upgrade Credit System	Given that the bank is now on a single core banking platform the immediate priority is to develop a robust credit system able to accommodate loan origination, rating systems, model validation and necessary statistical computations required for Basel 2. An integrated RFP was developed with a view to identifying a strategic software partner in 2010.
Develop High level Risk Dashboards	The focus will be to develop Dashboards to assess and monitor 'business health' on Credit, Operational and Market Risk against internally defined risk appetite. This development would require information from multiple information sources and will be a critical differentiator for decision making.
Implement ALM System	A critical initiative to improve Interest Rate and Liquidity Risk Management of the bank. The system would be able to accommodate multiple transfer pricing, analyse product yields, assess behavioural maturity profile of assets and liabilities and provide requisite MIS to improve decision making at ALCO.

**Risk Console**

Risk Category	Risk Rating	Mitigating Actions Implemented in 2009																															
		Risk Assessment	Risk Mitigating Strategies																														
<p><b>Credit Risk</b> Risk of Borrower Default</p> <hr/> <p>Effectiveness of Credit Policy</p> <p>Risk arises where Credit Policy amendments does not keep pace with changes in local and global environment</p>	Moderate	<p>Adequacy and Effectiveness of Credit Policies evaluated in Monthly Meetings</p> <p>Regular review of Credit Approval Structure based on feedback from Regional Management / Network</p>	<p>Credit Policy and Discretionary Lending Limits regularly updated.</p> <p>Risk Evaluation of new products prior to launch.</p> <p>Country Limits in place for SL Govt and Maldives.</p>																														
<p>Adequacy of Portfolio Monitoring</p> <p>Risk arises where systems and controls are not in place to regularly assess the health of the credit portfolio.</p>		Low	<p>Miscellaneous Reports developed for policy amendments as necessary. e.g. Impact of G20 Proposals on Sri Lankan Banking Sector, Peer Benchmarking on Key Risk Indicators, Study of Impact of Swine Flu on Credit Portfolio, Review of Exposure to Power and Energy Sector.</p> <p>Internalised KPI Wizard, a standardised MIS is used to track Risk Performance across business units. This will assist in improving overall management of Credit Risk through greater focus on Key Risk Ratios, improved sharing of best practices through performance benchmarking and improved accountability at all levels.</p> <p>Independent Regional Credit Reviews to assess effectiveness of monitoring and adherence to internal policies. 743 client facilities were reviewed as a part of this exercise. In addition a credit review of 43 customer accounts was completed for one large branch and 61 Corporates were reviewed as part of the Concentration Risk Analysis, in next section.</p>	<p>Reports circulated among relevant business segments, Credit Policy Members and Board as necessary.</p> <p>Risk Managers independently review Regional Performance and provide monthly feedback highlighting areas for improvement to line management</p> <p>Responses to our observations from business units obtained and followed through to implementation. Actions to address general control weaknesses shared across the network.</p>																													
		<p>Credit Quality Based on Internal Risk Ratings</p> <p>Corporate Banking Portfolio Based on Internal Risk Rating</p> <table border="1"> <caption>Estimated Data for Corporate Banking Portfolio Based on Internal Risk Rating</caption> <thead> <tr> <th>Year</th> <th>AAA</th> <th>AA</th> <th>A</th> <th>BBB</th> <th>BB</th> <th>B</th> <th>CCC</th> <th>CC</th> <th>C</th> </tr> </thead> <tbody> <tr> <td>2009</td> <td>5%</td> <td>15%</td> <td>25%</td> <td>25%</td> <td>15%</td> <td>10%</td> <td>5%</td> <td>5%</td> <td>5%</td> </tr> <tr> <td>2008</td> <td>5%</td> <td>20%</td> <td>35%</td> <td>20%</td> <td>10%</td> <td>5%</td> <td>5%</td> <td>5%</td> <td>5%</td> </tr> </tbody> </table>	Year	AAA	AA	A	BBB	BB	B	CCC	CC	C	2009	5%	15%	25%	25%	15%	10%	5%	5%	5%	2008	5%	20%	35%	20%	10%	5%	5%	5%	5%	<p>Focusing on High Risk Accounts (Internally Risk Rated B and below) reviews by Risk Managers</p> <p>Quarterly Review of Watch listed accounts to ensure adequate assessment of quality across the network and timely identification of account strategy under Temporary, Maintain and Exit categories.</p>
Year	AAA	AA	A	BBB	BB	B	CCC	CC	C																								
2009	5%	15%	25%	25%	15%	10%	5%	5%	5%																								
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## > Risk Management

Risk Category	Risk Rating	Mitigating Actions Implemented in 2009																							
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		<p>Non - Performing Advances</p> <table border="1"> <caption>Non-Performing Advances Data</caption> <thead> <tr> <th>Year</th> <th>NPA Gross as a % of Loans and Advances</th> <th>NPA Net as a % of Loans and Advances</th> </tr> </thead> <tbody> <tr> <td>2005</td> <td>8.37%</td> <td>2.87%</td> </tr> <tr> <td>2006</td> <td>7.05%</td> <td>1.85%</td> </tr> <tr> <td>2007</td> <td>5.78%</td> <td>1.41%</td> </tr> <tr> <td>2008</td> <td>6.73%</td> <td>2.28%</td> </tr> <tr> <td>2009</td> <td>6.16%</td> <td>2.90%</td> </tr> </tbody> </table>	Year	NPA Gross as a % of Loans and Advances	NPA Net as a % of Loans and Advances	2005	8.37%	2.87%	2006	7.05%	1.85%	2007	5.78%	1.41%	2008	6.73%	2.28%	2009	6.16%	2.90%	<p>Quarterly review of new additions to Non Performing Advances (“NPA”) by action category(i.e. housekeeping issues, legal action, negotiation etc.) for follow up.                      Quarterly review of Commodity Price Trends for circulation to network with recommendations.                       Observations shared with Business Line Managers for necessary actioning and agreed strategies followed through.</p>				
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<p><b>Credit Concentration Risk</b></p> <p>Risk arises where Credit Portfolio is not sufficiently diversified</p>	Low	<p>Industry Concentration</p> <table border="1"> <caption>Industrywise Exposure Data</caption> <thead> <tr> <th>Year</th> <th>Construction</th> <th>Traders</th> <th>Other Services</th> </tr> </thead> <tbody> <tr> <td>2008</td> <td>23%</td> <td>9%</td> <td>1%</td> </tr> <tr> <td>2009</td> <td>17%</td> <td>12%</td> <td>1%</td> </tr> </tbody> </table>	Year	Construction	Traders	Other Services	2008	23%	9%	1%	2009	17%	12%	1%	<p>Target Industry Limits developed based on Industry Risk Ratings. Strategies developed to gradually improve penetration of low risk industries and conversely reduce exposure to high risk industries.</p>										
Year	Construction	Traders	Other Services																						
2008	23%	9%	1%																						
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	High	<p>Geographical Concentration</p> <table border="1"> <caption>Geographical Distribution Data</caption> <thead> <tr> <th>Region</th> <th>Percentage</th> </tr> </thead> <tbody> <tr> <td>Western</td> <td>71%</td> </tr> <tr> <td>Southern</td> <td>4%</td> </tr> <tr> <td>Uva</td> <td>4%</td> </tr> <tr> <td>North Central</td> <td>5%</td> </tr> <tr> <td>North Western</td> <td>3%</td> </tr> <tr> <td>Eastern</td> <td>2%</td> </tr> <tr> <td>Northern</td> <td>2%</td> </tr> <tr> <td>Sabaragamuwa</td> <td>2%</td> </tr> <tr> <td>Central</td> <td>4%</td> </tr> <tr> <td>Overseas</td> <td>3%</td> </tr> </tbody> </table>	Region	Percentage	Western	71%	Southern	4%	Uva	4%	North Central	5%	North Western	3%	Eastern	2%	Northern	2%	Sabaragamuwa	2%	Central	4%	Overseas	3%	<p>Largely inevitable, given development efforts have been historically focused in Western Province. With the improvement in infrastructure and recent development efforts in Northeast and South HNB is ideally placed with its extensive, ever expanding branch network to leverage on emerging opportunities thereby reduce the level of concentration in any</p>
Region	Percentage																								
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Risk Category	Risk Rating	Mitigating Actions Implemented in 2009	
		Risk Assessment	Risk Mitigating Strategies
	Low	<p>Exposure by Counterparties</p> <p>2009: 10%, 24%, 8%, 10%, 4%, 31%, 5%</p> <p>2008: 10%, 21%, 7%, 10%, 3%, 35%, 6%</p> <p>Legend: Corporates &gt;1 Bn, Corporates 100 Mn - 1 Bn, Corporates 35 Mn - 100 Mn, SME 35 Mn - 10 Mn, Micro finance, Personal Loans, Leasing, Housing</p>	<p>one geographical area over time. HNB has a well diversified portfolio comprising large Corporates, Middle Market, SME, Retail and Microfinance segments.</p>
	Moderate	<p>Material Exposures</p> <p>2009: 21%</p> <p>2008: 19%</p> <p>Legend: Top 20</p>	<p>A modest increase in exposure to Top 20 customers is evident. It is relevant to mention that</p> <p>a) Aggregate of 'Material Exposures' (Lending Exposures above 15% of capital base) is well below the regulatory guideline of 55% of Credit Portfolio</p> <p>b) Exposure to Related Parties represents below 5% of the total portfolio</p>
Operational Risk Risk of Losses arising from faulty control systems, human negligence, internal and external fraud and acts of god			
Effectiveness of Operational Risk Policy	Low	<p>Adequacy and effectiveness of Operational Risk Policies regularly assessed at Risk Committee Meetings.</p>	<p>Developed Operational Risk Policy (after clear delineation of roles with Internal audit) to supplement Operational Risk Guidelines.</p> <p>Developed Operational Risk Manual for overseas agency offices</p>

## > Risk Management

Risk Category	Risk Rating	Mitigating Actions Implemented in 2009																									
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Risks arising from a poor Control Environment	Low	<p>A comprehensive Operational Loss database is in place to track losses by incident type and business line per BASEL 2 Guidelines.</p> <div data-bbox="450 586 1184 1102" data-label="Figure"> <p>Total Operational Losses for Year 2009 is 1.39 % of Net Income, analysed as follows.</p> <table border="1"> <caption>Operational Losses by Category</caption> <thead> <tr> <th>Category</th> <th>2009 (%)</th> <th>2008 (%)</th> </tr> </thead> <tbody> <tr> <td>Internal Fraud</td> <td>7%</td> <td>4%</td> </tr> <tr> <td>External Fraud</td> <td>2%</td> <td>29%</td> </tr> <tr> <td>Employment Practices &amp; Workplace Safety</td> <td>2%</td> <td>3%</td> </tr> <tr> <td>Clients, Products &amp; Business Services</td> <td>49%</td> <td>56%</td> </tr> <tr> <td>Execution, Delivery, &amp; Process Management</td> <td>40%</td> <td>8%</td> </tr> <tr> <td>Business Disruption &amp; System Failures</td> <td>2%</td> <td>3%</td> </tr> <tr> <td>Damage to Physical Assets</td> <td>2%</td> <td>3%</td> </tr> </tbody> </table> </div>	Category	2009 (%)	2008 (%)	Internal Fraud	7%	4%	External Fraud	2%	29%	Employment Practices & Workplace Safety	2%	3%	Clients, Products & Business Services	49%	56%	Execution, Delivery, & Process Management	40%	8%	Business Disruption & System Failures	2%	3%	Damage to Physical Assets	2%	3%	<p>Material Losses regularly analysed by cause and actions taken to improve systems and controls to prevent recurrence in the future.</p> <p>Regular meetings with Regional Management and Support Functions to ensure effectiveness of Operational Risk Meetings across the network and adequate follow up of issues identified for implementation</p>
Category	2009 (%)	2008 (%)																									
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Technology Risk arising from New Core Banking System implementation and consequent risks arising from system breakdowns and disruptions during the changeover	Moderate	<p>HNB successfully migrated to a new core banking system. Transfer of Branch G/L balances from legacy systems to Finacle were with the dual involvement of line management and Migration Team.</p> <p>Post migration issues are being identified and systematically resolved. The branch migration plan was preceded by a live simulation of the system. Technical and Security Features were reviewed by the Bank's IT Team supplemented by independent reviews by Internal Audit. Departmental / Branch Operational issues are surfaced for resolution by Departmental liaison officers.</p>	<p>Risk and Internal audit conducted an independent review to assess accuracy in migration of G/L balances to the new system. The findings were satisfactory.</p>																								
Technology Risk of not keeping abreast of latest technology and delivery channels in banking	Moderate	<p>The emergence of cost efficient alternative delivery channels (ie. Internet, mobile banking) threatens the traditional brick and mortar banking model</p>	<p>With the implementation of new core banking system HNB would be equipped with a superior platform to become a front runner in driving technology induced banking</p>																								
<p><b>High Impact Unforeseen Events</b></p> <p>Risk arising from lack of preparedness to Natural Disasters and Terrorism</p>		<p>A re-assessment of insurance adequacy of specific segments carried out and insurance cover enhanced.</p> <p>e.g. Exposure to Maldives Tourist resorts requires comprehensive insurance covering Tsunami, Storms, Tempest etc..</p> <p>Pawning insurance coverage strengthened given the significant appreciation in Gold prices during the year.</p>	<p>Specific Circulars issued and followed up for implementation.</p> <p>A Business Continuity Plan is in place to cover core systems and payments and settlements systems.</p>																								



Risk Category	Risk Rating	Mitigating Actions Implemented in 2009	
		Risk Assessment	Risk Mitigating Strategies
Risk arising from inadequate risk mitigation strategies	Moderate	Insurance is the key operational risk mitigant.	A comprehensive Risk Assessment of the Insurance Department incl. a cost benefit analysis, was conducted and recommendations being followed through for implementation.
<b>People Risk</b> Risk arising from inability to attract and retain skilled staff at middle to senior management levels	Moderate	The twin impact of the end of the Northeast conflict and the contagion effects of the Global economic crisis, expected to reflect in a reversal in the brain-drain which was a considerable issue in the local financial services sector.	Talent development, Retention of Top performers and Succession Planning for all departments are key focus areas. Performance Related Share Options were introduced for Management grade Staff and upwards  Preference given to bank staff for overseas job placements within bank
<b>Market Risk</b> Risks arising from fluctuations in interest rates, foreign exchange positions and prices of equity investments			
General appetite for Market Risk based on Treasury activity	Low	Treasury Management Focus is on covering Corporate Banking Positions with minimal trading on own account under the guidance of ALCO and Treasury Committee.	Treasury Policy amended to reflect CBSL Circular, Directions on Risk Management relating to FX Business
<b>Foreign Exchange Risk</b>  Risk arising from unhedged foreign exchange positions and poor treasury controls.	Low	Very little exposure to unhedged positions given internal policy and strengthened supervision by the regulators on minimising open foreign currency positions	New Treasury Trading System with new functionalities have been rolled out with new Core Banking System implementation.  A Market Risk Dashboard is being developed to assess, quantify and monitor adherence against internal limits

## > Risk Management

Risk Category	Risk Rating	Mitigating Actions Implemented in 2009	
		Risk Assessment	Risk Mitigating Strategies
<p><b>Liquidity Risk</b></p> <p>Risk arising from inability to meet maturing deposit liabilities as they fall due.</p>	Moderate	<p>Regular review of Asset and Liability Yield Analysis by product monitored at ALCO to ensure optimal Net Interest Margins.</p> <p>Bank maintains a Loans to Deposit ratio of well over 90% and is a net lender in the call money market.</p> <p>As a key remittance player in the country, foreign currency deposits of HNB exceed foreign currency lending by over 100%. Therefore, the reliance on interbank borrowing is low, which is a considerable strength.</p> <p>The absence of a long term yield curve, results in having to borrow short to lend long for both rupee and dollar exposures.</p>	<p>Specific Strategies developed to retain and grow Local and Foreign currency (low cost) deposit base</p> <p>Aggressive marketing of longer term Deposit products with a view to bridging the maturity mismatch gap.</p>
<p><b>Interest Rate Risk arising from Maturity Mismatch</b></p>	Moderate	<p>Contractual Maturity Mismatch of Rupee and Foreign Currency Earning Assets and Liabilities reviewed and implications identified.</p> <p>The absence of a system to assess behavioural maturity profile of Rupee and Foreign Currency Earning Assets and liabilities hinders development of precise strategies in this area.</p>	<p>Ensuring long-term lending on floating rate basis whilst ensuring regular re-pricing of fixed priced loans</p> <p>The investment in an ALM System as described under Priorities for 2010 above.</p>
<p><b>Regulatory Risk</b></p> <p>Risks arising from not conforming to statutory and regulatory requirements.</p>	Low	<p>In a continually changing regulatory environment, the Compliance unit centrally monitors adherence.</p>	<p>Quarterly checklist confirming adherence to regulatory requirements submitted to Board Audit Committee. Regulatory Circulars actioned through internal circulars and monitored for adherence.</p>
<p>Risk arising from non Compliance with Anti Money Laundering legislation</p>	Low	<p>In today's environment AML Risks are an integral element of bank risks and HNB has played a critical role in spearheading industry efforts in this area. Bank continues to maintain excellent relationships with regulators and law enforcement agencies</p>	<p>The bank's dedicated AML unit submits reports to FIU per regulations. The bank's intranet hosts an E-Learning module on AML which has been completed by branch staff and associates across the network. A common AML System for all banks will be implemented in mid 2010, which will significantly improve monitoring and reporting efforts in this area.</p>

Risk Category	Risk Rating	Mitigating Actions Implemented in 2009																			
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<p><b>Legal Risk</b> Risk arising from litigation against the bank or faulty legal documentation</p>	Low	HNB runs a full fledged legal department. Specialist legal advice is obtained from external consultants on a need basis.	No significant legislation against HNB during the year. Ongoing review of Service delivery provided by the Legal Department is monitored through internal customer surveys etc																		
<p><b>Reputation Risk</b> Risk arising from an event or behaviour that could adversely impact market 'perception' thereby affecting its going concern.</p>																					
<p>Risk arising from poor external and internal surveillance to identify strategic risks in a timely manner</p>	Moderate	Corporate Management meets at least annually at 'offsite' strategy meetings, to develop / review medium term goals and strategic priorities in the context of the environment.	Specific action plans with accountabilities and timelines developed to address each Strategic goal / Risk area identified.																		
<p>Risk to Brand / Reputation arising from lack of /inadequate Corporate Social Responsibility practices</p>	Low	<p>An active Corporate Social Responsibility ("CSR") Committee is in place with cross- functional representation to oversee implementation of CSR Projects</p> <table border="1"> <caption>CSR Budget Allocation</caption> <thead> <tr> <th>Category</th> <th>2008 (%)</th> <th>2009 (%)</th> </tr> </thead> <tbody> <tr> <td>School Libraries and Computer Centres</td> <td>36%</td> <td>47%</td> </tr> <tr> <td>Safe Drinking Water &amp; Sanitation</td> <td>20%</td> <td>20%</td> </tr> <tr> <td>Assistance to Cancer Patients</td> <td>20%</td> <td>5%</td> </tr> <tr> <td>Climate Change Project</td> <td>24%</td> <td>17%</td> </tr> <tr> <td>Health related assistance</td> <td>20%</td> <td>11%</td> </tr> </tbody> </table>	Category	2008 (%)	2009 (%)	School Libraries and Computer Centres	36%	47%	Safe Drinking Water & Sanitation	20%	20%	Assistance to Cancer Patients	20%	5%	Climate Change Project	24%	17%	Health related assistance	20%	11%	<p>Number of ongoing and new initiatives have been undertaken by HNB in areas of affordable drinking water, sanitation, health care, literacy and financial inclusion amongst others. These initiatives are considered imperative as a Good Corporate Citizen and ensure sustainability of our business strategies.</p>
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# Corporate Governance

## Chairman's Statement

HNB strives to be at the forefront of best practices in Corporate Governance. We are committed to continuous review and improvement of our Corporate Governance philosophy

The year proved to be extremely challenging for the financial services industry in Sri Lanka, as increasing vulnerabilities were exposed in the local and global financial systems which created a period of exceptional instability. Your Board of Directors wish to place on record their appreciation for the support received from you in this difficult period of time

This report sets out the initiatives we have taken to help embed in our culture, commitment to the highest standards of integrity and professionalism throughout HNB. Inclusion of another Independent Non-executive Director, this year on the Board, was one such initiative to further strengthen independent judgment on issues of

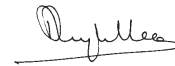
strategy, performance, risks and resources. Our goal is to be the most respected bank of the country. As part of that effort, we want to set the standard for Corporate Governance among our peers. We are guided by commitment to leadership and corporate responsibility and by our dedication to serve and cater to the best interests of our stakeholders. I am not aware of any material violations of any of the provisions of the Code of Business Conduct & Ethics of the Bank

We report below on how we have complied in 2009 with the Code of Best Practice on Corporate Governance issued jointly by the Securities and Exchange Commission of Sri Lanka and the Institute of Chartered Accountants of Sri Lanka in 2008, the Continuing Listing Requirements Section 7.10 on Corporate Governance Rules for Listed Companies issued by the Colombo Stock Exchange and the Banking Act Direction No 11 of 2007 and subsequent amendments thereto on Corporate

Governance for Licensed Commercial Banks in Sri Lanka issued by the Central Bank of Sri Lanka in 2008 which became effective from January 1, 2008, and required full compliance by Licensed Commercial Banks by January 1, 2009 except where extended compliance dates have been specifically provided for by the respective regulatory authorities

I hope that this Report will assist you to have a better understanding on how Corporate Governance works at HNB. Your feedback is important for us to continuously improve our Corporate Governance framework

Sincerely Yours,

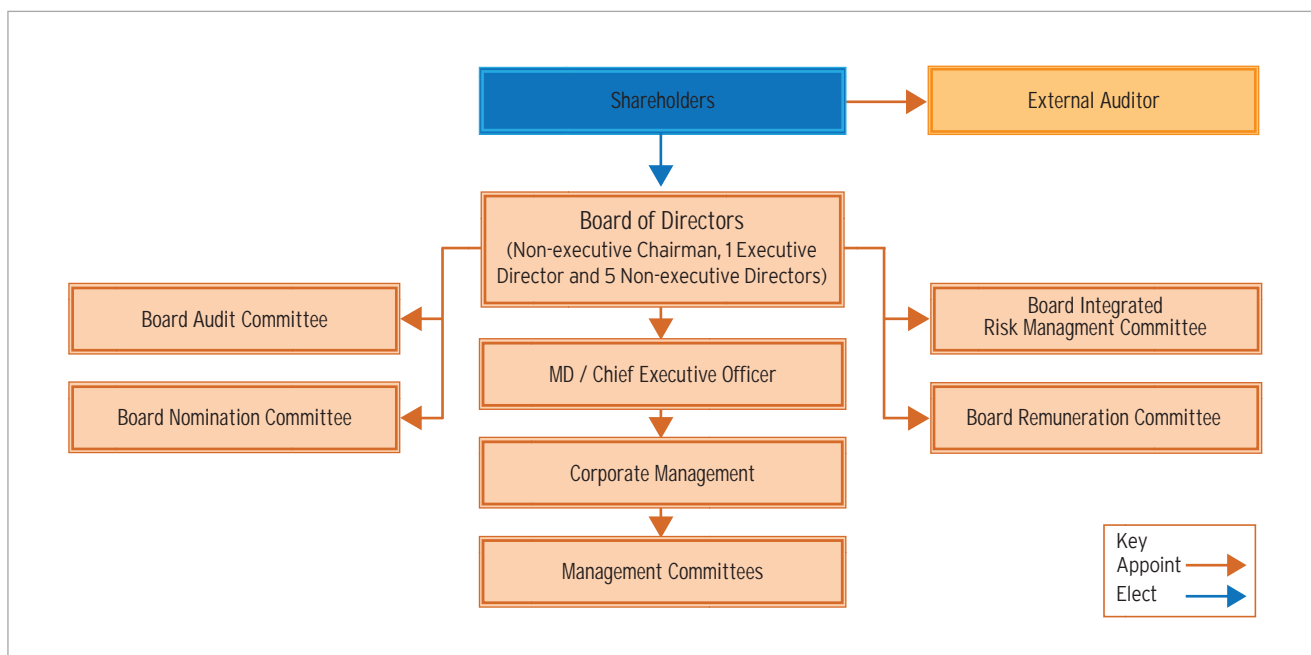


**Rienzie T. Wijetilleke**  
Chairman

Colombo, Sri Lanka  
15th February 2010

## Corporate Governance Framework

The Bank operates within a comprehensive governance framework, which is set out in the diagram below. It encompasses governance structures that are strategically linked with performance management, enabling HNB to focus on the areas that drive our business



## Corporate Governance

*“The Board has delegated the responsibility of day-to-day management of HNB to the MD/Chief Executive Officer, who is responsible for recommending strategy to the Board, leading and inspiring the Corporate Management and implementing the Board approved strategies through tactical and operational initiatives”.*

Corporate Governance is the management framework that facilitates the conduct of the business of HNB in a responsible and accountable manner so as to promote the credibility and soundness of the Bank, which will lead to the overall stability of the banking

sector in Sri Lanka. The Board is responsible and accountable for the management of the affairs of the bank, conduct of business and maintenance of prudent risk management and soundness of HNB

The Board’s role is to provide entrepreneurial leadership to the Bank within the framework of prudent and effective controls which enable risks to be managed. The Board sets the Bank’s strategic aims, ensuring that the necessary financial, human and physical resources are in place for the Bank to meet its objectives. The Board sets the Bank’s values and standards and ensures that its obligations to its stakeholders are clearly understood and met. The Board is also responsible for ensuring that management maintains an effective system of internal controls that provides assurance on efficient operations and compliance with applicable laws and regulations. In carrying out this responsibility, the Board gives regard to what is appropriate for HNB’s business and reputation, the materiality of financial and other risks inherent in the business and the relative costs and benefits of implementing specific controls. The

Board is also the policy-making body for all matters that are of strategic importance to HNB

Corporate Governance is a fundamental part of the culture and business practices of HNB. Our report this year comprises of three sections

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

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

**SECTION THREE** covers the Bank’s level of conformity with the Continuing Listing Requirements Section 7.10 on Corporate Governance Rules for Listed Companies issued by the Colombo Stock Exchange

## > Corporate Governance

### SECTION ONE

#### Statement of Compliance

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

The disclosures below reflect HNB's level of conformance to the above Code which comprises of six fundamental principles. These are namely Directors, Director's Remuneration, Relations with Shareholders, Audit and Accountability, Institutional Shareholders and Other Investors. The structures in place and the conformance to the requirement and expectations are tabulated below under the said six fundamental principles

Corporate Governance Principles	SEC & ICASL Code Reference	Adoption Status	HNB's Extent of Adoption
<b>A. DIRECTORS</b>			
<b>A.1. The Board</b>			
The Board consists of professionals in Banking, Accounting, Management, Law and Business Leaders. They possess the skills and experience and knowledge to set the directions and oversee the operations of the Bank. The Board reflects sound balance of independence and anchor shareholder commitment. All Directors are non executives except for the Managing Director / Chief Executive Officer			
1. Meetings	A 1.1	Adopted	During the year 12 Board meetings were held, at approximately monthly intervals, to review the Bank's performance and to determine which strategies and business practices are aligned with stakeholders' expectations. Additional meetings are held whenever necessary. Details of the meetings and the individual attendance of the members are given on page 75
2. Board responsibilities	A 1.2	Adopted	The Board of Directors has collective responsibility for the success of the Bank. The Board formulates strategy and ensures the implementation of same by the Corporate Management led by the MD/CEO. The MD / CEO is directly responsible for business operations and supported by the Corporate Management of the Bank. The Non-executive Directors are responsible for bringing independent judgment and scrutiny to decisions taken by the Board. Through the above process the Board ensures that the integrity of financial information, financial controls and systems of risk management are robust and the Bank complies with all applicable laws and regulations
3. Access to independent professional advice	A 1.3	Adopted	The Directors are mindful of their duties as set out in the laws and regulations affecting the Bank. The procedure for Directors to seek independent professional advice, in furtherance of their duties, at HNB's expense, is coordinated through the Board Secretary, as and when it's necessary
4. Board Secretary	A1.4	Adopted	All Directors have access to the Board Secretary who is an Attorney-at-Law by profession. She is responsible for supporting and advising the Chairman and the Board on all Corporate Governance matters, Board procedures and compliance with applicable laws and regulations
5. Independent judgment	A 1.5	Adopted	Non-executive Directors are responsible for bringing independent judgment and scrutinising the decisions taken by the Board on issues of strategy, performance, resources and business conduct
6. Dedication of adequate time and effort by the Board and Board Committees	A 1.6	Adopted	The Chairman and members of the Board dedicate adequate time for the fulfillment of their duties as Directors of the Bank. In addition to attending Board meetings, they attend sub-committee meetings and also make decisions via circular resolution. The Board sub-committees include; <ul style="list-style-type: none"> <li>- Audit Committee</li> <li>- Integrated Risk Management Committee</li> <li>- Human Resources / Remuneration Committee</li> <li>- Nomination Committee</li> <li>- Credit Committee</li> <li>- Procurement Committee</li> <li>- Asset Disposal Committee</li> </ul>

Corporate Governance Principles	SEC & ICASL Code Reference	Adoption Status	HNB's Extent of Adoption
7 Training for new Directors	A 1.7	Adopted	Directors recognise the need for continuous training and expansion of knowledge and undertake such professional development as they consider necessary in assisting them to carry out their duties as Directors. Presentations are made to the Board by the Corporate Management of HNB from time to time on industry related matters
<b>A.2. Chairman &amp; Chief Executive Officer</b> The roles of the Chairman and Chief Executive Officer are separate. The Chairman's main responsibility is to lead and manage the work of the Board to ensure that it operates effectively and fully discharges its legal and regulatory responsibilities. MD/CEO is responsible for the day to day operations of the Bank. Hence, there is a clear division of responsibilities in conducting the business of the Board and day to day management of the Bank			
8 Division of responsibilities of the Chairman & MD/CEO	A 2.1	Adopted	The functions of the Chairman and MD/CEO are clearly separated in order to ensure a balance of power and authority, such that no individual has unfettered powers of decision
<b>A.3. Chairman's Role</b> The Chairman's main role is to lead and manage the Board, ensuring that it discharges its legal and regulatory responsibilities effectively and fully. He preserves order and facilitates the effective discharge of the Board function			
9. Role of the Chairman	A 3.1	Adopted	The Chairman of HNB is a Non-executive Director, elected by the Board. The Chairman's role encompasses: <ul style="list-style-type: none"> <li>- Ensuring that Board members undertake appropriate induction, covering terms of appointment, duties and responsibilities</li> <li>- Providing effective leadership in formulating Board strategy</li> <li>- Representing the views of the Board to the public</li> <li>- Ensuring regular meetings, the minutes of which are accurately recorded and where appropriate included the individual and collective views of the Directors</li> <li>- Encouraging effective participation of all Directors in the decision making process to optimise contribution</li> <li>- Approving the agenda prepared by the Board Secretary and conducting Board meetings</li> </ul>
<b>A.4. Financial Acumen</b> The Code requires the Board to ensure the availability within it of sufficient financial acumen and knowledge to offer guidance on matters of finance. The Board is equipped with sufficient financial acumen as three out of eight of the Board members have appropriate financial background and hold fellow membership of their respective professional accountancy bodies			
10. Availability of sufficient financial acumen and knowledge	A 4	Adopted	The MD/CEO is a fellow member of the Institute of Chartered Accountants of Sri Lanka and a fellow member of the Chartered Institute of Management Accountants - UK. In addition, the Board includes a fellow member of the Chartered Institute of Management Accountants - UK, and a Director who is a fellow member of the Institute of Chartered Accountants of Sri Lanka & also a fellow member of the Institute of Chartered Accountants in England & Wales. These members of the Board have the ability to offer guidance on matters of finance to the Board
<b>A.5. Board Balance</b> The Code recommends having a balance of Executive and Non-executive Directors so that no individual or small group of individuals can dominate the Board's decision-making			
11 Presence of a strong independent element on the Board	A 5.1	Adopted	Seven of the eight Directors of the Board are Non-executives. The MD/CEO is the sole Executive Director. Chairman's and CEO's roles are not vested in one person

## > Corporate Governance

Corporate Governance Principles	SEC & ICASL Code Reference	Adoption Status	HNB's Extent of Adoption
12. Independent Directors	A 5.2 A 5.3	Adopted Adopted	Three out of the seven Non-executive Directors are independent as defined by the Code
13. Signed declaration of independence By the Non-executive Directors	A 5.4	Adopted	All Non-executive Directors of the Bank have made written submissions as to their independence against the specified criteria set out by the Bank, which is in line with the requirements of Schedule H of this Code
14. Determination of independence of the Directors by the Board	A 5.5	Adopted	The Board has determined that the submission of declaration by the Non-executive Directors, as to the independence of them, as a fair representation and will continue to evaluate their submission annually. Circumstances have not arisen for the determination of independence by the Board, beyond the criteria set out in the Code. Independent Non-executive Directors are; Mrs P C Cooray Mr R Seevaratnam Mr N G Wickremeratne
15. Senior Independent Director	A 5.6	N/A	The requirement to appoint a Senior Independent Director does not arise as the roles of Chairman and CEO are separated
16. Confidential discussion with the Senior Independent Director	A 5.7	N/A	Please refer comments above
17. Meeting of Non executive Directors	A 5.8	Adopted	Chairman meets with the Non executive Directors without the presence of MD/CEO, on a need basis
18. Recording of concerns in Board minutes	A 5.9	N/A	There were no concerns raised by the Directors during the year, which needed to be recorded in the Board meeting minutes
<b>A.6. Supply of Information</b>			
Management is required to provide time bound information in a form and of quality appropriate to enable the Board to discharge its duties. Financial and non financial information are analysed and presented in a form for the Board to make informed and accurate decisions			
19. Information to the Board by the management	A 6.1	Adopted	The Board was provided with timely and appropriate information by the management by way of Board papers and proposals. The Board sought additional information as and when necessary. Members of the Corporate Management made presentations on issues of importance. The Chairman ensured that all Directors were briefed on issues arising at Board meetings
20. Adequate time for Board meetings	A 6.2	Adopted	The Board papers were sent to the Directors at least a week before the respective Board Meetings, giving adequate time for Directors to study the related papers and prepare for a meaningful discussion at the meeting
<b>A.7. Appointment to the Board</b>			
The Board adopts a formal and transparent procedure for the appointment of new Directors to the Board. During the year an independent Non-executive Director was appointed to the Board			
21. Nomination Committee	A 7.1	Adopted	The Nomination Committee of HNB is comprised of the following four Directors. MD/CEO attends these meetings by invitation



Corporate Governance Principles	SEC & ICASL Code Reference	Adoption Status	HNB's Extent of Adoption
			Mr R T Wijetilleke - Non executive Chairman Mr D H S Jayawardena - Non executive Director Mr M V Theagarajah - Non executive Director Mr R K Obeyesekere - Non executive Director
22. Assessment of Board composition	A 7.2	Adopted	The Nomination Committee carried out continuous review of the composition of the Board, which includes identifying, evaluating and recommending candidates for suitable positions to ensure succession planning within HNB for the approval of the Board. More than 1/3rd of the existing Board comprises of Independent Non executive members
23. Disclosure of details of new Directors to shareholders	A 7.3	Adopted	Details of new Directors are disclosed to the shareholders on their appointment by way of public announcements as well as in the Annual Report. Prior notice on appointment of new Directors is given to the Director of Bank Supervision of CBSL as well as to the Colombo Stock Exchange. All new appointments as well as continuing Directorships are reviewed by the Nomination Committee. The Directors are required to report any substantial change in their professional responsibilities and business associations to the Nomination Committee, which will examine the facts and circumstances and make recommendations to the Board
<b>A.8 Re- election</b>			
The Code requires all Directors to submit themselves for re-election at regular intervals and at least once in every three years. It also requires that all Non-executive Directors to be appointed for a specific terms and subject to re-election			
24. Appointment of Non- executive Directors	A 8.1	Adopted	According to the Articles of Association of HNB, each Director other than the MD/CEO and any nominee Director, retires by rotation once in every three years and is required to stand for re-election by the shareholders at the Annual General Meeting. The proposed re-election of Directors is subject to prior review by the full Board. As required by the Companies Act No 7 of 2007, any Director who has reached the age of 70 years offers himself for re election on an annual basis. Mr M V Theagarajah and Mr R T Wijetilleke having reached the age of 70 have offered themselves for re election and the Board has recommended their re-appointment
25 Election of Directors by the shareholders	A 8.2	Adopted	Please refer comments above
<b>A.9 Appraisal of Board Performance</b>			
The Board periodically appraises its own performance against the pre set targets in order to ensure that the Board responsibilities are satisfactorily discharged			
26. Appraisal of Board performance	A 9.1	Adopted	The performance of the Board is evaluated by the Chairman. The sub Committees except for Audit Committee carry out a self assessment process annually to ensure they function effectively and efficiently with the objective of facilitating continuous improvement. The Audit Committee evaluation is conducted by the Non-Executive Chairman with the assessments from the Committee members CEO, CFO, the Head of Internal Audit and the External Auditor in accordance with International best practices
27. Annual self evaluation of the Board and its Committees	A 9.2	Adopted	Please refer comments above
28. Disclosure of the Appraisal of Board and Board Sub Committee performance	A 9.3	Adopted	Refer comments given for Section A 9.1

## > Corporate Governance

Corporate Governance Principles	SEC & ICASL Code Reference	Adoption Status	HNB's Extent of Adoption
<b>A.10 Disclosure of Information in respect of Directors</b>			
The Code requires that the details in respect of each Director to be disclosed in the annual report for the benefit of the shareholders			
29.Details in respect of Directors	A 10.1	Adopted	Details of the Directors are given on pages 12 and 13
<b>A.11 Appraisal of the CEO</b>			
The Board of Directors is required to evaluate annually to assess the performance of the Chief Executive Officer			
30.Financial targets for MD/CEO	A.11.1	Adopted	The performance targets for the MD/CEO are set at the commencement of every year by the full Board which are in line with the short, medium and long term objectives of HNB
31. Evaluation of the performance of the MD/CEO	A.11.2	Adopted	There is an ongoing process to evaluate the performance of MD/CEO against the financial and non financial targets set as described above, which is followed by a formal annual review by the Board at the end of each financial year
<b>B. DIRECTORS' REMUNERATION</b>			
<b>B.1 Remuneration Procedures</b>			
The Code requires companies to have a formal and transparent procedure for developing policy on executive remuneration and fixing the remuneration packages of individual Directors and also recommends that no Director should be involved in deciding his/ her remuneration in order to avoid the self review threat			
32.Remuneration / Human Resources Committee	B1.1	Adopted	The Remuneration Committee is responsible for assisting the Board with regard to the remuneration policy for the Executive Director and the Corporate Management, and for making all relevant disclosures The Committee determines and agrees with the Board, the broad policy framework for the remuneration of the MD/ CEO. The MD/CEO participates in meetings by invitation in deciding the remuneration of the Corporate Management in order to recruit, retain and motivate the Corporate Management team
33.Composition of the Remuneration Committee	B1.2 B1.3	Adopted Adopted	The Remuneration Committee comprises of the following four Non-executive Directors. Mrs P C Cooray - Non executive/ Independent Chairperson Mr R T Wijetilleke - Non executive Director Mr R K Obeyesekere - Non executive Director Mr N G Wickremeratne-Non executive /Independent Director
34.Remuneration of the Non executive Directors	B1.4	Adopted	The Board as a whole decides the remuneration of the Non executive Directors. The Non executive Directors receive a fee for being a Director of the Board and additional fee for either chairing or being a member of a committee, working on special committees and / or serving on subsidiary boards. They do not receive any performance / incentive payments
35.Consultation of the Chairman and access to professional advice	B1.5	Adopted	Input of the Chairman is obtained by his involvement as a member of the said sub committee. External professional advice is sought by the Remuneration Committee, on a need basis through the Board Secretary
<b>B.2 Level and make up of the Remuneration</b>			
The Board is mindful of the fact that the remuneration of Executive and the Non -executive Directors should reflect the expectation of the Bank and sufficient enough to attract and retain the quality of Directors needed to run the Bank.			
36.Level and make up of the remuneration of MD/CEO	B 2.1	Adopted	The remuneration package of the MD/CEO is structured to link rewards to corporate and individual performance. The Bank's remuneration framework for CEO is designed to create and enhance value for all HNB stakeholders and to ensure there is strong alignment between the short term and long term interest of the Bank and CEO

Corporate Governance Principles	SEC & ICASL Code Reference	Adoption Status	HNB's Extent of Adoption
37.Comparison of remuneration with other companies	B 2.2	Adopted	The Remuneration Committee in deciding the remuneration of the Directors (including the compensation package of the MD/CEO) takes into consideration the level of remuneration paid by the other comparable companies, performance and risk factors
38 Comparison of Remuneration with other companies in the Group	B 2.3	N/A	The size and scale of the Bank is not comparable with any other Group company
39.Performance related payment to MD/CEO	B 2.4	Adopted	Please refer item 36 on page 64
40.Executive share options	B 2.5	Adopted	Share options were offered to the Executive Director. The details of which are given in Note 48 of the financial statements on page 217
41.Designing the Executive Directors remuneration	B 2.6	Adopted	Please refer item 36 on page 64
42.Early termination of Directors	B 2.7	N/A	Not applicable to the Board except for the MD/CEO who is an employee of the Bank, and his terms of employment is governed by the contract of service
43.Early termination not included in the initial contract	B 2.8	N/A	Please refer comments above
44.Level of Remuneration of the NED	B 2.9	Adopted	Non-executive Directors receive a nominal fee in line with the market practices as disclosed in this Annual Report. Non executive Directors do not participate in the current share option plans of the Bank

### B.3 Disclosure of Remuneration

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

45.Disclosure of remuneration	B 3.1	Adopted	Please refer item 33 on page 64 for the details of the Committee. Remuneration Committee's report setting out the policy of the committee is given on page 143. The Compensation paid to the Board of Directors is disclosed in aggregate in note no 48 of the Financial Statements on page 217
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## C. RELATIONS WITH SHAREHOLDERS

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

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

46.Use of proxy votes	C.1.1	Adopted	The Bank has a mechanism to record all proxy votes and proxy votes lodged on each resolution
47. Separate resolution for all separate issues	C.1.2	Adopted	The Board remains mindful of being accountable to the shareholders and the need for transparency at all levels, striving to maintain it's value framework in all shareholder dealings and communications HNB proposes a separate resolution for each item of business, giving shareholders the opportunity to vote on each such issue

## > Corporate Governance

Corporate Governance Principles	SEC & ICASL Code Reference	Adoption Status	HNB's Extent of Adoption
48. Availability of all Board Sub Committee Chairmen	C.1.3	Adopted	The Board which includes the Chairmen of the Audit, Remuneration, Nomination and Integrated Risk Management Committees are present at the AGM to answer any questions
49. Adequate notice of the AGM	C.1.4	Adopted	The primary modes of communication between HNB and the shareholders are the Annual Report and AGM. Information is received by the shareholders prior to the AGM to give them an opportunity to exercise the prerogative to raise any issues relating to the business of HNB, either verbally or in writing prior to the AGM. All shareholders irrespective of their voting status are encouraged to attend the AGM. The Annual Report including financial statements and the notice of the meeting are sent to shareholders at least 21 calendar days prior to the date of the AGM
50. Procedures of voting at General Meetings	C.1.5	Adopted	Voting procedures at General Meetings are circulated to the shareholders along with the Annual Report
<b>C.2 Major transactions</b>			
Directors are required to disclose to shareholders all proposed material transactions which would materially alter the net asset position of the Bank, if entered into			
51. Major transactions	C.2.1	Adopted	During 2009 there were no major transactions as defined by Section 185 of the Companies Act No 7 of 2007 which materially affected HNB's net asset base. Transactions, if any, which materially affect the net assets base of HNB, will be disclosed in the quarterly/annual financial statements
<b>D. AUDIT AND ACCOUNTABILITY</b>			
<b>D.1 Financial Reporting.</b>			
The Board is required to present a balanced and understandable assessment of the Bank's financial position, performance and prospects			
52. Statutory and Regulatory reporting	D.1.1	Adopted	HNB has reported a true and fair view of its position and performance for the year ended 31st December and at the end of each quarter of 2009 In the preparation of quarterly and annual financial statements, HNB had strictly complied with the requirements of the Companies Act No 07 of 2007, the Banking Act No 30 of 1988 and amendments thereto, and are prepared and presented in conformity with Sri Lanka Accounting Standards. HNB has complied with the reporting requirements prescribed by the regulatory authorities such as the Central Bank and Colombo Stock Exchange As HNB's Global Depository Receipts (GDRs) are listed in the Luxembourg Stock Exchange, HNB has also complied with all the reporting requirements of the Luxembourg Stock Exchange
53. Directors' report in the Annual Report	D.1.2	Adopted	The Directors' report given on pages 134 to 140 of the annual report covers all areas of this section
54. Statement of Directors' responsibility for the financial statements	D.1.3	Adopted	The statement of Directors' responsibility for financial reporting is given on page 146 of the Annual Report
55. Management Discussions and Analysis	D.1.4	Adopted	The Management Discussion and Analysis is given on pages 20 to 37 of the Annual Report

Corporate Governance Principles	SEC & ICASL Code Reference	Adoption Status	HNB's Extent of Adoption
56. Declaration by the Board that the business is a going concern	D 1.5	Adopted	This is given in the Directors' report on page 134 of the Annual Report
57. Summoning an EGM to notify serious loss of capital	D 1.6	N/A	Likelihood of such occurrence is remote. However, should the situation arise, an EGM will be called for and shareholders will be notified
<b>D.2 Internal Control</b>			
The Code requires the Board to have a sound system of internal controls to safeguard shareholders' investments and the company's assets			
58. Annual evaluation of the internal control system	D 2.1	Adopted	The Board is responsible for establishing a sound framework of internal controls and monitoring its effectiveness on a continuous basis. Through such an effective framework, HNB manages business risks and ensures that the financial information on which business decisions are made and published is reliable. The system of internal controls is evaluated by the audit committee. In the year 2009, the Board of Directors was satisfied with the effectiveness of the system of internal controls, which is evidenced through the report of the CEO and CFO on internal controls over financial reporting given on page 147 of the Annual Report
59. Need for internal audit function	D 2.2	Adopted	The bank's internal audit function is managed by capacity which has been developed in house
<b>D.3 Audit Committee</b>			
The Code requires the Board to have a formal and transparent arrangements in selecting and applying the accounting policies, financial reporting and internal control principles and maintaining an appropriate relationship with the company's external auditor			
60. Composition and terms & conditions of the Audit Committee	D 3.1	Adopted	The Audit Committee of HNB is comprised of four Non-executive Directors, three of them are independent including the Chairman of the Committee. The said committee met six times during the year. The Board Secretary functions as the Secretary to the Audit Committee. The CEO, CFO, Head of Internal Audit and External Auditor attend meetings on invitation
61. Duties of the Audit Committee	D 3.2	Adopted	The Audit Committee monitors and reviews the External Auditor's independence, objectivity and the effectiveness of the audit process taking into account relevant professional and regulatory requirements. The Committee also sets out the policy for the engagement of the External Auditor to provide non-audit services, taking into account relevant regulations with regard to the provision of non-audit services and the guidelines issued by the Central Bank of Sri Lanka on "Prohibited Services". The Audit Committee has the primary responsibility for making recommendations on the appointment, re-appointment or removal of the External Auditor in-line with professional standards and regulatory requirements
62. Terms and reference of the Audit Committee	D 3.3	Adopted	The Audit Committee is guided by the Committee Charter which sets out authority and responsibility of the said committee. The Audit Committee monitors and reviews the effectiveness of HNB's Internal Audit function. The Head of Internal Audit reports to the Audit Committee. The Audit Committee reviews and approves the Internal Audit plan and resource requirements. It ensures that the internal audit plan adequately covers the significant risks of the bank, reviews the important Internal Audit findings and follow-up procedures The Internal Audit function is governed by the Internal Audit Charter that spells out its role, rights and responsibilities. The Internal Audit Charter is approved by the Audit Committee

## > Corporate Governance

Corporate Governance Principles	SEC & ICASL Code Reference	Adoption Status	HNB's Extent of Adoption
63. Disclosures of the Audit Committee	D.3.4	Adopted	The names of the members of the Audit Committee are given on page 148 The Committee ensures the rotation of External Audit Engagement Partner once in every 5 years The External Auditor has provided an Independence confirmation in compliance with the "Guidelines for Appointment of Auditors of Listed Companies" issued by SEC
<b>D.4 Code of business conduct &amp; ethics</b> The Bank has developed a code of business conduct & ethics for all employees in line with the requirement of the SEC & ICASL Code			
64. Code of business conduct and ethics	D 4.1	Adopted	The Bank has developed a code of business conduct & ethics for all employees, which addresses conflict of interest, corporate opportunities, confidentiality of information, fair dealing, protecting and proper use of the company's assets, compliance with laws and regulations and encouraging the reporting of any illegal or unethical behavior etc. The Bank is currently in the process of developing a code of business conduct and ethics specifically for Directors, to be implemented from the year 2010
65. Affirmation of the code of conduct & ethics	D 4.2	Adopted	Please refer the Chairman's statement on page 58 for details
<b>E. INSTITUTIONAL SHAREHOLDERS</b>			
<b>E.1 Shareholders voting</b> Institutional shareholders are required to make considered use of their votes and encouraged to ensure their voting intentions are translated into practice			
66 Institutional shareholders	E 1.1	Adopted	Annual General Meeting is used to have an effective dialogue with the shareholders on matters which are relevant and concern to the general membership. The Investor Relations team headed by the MD/CEO has regular discussions with key institutional shareholders to share highlights of the bank's performance and also with the view of obtaining constructive feed back
<b>E.2 Evaluation of Corporate Governance initiatives</b> Institutional investors are encouraged to give due weight to all relevant factors in Board structure and composition			
<b>F. OTHER INVESTORS</b>			
<b>F.1 Investing/ Divesting decision</b>			
67. Other Investors	F.1	Adopted	Individual shareholders are encouraged to carry out adequate analysis or seek independent advice on investing or divesting decisions
<b>F.2 Shareholder Voting</b>			
68. Individual shareholders voting	F.2	Adopted	Individual shareholders are encouraged to participate in General Meetings and exercise their voting rights

## SECTION TWO

### Statement of Compliance

BANKING ACT DIRECTION NO 11 OF 2007 AND SUBSEQUENT AMENDMENTS THERETO ON CORPORATE GOVERNANCE FOR LICENSED COMMERCIAL BANKS IN SRI LANKA

Central Bank of Sri Lanka issued the Direction on Corporate Governance (Banking Act Direction No 11 of 2007 and subsequent amendments thereto), to be fully complied with from January 1, 2009 except where extended compliance dates have been specifically provided for, in order to improve and sustain the Corporate Governance processes and practices of the Licensed Commercial Banks in Sri Lanka. The disclosures below reflect HNB's level of conformance to the above Direction which comprises of eight fundamental principles, namely The responsibilities of the Board, The Board's composition, Criteria to assess the fitness and propriety of Directors, Management functions delegated by the Board, the Chairman and the Chief Executive officer, Board appointed Committees, Related party transactions and Disclosures. The structures in place and the conformance to the requirement and expectations are tabulated below under the said eight fundamental principles

Corporate Governance Principles	CBSL Rule Reference	Compliance Status	HNB's Level of Compliance
<b>3 (1) The responsibilities of the Board</b>			
1. Strengthening the safety and soundness of the bank	Rule 3(1)(i)	Compliant	The Board is responsible for formulating strategy, ensuring the adequacy of the risk management processes, review the internal control system and defining the responsibility of the Corporate Management. Please refer item 2 of the SEC & ICASL Code table on page 60 for further details
2. Chairman & CEO	Rule 3 (1)(ii)	Compliant	The roles of the Chairman and the CEO are separate
3. Board Meetings	Rule 3 (1)(iii)	Compliant	Please refer item 1 of the SEC & ICASL Code table on page 60 for further details
4. Inclusion of proposals by all Directors in the agenda	Rule 3 (1)(iv)	Compliant	Proposals from all Directors on promotion of business and management of risk and other areas relevant to the progress of the bank are included in the agenda for regular meetings
5. Notice of Meetings	Rule 3 (1)(v)	Compliant	Directors are given adequate time and at least 7 days of notice for Board meetings
6. Non attendance of Directors	Rule 3 (1)(vi)	N/A	This situation has not arisen
7. Board Secretary	Rule 3(1)(vii) Rule 3(1)(viii)	Compliant Compliant	Please refer item 4 of the SEC & ICASL Code table on page 60 for details
8. Minutes of the Meetings	Rule 3 (1)(ix) Rule 3 (1)(x)	Compliant Compliant	Minutes of the Board Meetings are maintained in sufficient detail by the Board Secretary
9. Independent professional advice	Rule 3 (1)(xi)	Compliant	Please refer item 3 of the SEC & ICASL Code table on page 60 for details
10. Conflict of interests	Rule 3 (1)(xii)	Compliant	The Board is conscious of its obligations to ensure that Directors avoid conflicts of interest (both real and apparent) between their duty to HNB and their other interests. The Board has 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 declares his/her interest and unless the Board resolves otherwise, he/she does not participate in discussions or vote on that specific matter. Independent Directors do participate in such meetings

## > Corporate Governance

Corporate Governance Principles	CBSL Rule Reference	Compliance Status	HNB's Level of Compliance
11. Formal schedule of matters	Rule 3(1)(xiii)	Compliant	The Board operates on a formal pre set agenda which covers areas coming directly under its responsibility
12. Situation of insolvency	Rule 3(1)(xiv)	N/A	This situation has not arisen
13. Capital adequacy	Rule 3 (1)(xv)	Compliant	The bank is fully compliant with the capital adequacy requirements of the Monetary Board
14. Corporate Governance Report	Rule 3(1)(xvi)	Compliant	This report addresses this requirement
15. Annual self assessment by the Board	Rule3(1)(xvii)	Compliant	Please refer item 26 of the SEC & ICASL Code table on page 63 for details
<b>3 (2) The Board's Composition</b>			
16. Number of Directors	Rule 3 (2)(i)	Compliant	The Board comprises of eight Directors
17. Period of service of a Director	Rule 3 (2)(ii)	N/A	This section of the Rule is not applicable for the year under review and will become effective from January 1, 2012
18. Appointment of an employee as a Director	Rule 3 (2)(iii)	N/A	This situation has not arisen except in the case of the MD/CEO
19. Independent Non executive Director	Rule 3 (2)(iv)	Compliant	This section of the Rule becomes applicable from January 1, 2010. However, the Board includes four Independent Non executive Directors, which is more than one third of the Board
20. Alternative Director	Rule 3 (2)(v)	Compliant	This situation has not arisen
21. Credibility, skills & experience of Non executive Directors	Rule 3 (2)(vi)	Compliant	Please refer pages 12 and 13 for the profiles of the Non executive Directors
22. Presence of Non executive Directors in Board Meetings	Rule 3 (2)(vii)	N/A	This section of the Rule is applicable only from January 1, 2010
23. Details of Directors	Rule 3(2)(viii)	Compliant	Please refer page 75 for the details of the Directors and their categories
24. Appointment of new Directors	Rule 3 (2)(ix)	Compliant	Please refer item 23 of the SEC & ICASL Code table on page 63 for details
25. Appointment to fill a casual vacancy	Rule 3 (2)(x)	N/A	This situation has not arisen



Corporate Governance Principles	CBSL Rule Reference	Compliance Status	HNB's Level of Compliance
26. Resignation / removal of a Director	Rule 3 (2)(xi)	N/A	This situation has not arisen
27. Appointments to other banks	Rule 3 (2)(xii)	Compliant	Non of the Directors nor employees are Directors of another bank
<b>3 (3) Criteria to assess the fitness and propriety of Directors</b>			
28. Directors over 70 years of age	Rule 3 (3)(i)	N/A	This section of the Rule is not applicable for the year under review and will become effective from January 1, 2012
29. Holding of office in more than 20 companies	Rule 3 (3)(ii)	N/A	This section of the Rule is not applicable for the year under review and will become effective from January 1, 2012
<b>3 (4) Management function delegated by the Board</b>			
30. Delegation of work to the management	Rule 3 (4)(i)	Compliant	The Board annually evaluates the delegated authority process to ensure that the delegation of work does not materially affect the ability of the Board as a whole in discharging its functions
31. Extent of delegation	Rule 3 (4)(ii)	Compliant	Please refer comments above
32. Evaluation of the delegated process	Rule 3 (4)(iii)	Compliant	Please refer comments on item 30 above
<b>3 (5) The Chairman and Chief Executive Officer</b>			
33. Division of Responsibilities of the Chairman & MD/CEO	Rule 3 (5)(i)	Compliant	The roles of Chairman and Chief Executive Officer are separate. Please refer item 8 & 9 of the SEC & ICASL Code table on page 61 for further details
34. Chairman preferably be an Independent Director and if not appoint a Senior Director	Rule 3 (5)(ii)	Non-Compliant	The Chairman of HNB is not considered as independent as per the definition set out in the Direction on Corporate Governance for Licensed Commercial Banks issued by the CBSL which became effective on January 1, 2008. The Board has recognised this area and taken steps to appoint an Independent Non executive Director, as the Senior Independent Director, during 2010, as required by the said Rule
35. Relationship between Chairman and CEO & other Directors	Rule 3 (5)(iii)	Compliant	There are no material relationship between the Chairman /CEO and other members of the Board which will impair their respective roles
36. Role of the Chairman	Rule 3 (5)(iv) to Rule 3 (5)(ix)	Compliant	Please refer item 9 of the SEC & ICASL Code table on page 61 for detailed information of the role of the Non executive Chairman

## > Corporate Governance

Corporate Governance Principles	CBSL Rule Reference	Compliance Status	HNB's Level of Compliance
<b>3 (6) Board appointed committees</b>			
37. Board appointed four sub committees	Rule 3 (6)(i)	Compliant	There are seven Board appointed Sub Committees including the four Committees prescribed by the CBSL Direction. Please refer item 6 of the SEC & ICASL Code table on Page 60 for the names of the Board Sub Committees
38. Audit Committee	Rule 3 (6)(ii)	Compliant	Please refer section D3 of the SEC & ICASL Code table on page 67 for details of the Audit Committee
39. Human resources / Remuneration Committee	Rule 3 (6)(iii)	Compliant	Please refer item 32 of the SEC & ICASL Code table on page 64 for details
40. Nomination committee	Rule 3 (6)(iv)	Non-Compliant	Please refer item 21 of the SEC & ICASL Code table on page 62 for details for the composition of the Committee. As the Chairman of the committee is not independent, the Bank is non compliant with this Rule to that extent. The Bank is in the process of rectifying this aspect of non compliance
41. Integrated Risk Management Committee	Rule 3 (6)(v)	Compliant	Integrated Risk Management Committee comprises of the following personnel; Mr M V Theagarajah - Non executive Director (Chairman) Mr Rienzie T Wijetilleke- Non executive Director Mr R Theagarajah - Managing Director / CEO Mr R K Obeyesekere - Non executive Director Mr J D N Kekulawala - Chief Financial Officer Mr D P N Rodrigo - AGM Risk & Compliance The committee assess, review and take prompt action to mitigate the effects of the specific identified risks. The committee also oversees the compliance function of the Bank
<b>3 (7) Related Party Transactions</b>			
42. Avoiding conflict of interest in related party transaction and favourable treatment	Rule 3 (7)(i) Rule 3 (7)(ii) Rule 3 (7)(iii)	Compliant Compliant Compliant	Necessary steps have been taken by the Board to avoid any conflict of interests, that may arise, in transacting with related parties as per the definition of this Direction and Sri Lanka Accounting Standard-30 on Related Party Transactions. Further the Board ensures that there is no related party benefits from favourable treatment. The pricing applicable to such transactions is based on the assessment of risk and pricing model of the bank and is comparable with that what is applied to transactions between the bank and its unrelated customers
43. Accommodations to Directors and / or their close relatives	Rule 3 (7)(iv)	Compliant	All accommodations to Directors and/or their close relatives are approved by all Directors who are available in the country at the time the said accommodation is considered (other than the Director concerned)
44. Appointment of Director subsequent to approval of facilities	Rule 3 (7)(v)	N/A	This situation has not arisen
45. Accommodation to employees	Rule 3 (7)(vi) Rule 3 (7)(vii)	Compliant Compliant	No accommodation has been given to employees on a favourable basis other than the general schemes applicable to all employees of the Bank

Corporate Governance Principles	CBSL Rule Reference	Compliance Status	HNB's Level of Compliance												
<b>3 (8) Disclosures</b>															
46. Financial reporting, statutory and regulatory reporting	Rule 3 (8) (i)	Compliant	The financial statements for the year ended December 31, 2009 are in conformity with all rules and regulatory requirements and for the quarters then ended have been published in all three languages. All related party transactions are disclosed in note no 48 to the Financial Statements on page 216												
47. Minimum disclosure in the annual report	Rule 3 (8) (ii)	Compliant	<p>(a) Compliance with applicable accounting Standards and regulatory requirements has been reported in the Directors Responsibility Statement for Financial Reporting on page 146 and CEO / CFO's Responsibility Statement on page 147</p> <p>(b) Directors confirmation on the effectiveness of the internal control mechanism over the financial reporting system and compliance to accounting principles and regulatory requirements is given on pages 139 and 146 of this Annual Report</p> <p>(c) Effective date for the external auditor's certification on the effectiveness of Internal Controls has been extended until an auditing framework is developed by the ICASL</p> <p>(d) Details of the Directors is given on pages 12 and 13. Directors' transactions with the Bank have been disclosed in note 48 to the financial statements on page 216. Total remuneration and fees paid to the Directors and Key Management Personnel is given in note 48 to the financial statements on page 217</p> <p>(e) Accommodations granted to related parties are given in note 48 to the financial statements on pages 216 to 226 The net accommodations granted to each category of related parties is given below as a percentage of the Bank's regulatory capital</p> <table border="0" data-bbox="627 1310 1490 1512"> <thead> <tr> <th style="text-align: left;">CATEGORY OF RELATED PARTY TRANSACTIONS</th> <th style="text-align: right;">% OF REGULATORY CAPITAL</th> </tr> </thead> <tbody> <tr> <td>1. Credit Card balances outstanding from KMP's</td> <td style="text-align: right;">-</td> </tr> <tr> <td>2. Loans and advances outstanding form Subsidiaries</td> <td style="text-align: right;">12.05</td> </tr> <tr> <td>3. Advance payments to a Subsidiary</td> <td style="text-align: right;">0.10</td> </tr> <tr> <td>4. Loans and advances to other related entities</td> <td style="text-align: right;">16.22</td> </tr> <tr> <td>5. Transactions with companies in which a Director of the Bank is also a Director</td> <td style="text-align: right;">11.53</td> </tr> </tbody> </table> <p>(f) Please refer (d) &amp; ( e) above</p> <p>(g) Effective date for the external auditor's certification on Corporate Governance Disclosures has been extended until an auditing frame work is developed by ICASL</p> <p>(h) There were no material non compliance to prudential requirements, regulations, laws and internal controls affecting the Bank</p> <p>(i) There were no supervisory concerns on lapses in the Bank's risk management or non compliance with this Direction that have been pointed out by the Director of Bank Supervision of CBSL and requested by the Monetary Board to be disclosed to the public</p>	CATEGORY OF RELATED PARTY TRANSACTIONS	% OF REGULATORY CAPITAL	1. Credit Card balances outstanding from KMP's	-	2. Loans and advances outstanding form Subsidiaries	12.05	3. Advance payments to a Subsidiary	0.10	4. Loans and advances to other related entities	16.22	5. Transactions with companies in which a Director of the Bank is also a Director	11.53
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## > Corporate Governance

### SECTION THREE

#### Statement of Compliance

CONTINUING LISTING REQUIREMENTS SECTION 7.10 ON CORPORATE GOVERNANCE RULES FOR LISTED COMPANIES ISSUED BY THE COLOMBO STOCK EXCHANGE

The disclosures below reflect HNB's level of conformance to the above Rule which comprises of five fundamental principles, namely Non executive Directors, Independent Directors, Disclosures relating to Directors, Remuneration committee and Audit committee. The structures in place and the conformance to the requirement and expectations are tabulated below under the said five fundamental principles

Corporate Governance Principles	CSE Rule Reference	Compliance Status	HNB's Level of Compliance
Non executive Directors	7.10.1	Compliant	MD/CEO is the sole Executive Director. All other Directors are Non executives
Independent Directors	7.10.2 (a)	Compliant	Three out of the eight Directors are independent in terms of the criteria defined by CSE Rule 7.10.4 on Corporate Governance
	7.10.2 (b)	Compliant	All Non-executive Directors have submitted their confirmations on Independence as per the criteria set by the Bank, which is in line with the regulatory requirements
Disclosures relating to Directors	7.10.3 (a)	Compliant	The Board assessed the independence declared by the Directors and determined the Directors who are independent and disclosed same in item 14 of SEC & ICASL on page 62
	7.10.3 (b)	Compliant	Circumstances did not arise for the Board to specify a Director as independent beyond the criteria set by CSE, as the Board has adequate number of Independent Directors
	7.10.3 (c)	Compliant	Please refer pages 12 and 13 for the brief resume of each Director
	7.10.3 (d)	Compliant	The Bank disclosed the appointment of the new Director to the Colombo Stock Exchange when it disclosed to the Central Bank of Sri Lanka and the public
Remuneration Committee	7.10.5 (a) Composition	Non - Compliant	The Remuneration Committee comprises of two Non executive Independent Directors and two Non executive Directors. This does not comply with the requirement that the majority of the members should be Independent. The Bank has initiated steps towards rectifying the said non compliance
	7.10.5 (b) Function	Compliant	Please refer item 32 of the SEC & ICASL Code table on page 64 for details of the function of the Remuneration Committee
	7.10.5 (c) Disclosure in the Annual Report	Compliant	Names of the Remuneration Committee members are given in item 33 of the SEC & ICASL Code table on page 64 The report of the Remuneration Committee is given on page 143 and the remuneration paid to Directors is given in the note 48 to the financial statements on page 217
Audit Committee	7.10.6 (a) Composition	Compliant	The Audit Committee of HNB is comprised of four Non-executive Directors, three of them are Independent including the Chairman of the Committee. Chairman of the Committee is a member of two professional accountancy bodies. CEO and CFO attend Committee meetings by invitation. Please refer page 148 for further details
	7.10.6 (b) Function	Compliant	Please refer item 61 of the SEC & ICASL Code table on page 67 for the details of the functions of the Audit Committee
	7.10.6 (c) Disclosure in the Annual Report	Compliant	The names of the Audit Committee members and the report of the Committee has been given on page 148. The basis of determination of the independence of the auditor is also given in the Audit Committee report

## Meetings

Scheduled Board and Committee meetings are arranged well in advance to ensure, as far as possible, that the Directors can manage their time commitments. All Directors are provided with supporting papers and relevant information for each meeting and are expected to attend, unless there are exceptional circumstances that prevent them from doing so. Attendance at the scheduled Board meetings is set out below. Reasons for non-attendance are generally prior business or personal commitments. In the event that a Director is unable to attend a meeting, they will still receive the papers for the meeting and will normally discuss any matters they wish to raise with the Chairman of the meeting to ensure their views are taken into account. The Board papers are sent to the Directors at least a week before the respective board meetings, giving adequate time for Directors to study the related papers and prepare for a meaningful discussion at the meeting. In addition, all Directors are able to discuss any issues with the Chairman and Chief Executive Officer at any time

Names	Directorship Status	Board	Audit Committee	Nomination Committee	Remuneration/ HR Committee	Integrated Risk Management Committee
Number of meetings held		12	6	1	2	4 (Note 05)
Mr Rienzie T Wijetilleke	Non-executive Chairman	12	-	1	2	3
Mr R Theagarajah	Managing Director/ CEO	12	5 (Note 03)	1 (Note 03)	2 (Note 03)	4
Mr D H S Jayawardena	Non-executive Director	11	4	1	-	-
Mr M V Theagarajah	Independent Non-executive Director	11	-	1	-	4
Mr R K Obeyesekere	Non-executive Director	10	-	1	2	3
Mrs P C Cooray	Independent Non-executive Director	11	6	-	2	-
Mr R Seevaratnam	Independent Non-executive Director	12	6	-	-	-
Mr N G Wickremeratne	Independent Non-executive Director	05 (Note 01)	2 (Note 02)	-	0 (Note 04)	-

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

Names	Credit	Asset Disposal	Procurement Committee
Total No. of papers approved in 2009	389	2	26
Mr Rienzie T Wijetilleke	333	2	24
Mr R Theagarajah	320(Note 06)	2	26
Mr D H S Jayawardena	102	-	-
Mr M V Theagarajah	225	-	21
Mr R K Obeyesekere	176	1	23
Mrs P C Cooray	280	2	2(Note 08)
Mr R Seevaratnam	162	-	1(Note 09)
Mr N G Wickremeratne	112	1(Note 07)	10(Note 10)

- Note 01 - Mr N G Wickremeratne was appointed to the Board on July 03, 2009. There were 5 meetings after his appointment, he has attended all 5 meetings
- Note 02 - Mr N G Wickremeratne was appointed to the Audit Committee on September 03, 2009. There were 2 meetings after his appointment, he has attended both meetings
- Note 03 - Attended by invitation but is not a member of the sub committee
- Note 04 - Mr N G Wickremeratne was appointed with effect from September 03, 2009 after which there were no committee meetings held
- Note 05 - The Chief Financial Officer, AGM - Risk & Compliance and Head of Internal Audit who represent the management in the said Committee attended all 4 meetings during the year
- Note 06 - A further 63 papers were approved by Mr R Theagarajah's alternate when he was overseas
- Note 07 - While Mr N G Wickremeratne was not a regular member of this committee, he was co-opted as a member and approved 01 paper during the year when a regular committee member was not available
- Note 08 - While Ms P C Cooray was not a regular member of this committee, she co-opted as a member and approved 02 papers during the year when a regular committee member was not available
- Note 09 - While Mr R Seevaratnam was not a regular member of this committee, he was co-opted as a member and approved 01 paper during the year when a regular committee member was not available
- Note 10 - Mr N G Wickremeratne was appointed to this committee on September 03, 2009

2

HOW IT  
WORKS

9

# SOCIAL RESPONSIBILITY

INTEGRATING BUSINESS FOCUS WITH THE NEEDS and expectations of our stakeholders  
THAT IS HOW IT WORKS

## About Our Report



### Knowing How Sustainability Works

It is through commerce that the world and humanity have advanced to their current position. However, with each advancement and development, unsustainable practices have pushed the boundaries of ecological limits. In the last two decades, corporates and commercial entities have become more conscious of the need to do business in a sustainable manner.

Yet as far back as 1888, one fledgling financial institution embarked on a

journey to function beyond pure commercial interest. Emerging from the very centre of environmental abundance, it was born from the need to serve a community held within the valleys of Hatton's mountainside, thus embedding an innate consciousness for sustainability. That fledgling has now grown to be one of Sri Lanka's largest financial institutions and yet that heritage keeps Hatton National Bank PLC (Bank) true to its origins.

The Bank recognises its potential to promote the principles of sustainability from environmental protection, social

equity, sustainable development, employee responsibility, customer partnership to investor relations. It knows how sustainability works because sustainability is at the very core of its operations be it from deposits, lending, financial literacy or investment activities to greening of internal operations.

The Hatton National Bank operates in the belief that it can and does play a positive role in advancing environmental and social sustainability.

#### HNB embraces the following precepts:

##### 1. Commitment to Sustainability

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

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

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

##### 3. Commitment to Responsibility

The Bank bears responsibility for the environmental and social impacts of its transactions including financial risks, as well as the community's social and environmental costs.



#### 4. Commitment to Accountability

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

#### 5. Commitment to Transparency

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

#### 6. Commitment to Sustainable Markets and Governance

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

Our Sustainability Report seeks to demonstrate our commitment to each of these precepts and outlines the sustainability efforts during the year under review.

#### Aligning Business Strategy with Sustainability Reporting

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

#### Sustainability Reporting Frameworks, Principles and Reporting Guidelines:

(A) The Global Reporting Initiative (GRI) Reporting Framework  
This Sustainability Report has been developed based on the GRI Reporting Framework which serves as a generally accepted structure for reporting on an organisation's economic, environmental and social performance.

Global Reporting Guidelines (GRI 3) provide specific 'Reporting Principles' and 'Reporting Guidance' to assist companies through

decision making processes associated with the preparation of a sustainability report. This Report defines the content, the quality of the Report and sets the boundaries as outlined by the GRI Reporting Principles

(B) The International Federation of Accountants (IFAC) Sustainability Framework

To further enhance this Sustainability Report, the Bank has also referred to the IFAC Sustainability Framework laid out by the International Federation of Accountants (IFAC) which consolidates all of the important aspects of sustainability. The IFAC Sustainability Framework has been designed for organisations wishing to deliver long-term sustainable value to their stakeholders.

(C) Application of GRI 3 and IFAC Sustainability Framework

The Bank is confident that the combined application of GRI 3 guidelines and IFAC Sustainability Framework to the Sustainability Reporting process this year, will add further value to stakeholders.

#### Defining our Report Content

(A) The issue of Materiality

In the preparation and compilation of this Sustainability Report, materiality proved to be a challenge.

As outlined in the GRI guidelines, the Bank recognises and accepts the importance of materiality. Thus, in this light this Sustainability Report covers topics and indicators that reflect the Bank's significant economic, environmental and social impacts or that which would substantively influence the assessments and decisions of our stakeholders.

(B) Stakeholder Inclusiveness

Sustainability Reporting affords the Bank a means to communicate and engage with its stakeholders. Given the disparate nature (and interests) of various stakeholders, the Bank is compelled to strategically define its key stakeholder audience to ensure materiality in engagement and reporting. Thus, the Bank defines its key Stakeholders as investors, employees, customers, suppliers, communities and environment.

(C) Sustainability Content

The Report presents the Bank's performance in the wider context of sustainability. It provides an overview of how the Bank contributes to the improvement of economic, environmental and social conditions within which it operates.

## > About Our Report

### Defining Report Quality

#### (A) Balance, Accuracy and Clarity

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

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

#### (B) Defining Report Boundary

The Report covers only the sustainable performance of the Bank and has not been extended to cover its subsidiaries.

### Standard Disclosures in the Report

#### (A) Strategy and Profile

In this section the Report provides a high level strategic view of the Bank's relationship to sustainability in order to provide context for understanding the Bank's

performance such as its strategy, profile and governance.

#### (B) Management Approach & Performance Indicators

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

#### (C) GRI Application Level

For the purpose of this Report, the GRI Application Level grid has been utilised to conclude on the application level appropriate to the Report. On a self declaration basis, the Report is classified as 'A' level.

### Independent Assurance

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

M/s KPMG Ford Rhodes Thornton & Company has provided an Independent Assurance Report on Hatton National Bank's Sustainability Report. The Auditor's Review Engagement was carried out in accordance with the International Standard on Assurance Engagements (ISAE 3000).

### Collecting Stakeholder Feedback

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



## Chief Executive Officer's Message

**“We firmly believe that the scope of responsibility for financial institutions in Sri Lanka has widened from environmental protection to consideration of social issues and social inclusion of less privileged groups by providing access to finance.”**



### The scope for sustainability in a united Sri Lanka

The year 2009 has been a year of historical significance for the Sri Lankan people. While the nation stands as one, after more than three decades, a myriad of opportunities has been afforded to Sri Lankans. Whilst future economic prosperity for the nation is undoubtedly the mainstay amongst these opportunities, it is imperative that corporates and individuals come together to create opportunities for sustainable development of the Country including its Northern and Eastern provinces, helping in every possible manner to bring to those communities a semblance of hope through sustainable livelihoods.

### Call for industry to migrate from defensive to sustainable banking

In this context, we firmly believe that the scope of responsibility for financial institutions in Sri Lanka has widened: from environmental protection to

consideration of social issues and financial inclusion of less privileged groups by providing access to finance. In essence, this is exactly what Hatton National Bank has been engaged in for over 120 years, since its humble beginning as the Hatton Bank. Our business ethic has revolved around rural communities, in fact the very establishment of our Bank stems from a need to financially assist the community and the commerce of a tiny hamlet in the heartland of the tea country. Since then however, we have evolved to encompass sustainability into our business strategy in a concerted manner. We recognise and encourage our industry peers to take the initiative to migrate boldly from defensive banking—where management of social and environmental impacts is seen as an additional cost—to sustainable banking—where sustainable development is seen as an advantage and an opportunity for growth.

### Sustainability Reporting Framework

At Hatton National Bank, sustainability reporting is a gesture that demonstrates our commitment towards sustainability; it underlines our responsiveness to those who want to know us better, our customers and suppliers, the shareholders and local community, and of course our present and future employees. Our greatest pride in undertaking sustainability reporting stems from the fact that as a corporate that has a rich tradition for engaging in sustainability, we are now able to through the integration of strategic CSR to the Bank's business strategy to cater to the nation and its societal needs in a reportable and quantifiable manner.

### Establishment of the Sustainability Foundation

Sustainability will continue, in the future, to be an integral element in shaping how we do business. The holistic outlook, which melds

## > Chief Executive Officer's Message

sustainability into the very core of our business strategy has been and will continue to be the path of progression for our Bank's prosperity. Whilst in the past, the Bank's sustainability strategy had been one that was backed by resources committed each year for optimal utilisation, in 2009 a separate sustainability foundation was established to infuse greater involvement of the Board of Directors in defining the sustainability approach. The Sustainability Foundation is discussed in greater length on page 84 of this report.

### Recognition and Rewards

It was indeed gratifying to be recognised and rewarded for our sustainability initiatives and our sustainability reporting efforts during the previous financial year. As the Overall Winner of the Gold Award for the Best Presented Annual Report amongst

all sectors at the Institute of Chartered Accountants of Sri Lanka (ICASL) Annual Report Awards 2008 and Overall Winner for the large scale sector at the ACCA Sustainability Awards 2009, we firmly believe that our strategy towards embedding sustainability into our business practice has indeed truly paid dividends towards creating a culture of conscious action. This is further reinforced by the recognition of Hatton National Bank as the winner in the Governance and Economic contribution category at the Best Corporate Citizens Award 2009 organised by the Ceylon Chamber of Commerce.

### Future Outlook

In the medium term, we envision to propel change by embracing green practices, increasing commitment to financing of renewable energy projects, mobilising resources for sustainable development and inspiring our

customers to look beyond the conventional to the adoption of sustainable accounting. We firmly believe that the future prosperity of Sri Lanka's people is a direct indicator of our own success as a wealth generator and a social mobiliser. That is why responsible business dictates our every action.



**Rajendra Theagarajah**  
Managing Director / CEO

Colombo, Sri Lanka  
15th February 2010



## Our Strategic Approach

Hatton National Bank PLC has consistently adopted a strategic approach to sustainability where business and sustainability strategies are intrinsically aligned. Thus, sustainable development is an ongoing and continuous area of focus in strategic discussions, objectives, goals and targets, and is integrated with governance and accountability arrangements and risk management. The Bank ensures that sustainable development is featured at a strategic level, supported by leadership and vision whilst also integrated into all parts of the operational plan.

### Aligning business strategy with sustainable development

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

The Bank is committed to serve all strata of society and through product segmentation provides financial access and services across the continuum of

socio-demographic groups. Having served the Micro and Small & Medium Entrepreneurs (SME) for over four decades, Hatton National Bank PLC is considered a pioneer in the introduction of financial services to persons considered otherwise as "less-bankable" through its Gami Pubuduwa (Village Re-awakening) programme. The entrepreneurial poor remain a critical customer segment for the Bank with financial inclusion for these segments an area of strategic priority from the perspective of the development of commercial enterprise.

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

### CSR Strategy

Hatton National Bank's CSR strategy revolves around six strategic pillars:

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

With medium to long-term sustainability efforts that focus on each of the strategic pillars, the Bank has been dominant in pursuing a focused CSR strategy. With top-down leadership towards the effective implementation of the strategy, the Bank has consistently allocated resources - both monetary and through manpower - towards meeting the CSR objectives for each year.

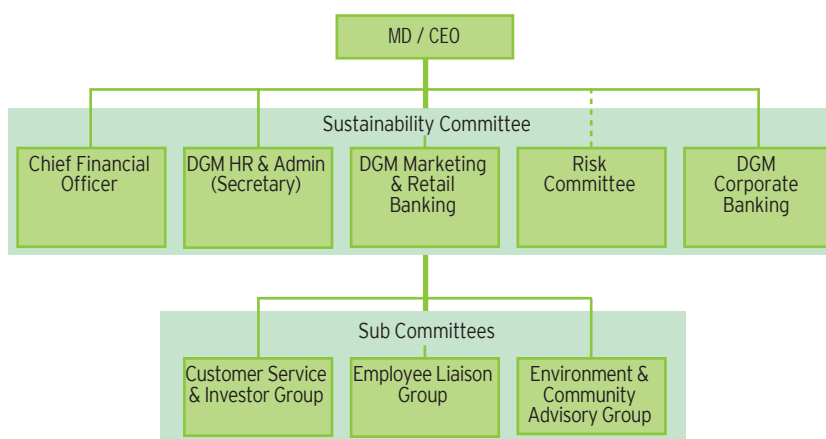
### Sustainability Stewardship & Structure

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

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

- Overseeing progress across the six strategic CSR pillars
- Acting as the "think tank" in developing the sustainability agenda
- Ensuring conformance with sustainability guidelines
- Identifying and managing areas of non-compliance within the sustainability principles
- Setting standards for policies and procedures in meeting sustainability principles

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



## > Our Strategic Approach



### HNB Sustainability Foundation

During the latter part of 2009, the Bank established a Sustainability Foundation to further consolidate its CSR efforts and set in place processes to carry out greater screening of initiatives to blend with the strategic intent of the Bank. The Foundation will independently drive the CSR strategy in the future in so far as it impacts on community development. The Foundation will

safeguard the interest of the CSR strategy despite challenging economic and business scenarios negating the possibility of reductions in budgets and scaling - back of strategy implementation.

The Foundation's Trustees comprise of two members of the Board of Directors and eight members of the Bank's management. The main function of the Trustees would be to formulate policy

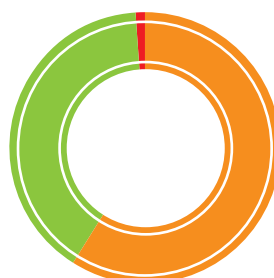
and strategic direction with the implementation being the responsibility of the Bank's employees.

The appointment of two members of the Board of Directors will facilitate shareholder interest to be represented at the Foundation and will further allow for the Foundation to explore the role of stakeholder dialogue in the long term shaping of sustainability initiatives.

### Contribution to the National Economy

- Bank's total expenditure Rs 32.7 Bn
- Of this, amount expended on staff emoluments and benefits Rs 4.9 Bn

Government Tax



- VAT on Financial Services - 59%
- Income Tax - 40%
- Debits Tax / Stamp Duty - 1%

## Internal Management

The Internal Management focuses on all those areas covering performance and change management that helps the Bank to deliver on its strategy and achieve sustainable development objectives and targets.

### Corporate Governance and Risk Management

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

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

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

### Enhancing Performance, Evaluation and Measurement

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

This sustainability system ensures that sustainability considerations play a part in the Bank's decision-making processes, including credit assessments and portfolio analysis. It enables the Bank to consider environmental and socio-economic issues comprehensively, and by so doing, move beyond simply complying with regulations to taking advantage of sustainability opportunities.

This systematic process is a part of the Bank's overall management system. It extends to the Bank's structure, planning activities, responsibilities, practices, procedures, processes, and resources for developing, implementing, achieving, reviewing, and maintaining the Bank's corporate and sustainability expectations. The system offers a more strategic approach, with defined objectives, formal policies, action plans, allocated resources, and trained and expert staff.

At the core of this sustainability system is the ability of the Bank to decide what services it will offer to which clients, what impacts of the client's business are to be taken into account, and what terms of business, advice, and support the Bank will offer. A number of parallel initiatives bring policies into action, such as capacity building in training, setting measurement and evaluation standards, implementing incentive schemes, and carrying out reporting initiatives that target both the Bank's shareholders as well as a wider group of stakeholders. These processes are tailored to fit the Bank's business goals and organisational culture.

Performance evaluation and measurement of sustainability criteria within the functions of the Bank are

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

As discussed in the Environment section (refer pages 115 to 118), the Bank has pioneered environmentally friendly construction technologies in the construction of its Head Office as well as commencing the construction of the Bank's first green branch that will utilise green building techniques.

The Bank is currently engaged in the quantification of its carbon impact. In the year 2010, the Bank will continue to refine the process as part of its green ethos.

### Changing Behaviours

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

Commencing with its own employees, in 2009, the Bank undertook a Green Pledge coinciding with the World Environment Day. The Bank drew inspiration from the United Nations theme for 2009 "Your planet needs you. Unite to combat climate change" to compose the actions stated in the Green Pledge. The pledge was preceded by a comprehensive training for team leaders on waste management and energy efficiency whilst an internal communication strategy supported the initiative, increasing awareness amongst the Bank's employees on an individuals' desired action towards a greener planet (refer the Environment section on page 115).

## > Internal Management

The Bank also considers the behaviours of all of its stakeholders in championing change towards sustainability awareness and empathy. From a supplier perspective, the Bank adopts a sustainability conscious procurement strategy which gives preference to suppliers who follow sustainability requirements as laid out in the procurement guidelines. Currently being in the first stage of implementation, the Bank expects the sustainability procurement strategy to heavily impact the roles and actions of suppliers in the years to come, necessitating change in the way they do business in the future. From a customer perspective, the Bank affords its customer base the choice for e-statements and online transactions thus minimising the use of paper. It hopes that in the medium term, it will be successful in contracting the annual consumption of paper considerably through this initiative.

From a national and business perspective, the Bank considers behavioural change to a more conducive social and economic focus, a dire need for the future development of the nation. In addressing these needs, the Bank undertook to build talent and catalyse change in the Northern and

Eastern provinces due to the vast gap in resources available for the communities resident therein. After more than three decades of conflict and with considerable brain drain due to it, the Bank recognised the need for a large drive for advocacy in the area. In developing the existing resources in the provinces, the Bank resolved to train and recruit from the Northern and Eastern provinces for the Bank's staff requirements for these areas. With several batches of school leavers, the Bank has undertaken to train and develop the participants to better equip them to enter the financial services industry. Consciously training more than the Bank's requirement, it is the expectation of the Bank to build capacity by developing the youth of the area from both an intellectual as well as social perspective to create employability. The programme is expected to continue over the next two to three years.

### Striking a Balance between Sustainable Performance and Cost

The Bank accepts that an effective sustainability management system can expand the range of benefits for a

financial institution. Social and environmental risk management generates indirect profits for the Bank. That is, effective management of cost and risk mitigates the quality of the portfolio and lowers bad debts. Actively pursuing opportunities by introducing and pursuing innovative financial solutions and products generates direct profits in new markets, with new clients.

Another major benefit is improved brand value. This is critical for the Bank, as its business depends on the trust placed in the Bank and its ability to provide products and services discretely and professionally. Good brand value opens new opportunities and helps attract capital and clients. To create and maintain the HNB brand, the Bank recognises the need to build a reputation of strong and sustainable financial performance, sound corporate governance, and solid corporate responsibility.



## Stakeholder Engagement

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

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

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

On the external front, the Bank engages with the wider community. Communicating the Bank's performance in sustainability initiatives and social and environmental management to external stakeholders is a key component in creating long-term value. Among other things, it enhances the Bank's reputation, builds its brand, and improves its image in the community.

Demonstrating financial gains from sustainable banking enhances shareholder value. Moreover, good

public reporting has improved the Bank's access to capital and to international markets. A major part of improving communication is engaging in clearer, more open, and more transparent public reporting on environmental, social, and economic performance. Leadership in reporting has assisted the Bank to develop and differentiate itself in the marketplace and generate positive relationships with external stakeholders.

Another aspect of increasing engagement with stakeholders is promoting corporate governance. The manner in which governance is embraced by the Bank has been described in detail in the Corporate Governance Section of this report on pages 58 to 75.



## How we engage with our stakeholders

Stakeholder Group	Engagement Activities in 2009
<b>Customers</b>	<ul style="list-style-type: none"> <li>Bank carries out regular series of surveys through qualitative and quantitative measures both through in-house and outsourced research houses. The results of these surveys and research processes are used continuously to determine how well and to what extent the Banks' service portfolio as well as the service levels require to be augmented.</li> <li>Meetings, events and festivities that bring a cluster of customers face to face with the Bank's Management also enable the Bank to gauge the relationship with each customer and to fortify these relationships going forward.</li> <li>Throughout the year, the Bank conducts a series of "mystery shopper" styled programmes which enable the Bank's Management to "experience" the service levels afforded to the customer base. These "experience" sessions allow the Management to determine changes to the service levels and service code.</li> </ul>
<b>Employees</b>	<ul style="list-style-type: none"> <li>Various internal communication tools, employee feedback tools, open door policies, HatnaMag and the Bank's inspiring innovation programme "Spark" all contribute towards the creation of an open and constructive dialogue.</li> <li>The "Green Pledge" undertaken by the Bank's employees during the year further served as an exercise to strengthen the engagement process across the Bank.</li> </ul>
<b>Investors</b>	<ul style="list-style-type: none"> <li>The Annual General Meeting is used to have an effective dialogue with the shareholders on matters which are of relevance and of concern to the general membership.</li> <li>The Investor Relations team headed by the MD/CEO has regular discussions with key institutional shareholders/ Fund Managers to share highlights of the Bank's performance and also with the view of obtaining constructive feed-back .</li> <li>The Bank's website also serves as a tool towards effective engagement.</li> </ul>
<b>Communities</b>	<ul style="list-style-type: none"> <li>The Bank's branches serve as the main medium for engagement with the community. With a high level of interaction taking place between the staff of branch offices and communities within which they operate, community focused sustainability initiatives have largely been stimulated through stakeholder dialogue.</li> </ul>
<b>Suppliers</b>	<ul style="list-style-type: none"> <li>With the adoption of the "Green Procurement Policy" during 2009, the Bank ensures that sustainability criteria are included in specifications to suppliers and that sustainability criteria are met in the award of contracts by ensuring that suppliers' environmental credentials are considered in the supplier appraisal process.</li> <li>The Bank communicated and educated one tier of suppliers on the Green policy and the need for the implementation of ethical manufacturing processes for the long term sustainability of their own businesses. Similar awareness programmes for the remaining tiers of suppliers are planned for the forthcoming financial year.</li> </ul>
<b>Environment</b>	<ul style="list-style-type: none"> <li>The Bank engaged with like-minded conservationists and experts in the areas of bio-diversity conservation, "green" design and construction and forged business partnerships along the lines of green finance/renewable energy.</li> <li>The "Green Pledge" undertaken by the Bank's employees during the year further served as an exercise to strengthen the engagement process across the Bank.</li> </ul>



## Customer Responsibility



Customers are the core of the Bank's existence. As an organisation that has been committed to the execution of robust customer-centric strategies from its inception over 120 years ago, Hatton National Bank recognises that a sustainable customer orientation extends beyond merely provisioning services sought by its customers. To this effect, the Bank employs five catalysts for the creation and maintenance of sustainable customer relations.

The Bank's Customer Responsibility initiatives as outlined in this Section will therefore be identified with each of these catalysts. Given that initiatives need to be long-term in nature, for the assured development of sound relationships and excellence in service, many of the Bank's customer responsibility programmes are sustained over many years for greater efficacy. However, during each fiscal year focused activities are planned and executed.

### The five catalysts



### Listening to our customers

#### Customer Expectations and Satisfaction Survey

Catalyst: Listening & Experience

Listening and experiencing are two catalysts that are given prominence at HNB for the primary reason that listening allows the Bank not only to understand the needs of the customers

but also to rectify situations, products and services that do not meet the expectations of the customers. To this end the Bank carries out on an on-going basis a series of qualitative and quantitative measures through in-house as well as through outsourced research houses. The results of these surveys and research processes are used continually to determine how well and to what extent the Bank's service portfolio as well as the service levels require augmentation.

## > Customer Responsibility

Meetings, events and festivities that bring a cluster of customers face to face with the Bank's Management also allow the Bank to gauge the relationship with each customer and to fortify these relationship going forward.

Throughout the year, the Bank conducted a series of "mystery shopper" styled programmes that aim to allow the Bank's Management to "experience" the service levels afforded to the customer base. These "experience" sessions allow the Management to determine changes to the service levels.

The Financial Ombudsman continues to be a focal feature in impartially listening to customer complaints. During the year a total of 126 written complaints were received to the Bank of which 89 per cent were resolved through the Bank's Management whilst 11 per cent were escalated to the Financial Ombudsman.

## Sustainability Depends on Future Generations

### Lowa Dinana Singiththo

Investment for the year:  
Rs. 10,000,000

Total Programme Investment to date:  
Rs 20,000,000

Catalyst: Action

Inspired by the belief that the Bank's own sustainability firmly depends on the future generations, Hatton National Bank conceptualised and launched a programme to help nurture the nation's future leaders. Steadfast in its belief that through corporate partnership, and through inclusive action the Bank can assume responsibility for the shaping of young minds and creation of future leaders, Hatton National Bank undertook the task of presenting Lowa Dinana Singiththo for the first time in 2008.

In 2009 the Programme created a unique opportunity for the younger generation to bring out their creative

skills and inbuilt talents in different areas such as Art, Music, Speech, Drama and Writing. The Bank is confident that through the development of these skills a child will benefit and be better facilitated towards meeting challenges in the future especially through the development of character and self-assurance and by empowering them through opportunity to reach out for bigger goals.

Lowa Dinana Singiththo 2009 had a participation of 150,000 children from over 9,800 schools island wide, participating to display their talents and creativity in any of the three national languages. Conducted in association with the Ministry of Education, the programme and ensuing competition were held over a period of three months both at district and national level from all provinces including the North and East.

The programme culminated in a grand finale comprising of a prize presentation, an art exhibition and an evening of entertainment held at the Bandaranaike Memorial International Conference Hall (BMICH). Winners, their colleagues, parents, family and well-wishers from across the country attended the grand finale. At the evening of entertainment, the winners were afforded the opportunity to dance, sing and act alongside young professionals.

### Student Banking: Financial Literacy to the Youth

Investment for the year:  
Rs. 2,500,000

Total Programme Investment from 2007:  
Rs 4,500,000

Catalyst: Relationship

In 1994, the Hatton National Bank embarked on a drive to involve the rural youth, provide them access to resources and to allow them to interact with the rest of the nation. Spurred to action by outcomes of two youth led insurgencies, the Bank recognised the need to bridge a gap by fostering relationships and by

taking financial literacy to the rural youth. Thus was born the Student Banking Programme.

Through the aegis of the Ministry of Education, the Bank progressively approached schools, assisted them in infrastructure development and capacity building. To complement the national curriculum, the Bank established Student Banking Units within the premises of these schools. Through this process the Bank undertook to not only inculcate the savings habit but also to impart financial education, responsibility and accountability to the Student Bankers. In the long term, the Bank was confident that its interaction with the students would enable them to procure employment with ease. To this effect the Bank certifies the participation of each Student Banker in the Financial Literacy Programme.

The Bank closely monitors the Student Banking Programme. On a quarterly basis, Branch level training is conducted for the Student Bankers whilst special financial education programmes are conducted at the participating schools focused on educating the majority of the student population. The Student Banking Units fall under the purview of the respective eight Regional Offices of the Bank for overall supervision. In addition, the Bank conducts regional level Student Managers Conferences and annually a full day Student Managers Conference at the Banks' Head Office. These interactions and training sessions expose them to a myriad of learnings including global and national developments in Banking, Finance, IT as well as an exposure to National and International Economic scenarios, strategic discussions and contingency planning.

Over the years the Student Banker programme has successfully trained over 16,000 students. The cascading effect of the programme has not been quantifiably determined although the Bank is aware that each participating Student Banker has passed on and shared their financial know-how with

countless colleagues who themselves have been customers at the Student Banking Units.

Similarly, the objective of promoting a savings culture among students has been significantly met with 153 HNB Student Banking Centres administrated by approximately 1000 Student Bankers. The Bank is content in the knowledge that it has not only imparted and developed financial literacy amongst youth but that its Student Banker Programme has significantly contributed towards personal growth, marketing and administrative know-how amongst students whilst creating a scenario of self-assurance, capability and positivism amongst students from an early age.



## Extending our hands to rekindle commerce

### “Vanakkam - Yalpanam” Jaffna Reawakening Week

Investment for the Year:  
Rs 400,000

Catalyst: Relationship

As the people of Jaffna reawakened to a future devoid of violence and terror, but filled with hope and future prosperity, the Bank undertook the initiative to be at the forefront of laying a base for the dawn of commercial and economic reawakening for the peninsula’s people.



As an institution that has been recognised as one that has reached out to the rural population through programmes aimed at financial literacy, the Bank understood the dire need for a programme focused primarily at Jaffna’s agro and fisheries industries which portray cultivation and fisheries patterns that are exclusive to the region.

The “Vanakkam Yalpanam” programme was conceptualised and activated over a week during the month of August with the first sub-programme dedicated to agro-techniques. With the collaboration of agro-experts from the Department of Agriculture and the University of Jaffna,



## > Customer Responsibility

the participants were exposed to the latest technological aspects of farming, quality improvement methodologies, packaging techniques as well as how to obtain marketing linkages. The agro sub- programme focused on the entirety of the crop process from planting and harvesting to marketing and aimed at allowing farmers to utilise this knowledge towards the achievement of optimal crop profitability.

The second sub-programme focused on the peninsula's fisher community. Fisheries has been a mainstay of the peninsula's economy but had been constricted due to the previously prevalent security situation. Given the lapse of time, the fisher community lacked know-how on the latest fishing techniques, the more optimal fishing catchment areas as well as preservation and transportation methods. The sub-programme touched each of these areas. The Bank through the Jaffna Reawakening Programme offered incentivised financing options to those who participated as an added feature although the main focus of the programme was both financial and commercial literacy.

The third sub-programme focused on professionals from the area. Residents from disciplines as varied as education and medicine participated in these sessions where savings and investment options were highlighted.

### Financial Inclusion of Rural Micro Entrepreneurs

Catalyst: Collaboration

From the Bank's point of view, empowering the entrepreneurial poor is cyclical in nature. As the micro entrepreneur enters the SME threshold, the Bank undertakes to further assist him across to the next level of the business cycle through the introduction of new financial services, thus enhancing access to finance in line with growing needs. This scenario lends a symbiotic dependency which enables

the Bank to achieve a sound cost-benefit through cross-selling of services, thus off-setting the high costs of sustainability banking, allowing the Bank and the customer to achieve sustainability from a business perspective.

The Bank's value proposition ranges across the enterprise chain. It identifies that apart from a lack of financial literacy, the second most debilitating deterrent to business failure amongst Micro Entrepreneurs is, in fact, access to markets. The Bank has actively sought to assist Micro Entrepreneurs to overcome this weakness. In the year under review, HNB concertedly acted towards the establishment of linkages between Multi-National Corporations (MNCs), blue-chip agri-based corporates and SMEs to further the business potential of small producers and enterprises. A case in point - for illustration purposes at this juncture - is the provision of access to markets for farmers in the Northern and Eastern provinces, which has aided them towards a departure from otherwise certain poverty traps. The linkages have instead assured them of future prosperity through stock purchase guarantees and buy back agreements.

### "Divi Saviya": Financial Literacy to Rural Micro-Entrepreneurs

Investment for the year:

Rs. 600,000

Catalyst: Action

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

In a country where over 70 per cent of the population is rural, a majority of the youth population too is rural based. Although agriculture offers abundant opportunities, most often rural youth lack the resources both in terms of know-how and finances to create profitable and sustainable agro-based enterprises.

To this effect the Bank's finest achievement, lies in the rural areas of Sri Lanka. Hatton National Bank's Barefoot Banker named "Gami Pubuduwa Upadeshaka" (Village Awakening Advisor) steers both the financial literacy and the micro-financing programmes and acts as a mentor to budding rural entrepreneurs. With over 120 Barefoot Bankers across rural Sri Lanka espousing both financial and commercial literacy - from financial know-how to technical know-how and marketing linkages - the Bank has spurred into commercial action a number of micro-enterprises. Sustainable development and financial security have been the outcomes of this programme. Empowered intellectually and financially, the rural youth associated with the Bank's programme understand and accept that self-sustenance through agriculture is a sound proposition for future wealth creation.

The financial literacy programmes were relaunched during the year under the brand name of "Divi Saviya - Danumen Diyunuwata" (Strength to Life - Progress through Knowledge). The features included in this programme are Financial Literacy, Technology Transfer, Entrepreneur Skills Development, Personal Development and Health Education. The Bank works closely with relevant government and private organisations to obtain their assistance for the success of these programmes.



## > Customer Responsibility



### SMILE & E - FRIENDS Loan Schemes

#### Catalyst: Collaboration

The Bank offers two popular funding programmes sponsored by the Japan Bank for International Cooperation, namely SMILE and E-FRIENDS loan schemes. The SMILE and E-FRIENDS schemes provide concessionary loans that would propel the development of Sri Lanka's SMEs and ensure environmental friendly methods for industrial development, while simultaneously contributing to the overall progress of the country.

SMILE-1 and SMILE-2 Revolving (Small & Micro Industries Leader & Entrepreneur Promotion Project I-Revolving ) provides small and medium-scale industries the financial backing to upgrade their enterprises - from start-up to business/factory expansion to purchase of equipment or working capital infusion. E-FRIENDS-2 is a fund set up to provide long-term low-cost loans to industrial firms looking to develop in an environment friendly manner. As expenses due to resource and energy wastage, new and stringent government clamp downs and loss of business deals from environment-conscious customers are on the increase, acquiring assistance to ensure waste

minimisation, pollution control and resource recovery/savings pave the way for the future.

The Bank therefore, provides concessionary loans to those seeking to purchase equipment to reduce harmful emissions and lower waste production, obtain facilities that would reduce consumption of energy, reduce usage and resources that produce energy, and to purchase equipment that would substantially improve the safety of work places, especially with regard to the exposure of workers to potentially hazardous substances, noise and air pollution. The loans also cover investments relating to the purchase of equipment for the monitoring of pollutants.

The Bank also offers Technical Assistance Loans which enable clients to cover the cost of the consultancy and technical services directly related to the investigation of measures to control pollution, and ensure waste minimisation.

### Financial Hardship Assistance

#### Catalyst: Action

The Bank proactively extended financial hardship assistance to both the tourism and tea industries during the year.

Whilst adverse weather conditions constrained the production potential of the Sri Lankan tea industry, it also reeled from a shrinking demand due to the global recession. The Bank proactively offered hardship assistance to this industry prior to the offer of assistance by the Government of Sri Lanka. Similarly, the nation's tourism industry failed in the first half of the year due in most to the aggravated stance of the conflict against terror and the Bank assisted those customers affected by these changes.

### Collaborating for Customer Wealth Creation

#### Catalyst: Collaboration

As a part of its innovative initiatives to develop the rural economy in Sri Lanka and in part to further augment the "Divi Saviya" Programme, Hatton National Bank collaborated with two major corporate partners Chemical Industries (Colombo) PLC (CIC PLC) and Hayleys PLC during the year, both of whom have established reputations among communities in the rural sector. Though the Bank had several informal relationships with other organisations in terms of financing micro entrepreneurs who had entered into sub contract / outgrower partnerships, this was the



first time a formal agreement was entered into. This collaborative programme aims to build and strengthen new linkages within these communities.

Having recognised the need for greater agro-based resource infrastructure, the Bank sourced and partnered with CIC PLC and Hayleys PLC to cascade a greater wealth of agro and agri practices, expertise and know-how to the rural micro farmer. As two institutions that have the resources and the experience in working with rural farmers to optimise crop harvest, as well as being in the agro and agri businesses, these two stalwarts are seen as commendable corporate partners for the Banks' ongoing efforts towards imparting financial and commercial literacy.

Whilst in the past, the Bank has collaborated to go beyond the normal engagement of providing financial assistance to finding markets for customers' products by conducting trade fairs, through the use of information technology to actively promote products and by linking the producers to online buyers, and in quality improvements through introduction to quality assurance experts, this new collaboration sets the bar of commercial activation for the Bank's customers at a new high.

The collective efforts of the tripartite partnership will assist in identifying prospective farmers and entrepreneurs who are eligible to be linked with each of the company's out grower networks in sectors such as paddy, livestock, fisheries, fruit and vegetables supply, and will further benefit through agri input and advisory services, assistance in agro technologies and the implementation of buy back agreements to purchase their produce. Meanwhile, the Bank will drive the approach of building financial literacy, technical know-how among the rural farmer community through its branch managers, agricultural officers and micro finance officers serving in the rural areas whilst also providing



## > Customer Responsibility

financial assistance through credit based products.

### Ensuring Customer Security

Catalyst: Action

Fraud protection and the maintenance of customer confidence ranks high as a key priority at the Bank. With the advent and accelerated penetration of internet banking and e-banking amongst the Bank's customer base, the need for secure transaction processing has been critical to the Bank. Towards this end, the Bank established initiatives aimed at increasing the awareness of customers on the need to protect their personal information whilst online. Aimed at minimising "phishing" and identity theft, these initiatives have worked towards creating a greater awareness and the scenario of a well-informed client base.

ATM security too was enhanced during the year with the introduction of new ATM technologies. New generation ATMs have enhanced security features including:

- In-built cameras at the rear of the ATM which are not physically visible to the user capture multiple image frames from the very moment an ATM card is inserted into the machine.
- Newly acquired ATMs are equipped with Card Reader Surround Systems to minimise the possibility of card skimming through multiple protection layers. Encryption of personal information is used to prevent fraud. Sensitive data in ATM transactions use Triple Data Encryption Standard. Card holders have the option of registering for the SMS alert feature. This optional

security feature, generates SMS alerts for all POS and ATM transactions performed using VISA Debit Cards. This would enable the customer to identify fraudulent transactions and take appropriate measures.

### Enhancing the Quality of Service

Catalyst: Relationship

Subsequent to the migration of the Bank's core system to Finacle, its customers receive an enhanced quality of service. The Finacle migration allows customers to have speedy access to multiple account information, print statements, track transactions, and make payments amidst numerous other features. Overall, the migration enables customers to bank with ease and has fostered a customer service culture that pivots on convenience.

### Enabling the Differently-Abled

Catalyst: Relationship

Hatton National Bank is a Bank which is focused on providing equitable service to all its customers irrespective of social structures and communal differences, or life circumstances. As such it has worked diligently towards incorporating infrastructure into its banking network to facilitate and assist differently-abled customers. Towards this end, the Bank precipitated a drive towards wheel-chair accessibility and other services to its customer centres and ATM network. With a progressive plan to incorporate the entirety of the customer centre and ATM network over the medium term, the Bank is focused towards enabling and including differently-abled customers.

#### Summary of the Disabled Friendly HNB Customer Centres & ATMs - 31 December 2009

No. of Customer Centres	Disabled Friendly			
	Customer Centers	ATMs	Standalone ATMs	Toilets
186	105	71	06	08

## Employee Responsibility



The very success of Hatton National Bank over the years has been its people. From its inception in 1888, the Bank has nurtured financial and banking specialists who in turn have contributed towards the development of Sri Lanka's banking industry.

The Bank is a firm believer in leading its employees towards excellence in every aspect of financial management and banking. Sharing knowledge across the talent pool irrespective of job function-proactively and on a continuous basis-has enabled the Bank to create a culture of learning. Foreseeing change and adapting proactively to acquire new skills and competencies to the talent pool have allowed the Bank to achieve sustainable business.

### Creating a Culture of Learning through Strategic Development

The Bank actively strives towards the creation of a culture of learning, one that is built on a firm foundation of knowledge, skills and attitude. In nurturing people to understand "how it works" Hatton National Bank effectively utilises Training and Development as a tool towards the creation of high levels of functional capability and emotional balance.

Most importantly, the Bank's Training Plan mirrors the vision, mission objectives and the overall strategic intent for the Bank. Thus, the Training Plan for the year is in direct alignment with the long-term objectives of the business. In the belief that strategic focus is imperative for the development of competencies for business growth, cost management, productivity, compliance and regulatory requirements, the Bank's training and development initiatives emphasise upon these core themes. Building and retaining lasting customer relationships, customer service excellence, understanding the importance of self management in realising individual and Bank's objectives, the need to develop managerial competencies, pursuit of multi-skills to support succession planning and job rotations are also encapsulated in the overall training and development process.

### The Training Focus

The Bank's training needs analysis is based on information gathered from performance appraisals, questionnaires and recommendations from heads of departments. The Annual Training Needs Analysis and Annual Training Plan form the basis of continuous development of the workforce in terms

of technical, managerial and specialised areas of knowledge and skills development.

During the year the focus of overseas training was to spur the talent pool to a higher level of attainment. Twenty two managers with potential for growth, identified from the network and the centre underwent training at the Malaysian Institute of Management on leadership, strategic management, general management and other specialist areas of study. Selected members of the Corporate Management attended comprehensive leadership programmes at

- The Wharton School, University of Pennsylvania, USA
- IMD, Switzerland
- Mt. Eliza Business School Melbourne, Australia.

A total of 65 employees participated in overseas training programmes in 2009 at an approximate cost of Rs. 22,000,000.

Over 300 employees benefited from 76 training programmes held within Sri Lanka by local institutes at a cost of Rs. 2,500,000.

The impact of training and the transfer of learning to practical usage are

## > Employee Responsibility



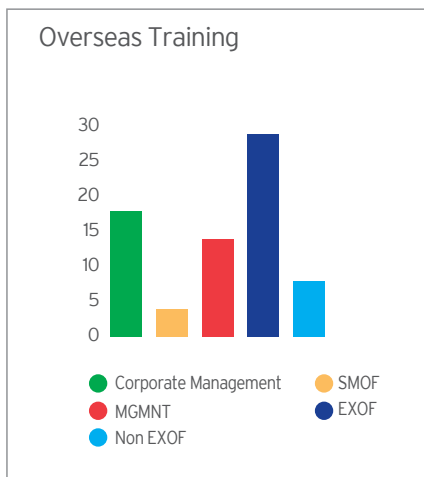
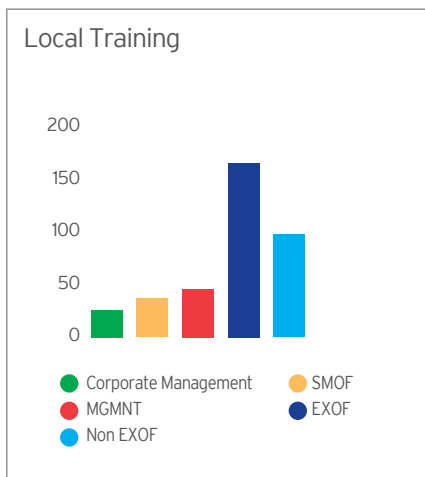
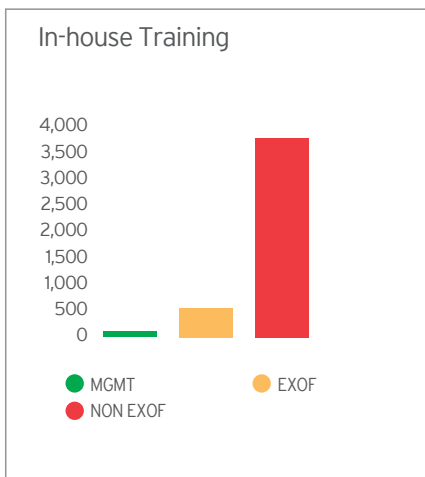
ascertained in a systematic manner. Towards this end, the Training Centre carries out post training audits and appraisals. In 2009, a series of mystery shopper audits were carried out across the branch network to determine the impact of customer service programmes conducted in 2008.

### Continuous Professional Development

Continuous Professional Development (CPD) programmes are an inherent component of the Bank's quest for knowledge enhancement. A three-tiered structured curriculum is available for Banking Assistants to enhance their knowledge through continuous learning. Efficiency Bar examinations based on this curriculum are held periodically to provide opportunities for evaluation of their technical know-how. The examinations assist employees to acquire CPD Points, which are linked to career progression.



The Bank also recognises the need to secure the assistance of specialist management education experts to formulate a unique curriculum for Management Development. The Bank sought the assistance of the Postgraduate Institute of Management (PIM), for the second consecutive year, to formulate and conduct a Management Development Programme for a batch of 30 branch managers and assistant managers.



The programme aimed to give the participants a systematic view of their organisation, including a review of how major functions affect each other. The programme was considered as a process from which managers learnt and improved their skills whilst certain modules focused on sharpening of leadership and managerial personality traits.

The programme consisted of 11 different modules and 22 sessions, spread over a period of four months. These modules addressed a variety of areas including a renewed vision and value system, task-competency framework, business excellence and service excellence, which enabled the participants to see the organisation as more than the sum of its parts. This holistic approach was seen as a basis for effective management decision-making.

### e-Learning: access to knowledge 24x7

Hatton National Bank harnessed its internal IT resources to develop a unique learning tool in 2006. The development was in response to an outcome of a survey conducted amongst staff to determine enhancements to the overall learning culture at the Bank. With a large number of employees showing an interest in the use of new learning approaches, their specific choice of medium was highlighted as information technology. Thus, the Bank developed an integrated, role based e-learning platform with a user-friendly interface.

The e-Learning tool has been adopted by the Bank's employees with enthusiasm and has proved to be an effective teaching and knowledge enhancement mechanism. In an attempt to refine the system during the year, modifications were carried out to the courses available on-line whilst the graphical interface was enhanced.

It is without doubt that e-Learning has contributed to the creation of a culture of learning. It has reached out and given access to knowledge to every one of the

Bank's employees irrespective of their location. As a centralised system it has allowed employees in the remotest of locations to benefit in the same manner as an employee based in Colombo, thus eliminating geographic limitations. The e-Learning system can be accessed either in the office or elsewhere thus providing employees the option to benefit from accessing the learning modules at their convenience from the comfort of their homes.

### Igniting the "Spark"

The employee suggestion scheme "SEARCH" which aims to give voice to employees on the activities of the Bank and on new initiatives, was relaunched as "SPARK" during the year. The scheme epitomises the Bank's attitude towards employee inclusiveness in the quest for strategic and operational excellence.

SPARK is an online scheme designed to drive employees to greater levels of creative thinking. It also acts as an outlet for the enhanced learning and training undertaken during the year. Focused on innovation, the revised scheme calls for fresh thinking and is expected to impel employee creativity to new heights.

### e-Recruitment: real-time recruitment

The Bank's recruitment process underwent an overhaul in 2009 with the implementation of the e-recruitment process in July. Conducting a recruitment drive in the Northern Province, the Bank undertook the entire recruitment process - from application assessment to evaluation tests - online. The new application decreased the recruitment time frame significantly in comparison to the traditional process. Thus the e-recruitment process will accelerate the recruitment cycle. Hatton National Bank is the first organisation in Sri Lanka to introduce an online recruitment system that covers every aspect of the recruitment process.

### Upward Mobility System (UMS)

The HR Information System that was under development over the last year was implemented during the year. The system enables strategic Human Resource intelligence tools to be utilised for planning and decision-making and is expected to improve business performance.

The UMS was recognised at the National Best Software Quality Awards 2009, organised by the British Computer Society (BCS) in the "In-house" category and was selected for the Asia Pacific ICT Awards as well.

### 5S - Productivity Scheme

Implementation of the 5S productivity scheme which commenced in 2008 was completed in the branch network during the year. Regional level competitions were held in four regions to encourage and recognise the improvements carried out by employees. 11 champion units have been selected to participate in the Taiki Aki Moto 5S Award conducted by the Japan Sri Lanka Technical & Cultural Association.

This exercise has yielded considerable savings in terms of space and fixed assets, and contributed to overall efficiency and productivity.

### Diversified HATNA Team

The HATNA team is one that is a truly diversified team. The Bank has consistently espoused team spirit and a culture of togetherness as the Bank's very backbone. The team brings together a myriad of cultures that harmonise as one HATNA culture. Sportsmen, artistes, and enthusiasts of every conceivable nature enhance the flavour and bring in a semblance of acute empathy for the arts, sports, and life in general. This diversity has been the very essence of the HATNA team and the pride of the Hatton National Bank.

As an active member of the Employers Network on Disability, the Bank participated in the "Disability Poses No

## > Employee Responsibility



Limitations” Exhibition during the year with the aim of educating differently abled persons on virtual banking.

### Work Life Balance

Every encouragement is given to employees to develop their aesthetic and sporting talents. During the year several events were organised involving the entire organisation.

The HNB Toastmasters Club initiated a “Best Speaker Competition” for the first time to bring to light inherent public speaking talents of employees. At the preliminary level, competitions were conducted at every branch and department expanding to regional level and culminating in an All Island final. Enthusiastic participation by the employees resulted in the discovery of many latent talents in public speaking.

The Vesak Bakthi Gee and the Carol Service are events much awaited by employees. The participation of families of employees and retired employees demonstrate the extent of the HATNA family concept.

Another much looked forward to event is the Talent Show. The event is organised to encourage developing and sustaining aesthetic and creative talents of employees as the Bank firmly believes in promoting a balanced lifestyle amongst its employees. The participation of employees from the entire network signifies their interest and keenness in participating as well as in interacting with other members of the HATNA family.



Regional level Sports Days provide an outlet to employees to display their sporting prowess with 3670 employees participating in these events during the year. It further acts as an incentive to be more health conscious.

Winning the Regional Award in the annual Inter-branch Quiz Competition is a matter of prestige. Teams from each branch and department prepare weeks in advance for the competition. The event is held on a selected date in



Training & Development	2007	2008	2009
Training & Development Cost (Rs Mn)	87.4	104.4	119.9
Training & Development Cost / Employee (Rs 000)	20	24	28

Staff Welfare	2007	2008	2009
Staff welfare Cost (Rs Mn)	72.6	103.2	97.4
Staff welfare Cost per employee (Rs 000)	17	23	23

different locations in various parts of the country and region-wise winners are selected and rewarded.

The families of employees were also invited to participate in the annual christmas celebrations at 'Sathutu Uyana' with 2600 children participating with their parents.

### Employee Engagement

Employee engagement has been a key driver of organisational effectiveness and workforce performance. Inclusive engagement that harnesses all of the team's efforts towards the achievement of the Bank's strategic objectives and goals has been a key driver of the Bank's business strategy. The Bank recognises that employee engagement is a positive contributor to the mindset of people and understands that engaged

employees believe that they can make a difference in the organisations they work for. Confidence in the knowledge, skills, and abilities that people possess - in both themselves and others - is a powerful predictor of behaviour and subsequent performance. At Hatton National Bank employee engagement across the organisation is a continuous process. With personal goals aligned to the overall business goals, the Bank's employees work towards the achievement of mutually beneficial objectives.

### Performance Management and Recognition

The Bank's overall management philosophy is attuned towards participatory management which creates a conducive environment for

performance management and recognition. The Bank's orientation towards a performance management philosophy has earned it recognition in the industry as a preferred employer. With career progression a constant in a scenario where performance management is practiced, employees are assured of meeting personal career growth expectations in turn for commendable performance towards achieving business objectives.

### Remuneration and Benefits

Formal recognition in the form of awards and career enhancements works in tandem with direct financial rewards. The Bank also practices numerous initiatives that go beyond mere recognition. Staff welfare, medical insurance for employee and family, incentives such as concessionary financial credit schemes for housing, education etc are amongst just a few of



Agewise Analysis of Employees



18 - 25	16%	25 - 35	36%
35 - 40	22%	40 - 45	12%
45 - 50	8%	50 - 55	5%
Over 55	1%		

Genderwise Analysis of Employees



Male	63%
Female	37%

Servicewise Analysis of Employees



upto 5 Yrs	31%	5 - 10 Yrs	13%
10 - 15 Yrs	28%	15 - 20 Yrs	16%
20 - 25 Yrs	5%	Over 25 Yrs	7%

## > Employee Responsibility

the benefits conferred by the Bank to its employees.

### Caring Employer

The Bank, as a caring employer extends financial assistance to employees and their families in instances of critical illness.

Scholarships were awarded to seven children who excelled in the GCE Advanced Level Examinations and gained entry to University in 2009 under the Bank's Scholarship Scheme for Children of Employees. Twelve children have benefited from this scheme to date.

### Industrial Relations

The Bank adheres strictly to the International Labour Organisation (ILO) labour practices and standards as well as the local labour laws and regulations. In recognition of the need for industrial harmony the Bank has established continuous dialogue with the Unions.

The Collective Agreements that exist between the Bank and the Ceylon Bank Employees Union and the Officers Union were renewed during the year and compensation and other benefits of employees were enhanced.

### Ethics and Code of Conduct

The Bank values honesty and integrity in everything it does and expects the same from its employees. The official Code of Ethics is expected to be strictly adhered to and any violation of professional and personal ethics is dealt with seriously.

## Achievements in Sports 2009

### Hockey

- Mercantile Knock out Hockey Tournament 2009 - Champions
- Annual 7 a side Hockey Tournament
  - Champions
- Winners of Denis De Rosairo Fair Play Trophy
- Mercantile Hockey league 2009
  - Runner Up

### Badminton

- Mercantile Open Badminton Champions 2009
  - Overall second Place
  - Mixed Double - Runner Up
  - Men's Double - Runner Up
- Mercantile Team Championship 2009
  - Men 'A' Division Runners Up

### Athletics

- Mercantile Athletics Champions Women's Novices Champions

### Basketball - Men

- Delmege Sponsored Super League Champions ('B' Division)
- Mercantile knock out Tournament - Runner Up ('B' Division)

### Basketball - Women

- Delmege Sponsored Mercantile League Tournament 2008/ 2009 - Champions
- Colombo Sports Club Sponsored Super League Tournament 2009 - Champions
- All Green Basketball Tournament - Runner up
- Mercantile Semi League Tournament 2009 - Runner up
- Mercantile Knock out Tournament 2009 - Runner Up
- Delmege Sponsored Mercantile League Tournament 2009 - Runner Up

### Netball

- Mercantile Netball League 2009
  - Open Mixed - Winner
  - 'A' Division - Runner up
- Inter Open Club Netball Tournament
  - 'A' Division - Runner Up
  - Over 40 - Runner up
- Mercantile Netball League - Runner up
- Super League Netball Tournament - Runner Up
- Srilankasports.com Netball Challenge Inter Company Netball Championship

### High Flyers

- Ms. Dinuka Karunaratne participated in the Asian Badminton Championship in Korea and was Runner Up at the National Badminton Tournament
- Ms. Nadeesha Gayathri won the Bronze Medal at the Iran Satellite Championship Women's Double Badminton Tournament
- Ms. Gayathri Lankatileke, Ms. Sashika Samarasinghe, Ms. Harshani Wijayalath, Ms. Dharshika Abeywickrema participated at the 7th Asian Netball Championship in Malaysia

### Cricket

- Mr. Kumar Dharmasena former National Test Cricketer was selected to the ICC Umpires panel to officiate at International Cricket Matches

### HNB Toastmasters Club

HNB Toastmasters' Club was awarded the prestigious President's Distinguished Club Award for the second consecutive year for 2008/09, achieving all ten goals stipulated by Toastmasters International USA

First Club in Division A and the Fourth club in District 82, to win the Golden Gavel award presented by District 82.



## Investor Responsibility



The Bank's business strategy is attuned towards maximisation of returns to shareholders. From an investor relations perspective, Hatton National Bank has over the years continued to focus on creating consistent value to shareholders. In meeting the Bank's business objectives, it simultaneously meets the expectations of investors and shareholders. In a scenario where enhanced profitability leads to enhanced wealth creation for shareholders, the Bank's strategy towards investor relations works hand in hand with that of the overall business strategy. Therefore, investor relations is an on-going and inherent process.

### Shareholder Value Creation

The Bank has consistently endeavoured to create and enhance shareholder value through robust long-term financial performance. Over the last five years the bank has consistently grown its bottom line while improving key performance indicators such as ROA, ROE, EPS and NPA. The earnings have grown by a compounded annual rate of 27.3% from 2005 to 2009, while continuously improving the quality of its asset portfolio through robust risk management practices. This strong and consistent performance of the Bank has enhanced the confidence placed by its shareholders as demonstrated by the

Bank's share price movement over the last five years significantly outperforming the movement of the All Share Price Index (ASPI).

In keeping with these trends, in the year under review, the Bank's Voting and Non Voting share price movements peaked at the end of the financial year posting an increase of 144% and 228% from that of the start of 2009. The share price movement during the first quarter of the year was reflective of market dynamics with external factors inhibiting the demand for the share. This trend mirrored the market behaviour at the time specifically due to depressed demand owing to the escalation of the war. However, it is noteworthy that the HNB share price has remained more resilient than the overall market during these difficult times. Towards the last two quarters - as peace and a united Sri Lanka became a reality - investor confidence drove both the share index and the Bank's share values to an all time high.

However, the most demonstrative factor that illustrates the Bank's commitment towards Shareholder value creation is undoubtedly its consistent and above industry dividend payouts. The most compelling evidence towards this factor is that the Bank has over the last five years consistently paid out a dividend

that exceeds 25% per annum. Thus, the Bank has effectively yielded a compounded annual return of 51.4% to investors during the period from 2005 to 2009.

### Growth Initiatives to support a united Sri Lanka

Post conflict, Sri Lanka stands on the threshold of economic progress. The Bank as a catalyst of economic progress envisions a specific role for itself in creating greater wealth for the nation, its people and its own stakeholders. Towards this end, the Bank has employed a two-pronged strategy to accelerate the growth momentum through an international and domestic development programme.

From the perspective of international strategy, the Bank will lay a concerted focus on attracting foreign investment to support the projected economic growth. To this effect, during the year in review, the Bank undertook a series of meetings with fund managers in New York, and Boston, United States and Singapore to create awareness on the viability and latent potential of the national economy, whilst simultaneously showcasing the robust performance of the Bank. Going forward, similar initiatives will be undertaken in Europe and the Far East during early 2010. It is

## > Investor Responsibility



expected that this strategy will continue to be deployed on a regular basis in the medium term.

On the domestic front, the Bank's post conflict development strategy has seen an increased momentum of operations in the Northern and Eastern provinces. As one of the few Banks that continued to operate in the region even during times of conflict, the Bank enhanced its operations through renewed focus with a view towards economic resurgence. During the year, the Bank carried out an expansion drive, opening four new branches in the area. To inspire entrepreneurial spirit, the Bank also strived to develop the community through a programme aimed at financial literacy. Thus, the Bank expects financial inclusiveness and accessibility together with financial literacy to act as motivators towards economic development for the area.



### Investor Engagement

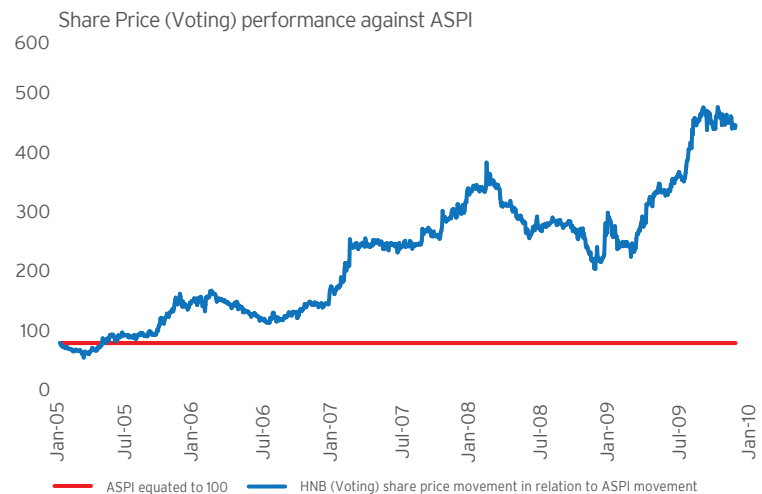
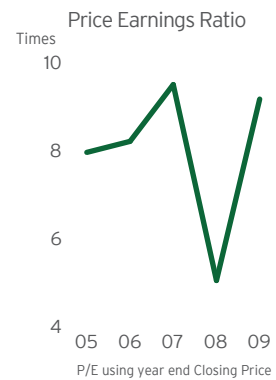
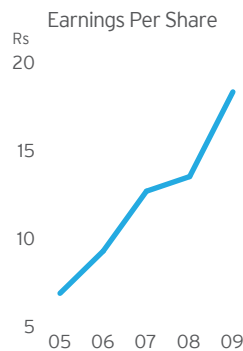
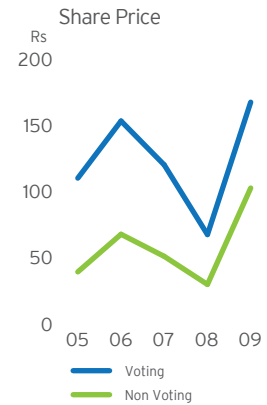
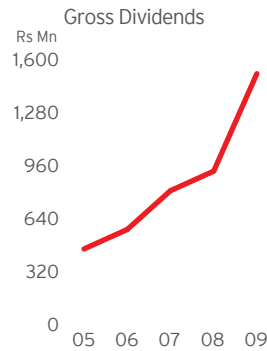
Traditionally, the Bank has conducted investor forums on a periodic basis to interact with existing and potential investors. However, during the year under review investor engagement initiatives were limited to interactions via web queries, investor information hotline and the investor feedback form in the Annual Report 2008.

However, in 2009 a marked increase in investor interest in the Bank was evident from the number of international queries pertaining to the Bank's financial and share performance. International fund managers from reputed global funds interacted with the Bank on an ongoing basis during the second half of the year to collate information to further review the Bank as an investment prospect.



### Awards and Recognition

- Winner for the “Best Retail Bank in Sri Lanka 2008” presented by “The Asian Banker” in The Asian Banker Excellence in Retail Financial Services Awards 2009
- Euromoney Finance Magazine recognised HNB as the “Best Bank in Sri Lanka” at the Euromoney Awards for Excellence 2009
- Institute of Chartered Accountants of Sri Lanka (ICASL) Annual Report Awards 2009
  - Overall Winner of the Gold Award and the Cyril Gardiner Memorial Trophy for Excellence in Annual Financial Reporting
  - Gold Award and the Edmund J Cooray Trophy for the Best Presented Annual Report in the Banking Sector
  - Silver Award for the Best Presentation of the Management Discussion and Analysis
- South Asian Federation of Accountants (SAFA): Best Presented Accounts and Corporate Disclosure Awards
  - Joint winner - Best Presented Accounts for the “Banking sector subjected to prudential supervision”
  - First runner up in the category of “Corporate Governance Disclosure”
- Ten Best Corporate Citizens Award 2009 organised by the Ceylon Chamber of Commerce.
  - One of the Top 10 Best Corporate Citizens
  - Winner - Governance & Economic Contribution Category
- Winner - ACCA Sustainability Award Large Category
- The LMD 50
- Business Today Top 10
- The HRIS Upward Mobility System was recognised at the National Best Software Quality Awards 2009, organised by the British Computer Society (BCS) in the “In-house” category and was selected for the Asia Pacific ICT Awards



	2005	2006	2007	2008	2009
Earnings per Share (Rs)	7.02	9.43	12.83	13.67	18.47
Dividend Yield (%) - Voting	3.56	3.21	2.86	5.73	3.82
Dividend Yield (%) - Non Voting	9.64	7.14	6.57	12.50	6.21
Assets Growth (YOY) (%)	8.66	18.11	18.79	10.22	9.30
Holding Period Return - Voting (%)	104.39	42.89	61.80	(39.80)	153.41
Holding Period Return - Non Voting (%)	38.93	80.72	62.14	(32.39)	247.66
Operating Cost - Efficiency Ratio (%)	60.28	57.80	56.21	54.23	54.37
Share Price - Voting (Rs)	112.50	155.75	122.50	69.75	170.25
Share Price - Non Voting (Rs)	41.50	70.00	53.25	32.00	104.75
Gross Dividends (Rs Mn)	471.06	588.82	824.35	942.12	1,533.06

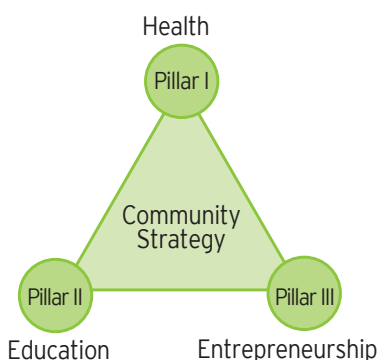
## Community Responsibility



Over many decades, the Hatton National Bank has been in the forefront of creating opportunities. The Bank, with a legacy that originates deep in the hillsides of Hatton, has been consciously and concertedly creating a change momentum for the communities within which it operates. Catalysing change in many ways, the Bank has been the epitome of responsible stewardship, and has been the very means of social inclusiveness for many rural communities.

As an organisation whose very beginnings stem from an intuitive understanding of the people and their aspirations, the Bank has worked strategically to enhance the lives of communities across Sri Lanka.

The Bank's Community Responsibility Strategy focuses on three pillars;



### Pillar I : Health

#### Project: Cancer Counseling Centre

Investment during the year:  
Rs 1.0 million and 552 man hours  
Investment to date: Rs. 3.0 million

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

Sri Lanka as a nation grapples with an annual affliction rate of approximately 10,000 per annum and has commendable infrastructure in place for preventive screening, radiotherapy and treatment through the National Cancer Control Programme, and the National Cancer Institute of Sri Lanka. However, despite the availability of medical infrastructure, many patients and their families continue to be psychologically scarred by the effects of the disease on their lives and relationships.

The availability of a professional Counseling Centre dedicated to those afflicted by the disease has enhanced the mental wellbeing of those concerned through the cumulative effects of guidance, support and reassurance.

In the year 2009, the Bank increased its commitment to the project by progressively enhancing its role by becoming more involved in the operational aspects of the Centre. The Counseling Centre - which till April 2009 was being maintained under a funding partnership with ASB - came wholly under the purview of the Bank with ASB's interest in the project ceasing from the first quarter of the year. Thereafter, the Bank has undertaken to bear the maintenance and operational costs. A number of initiatives were undertaken during the year to renovate

**“Selected as one of the Top Ten Best Corporate Citizens by the Ceylon Chamber of Commerce”**

and upgrade the infrastructure at the Counseling Centre.

Notably, the Bank’s commitment to the project is reflected by the involvement of its staff members in the counseling process. To this effect four of the Bank’s employees are following a professional counseling programme and are now involved in the counseling process.

**Project: National Cancer Institute of Sri Lanka**

Investment during the year:  
Rs. 1,250,000

Investment to date: Rs. 1,250,000

During the year the Bank continued to actively support the National Cancer Institute of Sri Lanka towards enhancing the lives of its patients. The Bank completed the renovation and repair work at Ward No. 12 housing the male patients who undergo surgery. The Bank will continue to assist in the maintenance of the Ward.

**Financial Assistance to Cancer Patients**

Investment - Rs 15,000,000.

During the year the Bank was able to make real its long term vision of providing financial assistance to families of cancer patients. With the establishment of the HNB Sustainability Foundation, a separate fund has been established to assist patients and their families cushion against the financial repercussions of the disease, especially in cases wherein the sole bread winner is affected.

The beneficiaries are selected in conjunction with the Patients Advisory Liaison Unit of the National Cancer Institute of Sri Lanka. 10 families have benefited from this scheme in the year under review.



## > Community Responsibility

### Project: Dengue Prevention

Investment during the year:  
Rs. 130,000

Investment to date: Rs. 248,000

With a rise in the incidence of dengue across the country, the Bank reiterated its efforts towards dengue prevention and control in the Colombo District by supporting the Colombo Municipal Council.

### Project: HIV AIDS Awareness

Investment during the year: Rs.  
70,000

Investment to date: Rs. 70,000

The Bank joined the Lanka Business Coalition on HIV/AIDS with a view to raising awareness on HIV and AIDS in the workplace. The Lanka Business Community on HIV and AIDS (LBCH) was established after the 8th International Congress on AIDS in Asia and the Pacific (ICAAP) was held in Sri Lanka in August 2007. LBCH is modelled on the Global Business Coalition on HIV and AIDS and is a member of the Asia Pacific Business Coalition on AIDS.

During the year, two awareness programmes were conducted for 101 staff members. To commemorate and create awareness for the World AIDS Day, the Bank distributed awareness ribbons throughout the week.

### Project: Safe Drinking Water and Sanitation

Investment during the year: Rs.  
5,000,000

Investment to date: Rs. 10,000,000

Providing communities with safe drinking water and sanitation has been a priority for the Bank over the last three years. A United Nations Millennium Goal, access to safe drinking water and sanitation, though a bare necessity, is one that is lacked by many rural communities in Sri Lanka. To date, the Bank has carried out six projects in the Mannar, Jaffna, Anuradhapura, Puttalam, Kataragama and Batticaloa Districts.

- Gonewa, Rambewa, Anuradhapura  
The third of the safe drinking water and sanitation projects to be undertaken by the Bank, this project benefited Gonewa, Anuradhapura. The residents of Gonewa lacked sufficient sanitation facilities and access to fresh water prior to the launch of this project.

In the recent past, areas in and around Anuradhapura have shown a high incidence of kidney diseases due to water contamination, primarily as a result of the excessive use of weedicide and sub quality artificial manure.

The project included identification of a safe water source, installation of water tanks and pumps and construction of toilets .

- Norachcholai, Kalpitiya, Puttalam  
In April 2009, the Bank extended its safe drinking water and sanitation programme to Norachcholai, a village in the Puttalam District.

The residents of the area - approximately one hundred families composed of six hundred individuals - had limited access to safe drinking water as the only available water source was permeated with salts and metals. The specifics of the project at this location included the identification of a new, safe water source, the construction of a new water tank with the installation of a pump and pipe network that would ensure pipe borne water to the village.

To further convenience the villagers forty taps were installed at a distance of fifty meters from each other within the village.

Approximately 100 families benefited from this project.

- Bodhirajapura, Kataragama  
During the year under review, the Bank extended the project to a temple located at Bodhirajapura village on the Sithulpauwva Road bordering the Yala sanctuary about 5 kilometers away from the Kataragama main town.

As the last point of rest for pilgrims before entering the sacred sites of Kataragama, the temple is a refuge for an estimated 50,000 pilgrims who travel along the Sithulpauwva Road from the Eastern province during the months of July and August to participate in the Kataragama festival. Till the completion of the project, an old well served as the sole source of safe drinking water for pilgrims. The project also benefited approximately seventy five families resident in and around the area.

The project included the renovation of the well with measures undertaken to increase its depth, the installation of a 2000 litre plastic water tank, an electric pump, construction of water outlets and installation of taps.

HNB also provided sanitation facilities for the devotees and pilgrims by

Other investments in Healthcare Projects	Contribution
Karapitiya Teaching Hospital - fixing wall tiles at the female ward	Rs 59,000/-
Polonnaruwa District General Hospital Pediatric Unit - 1 unit pulse oxymeter	Rs 140,000/-
The Colombo Friend-in-Need Society - conducting a mobile service in Trincomalee to provide prosthetic custom made limbs for disabled persons	Rs 25,000/-
The Centre for Women's Research - sponsoring a seminar	Rs 50,000/-
Teaching Hospital Kurunegala - 2 glass trolleys and 1 glass cabinet	Rs 51,223/-
General / Teaching Hospital, Jaffna - the cost of tiling, plastering and painting of one unit - ward 7	Rs 700,000/-
Shear Hope Project in aid of the Cancer Hospital building project of Women's International	Rs 50,000/-

constructing 6 toilets with proper sanitation facilities.

- Kokuvil, Vakarai, Batticaloa

The Bank expanded its community development initiatives in the East by extending the safe drinking water programme to Kokuvil in the Batticaloa district on the 11th of September 2009.

The people of Kokuvil were affected by both the Tsunami and the internal conflict and had resettled in their village two years ago. However their sufferings continued due to the lack of fresh water. The only sources of water to this village which houses about 500 people from 65 families, were an old and dilapidated well situated a few kilometers in the depths of a jungle and a small water hole outside the village. This water too was contaminated and unsafe for drinking.

The plight of these villagers was brought to the notice of the Bank by the HNB Batticaloa Team and the project was undertaken by the Bank as part of its safe drinking water programme. The existing water hole was dredged and deepened to a proper well. A new water tank was constructed with pumping facilities, pipes and taps to increase the convenience to the villagers.

Project: Water and Sanitation support to IDP camps

Investment during the year:  
Rs. 5,417,480

The Bank, during the year, identified the acute need for water and sanitation infrastructure at the IDP camps in the Northern province. With the support of the Consortium of Humanitarian Agencies (CHA), the Bank undertook to finance the construction of 100 cluster toilets in the IDP camps. The sanitation infrastructure supported by the Bank included the construction of a septic tank, soakage pit, drain and water pipes, flooring, gullies and other accessories in order to ensure the camps remain free of health hazards. During the year the Bank also contributed towards the installation of 50 water tanks across IDP camps.



## > Community Responsibility

Project: S-H-A-R-E Foundation  
Investment during the year: Rs 300,000

Total investment to date: Rs 600,000

The S-H-A-R-E (Samarasinghe Healthcare Assistance and Rehabilitation for the Elderly) Foundation is a UK and Sri Lankan registered charity and is modelled on the District Nursing Service in the United Kingdom. It is involved in community health projects in under privileged areas. The main objective of the project is to assist in the support and care of the patients in their homes and promote prevention of ill health by public health education. The Bank continued its commitment to the Foundation by donating Rs 300,000 towards funding the work of three nursing sisters at Kotahena (Colombo), Payagala (Kalutara) and Alagollawa (Anuradhapura).

### Pillar II : Education

Project: Nana Pubuduwa  
Investment during the year: Rs. 6,700,000

Investment to date: Rs. 27,700,000

The Bank's Nana Pubuduwa project is ambitious in that it originally aimed to provide a hundred libraries to schools lacking in facilities and financial resources, predominantly those placed in remote areas. The project commenced in the year 2005 and has progressively enhanced the literacy skills of over 50,000 children across Sri Lanka.

The project has given the opportunity for children to be stimulated and to derive the simple pleasure of exploring the world through books, enhancing not only their knowledge but also their psychological skills, enabling little minds to empathise as well as to be empirically astute.

To date the Bank has gifted 155 new libraries for rural schools of which 10 were opened during the year. Coinciding and working in tandem with

this project, the Bank is the process of setting up computer centres in 8 schools already supported by the Bank. Each school will be donated 20 computers to aid computer literacy.

### Project: One Laptop per Child programme

Investment during the year: Rs. 3,030,000

A global initiative, the One Laptop per Child Programme envisions "to create educational opportunities for the world's poorest children by providing each child with a rugged, low-cost, low-power, connected laptop with content and software designed for collaborative, joyful, self-empowered learning. When children have access to this type of tool they get engaged in their own education. They learn, share, create, and collaborate. They become connected to each other, to the world and to a brighter future".

Spearheaded in Sri Lanka by the OLPC Lanka Foundation and the Ministry of Education in collaboration with several local and foreign financial, technological and academic institutions, the One Laptop per Child Programme is a farsighted initiative that aims to provide laptops to two million school children with special focus on empowering the rural students. With localised software and teaching modules that run in Sinhala and Tamil languages, the specially designed computers will supplement the current syllabi at school level.

The Hatton National Bank, in recognition of the importance of this project to Sri Lanka's educational system and the ensuing benefits of the programme to children has committed to support the endeavour by sponsoring 100 computers to Weihena KV, a deserving school in Weihena, Baddegama in the Galle District.

**The Bank has utilised monies earned from recycling of paper to invest into this project.**

### Project: Empowering the Youth of Jaffna

Investment during the year: Rs. 700,000

The Bank during the year under review recognised the need for corporate intervention in enhancing the future employability of the youth of Jaffna. Toward this end it stepped forward to uplift Banking and Finance education among the youth in the Jaffna peninsula in anticipation of an increase in demand for skilled & trained financial services sector professionals in the North and Eastern provinces.

An initiative was taken by the Bank to cater to this requirement by provisioning school leavers with knowledge and exposure in banking and finance. Thus, an academic programme under the title, "Certificate in Elementary Banking and Finance" was launched at the HNB Chunnakam customer centre.

Resource persons from the Bank as well as several senior lecturers from the University of Jaffna form the faculty for the programme. The course is provided free of charge for selected candidates and consists of four subjects namely Business of Banking, Accounting, Economics and Management and Organisation, with a total course duration of three months. The programme is unique in that it is the first in the peninsula to harness the power of the internet with video conferencing being used as a support medium in youth education.

The Bank considers the programme to be instrumental in the Development of youth in the North and East, and as one that propagates a keenness amongst the youth to embark on careers related to Financial Services sector. The end outcome of the programme is expected to uplift the living standards of the community in the long term. This will further address potential barriers in meeting up with expected employment standards in future at a macro level.



The participants will be able to seek employment with the Bank, as well as with other Banks and Institutions providing financial services in the peninsula. The first batch consisted of 50 students and it is envisaged that two batches would be trained per year during the next two years.

The Bank also donated 25 computers to the Jaffna Library during the year.

### Project: HNB Museum

The HNB Museum was established in 2005 with a view to educate the general public on the history of the banking industry in Sri Lanka whilst also highlighting the role of the Bank in the development of the sector. Hatton National Bank, as a bank with 120 years of history utilises the Museum to portray the history of finance and banking in Sri Lanka. The Museum houses coins and memorabilia that date back to medieval times. In 2009, the Museum was visited by a range of interested parties including students, financial industry enthusiasts as well as delegates from international financial bodies.

## Pillar III : Entrepreneurship

### Project: Gami Pubuduwa

Total number of projects completed:  
89,400

Total Financing of projects:  
Rs. 7.0 Billion

In 1989 the Bank introduced 'Gami Pubuduwa' (village reawakening), a micro financing programme, to extend financial services to self employment projects and other micro enterprises sector in the rural and semi-rural areas. The primary objective of this scheme was to establish a closer linkage between the Bank and the rural community who were treated as 'Non Bankable'. This scheme emphasises harnessing inherent skills of the rural community, thereby assisting them to become self-reliant.



## > Community Responsibility



Presently over 120 Barefoot Bankers assist the rural community by way of financial know-how. Apart from the purely commercial aspects of micro finance, Gami Pubuduwa has been a sustainability tool to precipitate financial awareness and empathy whilst also removing the associated “reluctance to enter the Banking Sector” amongst village folk. In essence, Gami Pubuduwa has worked towards creating a culture of acceptance for entrepreneurship and financial literacy amongst the rural community.

### Employee voluntarism

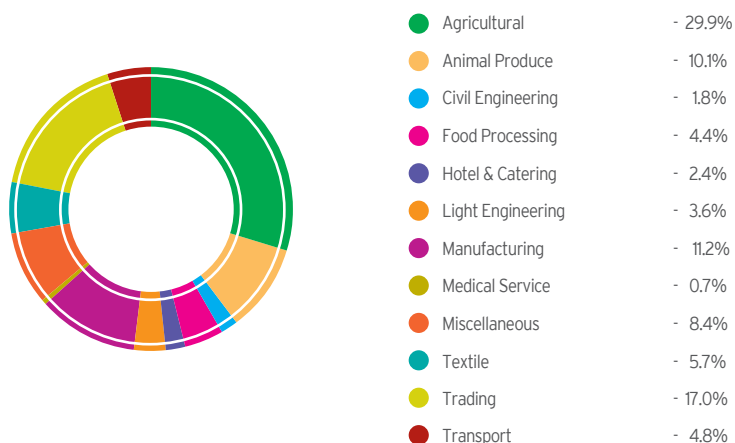
The culture of community service is inbred in every one of the Bank’s employees. The employees voluntarily participate in community development and social activities in excess of their considerable involvement in the CSR programmes initiated at corporate level and the numerous customer awareness and financial literacy programmes carried out. With 4,302 employees, these activities are too many to enumerate. Nearly all branches engage in the following:

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

In the year under review, the Bank’s employees also donated generously towards supporting internally displaced people and disabled soldiers.



Gami Pubuduwa Review - 2009  
Sectorwise Distribution of Number of Loans



## Supplier Responsibility



Suppliers play a fundamental role in the Bank's micro environment. As an essential component of the overall business function, suppliers are regarded as inclusive partners. The Bank is conscious of the role of suppliers in the achievement of strategic objectives and therefore views supplier relations as critical to the long term viability of Hatton National Bank. It also recognises that its relationships with supplier organisations are built on a solid foundation of value and trust.

### Ethical Procurement Practices

The Bank holds ethical conduct as a priority in building supplier relations.

By communicating and engaging with all employees, but particularly those involved in the procurement function, the Bank strives to maintain this unimpeachable standard of integrity in all business relationships, both internally and externally. The Bank is of the view that ethical behaviour must be promoted and supported by appropriate systems and procedures. Likewise the Bank expects the highest ethical standards from its suppliers.

The employment of ethical practices – such as the institution of a number of procurement committees that delegates the responsibility for procurements

across a number of people as opposed to one or a few - diminishes and firmly rejects those practices that might reasonably be deemed improper thus ensuring that both employees and the Bank are trusted and respected.

All procurements follow a transparent tender procedure and price negotiations are conducted by designated teams and committees depending on the contract value and focus. Suppliers and supplier information is treated with confidentiality and fair dealing.

In situations of supplier discontent two appeal schemes afford suppliers with the ability to appeal firstly to the Deputy General Manager Services and thereafter to the Bank's Managing Director/Chief Executive Officer. These numerous practices enable the Bank to not only carry out its business efficiently but to do so in a fair and reasonable manner and with integrity.

### Sustainable Procurement Policy

Hatton National Bank recognises its responsibility to carry out its procurement activities in an environmentally and socially responsible manner. Thus, in accordance with the Bank's Sustainability Strategy and Corporate Procurement Strategy it

strives to incorporate environmental and social considerations into the procurement process. The Bank recognises its responsibility to encourage suppliers to minimise negative environmental and social effects associated with the products and services they provide.

From an internal perspective, the Bank encourages departments and branch offices to review their consumption of goods and services in order to reduce usage, recycle and reuse in a bid to operate according to sustainable business principles.

With the adoption of the "Green Procurement Policy" during the financial year in review, the Bank ensures that sustainability criteria are included in specifications to suppliers and that sustainability criteria are met in the award of contracts by ensuring that suppliers' environmental credentials are considered in the supplier appraisal process. Towards this end the Bank communicated and educated one tier of suppliers on the Green policy and the need for the implementation of ethical manufacturing processes for the long term sustainability of their own businesses. Similar awareness programmes for the remaining tiers of suppliers are planned for the

## > Supplier Responsibility

forthcoming financial year. In addition, the Bank increased employee awareness of relevant environmental and social effects of purchases through a number of appropriate training exercises during the year. Under the Green Policy, the Bank, in the long term intends to work proactively with existing and potential suppliers to investigate and introduce environmentally friendly processes and products.

Under the sustainable procurement policy, processes were implemented in 2009 to ensure an equitable share of wealth to a larger number of suppliers. Through the enhancement of the supplier base by a further 25 per cent, the Bank intends to afford a greater number of enterprises the ability to supply to the Bank. Furthermore, the Bank extends supplier credit at zero cost on the strength of an advance payment bond. This initiative has enabled small-scale suppliers who lack the financial wherewithal of large-scale enterprises to confidently accept and provision goods and services to the Bank.

The Bank follows a concerted policy of non-discrimination against small scale suppliers. Whilst 15 per cent of the supplier portfolio can be categorised as

micro level entrepreneurs, nearly 60 per cent of the supplier portfolio is composed of Small and Medium Enterprises (SME's).

### Streamlined Procurement Process

A series of process improvements were undertaken during the year in a bid to streamline the procurement process. These included the introduction of a standardised packaging system and the outsourcing of time intensive activities such as the packing of complimentary items. With the introduction of an invoice tracking system, the invoice settlement process has reached higher levels of efficiency thus benefiting the supplier base through timely payments for services rendered. Rectification of stock levels through a write-off of obsolete stocks has yielded more realistic and current information whilst also minimising the stock holding costs for certain items such as stationery. A new warehouse with increased capacity to locate all units of the procurement division has been planned and construction will commence in the forthcoming financial year. The warehouse will optimise the procurement process through the utilisation of advanced stock

management technology that will minimise stock holding and lead times thereby garnering greater efficiencies for the Bank whilst also allowing the supplier base adequate time for planning for provisions and supplies.

The Bank initiated the re-registration of existing suppliers during the year. The process is expected to reach completion in 2010. This initiative is expected to enhance the procurement process as it compels the Bank to carry out a complete analysis of the present supplier base, thereby affording the bank with current data, the ability to rate suppliers based on a pre-determined criteria, to evaluate the strengths and weaknesses of suppliers as well as to categorise suppliers based on their historical performances. The Bank expects the general outcome of the process to be one in which a fair distribution of invitations for tender can be reached for suppliers based on merit, thereby narrowing the margin for discrimination or canvassing at any point in the procurement process.

## Environmental Responsibility



The foundation of Hatton National Bank's sustainability strategy lies in six focus areas; of these, Environmental Responsibility impels the Bank towards recognising and contributing towards conservation and preservation of the environment. As an area of focus that is sizeable in nature and one which necessitates a greater focus for not only the achievement but also in the measurement of impact, the Bank precipitated a series of initiatives during the year which will act as the base point for future emphasis on environmental responsibility. The initiatives discussed below demonstrate this strategic intent.

### Environmental Responsibility Ethics: The Green Pledge

Investment during the year:  
Rs. 3,000,000

In the belief that cohesion and consistency are the pillars of a successful strategic approach to environmental responsibility, the Bank initiated a two-pronged environmental responsibility ethics programme during the year. Designed to educate the employees of the Bank as well as to garner commitment towards the cause, a pledge was made by all employees, simultaneously, to undertake 12 actions in a bid to create a greener office.

Made on June 5th - coinciding with the World Environment Day - the Bank drew inspiration from the United Nations theme for 2009 "Your planet needs you. Unite to combat climate change" to compose the actions stated in the Green Pledge. The pledge was first made by the Chief Executive Officer through an announcement to all employees, clearly demonstrating the top management's commitment towards sustainable actions.

The pledge was preceded by a comprehensive training for team leaders on waste management and energy efficiency conducted by the Central Environmental Authority. An internal communication strategy supported the initiative increasing awareness amongst the Bank's employees and customers on an individual's desired action towards a greener planet. The Bank's e-learning system formed the crux of the communications effort for employees whilst minimal utilisation of banners and handbills further enhanced the reach of the message to customers.

As support mechanisms, coded bins for segregated waste - paper, plastic and biodegradable - were introduced aimed at motivating employees to achieve the desired actions laid out in the Green Pledge.

The pledge is considered to be a fundamental base for future environmental sustainability efforts. It is viewed by the Bank as a critical step towards engaging and enlightening every employee to not only practice sustainable principles at the workplace but also to translate those learnings, and principles to their homes, thereby creating a shift in mindsets and attitudes amongst family and friends.

### Energy Efficiency: Combating Climate Change

Investment during the year:  
Rs. 3,400,000

Energy has become a focal issue for business in recent years, with rising prices and concerns over disruptions to supply. On a broader scale, depletion of non-renewable energy sources has caused grave concerns over future global demand. With the future sustenance of the world at peril as carbon emissions trigger climate change, commercial entities the world over are exploring the business benefits of energy efficiency.

At Hatton National Bank we believe that the efficient utilisation of energy across the business provides a number of benefits including the protection of global energy reserves and in the reduction of the Banks' environmental

## > Environmental Responsibility



impact. Through the effective implementation of a range of energy efficiency principles and processes, instituted over the last few years, the Bank has garnered returns from cost minimisation.

The Bank's energy efficiency tactics have varied from generating increased awareness on effective and necessary use of energy and implementation of energy efficient technologies to the utilisation of alternative energy (refer Resource Efficiency: Recycle, Reuse, Reduce).

During the year in review, the Bank initiated the replacement of traditional tungsten filament (incandescent) bulbs - which are renowned for being inefficient, wasting up to 95 per cent of the energy they use as heat - to energy-efficient bulbs. It is estimated that as a result the Bank will achieve efficiencies as much as five times that of incandescent bulbs. Air conditioning continues to be a contributing factor to the Bank's high energy utilisation and as a result, a conversion to energy efficient air conditioning units is currently under implementation.

### Resource Efficiency: Recycle, Re-use, Reduce

The Bank adopts a 3R policy - Recycle, Re-use, Reduce - towards all tangible resources. With initiatives in place for the creation of a paperless office, the Bank strives to minimise the utilisation of paper. Where use of paper is essential it is ensured that maximum utilisation of the paper is garnered through the utilisation of duplex printers. Subsequently the used paper is collected and recycled. 280,747 kg of paper was recycled, for the 12 months period to October 2009 saving an estimated:

Trees	4772
Water	8,922,139 litres
Electricity	112,988 kWh
Oil	492,710 litres
Landfill	842 cubic meters

The Bank reconditions and reuses office furniture, prolonging the lifetime

### Savings from Energy Efficient Lights in the HNB Network

- Investment during the last 3 years (Rs.'000) 8,400
- Savings from Energy Efficient Lights (Rs.'000) 11,500

### Annual Savings from Reducing Maximum Demand by Correcting Power Factor

	Savings (Rs '000)
• Investment in refurbishment of equipment (Rs.'000) 700	
RA De Mel Mawatha from 293 kVA to 253 kVA	360
Bambalapitiya from 112 kVA to 99 kVA	117
Pettah from 121 kVA to 111 kVA	90
Nugegoda from 58 kVA to 50 kVA	72
<b>Total</b>	<b>639</b>

thereby reducing the waste generated through routine replacement. During the year 5,461 items were refurbished by the Procurement Division.

The Bank has in recent times undertaken an initiative to clad the external walls of its Branch offices in an effort to minimise the use of paint. Cladding is considered a “greener” alternative given its propensity to require only continuous surface cleaning.

Paint pollution is a direct by-product of the process of paint application. Paints generally include pigment (the colour), carried by a resin and/or binder, a solvent to help the paint application, and a dryer. In vinyl and acrylic paints plastic compounds are also contained. Some will include formaldehyde, arsenic, thinners, and foamers. It is proven that prolonged or high exposure to paint and paint fumes can cause headaches, trigger allergies and asthmatic reactions, irritate skin, eyes, and put increased stress on vital organs such as the heart. The World Health Organisation (WHO) has reported a 20% to 40% increased risk of certain types of cancer (in particular lung cancer) for those who come into regular contact with, or work with paint while Danish researchers point to the added possibility of neurological damage.

As paint is applied, the World Health Organisation reports that the levels of volatile organic compounds (VOCs) given off are as much as 1000 times higher than found outdoors. Continuous re-application of paint over the lifetime of a building, will continue to release chemicals into the environment as invisible paint pollution. When VOCs react with oxygen, they form ‘bad’ ozone in the presence of sunlight. This is a contributory factor to the greenhouse effect and a cause of global warming.

Thus, the Bank has to date cladded 81 buildings amounting to a total area of 99,213 Sq.ft. at an investment of Rs. 69,449,100 of which Rs. 23,814,700 was invested in the year under review.

## Green Buildings

The HNB Tower sets the precedence as an energy efficient high rise building and is one of the few buildings in Sri Lanka that utilises revolutionary technology from variable air volume units that control ambient temperature, a demand controlled ventilation system, and an intelligent, micro processor controlled illumination system for energy efficiency lighting. The Tower is currently being reviewed for the award of Leadership in Energy and Environmental Design (LEED) Green Building Certification and expects to obtain the GOLD category certification in the year 2010.

A total investment of Rs. 1.1 billion in energy efficient systems for HNB Towers has yielded the accrued benefits of greater energy savings and improved indoor air quality. The electrical power consumption for air conditioning is less than 50 percent compared to a conventional building of similar infrastructure where the consumption of power for airconditioning would be over 60 percent of the total power utilisation. Similarly, the After Diversity Maximum Demand (ADMD) is in the neighbourhood of 50 VA/m<sup>2</sup> whereas in a conventional building this is in the range 70 ~ 100 VA/m<sup>2</sup>. The energy savings from HNB Towers when converted to monetary values approximates to Rs. 1.5 million per month in comparison with a similar conventional building.

In replicating the learnings gleaned from the HNB Tower, the Bank plans to commence construction of its second green building in Nittambuwa. The construction work commenced in November 2009 and the building is expected to be completed by November 2010. This facility, which will house the Bank’s Nittambuwa branch office, will be the first office in the financial services sector to receive LEED accreditation.

Built on a sustainable design which takes a holistic approach towards building design and concept, the “green branch” is expected to achieve efficiencies of 30 per cent reduction in

energy utilisation when compared with an average bank branch building and 56 per cent reduction in potable water consumption. The other features of the building include:

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

## > Environmental Responsibility

### Eco-Conscious Purchase

The Bank adopted a green procurement policy during the year under review that aims to inculcate green business practices amongst the supplier base. The procurement policy provides preference to suppliers who manufacture or follow principles that minimise their impact on mother earth. As a responsible corporate citizen, Hatton National Bank is aware of its role as a catalyst in creating change towards the sustainability of the environment.

### Conservation of Natural Habitats

Project Duration: ongoing

Investment during the year:  
Rs. 1,302,400

Total Investment to date:  
Rs. 2,302,400

The Bank reinvested into the conservation of the Bundala National Park during the year in review reaffirming its commitment towards the

protection of Sri Lanka's natural and biodiversity resources.

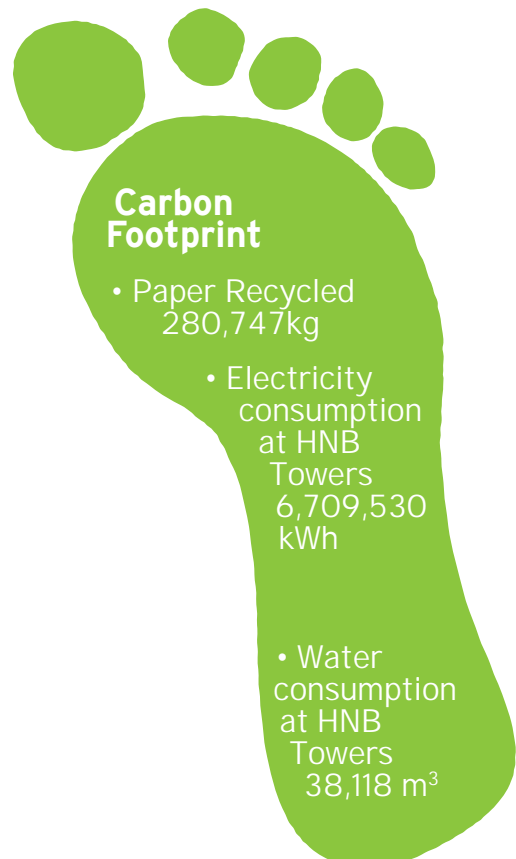
The Hatton National Bank was party to a project aimed at the eradication of two invasive plant species - Cacti and Andara (Prosopis Juliflora) - which cover an estimated 10,000 hectares or 60 per cent of the total area of the Bundala National Park. Responsible corporate citizens including the Hatton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

The Bundala National Park is considered a critical wintering ground for migratory birds and recognised internationally as a haven for 197 species of birds including the magnificent Greater Flamingo that migrates in flocks to the water bodies of the National Park. Bundala was Sri Lanka's first wetland to be declared as a RAMSAR site under the Convention on Wetlands of International Importance thus recognising the ecological

importance of the Park as a habitat for water birds. However, over the past 30 years the increasing presence of the two invasive plants have led to the contamination of water bodies, and threatens the existence of wildlife. With Cacti covering the ground and the Andara scrub plant growing above, sunlight is cut off for the undergrowth and mid-height plants. With the density of the Cacti increasing profusely, growth of feeding plants for Deer and Elephants have been restricted.

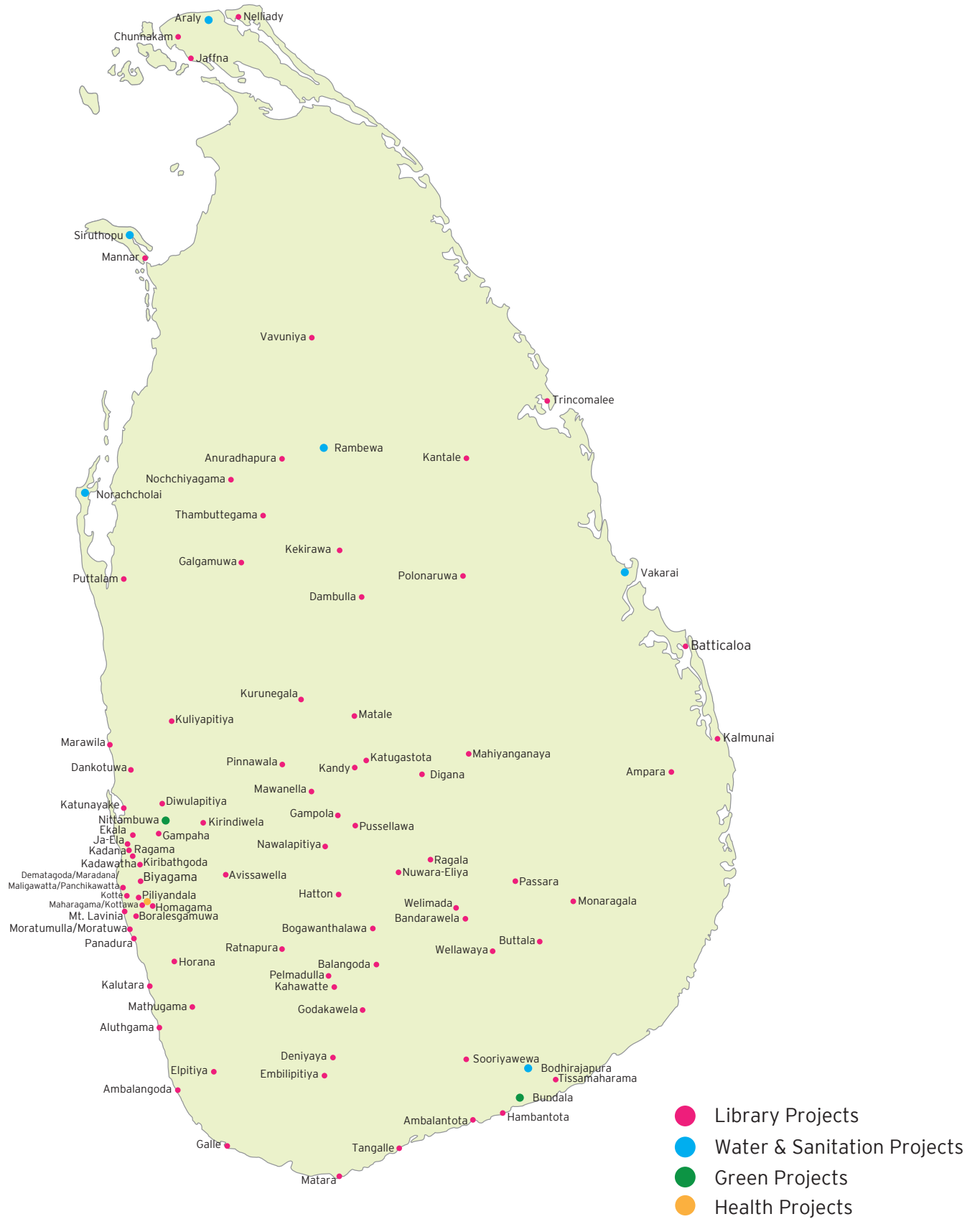
Hatton National Bank in the year 2009 undertook the financial responsibility for the clearing of 10 hectares at Rs. 130,240 per hectares thus contributing to the clearing of a total 20 hectares in all.

The Bank is also engaged in a re-forestation initiative for the cleared areas working within the strategic intent of the project to re-introduce endemic flora and vegetation to the Bundala National Park.





# Commitment to the Community



## Commitment to Our Promises

Promises made in 2008	Progress
<b>Customers</b>	
Revamp online Banking with more features and bring it in line with the core banking solution.	●
Establish more Exchange Houses in UAE & Canada.	●
To commence investment banking operations in India in collaboration with a domestic bank. <i>** The goal not achieved yet due to delay obtaining regulatory approval.</i>	●
Continue to upgrade our facilities to be easily accessible to our differently abled customers. <i>** Refer Customer Responsibility section of this Report for number of locations. This is an ongoing process for existing buildings and these facilities form part of the requirements for new customer centres and ATMs.</i>	●
Signage and exteriors of 10 locations to be refurbished in line with the new branding standards.	●
Establish a Priority Banking Centre.	●
To provide more value added features for our MoneyGram remittance customers.	●
Complete the implementation of the new core banking system and bring the entire network of customer centres onto a single platform. <i>** Finacle the new core banking system has been fully implemented.</i>	●
<b>Employees</b>	
Implementation of 5S practices throughout the Bank.	●
Implementation of a sophisticated online HR system that would increase productivity and user friendliness and be a lively and interactive tool. <i>** The home grown Upward Mobility HR Management System was recognised with a Bronze Award at the National Best Software Quality Awards 2009.</i>	●
Introduce online system of examinations for candidates and exploit technology in the interview and appraisal process for recruitment. <i>** A batch of 34 trainees was recruited from the North through the online system saving time and travel for the candidates.</i>	●
Implement a Management Development Programme for Managers & Assistant Managers. <i>** 30 Managers and Assistant Managers successfully completed a customised Management Development Programme at the Post Graduate Institute of Management.</i>	●
Implement an International Credit Skills Assessment Training Programme for Credit Staff and Branch Managers. <i>** 15 Branch Managers and Account Relationship Managers followed the International Omega Credit Skills Assessment programme.</i>	●
<b>Community</b>	
Carry out renovation work and maintain the facilities at the Male Surgical Ward at the National Cancer Institute, Maharagama.	●
Implement a scheme to provide financial assistance to families where the sole breadwinner is afflicted with cancer.	●
<b>Suppliers</b>	
To outsource packing services	●
<b>Environment</b>	
Construct a "Green" Building by 2010. <i>** Construction work of the Green Building in Nittambuwa is progressing satisfactorily and with completion scheduled for November 2010.</i>	●

● Achieved

● In progress

## Key Performance Indicators

### 1. CUSTOMER RESPONSIBILITY

Number of written customer complaints received and resolved - 126

Summary of the Disabled Friendly HNB Customer Centres & ATMs - Refer page - 96

Number of customer centres opened during the year - 9

Investment on projects for future generation in 2009

- Lowa Dinana Singiththo Rs. 10,000,000

- Student Banking Rs. 2,500,000

### 2. EMPLOYEE RESPONSIBILITY

The in-house, local and overseas training data are available on page 98

Agewise, Genderwise and Servicewise analyses of the Bank employees are shown on page 101

The amount spent on Training & Development and Staff Welfare given on page 101

### 3. INVESTOR RESPONSIBILITY

The economic performance indicators of the Bank have been disclosed on page 105

### 4. COMMUNITY RESPONSIBILITY

The investment committed for community projects - page 106 to page 112

Sector analysis of micro finance loans given on page 112

Number of Safe Drinking Water and Sanitation Projects completed during the year - 4

Number of School Libraries completed during the year - 10

### 5. SUPPLIER RESPONSIBILITY

Supplies from and Micro Entrepreneurs - 15%

### 6. ENVIRONMENTAL RESPONSIBILITY

The investment in combating climate change during the year Rs 3,400,000

Savings from Energy efficient lights during the year Rs 11,500,000

Investment in cladding work during the year Rs 23,814,700

Paper recycled for a period of 12 months 280,747kg

## Independent Assurance Report



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### INDEPENDENT ASSURANCE REPORT TO HATTON NATIONAL BANK PLC

#### Introduction

We were engaged by the Board of Directors Hatton National Bank PLC ("Bank") to provide assurance on the following elements of the Sustainability Report 2009 ("Report") for the year ended 31st December 2009:

- Reasonable assurance on the data on financial performance, as specified on page 105 of the Report 2009;
- Limited assurance on the key performance indicators for 2009 specified on page 121 and other information presented in the Report.

#### Managements' responsibilities and the criteria applied

Management is responsible for the preparation and presentation of the Report in accordance with the GRI Sustainability Reporting Guidelines as described on page 79 of the Report and the information and assertions contained within it: for determining the Bank's objectives in respect of sustainable development performance and reporting, including the identification of stakeholder and material issues, and for establishing and maintaining appropriate performance management and internal control systems from which the reported performance information is derived.

#### Our responsibilities and compliance with ISAE 3000

Our responsibility is to carry out a reasonable and limited assurance engagement and to express a conclusion based on the work performed. We conducted our engagement in accordance with International Standard on Assurance Engagements ISAE 3000, "Assurance Engagements other than Audits or Reviews of Historical Financial Information", issued by the International Auditing and Assurance Standards Board.

This Standard requires that we comply with applicable ethical requirements, including independence requirements, and plan and perform the engagement to obtain reasonable and limited assurance about whether the Report is free of material misstatement.

#### Summary of work performed

##### Financial Data

We have reconciled the data on financial performance reported on page 105 of the Report with the audited financial statements of the Bank for the year ended 31st December 2009.

##### Key Performance Indicators

We reviewed the reliability of the data on Key Performance Indicators for 2009 based on:

- Visits to selected project sites and branches to review systems and data;
- Review of the systems used to generate, aggregate and report these data;
- Review of the data reported by the relevant business units to corporate level;
- Review of the data validation processes at corporate and business level; and
- Review of the data trends in discussions with management.

##### Other Information

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

- Interviews with senior management and relevant staff at corporate and selected business unit level concerning sustainability strategy and policies for material issues, and these implementation across the business;
- Inquiries with relevant staff at corporate and business level responsible for providing the information in the Report;

- Inquiries about the design and implementation of the systems and methods used to collect and process the information reported, including the aggregation of data into information as presented in the Report; and
- Reading the information presented in the Report to determine whether it is in line with our overall knowledge of, and experience with, sustainability performance of the Bank.

#### Our conclusion

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

- The data on financial performance, as specified on page 105 of the Report 2009 are properly derived from the financial statements of the Bank for the year ended 31 December 2009 for which the independent auditors have issued an unqualified audit opinion dated 15 February, 2010 on page 149 of the Annual Report;
- Nothing has come to our attention that causes us to believe that the Key Performance Indicators for 2009 specified on page 121 and other information presented in the Report are not prepared, in all material respects, in accordance with the GRI Sustainability Reporting Guidelines as described in page 79 of the Report.

*Ford Rhodes Thornton & Co.*

CHARTERED ACCOUNTANTS

Colombo  
15 February 2010

## The Global Reporting Initiatives (GRI) G3

The Global Reporting Initiative (GRI) provides a generally accepted framework for reporting on an organisation's economic, environmental and social performance. Hatton National Bank PLC (Bank) has used the GRI Sustainability Reporting Guidelines (G3) in the development of this 2009 Sustainability Report. This index provides a comprehensive listing of the GRI indicators reported by the Bank. We have also used the financial services sector supplements on social and environmental performance. This Index refers to information in our 2009 Sustainability Report, as well as the other sections of our 2009 Annual Report.

We have self assessed our report as an A

		C	C+	B	B+	A	A+
Mandatory	Self declared					✓	
Optional	Third party checked						
	GRI checked						

### GRI Index

#### Profile

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

#### Economic

- Economic performance
- Market presence
- Indirect economic impacts

#### Society

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

#### Environmental

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

#### Product responsibility

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

#### Labour practices and decent work

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

#### Human rights

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

## The Global Reporting Initiatives (GRI) G3

Profile		
1. Strategy and analysis		Page Reference
1.1 Statement from the CEO and Chairman	<ul style="list-style-type: none"> <li>Chairman's Message</li> <li>CEO's Review</li> </ul>	4 - 7 8 - 11
1.2 Description of key impacts, risks and opportunities	<ul style="list-style-type: none"> <li>CEO's Review/CEO's Message</li> <li>Inspiring and engaging our people</li> <li>Supporting high literacy</li> <li>Towards service excellence</li> <li>Corporate responsibility highlights</li> <li>Corporate Governance and Compliance</li> </ul>	8 - 11, 81 - 82 97 110 89 89 - 118 58 - 75
2. Organisational Profile		
2.1 Name of the reporting organisation	<ul style="list-style-type: none"> <li>Hatton National Bank PLC</li> </ul>	
2.2 Primary brands, products and services	<ul style="list-style-type: none"> <li>Management Discussion &amp; Analysis</li> </ul>	19 - 43
2.3 Operational structure of the organisation	<ul style="list-style-type: none"> <li>Management Discussion &amp; Analysis</li> </ul>	19 - 43
2.4 Location of organisation's headquarters	<ul style="list-style-type: none"> <li>HNB Towers, 479 T B Jayah Mawatha, Colombo 10</li> </ul>	
2.5 Number and name of countries with operations	<ul style="list-style-type: none"> <li>Sri Lanka, Oman, UAE and Canada (Rep offices in India and Pakistan)</li> </ul>	
2.6 Nature of ownership and legal form	<ul style="list-style-type: none"> <li>Corporate Information</li> </ul>	IBC
2.7 Markets served	<ul style="list-style-type: none"> <li>Management Discussion &amp; Analysis</li> </ul>	19 - 43
2.8 Scale of the reporting organisation	<ul style="list-style-type: none"> <li>Number of employees</li> <li>Income Statement</li> <li>Ten year summary</li> <li>Twenty largest shareholders</li> <li>Breakdowns of operating income / expenses</li> </ul>	156 150 244 251 175
2.9 Significant changes during the reporting period	<ul style="list-style-type: none"> <li>Changes to the Group structure</li> </ul>	134
2.10 Awards received	<ul style="list-style-type: none"> <li>Recognition</li> </ul>	105
3. Report profile		
3.1 Reporting period	<ul style="list-style-type: none"> <li>1 January 2009 to 31 December 2009</li> </ul>	
3.2 Date of most recent previous report	<ul style="list-style-type: none"> <li>December 2008</li> </ul>	
3.3 Reporting cycle	<ul style="list-style-type: none"> <li>Annual</li> </ul>	
3.4 Contact point	<ul style="list-style-type: none"> <li>Contact details</li> </ul>	IBC
3.5 Report Scope and Boundary	<ul style="list-style-type: none"> <li>GRI 3</li> </ul>	
3.5 Defining report content	<ul style="list-style-type: none"> <li>HNB's 2009 Sustainability Report covers the operations of the Bank.</li> </ul>	
3.6 Boundary of report	<ul style="list-style-type: none"> <li>About our Report</li> </ul>	77 - 80
3.7 Limitations on scope/boundary	<ul style="list-style-type: none"> <li>The report covers only the Sri Lankan operations of HNB</li> </ul>	
3.8 Data measurement techniques	<ul style="list-style-type: none"> <li>Based on GRI</li> </ul>	
3.10 Restatements	<ul style="list-style-type: none"> <li>None</li> </ul>	
3.11 Significant changes	<ul style="list-style-type: none"> <li>No significant changes.</li> <li>The initiatives taken by the Bank have been reported</li> </ul>	
3.12 Location of content	<ul style="list-style-type: none"> <li>Will be uploaded on the HNB website</li> </ul>	
3.13 External assurance	<ul style="list-style-type: none"> <li>Independent Assurance Report</li> </ul>	122
4. Governance, commitments and engagement		
4.1 Governance structure	<ul style="list-style-type: none"> <li>Corporate Governance</li> </ul>	58 - 75
4.2 Chair of the highest governance body	<ul style="list-style-type: none"> <li>Chairman's message</li> <li>Chairman's introduction</li> </ul>	4 - 7 58
4.3 Highest governance body	<ul style="list-style-type: none"> <li>Sustainability Stewardship</li> <li>Corporate Governance framework</li> </ul>	83 58
4.4 Mechanisms for employees/share holders to provide recommendations/direction to the board	<ul style="list-style-type: none"> <li>Investor Feedback form</li> <li>Access to directors</li> <li>Stakeholder engagement</li> </ul>	263 AGM 87 - 88
4.5 Compensation and performance	<ul style="list-style-type: none"> <li>Employee Responsibility</li> <li>Performance appraisal based on balance scorecard</li> </ul>	97 - 102
4.6 Avoidance of conflicts of interest	<ul style="list-style-type: none"> <li>Conflict of interest</li> <li>Directors' Disclosure of Interest Policy and Policy for handling conflicts of interest</li> </ul>	69 69, 141 - 142
4.7 Expertise of governance body	<ul style="list-style-type: none"> <li>Board composition, selection and appointment</li> </ul>	12 - 13, 60
4.8 Mission and values statements	<ul style="list-style-type: none"> <li>Annual Report</li> </ul>	2
4.9 Management of performance	<ul style="list-style-type: none"> <li>Financial Review</li> </ul>	41 - 43
4.10 Evaluating the performance	<ul style="list-style-type: none"> <li>Performance evaluations</li> <li>Financial Review</li> </ul>	101 41

		Page Reference
4.11 Precautionary approach	• Risk Management Framework	46-47
4.12 Externally developed initiatives	• Health, Education	106
4.13 Membership in associations		None
4.14 List of stakeholder groups	• Stakeholder Engagement	88
4.15 Identification and selection of stakeholders	• CSR Strategy • GRI 3	79
4.16 Approaches to stakeholder engagement	• Stakeholder Engagement • GRI 3	88
4.17 Key issues and concerns of stakeholders	• Key challenges and opportunities • Stakeholder Relations	78 - 118

Economic		
<b>Management approach</b>		
Disclosure of management approach	• Management Discussion & Analysis	20 - 37
<b>Economic performance</b>		
EC1 Economic value generated and distributed	• Value added statement	242
EC2 Financial implications of climate change	• Savings in energy efficiency reported	115 - 118
EC3 Organisation's defined benefit pension plan	• Description of the Pension Plan	211
EC4 Financial assistance from government	• HNB does not receive any significant assistance from government	
<b>Market Presence</b>		
EC5 Entry-level wage-local minimum age (additional)	• Defined in the Collective Agreement and Labour law	
EC6 Policy, practices, and proportion of spending on locally-based suppliers at significant locations of operation	• Significant sourcing from local suppliers	
EC7 Procedures for local hiring and proportion of senior management hired from the local community at significant locations of operation	• Recruitment locally	
EC7 Development and impact of infrastructure investments and services provided primarily for public benefit through commercial, in-kind, or pro bono engagement	• Refer Community section	106
EC9 Indirect Economic impacts (additional)	• Improving financial literacy and inclusion. • Supporting rural employment and access to financial services • Taking the next step in responsible lending. • Indigenous employment, mature-aged workers, women in management and disability advocacy • Investment in the community	89 - 112

Society		
<b>Management approach</b>		
Disclosure of management approach	• Policy • Goals and performance	106 120
<b>Community</b>		
S01 Impacts of operations on communities	Refer Community section	106
<b>Corruption</b>		
S02 Analysis for risks of corruption	Training on ethics and Employees handbook	
S03 Training in anti-corruption	• Employees handbook • Internal Training sessions	
S04 Instances of corruption	• None reported	
<b>Public Policy</b>		
S05 Public policy development and lobbying	• No significant involvement during the year	
S06 Contributions to political parties or related institutions (additional)	• No contributions to political parties	
<b>Anti-Competitive Behavior</b>		
S07 Legal actions for anti-competitive, antitrust and monopoly practices (additional)	• None reported during the year	
<b>Compliance</b>		
S08 Monetary value of significant fines	• None reported during the year	

## > The Global Reporting Initiatives (GRI) G3

<b>Environment</b>		
<b>Management Approach</b>	<b>2009</b>	<b>Page Reference</b>
Disclosure of management approach	<ul style="list-style-type: none"> <li>• Policy</li> <li>• Goals and performance</li> </ul>	115 120
<b>Materials</b>		
EN1 Material used by weight or volume	Not Applicable	
EN2 Percentage of materials used that are recycled input materials	Not Applicable	
EN3 Direct energy consumption by primary energy source	Not Applicable	
EN4 Indirect energy consumption by primary source.	Information on energy consumption at Head Office reported	118
EN5 Energy saved due to conservation and efficiency improvements (Additional).	Refer Environment section	116
EN6 Initiatives to provide energy-efficient or renewable energy based products and services, and reduction in energy requirements as a result of these initiatives (additional).	Not Applicable	
EN7 Initiatives to reduce indirect energy consumption and reductions achieved (additional)	Refer Environment Section	116
<b>Water</b>		
EN8 Total water withdrawal by source.	Not Reported	
<b>Emissions, Effluents and Waste</b>		
EN18 Initiatives to reduce emissions and reductions achieved (additional)	Not Applicable	
EN21 Total water discharge by quality and destination.	Not Applicable	
EN22 Total weight of waste by type and disposal method	Refer Environment Section - Paper recycled	116
EN23 Total number and volume of significant spills	Not Applicable	
EN24 Weight of transported, imported, exported, or treated waste deemed hazardous under the terms of the Basel Convention Annex I,II,III and VIII and percentage of transported waste shipped internationally (additional)	Not Applicable	
EN25 Identity, size, protected status, and biodiversity value of water bodies and related habitats significantly affected by the reporting organisation's discharges of water and runoff (additional).	Not Applicable	
<b>Products and Services</b>		
EN26 Initiatives to mitigate environmental impacts of products and services, and extent of impact mitigation.	Not Applicable	
EN27 Percentage of products sold and their packaging materials that are reclaimed by category.	Not Applicable	
<b>Compliance</b>		
EN28 Monetary value of significant fines and total number of non-monetary sanctions for non-compliance with environmental laws and regulations.	Nil	
<b>Transport</b>		
EN29 Significant environmental impacts of transporting products and other goods and materials used for the organisation's operations, and transporting members of the workforce (additional).	The Bank's recruitment and placement policy is such that a significant number of employees are placed in customer centres close to their homes as well as staff quarters are provided to reduce commuting.	
<b>Overall</b>		
EN30 Total environmental protection expenditures and investments by type (additional)	Refer Environment Section	115-118

<b>Product Responsibility</b>		
<b>Management approach</b>		
Disclosure of management approach	<ul style="list-style-type: none"> <li>• Policy</li> <li>• Goals and performance</li> </ul>	89 120
<b>Customer Health &amp; safety</b>		
PR2 Non-compliance with regulations/codes (additional)	Nil	
<b>Product and Service Labelling</b>		
PR3 Information required by procedures	Disclosed on product brochures	
PR4 Non-compliance concerning labelling (additional)	Nil	
PR5 Customer satisfaction (additional)	Regular customer meetings and customer surveys	



		Page Reference
<b>Marketing Communications</b>		
PR6	Adherence to laws, standards and codes	Adhere to local laws and regulations
PR7	Non-compliance concerning marketing (additional)	Nil
<b>Customer Privacy</b>		
PR8	No of breaches of customer privacy (additional)	None reported during the year
<b>Compliance</b>		
PR9	Non-Compliance with laws/regulations	• None reported during the year. Directors Responsibility statement - CEO / CFO Report 146 - 147

<b>Labour practices and decent work</b>		
<b>Management approach</b>		
	Disclosure of management approach	Policy 97
<b>Employment</b>		
LA1	Breakdown of total workforce.	Refer Employee Section 101
LA2	Employee turnover	Regularly monitored by HR division
LA3	Minimum benefits (additional)	As defined in Collective Agreements
<b>Labour /Management Relations</b>		
LA5	Notice period regarding operational changes	As defined in Collective Agreements, prevailing Labour laws and conditions of employment
<b>Occupational Health &amp; Safety</b>		
LA6	Management - Worker health and safety committees (additional)	Prevailing labour laws, health and safety policy of the Bank
LA7	Lost Time Injury Frequency Rate	None reported during the year
LA8	Serious communicable diseases	None reported during the year
LA9	Health and safety in union agreements (additional)	As defined in Collective Agreements
<b>Training and Education</b>		
LA10	Hours of training	Refer Employee section 98
LA11	Employability and managing career endings (additional)	Refer Employee section
<b>Diversity and Equal Opportunity</b>		
LA13	Employees according to diversity	Refer Employee section 101
LA14	Basic salary of men and women	The Bank is an equal opportunity employer

<b>Human Rights</b>		
<b>Management approach</b>		
	Disclosure of management approach	HR Policy 97
<b>Investment and procurement practices</b>		
HR1	Investments with HR clauses/screening	Refer Employee section 97
HR2	Suppliers that underwent HR screening	All suppliers are screened. No incidents of lapses reported during the year
HR3	Employee training on human rights (additional)	During induction programme
<b>Non- Discrimination</b>		
HR4	Incidents of discrimination	The Bank is an equal opportunity employer
<b>Freedom of association and collective bargaining</b>		
HR5	FOA and collective bargaining	Collective Agreements are adhered to
<b>Child Labour</b>		
HR6	Child labour	Nil
<b>Forced and Compulsory Labour</b>		
HR7	Forced or compulsory labour	Nil
<b>Security Practices</b>		
HR8	Security personnel trained in human rights (additional)	A security coordinator is employed to monitor the Security function which is outsourced
<b>Indigenous Rights</b>		
HR9	Rights of indigenous people (additional)	Not applicable

## Financial Services Sector Supplement (FSSS)

FSSS is the G3 guidelines plus sector specific content. The Table provides a summary of financial services sector - specific disclosures & performance indicators.

From 1 January 2010, reporting with the Financial Services Sector Supplement has become obligatory for reporters to be recognised as GRI application level **A** reporter. Accordingly the Bank has applied the said supplement.

### Product and Service Impact Section

Financial Services Sector specific disclosures on management approach		
Aspect	Disclosure	Page Reference
Product Portfolio	FS1: Policies with specific environmental and social components applied to business lines	78 - 118
	FS2: Procedures for assessing screening environmental and social risk in business lines	78 - 118
	FS3: Process for monitoring compliance with environmental and social requirements	78 - 118
	FS4: Process for improving staff competency to implement the environmental and social policies and procedures as applied in business lines	78 - 118
	FS5: Interaction with clients/investees/business partners regarding environmental and social risk opportunities	78 - 118
Financial Services Sector specific performance indicators		
Aspect	Indicator	Page Reference
Product Portfolio	FS6: Percentage of portfolio for business lines by specific region, size and sector	155 - 158
	FS7: Monetary value of products and services designed to deliver specific social benefit for each business lines broken down by purpose	19 - 43
	FS8: Monetary value of products and services designed to deliver a specific social benefit for each business line broken down by purpose	19 - 43
Audit	FS9: Coverage and frequency of audits to assess implementation of environmental and social policies and risk assessment procedures benefit for each business line	In progress
Active Ownership	FS10: Percentage of number and companies held in institution's portfolio with which the reporting organisation has interacted on environmental and social issues	89 - 96 113 - 114
	FS11: Percentage of assets subject to positive and negative environmental or social screening	Currently not available
	FS12: Voting policies applied to environmental or social issues for shares over which the reporting organisation holds the right to vote or advise on voting	Not Applicable

### Economic Section

Financial Services Sector specific commentary on G3 Economic disclosure on management approach		
Aspect	Commentary	Page Reference
Economic Performance	Organisation's community investment strategy in association with data reported on community investment	106 - 112
Financial Services Sector specific commentary on G3 Indicators		
Aspect	Commentary	Page Reference
Economic performance	Direct economic value generated and distributed, revenues, operating costs, employee compensation, donations, community investments etc	103 - 105
	Breakdown of the organisation's community investment by theme	106 - 112

## Environment Section

Financial Services Sector specific commentary on G3 Indicators		
Aspect	Commentary	Page Reference
Emissions , Effluent and Waste	Commentary on EN 16 Commentary on EN22	115 - 118

## Social Section

Financial Services Sector specific commentary on G3 Labour Disclosure on management approach		
Aspect	Commentary	Page Reference
Occupational Health and Safety	Organisation's policies and practices regarding threats and violence in place to assist workforce members, their families or community members	97 - 102
Financial Services Sector specific Human Rights commentary on G3 Indicators		
Aspect	Commentary	Page Reference
Investment and Procurement Practices	Commentary on HR1	113 - 114
Financial Services Sector specific on Product responsibility society performance indicators		
Society Performance Indicators		
Aspect	Indicator	Page Reference
Community	FS13: Access points in low populated or economically disadvantaged areas by type	38
	FS 14: Initiatives to improve access to financial services to disadvantaged people	89 - 96
Financial Services Sector specific disclosures on management approach		
Product Responsibility Performance Disclosures		
Aspect	Disclosure	Page Reference
Product and Service labelling	FS15: policies for the fair design and sale of financial product and services	89 - 96
Financial Services Sector specific on Product responsibility performance indicators		
Product Responsibility Performance Indicators		
Aspect	Indicator	Page Reference
Product and Service Labeling	FS16: Initiatives to enhance financial literacy by type of beneficiary	89 - 96

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# FINANCIAL INFORMATION

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THAT IS HOW IT WORKS

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## Financial Calendar

### Financial Calendar - 2009

Rs 1.50 per share Interim Dividend for 2009 paid on	17th November 2009
Audited Financial Statements signed on	15th February 2010
41st Annual General Meeting to be held on	31st March 2010
Rs 5.00 per share Final Dividend for 2009 payable on *	12th April 2010

Interim Financial Statements published in terms of Rule 8.3 of the Colombo Stock Exchange and as per the requirements of the Central Bank of Sri Lanka:

1st Quarter Interim Results released on	12th May 2009
2nd Quarter Interim Results released on	4th August 2009
3rd Quarter Interim Results released on	9th November 2009

### Proposed Financial Calendar - 2010

Interim Dividend for 2010 to be payable in **	December 2010
42nd Annual General Meeting to be held in	March 2011
Final Dividend for 2010 to be payable in ***	April 2011

Interim Financial Statements to be published in terms of Rule 8.3 of the Colombo Stock Exchange and as per the requirements of the Central Bank of Sri Lanka:

1st Quarter Interim Results to be released in	May 2010
2nd Quarter Interim Results to be released in	August 2010
3rd Quarter Interim Results to be released in	November 2010

\* Subject to confirmation by Shareholders

\*\* Subject to confirmation by Directors

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

## Annual Report of the Board of Directors on the Affairs of the Company

The Board of Directors of Hatton National Bank PLC has pleasure in presenting their Annual Report to the members for the financial year ended 31st December 2009, together with the audited Financial Statements of the Bank and Consolidated Financial Statements of the Group for that year, the Auditors' Report on those Financial Statements, conforming to the requirements of the Companies Act. The Financial Statements were accepted and approved by the Board of Directors on 15th February 2010. The Report also includes certain disclosures required to be made under the Banking Act direction on Corporate Governance, Listing Rules of the Colombo Stock Exchange and are guided by the recommended best practices on Corporate Governance.

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

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

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

### Principal Activities

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

### Changes to the Group Structure

During 2008 Acuity Partners (Pvt) Ltd (Acuity) was formed as a Joint Venture between the Bank and the DFCC Bank, whereby HNB Stockbrokers (Pvt) Ltd, DFCC Stockbrokers (Pvt) Ltd and HNB Securities Ltd became Subsidiaries of Acuity. Under the Joint Venture, stockbroking business was promoted through DFCC Stockbrokers (Pvt) which was renamed as Acuity Stockbrokers (Pvt) Ltd. In promoting the Acuity brand, HNB Securities Ltd too was renamed as Acuity Securities Ltd in July 2009. In October 2009, HNB Stockbrokers (Pvt) Ltd was sold with the broking license by Acuity.

On 23rd April 2009, the Bank invested 95% in the equity of Commercial Interlink Services Inc (O/A of Delma Exchange Canada) in Canada to actively engage in the remittance business and in other related business activities in that country. This Company is classified as a subsidiary company of the Bank.

The Bank also invested 20% in the equity of Delma Exchange in Abu Dhabi, United Arab Emirates during the year. This Company is classified as an associate of the Bank.

### Review of Operations

A review of the operations of the Bank during the financial year 2009 and results of those operations are contained in the Chairman's Message (pages 4 to 7), the Chief Executive Officer's Review (pages 8 to 11) and Management Discussion (pages 20 to 43). These reports form an integral part of the Annual Report.

### Future Developments

An overview of the future developments of the Bank is given in the Chairman's Message (pages 4 to 7), the Chief Executive Officer's Review (pages 8 to 11) and Management Discussion and Analysis (pages 20 to 43).

### Financial Statements

The Financial Statements of the Bank and the Group for the year ended 31st December 2009 duly signed by the Chief Financial Officer, two of the Directors of the Bank and the Board Secretary are given on pages 150 to 232 which form an integral part of the Annual Report of the Board.

### Significant Accounting Policies

The significant accounting policies adopted in the preparation of the Financial Statements and the impact of the changes in Sri Lanka Accounting Standards during the year are given on pages 156 to 173.

### Going Concern

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

### Auditors' Report

Bank's Auditors, Messrs KPMG Ford, Rhodes, Thornton & Company carried out the audit on the Financial Statements of the Bank and the Consolidated Financial Statements of the Group for the year ended 31st December 2009 and their report on those Financial Statements which forms an integral part of the Report of the Board of Directors, is given on page 149 of this Annual Report.



## Income

The Income of the Group for 2009 was Rs 41,317,345,000/= (2008 - Rs 38,710,575,000/=) while the Bank's income was Rs 39,374,435,000/= (2008 - Rs 37,151,086,000/=). An analysis of the income is given in Note 9 to the Financial Statements.

## Financial Results and Appropriations

The Bank has recorded a profit before tax and profit after tax growth of 23.7% and 35.2% respectively in 2009. The Group's profit after tax for the year too recorded a growth of 57.8% over 2008.

	2009 Rs '000	2008 Rs '000
The Group Profit for the year ended 31st December 2009 after payment of all expenses of management and providing for depreciation and contingencies	6,166,824	4,485,126
Less: Taxation	(1,613,464)	(1,599,300)
Group Net Profit after taxation	4,553,360	2,885,826
Minority Interest	(70,083)	(55,288)
	4,483,277	2,830,538
Unappropriated Profit brought forward from previous year	2,616,620	2,861,252
Balance available for Appropriation	7,099,897	5,691,790
Appropriations		
Transfer to General Reserve	(2,210,947)	(1,700,000)
Transfer to Reserve Fund	(277,293)	(161,000)
Final Dividend	(706,588)	(824,353)
Interim Dividend	(353,415)	(235,530)
Disposal of Subsidiaries	(1,386)	(154,287)
Balance carried forward as at 31st December	3,550,268	2,616,620

## Reserves

The Group Reserves consist of:

	2009 Rs '000	2008 Rs '000
Capital Reserve	5,773,882	5,771,072
Statutory Reserve Fund	1,260,000	982,707
Repairs and Renovation Reserve*	-	6,700
Exchange Equalisation Reserve	5,505	2,459
Revenue Reserve	14,250,268	11,098,973
<b>Total</b>	<b>21,289,655</b>	<b>17,861,911</b>

\* Rs 6,700,000/= was transferred to General Reserve during the year.

The movement in these reserves is shown in the Statement of Changes in Equity on page 152 of the Annual Report.

The Directors propose to transfer Rs 277,293,000/= (2008 - Rs 161,000,000/=) to Statutory Reserve Fund and

Rs 2,210,947,000/= (2008 - Rs 1,700,000,000/=) to General Reserve Account.

## Corporate Donations

During the year the Bank made donations amounting to Rs 29,184,000/= (2008 - Rs 19,405,000/=) in terms of the resolution passed at the last Annual General Meeting. Donations made by the Group during the year amounted to Rs 29,542,000/= (2008 - Rs 19,665,000/=)

The donations made to Government approved charities from the above sum amount to Rs 325,000/= (2008 - Rs 225,000/=).

## Taxation

The income tax rate applicable on the Bank's domestic operations and FCBU on-shore banking operations is 35% (2008 - 35%). The off-shore operations of the FCBU are taxed at 20% (2008 - 20%).

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

The Bank is also liable for Financial VAT at 20% (2008 - 20%).

## Statutory Payments

The Directors, to the best of their knowledge and belief, are satisfied that all statutory payments in relation to the Government and the employees have been made up to date.

## Dividends

An interim dividend of Rs 1.50 per share (2008 - Rs 1.00) was paid on 17th November 2009 to the holders of the ordinary shares (both voting and non-voting) for the financial year 2009. A part of the interim dividend paid for the year represents a redistribution of the exempt dividends received by the Bank and will therefore be free of income tax in the hands of the shareholders. On this basis 47.8% of the interim dividend paid for 2009 is subject to income tax.

The Directors recommend a Final Dividend of Rs 5.00 per share (2008 - Rs 3.00 per share) for the financial year 2009 and the dividend to be paid on 12th April 2010 to the holders of ordinary shares (voting and non-voting) of the Bank as at the close of business on 31st March 2010, subject to withholding tax.

The Board of Directors was satisfied that the Bank would meet the solvency test in terms of the provisions of the Companies Act No 7 of 2007 immediately after the interim dividend was paid in November 2009 and the final dividend proposed which will be paid in April 2010. The Board provided the Statements of Solvency to the Auditors and obtained Certificates of Solvency from the Auditors in

## > Annual Report of the Board of Directors on the Affairs of the Company

respect of each dividend payment conforming to the statutory provision.

### Capital Expenditure

The total capital expenditure on acquisition of investment property; property, plant and equipment and intangible assets of the Bank and the Group amounted to Rs 1,182,121,000/= and Rs 1,290,885,000/= respectively (2008 Bank - Rs 1,904,798,000/= and Group - Rs 2,353,344,000/=). Details of which are given in Notes 33, 34 and 35 to the Financial Statements. The capital expenditure approved and contracted for, after the year end is given in Note 47 (a) to the Financial Statements.

### Property, Plant and Equipment (PPE)

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

### Market Value of Freehold Properties

The net book value of freehold properties owned by the Bank and the Group as at 31st December 2009 is included in the accounts at Rs 4,747,287,000/= and Rs 9,951,149,000/= respectively (2008 Bank - Rs 4,655,057,000/= and Group Rs 9,748,401,000/=).

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

### Outstanding Litigation

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

### Events after the Balance Sheet Date

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

### Stated Capital and Debentures

The stated capital of the Bank as at 31st December 2009 was Rs 5,084,084,000/=, consisting of 235,770,147 ordinary shares (189,520,615 - Voting and 46,249,532 - Non-voting). - 2008 Rs 5,059,390,000/= consisting of 235,529,400 ordinary shares (189,329,400 - Voting and 46,200,000 - Non-voting). The Bank issued 191,215 Voting shares at Rs 115.54 per share and 49,532 Non-voting shares at 52.51 per share during the year under the approved Employee Share Option

Plan. Thereby the Stated Capital of the Bank increased by Rs. 24,694,000/=.

The Bank had issued debentures Rs 2,673,192,000/= as at 31st December 2009 (2008 - Rs 2,754,851,000/=).

### Share Information

Information relating to earnings, dividend, net assets and market price per share is given in the Financial Highlights on page 3 of the Annual Report. Information on share trading is given on page 248 of the Annual Report.

### Shareholdings

As at 31st December 2009 there were 4,169 and 11,252 registered voting and non-voting shareholders respectively. The distribution is indicated on pages 247 and 248 of the Annual Report. The twenty largest voting shareholders and twenty largest non-voting shareholders of the Bank as at 31st December 2009, together with an analysis are given on pages 251 and 252 of the Annual Report.

### Equitable Treatment to Shareholders

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

### The Board of Directors

The Board of Directors of the Bank consists of eight (2008 - seven) Directors with wide financial and commercial knowledge and experience. The following Directors held office as at the Balance Sheet date and their brief profiles appear on pages 12 and 13 of the Annual Report.

Name of the Director	Status
Mr Rienzie T. Wijetilleke (Chairman)	NED
Mr Rajendra Theagarajah (MD / CEO)	ED
Mr D H S Jayawardena	NED
Mr M V Theagarajah	IND / NED
Mr R K Obeyesekere	NED
Ms Pamela C. Cooray	IND / NED
Mr Ranjeevan Seevaratnam	IND / NED
Mr N G Wickremeratne (appointed w.e.f. 1st July 2009)	IND / NED

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

### Appointment of Directors

Mr N G Wickremeratne was appointed to the Board in terms of Article 93 of the Articles of Association of the Bank, as an Independent / Non Executive Director, with effect from 1st July 2009. The profile of Mr Wickremeratne appears on page 13 of the Annual Report.

Mrs Rose C. Cooray was appointed to the Board in terms of Article 93 of the Articles of Association of the Bank, as an Independent / Non Executive Director, with effect from 15th February 2010.

Mrs Cooray had been a Deputy Governor of the Central Bank of Sri Lanka and retired in May 2009. She has over 35 years of extensive experience in Banking and Finance both at the Central Bank and at the Ministry of Finance. During this period she has served on the boards of several companies representing the Government of Sri Lanka and the Monetary Board. She holds a Bachelor of Arts Degree (Hons) - Economics - from the University of Ceylon, Peradeniya and a Masters Degree from the University of Strathclyde, UK.

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

Mr N G Wickremeratne and Mrs Rose C. Cooray retire at the AGM under Article 93 of the Articles of Association of the Bank and offer themselves for re-election under the said Article.

Mr D H S Jayawardena retires by rotation at the AGM and offers himself for re-election under Articles 86 and 87 of the Articles of Association of the Bank.

Mr Rienzie T. Wijetilleke and Mr M V Theagarajah - Directors retire at the AGM having attained the age of 70 years. Under the provisions of the Companies Act No 7 of 2007, a Director over 70 years who continues on the Board must be re-appointed by the Membership and such re-appointment must be made annually in respect of such Director. The two Directors have offered themselves to be re-appointed conforming to Section 211 of the Companies Act and two separate resolutions will be proposed to re-appoint Mr Wijetilleke and Mr Theagarajah, Directors of the Bank notwithstanding the age limit stipulated by Section 210 of the Companies Act of which due notice is given.

Under the Banking Act Direction No 11 of 2007 read together with Direction No 5 of 2008, the Directors are permitted to continue in Office for 3 years from 1st January 2009

The re-election / re-appointment of the aforesaid Directors is with the unanimous support of the Board.

### Board Committees

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

Audit Committee	- Comprises	- • Mr Ranjeevan Seevaratnam (Chairman) • Mr D H S Jayawardena • Ms Pamela C. Cooray • Mr N G Wickremeratne
The Report of the Audit Committee is given on page 148 which forms part of the Annual Report of the Board.		
Nomination Committee	- Comprises	- • Mr Rienzie T. Wijetilleke (Chairman) • Mr D H S Jayawardena • Mr M V Theagarajah • Mr R K Obeyesekere
The Report of the Nomination Committee is given on page 144 which forms part of the Annual Report of the Board.		
Remuneration Committee	- Comprises	- • Ms Pamela C. Cooray (Chairperson) • Mr Rienzie T. Wijetilleke • Mr R K Obeyesekere • Mr N G Wickremeratne
The Report of the Remuneration Committee is given on page 143 which forms part of the Annual Report of the Board.		
Integrated Risk Management Committee	- Comprises	- • Mr M V Theagarajah (Chairman) • Mr Rienzie T. Wijetilleke • Mr R K Obeyesekere • Mr R Theagarajah (MD / CEO) • Mr J D N Kekulawela (CFO) • Mr D P N Rodrigo (AGM - Risk and Compliance)
The Report of the Integrated Risk Management Committee is given on page 145 which forms part of the Annual Report of the Board.		
(Mr R Theagarajah, Mr J D N Kekulawela and Mr D P N Rodrigo represent the Management)		

## > Annual Report of the Board of Directors on the Affairs of the Company

### Directors' Meetings

The number of Directors' meetings which comprise Board meetings, Audit Committee meetings, Nomination Committee meetings, Remuneration Committee meetings and Integrated Risk Management Committee meetings and the attendance of Directors at these meetings are given on page 75 of the Annual Report.

### Directors' Responsibility for Financial Reporting

The Directors are responsible for the preparation of the Financial Statements of the Bank to reflect a true and fair view of the state of its affairs. The Directors are of the view that these Financial Statements have been prepared in conformity with the requirements of the Sri Lanka Accounting Standards, Companies Act No 7 of 2007, Sri Lanka Accounting and Auditing Standards Act No 15 of 1995, Banking Act No 30 of 1988 and amendments thereto and the Listing Rules of the Colombo Stock Exchange. The Statement of Directors' Responsibility for Financial Reporting is given on page 146 which forms an integral part of the Annual Report of the Board of Directors.

### Directors' Interest Register

The Bank maintains Directors' Interest Register conforming to the provisions of the Companies Act. The Directors of the Bank have disclosed their interests in other Companies to the Board and those interests are recorded in the interest register conforming to the provisions of the Companies Act. The particulars of those entries are set out on pages 141 and 142 of the Annual Report which form an integral part of the Annual Report of the Board.

### Directors' interests in the Ordinary Shares

The Shareholdings of Directors were as follows:-

	As at 31st December 2009	As at 31st December 2008
Mr Rienzie T. Wijetilleke	7,806	7,806
Mr Rajendra Theagarajah	18,644	18,644
Mr D H S Jayawardena	10,010	10,010
Mr M V Theagarajah	294,948	289,948
Mr R K Obeyesekere	10,010	10,010
Ms Pamela C. Cooray	46,599	46,599
Mr Ranjeevan Seevaratnam	500	500
Mr N G Wickremeratne	2,000	-

There has been no change in their interests in shares between 31st December 2009 and 15th February 2010, being the date of this Report.

### Related Party Transactions

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

### Directors' Remuneration

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

### Human Resources

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

### Employee Share Ownership Plan

The Bank established an Employee Share Ownership Plan in the year 2005 for the benefit of the staff members in the grade of Executive and above with the approval of the shareholders. Upto 31st December 2009 a total of 1,265 staff members have benefited from the scheme.

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

The loan outstanding as at end 2009 was Rs 136,518,000/=. The amount released to the employees who left the services of the Bank during 2009 is Rs 23,162,639/=.

### Employee Share Option Plan

In the year 2008 with the approval of the shareholders, the Bank formulated an Employee Share Option Plan for the staff in the Management grades, recognising and rewarding them for their contribution. The Scheme was aimed at motivating the Management staff further. This gives an option to the

Management staff to acquire ownership in the ordinary shares (both voting and non-voting) of the Bank, provided the Bank has met certain set profit goals. It is operative for 5 years and the Management staff has the option to purchase ordinary shares (voting and non-voting) of the Bank each year up to a limit of 1.25% of the shares issued up to a maximum of 5% of the shares issued. Based on the performance achieved for the year 2007, first option to purchase shares, has been offered to 175 Management officers. While the option to purchase shares is exercisable upto 1st October 2013, as at 31st December 2009, 19 Management officers have exercised the option (some fully some partly) and purchased shares.

The details of the options offered to the employees as at 31st December 2009 are as follows:

	Voting	Non voting
Number of options brought forward	2,246,902	548,282
Number of options exercised*	(191,215)	(49,532)
Number of options expired during the year	(92,489)	(22,607)
Number of options remaining	1,963,198	476,143
Allotment Price (Rs)	115.54	52.51
Closing Market Price as at exercise date		
ESOP Batch 1 (Rs)	167.50	86.00
ESOP Batch 2 (Rs)	169.00	89.00
ESOP Batch 3 (Rs)	160.00	82.25
ESOP Batch 4 (Rs)	165.00	88.00
ESOP Batch 5 (Rs)	168.50	104.50
*Number of options exercised		
ESOP Batch 1	33,733	10,706
ESOP Batch 2	27,202	9,293
ESOP Batch 3	43,605	10,620
ESOP Batch 4	30,224	5,310
ESOP Batch 5	56,451	13,603
Total Options Exercised	191,215	49,532

### Environmental Protection

The Bank has used its best endeavours to comply with the relevant environmental laws and regulations. The Bank has not engaged in any activity that is harmful or hazardous to the environment.

### Statutory Payments

The Board of Directors confirm that all statutory payments to the Government and the employees have been made up to date.

### Risk and Internal Control

The Board considers that strong internal controls are integral to the sound management of the Bank and it is committed to maintain strict financial, operational and risk management controls over all its activities.

The Directors are ultimately responsible for the Bank's system of internal control and for reviewing its effectiveness. Such a system is designed to manage, rather than eliminate, the risk of failure to achieve business objectives and can provide only reasonable and not absolute assurance against material misstatement or loss. There is an ongoing process for identifying, evaluating and managing the risks that are faced by the Bank, and the Directors have reviewed this process, through the Audit Committee.

The Board of Directors is satisfied with the effectiveness of the system of internal control for the year under review and up to the date of approval of the Annual Report and Financial Statements.

### Corporate Governance

In the management of the Bank, the Directors have placed emphasis in conforming to the best corporate governance practices and procedures. Accordingly, systems and structures have been introduced / improved from time to time to enhance risk management measures and to improve accountability and transparency. A separate report on governance is given on pages 58 to 75.

### Banking Act Directions on Corporate Governance

Under the Banking Act, the Monetary Board issued Direction No 11 of 2007 on Corporate Governance for Licensed Commercial Banks in Sri Lanka, which was amended by Direction No 5 of 2008. The aforesaid Directions mandated the licensed commercial banks to start conforming to the rules from 1st January 2008 and to be fully compliant by 1st January 2009, except where extended compliance dates have been expressly provided in the rules. As at 31st December 2009, the Bank was compliant with the said Directions of the Monetary Board on Governance.

### CSE Listing Rules on Corporate Governance

In March 2007, the Colombo Stock Exchange (CSE) introduced mandatory rules on corporate governance for listed companies. The rules mandated the listed companies to conform to those rules relating to the composition of the Board and Board Sub-Committees. Every listed company was required to comply with the rules from the financial year commencing on or after 1st April 2008.

## > Annual Report of the Board of Directors on the Affairs of the Company

### Code of Best Practice on Corporate Governance issued jointly by the Securities and Exchange Commission of Sri Lanka (SEC) and the Institute of Chartered Accountants of Sri Lanka (ICASL).

In June 2008 the SEC / ICASL jointly issued the Code which is adopted by the listed companies on a voluntary basis.

The Bank has adopted the best practices on corporate governance, in addition to conforming to the mandatory requirements, thereby ensuring long term sustainability and stability of the Bank.

### Compliance with Laws and Regulations

The Bank has at all times ensured that it complied with the applicable laws and regulations including the listing rules of the Colombo Stock Exchange as a listed company. The management officers responsible for compliance, table a report on compliance at the quarterly meetings of the Board Audit Committee.

### Auditors

The Bank's Auditors during the period under review were Messrs KPMG Ford, Rhodes, Thornton & Company (KPMG), Chartered Accountants.

Audit fees and reimbursement of expenses paid to KPMG during the year under review by the Bank and the Group amounted to Rs 7,401,000/= (2008 - Rs 5,855,000/=) and Rs 10,318,000/= (2008 - Rs 7,798,000/=) respectively. Further Rs 575,000/= (2008 - Rs 1,734,000/=) and Rs 575,000/= (2008 - Rs 1,809,000/=) were paid by the Bank and the Group respectively for Audit related and non-audit services including reimbursement of expenses.

Based on the declaration provided by Messrs KPMG Ford, Rhodes, Thornton & Company (KPMG), and as far as the Directors are aware, the Auditors do not have any relationship with or interest with the Bank that in our

judgment, may reasonably be thought to have a bearing on their independence within the meaning of the Code of Professional Conduct and Ethics issued by the Institute of Chartered Accountants of Sri Lanka, applicable on the date of this Report.

The retiring Auditors, KPMG Ford, Rhodes, Thornton & Company, have expressed their willingness to continue in office. A resolution relating to their re-appointment and authorising the Directors to fix their remuneration, will be proposed at the forthcoming Annual General Meeting.

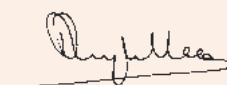
### Notice of Meeting

The 41st Annual General Meeting of the Bank is convened on Wednesday the 31st day of March, 2010, at 10.00 in the forenoon, at the Auditorium on Level 22 of "HNB Towers" (Registered Office), No 479, T B Jayah Mawatha, Colombo 10. The Notice of the 41st Annual General Meeting is on page 257 of the Annual Report.

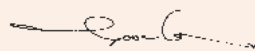
For and on behalf of the Board of Directors.



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



**Rienzie T. Wijetilleke**  
Chairman



**Indrani Goonesekera**  
Deputy General Manager (Legal) / Board Secretary

Colombo, Sri Lanka  
15th February 2010

## Directors' Interest in Contracts with the Bank

The Bank carries out transactions in the ordinary course of business at commercial rates with entities in which a Director of the Bank is the Chairman or a Director of such entities. The transactions with entities where a Director of the Bank either has control or exercises significant influence, have been classified as related party transactions and disclosed in Note 48 to the Financial Statements.

The transactions with entities where a Directors of the Bank neither have control nor exercise significant influence, but only hold directorships are disclosed below:

### 1 LENDING TRANSACTIONS WITH BANK

Company	Name of Director (Relationship)	Nature of Transaction	Aggregate Amount of Accommodation as at 31st December 2009		Security
			Limit (Rs Mn)	Outstanding (Rs Mn)	
Mahaweli Reach Hotels PLC	Mr Rienzie T. Wijetilleke (Director)	Overdraft	7.50	* 11.67	Immovable property Excess since reduced to Rs 3.13 Mn Arrears recovered in January 2010
		Term Loans	24.23	* 25.30	
		Term Loans	7.21	** 7.49	
		Term Loans	37.50	** 38.28	
		<b>Total</b>	<b>76.44</b>	<b>82.74</b>	
Convenience Foods (Lanka) Ltd	Subsidiary of Ceylon Biscuits Ltd in which company Mr Rienzie T. Wijetilleke is a Director	Overdraft	20.00	-	Negative pledge over the project assets
		Letters of Credit	80.00	64.63	
		Letters of Guarantee	23.00	20.80	
		Short Term Loan	(20.00)	-	
		Import Loan	(20.00)	-	
<b>Total</b>	<b>123.00</b>	<b>85.43</b>			
Watawala Plantations PLC	Subsidiary of Sunshine Holding PLC in which company Mr Rienzie T. Wijetilleke is the Chairman	Overdraft	100.00	15.09	Immovable property (leasehold), - machinery, equipment - leased etc
		Letters of Credit	5.00	5.00	
		Letters of Guarantee	15.00	5.66	
		Packing Credit	50.00	-	
		Short Term Money Market Loan	(50.00)	-	
		Term Loan 1	2.55	2.55	
		Term Loan 11	43.75	43.75	
		Revolving Lease	15.00	4.01	
		<b>Total</b>	<b>231.30</b>	<b>76.06</b>	
Swiss Biogenics Ltd	Subsidiary of Sunshine Holding PLC in which company Mr Rienzie T. Wijetilleke is the Chairman	Overdraft	(5.00)	0.41	Corporate Guarantee and inventories
		Letters of Credit	200.00	112.25	
		Import Loan	(100.00)	-	
		Letters of Guarantee	(10.00)	-	
		Forex Forward Contracts	(100.00)	-	
<b>Total</b>	<b>200.00</b>	<b>112.66</b>			
Sunshine Travels & Tours Ltd	Subsidiary of Sunshine Holding PLC in which company Mr Rienzie T. Wijetilleke is the Chairman	Overdraft	5.00	2.86	Cash deposit and Corporate Guarantee
		Letters of Guarantee	10.00	6.00	
		<b>Total</b>	<b>15.00</b>	<b>8.86</b>	
Sunshine Teas (Pvt) Ltd	Subsidiary of Swiss Biogenics Ltd which is a Subsidiary of Sunshine Holding PLC in which company Mr Rienzie T. Wijetilleke is the Chairman	Overdraft	(25.00)	*30.50	Inventories * Excess temporary, Regularised on 5th January 2010
		Letters of Credit	(50.00)	2.62	
		Letters of Guarantee	10.00	12.41	
		Term Loan	100.00	88.00	
		<b>Total</b>	<b>110.00</b>	<b>133.53</b>	
		Packing Credit Loan US \$ Mn	1.45	1.38	
		Export Bill Discounting US\$ Mn	(0.75)	-	
		Forex Forward Contracts US \$ Mn	0.60	0.30	
		<b>Total US \$ Mn</b>	<b>2.05</b>	<b>1.68</b>	
		New Nawaloka Hospitals (Pvt) Ltd	Subsidiary of Nawaloka Hospitals PLC in which company Mr Rienzie T. Wijetilleke is a Director	Letter of Credit	
Letter of Credit	130.00			85.20	
Term Loan	189.99			189.99	
Term Loan	9.98			9.98	
Term Loan	23.84			23.84	
Term Loan	75.00			75.00	
Overdraft	20.00			*30.73	
Temporary Overdraft	26.00			26.00	
<b>Total</b>	<b>484.81</b>			<b>443.03</b>	
Tea Smallholder Factories PLC	Mr R Seevaratnam (Director)	Overdraft	50.00	-	Immovable property
		Short Term Money Market Loan	(50.00)	-	
		<b>Total</b>	<b>50.00</b>	<b>-</b>	

## > Directors Interest in Contracts with the Bank

### 1 LENDING TRANSACTIONS WITH BANK (CONTD.)

Company	Name of Director (Relationship)	Nature of Transaction	Aggregate Amount of Accommodation as at 31st December 2009		Security
			Limit (Rs Mn)	Outstanding (Rs Mn)	
Diesel and Motor Engineering PLC	Mr R Seevaratnam (Director)	Letter of Credit	1,750.00	-	Immovable property, absolute ownership over leased assets
		Import Loans		476.19	
		Short Term Loan		432.76	
		Overdraft		25.09	
		Letter of Guarantee		-	
		Forward Exchange Contracts		-	
		Term Loan I		11.66	
		Term Loan II		41.88	
		Term Loan III		170.00	
		Leases		3.17	
		<b>Total</b>		<b>1,806.71</b>	
Shaw Wallace Marketing PLC	Mr R Seevaratnam (Director)	Overdraft	15.00	13.74	Immovable property, inventories and Corporate Guarantee
		Letter of Credit	270.00	143.83	
		Letter of Credit	40.00	4.10	
		Letter of Guarantee	5.00	0.20	
		Short Term Money Market Loan	100.00	297.00	
		Short Term Money Market Loan	200.00		
		Short Term Loan	20.00	20.00	
		Short Term Loan	20.00	20.00	
<b>Total</b>	<b>670.00</b>	<b>498.87</b>			
Acme Printing and Packaging PLC	Mr R Seevaratnam (Director)	Overdraft	5.00	5.00	Board Resolution
		Term Loan	4.37	4.37	
		Letter of Credit	15.00	2.99	
		Import Loan	(15.00)	10.83	
		Cheque Discounting	5.00	2.16	
		<b>Total</b>	<b>29.37</b>	<b>25.35</b>	
Dipped Products PLC*	Mr R Seevaratnam (Director)	Overdraft	20.00	0.34	Demand Promissory Note
		Overdraft	(30.00)	-	
		Export Loan	100.00	-	
		Short Term Money Market Loan	(100.00)	-	
		<b>Total</b>	<b>120.00</b>	<b>0.34</b>	
Kelani Valley Plantations PLC*	Mr R Seevaratnam (Director)	Overdraft	50.00	6.06	Title to goods imported
		Letter of Credit	(15.00)	-	
		<b>Total</b>	<b>50.00</b>	<b>6.06</b>	
Hayleys MGT Knitting Mills PLC*	Mr R Seevaratnam (Director)	Overdraft	15.00	11.75	Immovable property and machinery
		<b>Total</b>	<b>15.00</b>	<b>11.75</b>	
		Overdraft US\$ Mn	0.50	0.09	
		Import Letter of Credit US\$ Mn		0.02	
		Export Bills US\$ Mn		-	
		Import Bills US\$ Mn		0.03	
		Import Loans US\$ Mn		0.01	
		<b>Total US\$ Mn</b>	<b>0.50</b>	<b>0.15</b>	
Classic Teas (Pvt) Ltd	Mr R Seevaratnam (Director)	Short Term Export Loan	50.00	12.76	Inventories
		Negotiation of Documentary Bills	(50.00)	-	
		<b>Total</b>	<b>50.00</b>	<b>12.76</b>	

\* Mr N G Wickremeratne who was the Chairman of Dipped Products PLC, Kelani Valley Plantations PLC and Hayleys MGT Knitting Mills PLC retired from the said companies on 30th June 2009 and was appointed to Hatton National Bank PLC Board w.e.f. 1st July 2009. These facilities referred to herein have been granted prior to his appointment to the Board.

### 2 TRADING TRANSACTIONS WITH BANK

Company	Name of Director (Relationship)	Nature of Transaction	Amount (Rs Mn)
Diesel and Motor Engineering PLC	Mr R Seevaratnam (Director)	Repairs and maintenance of Vehicles	0.27
		Purchase of Motor Vehicles	49.92
		Purchase of Telephone System	1.25
Finlay Rentokil Ceylon (Pvt) Ltd	Subsidiary of Finlays Colombo PLC in which company Mr N G Wickremeratne is a Director	Pest Control Services	0.10



## Remuneration Committee Report

The Remuneration Committee, appointed by and responsible to the Board of Directors comprises four Non Executive Directors.

**Ms Pamela C. Cooray** Chairperson  
(IND / NED)

**Mr Rienzie T. Wijetilleke** (NED)

**Mr R K Obeyesekere** (NED)

**Mr N G Wickremeratne** (IND / NED)  
- appointed w.e.f. 3rd September 2009  
(IND - Independent Director and  
NED - Non Executive Director)

### Policy

The Bank's remuneration policy aims to attract, motivate and retain management in a highly competitive environment with the appropriate professional, managerial and operational expertise necessary to achieve the objectives of the Bank. It is the focus of the Committee to ensure that the total package is sufficiently competitive to attract the best talent for the benefit of the Bank.

The Bank's remuneration framework for the CEO and Corporate Management is designed to create and enhance value for all stakeholders of the Bank and to ensure alignment between the short and long-term interests of the Bank and its Executives. In designing competitive compensation packages, the Committee consciously balances the short-term performance with medium to long-term commitment to the Bank.

### Scope

The Committee reviews all significant Bank-wide changes in salary structures and terms and conditions relating to staff at senior executive level. In this decision making process, necessary information and recommendations are obtained from the CEO and DGM - Human Resources and Administration. The Committee deliberates and recommends to the Board of Directors the remuneration packages and annual increments and bonuses of the MD / CEO, members of the Corporate Management and senior executive staff.

The MD / CEO who is responsible for the overall management of the Bank attends all meetings by invitation and participates in the deliberations except when his own performance and compensation package is discussed.

Recruitment / promotions of staff at management level are also determined based on the proposals submitted by DGM - Human Resources and Administration and on the recommendations of the MD / CEO. When necessary, interviews are held to assess the core competencies of the proposed applicant.

### Fees

All Non Executive Directors receive a fee for attendance at Board meetings and serving on sub-committees, special committees and / or subsidiary boards. They do not receive any performance or incentive payments. The total remuneration to Directors is shown in Note 15 on page 175.

### Meetings

The Committee met twice during 2009. A report of the decisions approved and recommended to the Board by the Committee is circulated and affirmed by the Board of Directors.

Attendances at the meetings are given in table on page 75 of the Annual Report.

### Professional Advice

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

### Committee Evaluation

Self-assessment by Committee members was complied with at the commencement of 2009.



**Pamela C. Cooray**  
Chairperson  
Remuneration Committee

Colombo, Sri Lanka  
15th February 2010

## Nomination Committee Report

### Composition of the Nomination Committee

The Nomination Committee comprises four Non Executive Directors appointed by the Board of Directors of the Bank. The following Directors serve on the Nomination Committee:

**Mr Rienzie T. Wijetilleke** Chairman  
(NED)

**Mr D H S Jayawardena**  
(NED)

**Mr M V Theagarajah**  
(IND / NED)

**Mr R K Obeyesekere**  
(NED)

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

### The Primary Responsibilities of the Nomination Committee

The mandate of the Nomination Committee includes the following:

- 1 To establish a procedure to select / appoint new Directors
- 2 To consider and recommend (or not recommend) the re-election of current Directors, taking into account the performance and contribution made by the Director concerned.
- 3 To assess at the time of appointment and annually thereafter whether a director is fit and proper to hold office.
- 4 To recommend from time to time, the requirements of additional / new expertise and the succession arrangements for retiring Directors.
- 5 To look into and make recommendations to any other matters referred to it by the Board of Directors.

### Nomination Committee Meeting

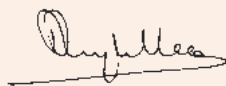
The Nomination Committee met once during the year under review to consider and recommend the appointment of additional Independent / Non Executive Directors to the Board and to assess the fitness and propriety of each of the Directors holding office in terms of the provisions of the Banking Act and the Directions of the Monetary Board relating to Corporate Governance. Attendance by the Committee members at the meeting is given in the table on page 75 of the Annual Report. The Chief Executive Officer also attended the meeting by invitation.

### Re-election / Re-appointment of Directors at the 41st Annual General Meeting

Since 3 Directors out of the 4 Nomination Committee members had to be re-elected / re-appointed at the 41st Annual General Meeting to be held on 31st March 2010, the Committee members had felt that the matter be decided by the Board.

### Committee Evaluation

The Committee commenced the evaluation process with self assessment in 2009, which was conducted by the Chairman and Committee Members and was deemed to be satisfactory.



**Rienzie T. Wijetilleke**  
Chairman  
Nomination Committee

Colombo, Sri Lanka  
15th February 2010

# The Board Integrated Risk Management Committee Report

## Composition

The Board Integrated Risk Management Committee (BIRMC) comprises six members of which three members are Non-Executive Directors.

**Mr M V Theagarajah** Chairman  
(IND / NED)

**Mr R T Wijetilleke** (NED)

**Mr R K Obeyesekere** (NED)

**Mr R Theagarajah** (CEO / MD)

**Mr J D N Kekulawela** (CFO)

**Mr D P N Rodrigo**  
(AGM - Risk and Compliance)  
(IND - Independent Director and  
NED - Non Executive Director)

## Terms of Reference

The Terms of Reference set out by the Board of Directors, includes the following:

- 1 To ensure that the Bank has a comprehensive risk management framework and appropriate compliance policies and systems in place.
- 2 To assess all risk types, including but not limited to: credit, market, liquidity, operational and strategic risks to the bank through appropriate risk indicators and management information.
- 3 To ensure risk decisions are taken in accordance with established delegated authorities and corrective actions are taken to mitigate risks taken beyond the risk tolerance set by the committee on the basis of bank's policies and regulatory and supervisory requirements.
- 4 To monitor and assess the effectiveness of the Bank's Risk Management System and the robustness of the risk management function.
- 5 To establish a compliance function to assess the Bank's compliance with laws, regulations, regulatory guidelines, internal controls and approved policies relating to all areas of business operations.
- 6 To review progress on Basel II Roadmap implementation.

## Meetings

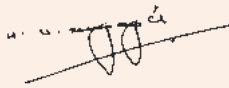
For the year four (4 nos) quarterly meetings were held.

Attendances at the meetings are given in table on page 75 of the Annual Report.

The discussions and conclusions reached at the meeting are recorded in minutes and circulated to the Board of Directors for information and advice.

## Committee Evaluation

An annual review to assess the contribution and effectiveness of the committee was carried out at the end of the fourth quarter and considered positive and constructive.



**M V Theagarajah**  
Chairman  
Integrated Risk Management  
Committee

Colombo, Sri Lanka  
15th February 2010

## Directors' Responsibility for Financial Reporting

The responsibility of the Directors in relation to the Financial Statements of the Bank and its subsidiaries prepared in accordance with the provisions of the Companies Act No 7 of 2007 is set out in the following statement. The responsibilities of the External Auditors in relation to the Financial Statements are set out in the Report of the Auditors given on page 149 of the Annual Report.

As per the provisions of the Companies Act No 7 of 2007 the Directors are required to prepare Financial Statements for each financial year and place them before a general meeting. The Financial Statements comprise the balance sheet as at 31st December 2009, and the income statement, statement of changes in equity and cash flow for the year then ended and notes thereto.

The Financial Statements of the Bank and its Subsidiaries give a true and fair view of:

- 1 the state of affairs of the Bank and its Subsidiaries as at balance sheet date; and
- 2 the profit or loss of the Bank and its Subsidiaries for the financial year ended on the balance sheet date.

In preparing these Financial Statements the Directors are required to ensure that:

- 1 the appropriate accounting policies have been selected and applied in a consistent manner and material departures, if any, have been disclosed and explained;
- 2 judgments and estimates have been made which are reasonable and prudent; and
- 3 all applicable Accounting Standards, as relevant, have been followed.

The Directors are also required to ensure that the Bank and its Subsidiaries have adequate resources to continue in operation to justify applying the going concern basis in preparing these Financial Statements.

Further, the Directors have a responsibility to ensure that the companies within the Group maintain sufficient accounting records to disclose, with reasonable accuracy the financial position of the Bank and its Subsidiaries.

Financial Statements prepared and presented in the Report are consistent with the underlying books of account and are in conformity with the requirements of Sri Lanka Accounting Standards, Companies Act No 7 of 2007, Sri Lanka Accounting and Auditing Standard Act No 15 of 1995, Banking Act No 30 of 1988 and amendments thereto and the Listing Rules of the Colombo Stock Exchange.

The Directors have also 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, prevent and detect frauds and other irregularities and secure as far as practicable the accuracy and reliability of the records.

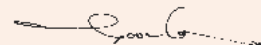
Directors are required to prepare the Financial Statements and to provide the Bank's External Auditors, Messrs KPMG Ford, Rhodes, Thornton & Company, with every opportunity to carry out whatever reviews and sample checks on the system of internal control they may consider appropriate and necessary for expressing their independent audit opinion on the Financial Statements.

Further, as required by Section 56 (2) of the Companies Act No 7 of 2007, the Directors have confirmed that the Bank, based on the information available, satisfies the solvency test immediately after the distribution of dividends, in accordance with Section 57 of the Companies Act No 7 of 2007, and has obtained a certificate from the Auditors, prior to declaring a final dividend of Rs 5.00 per share for this year, to be paid on 12th April 2010.

The Directors to the best of their knowledge and belief, are satisfied that all statutory payments in relation to all relevant regulatory and statutory authorities which were due and payable by the Bank and its Subsidiaries as at the Balance Sheet date have been paid or where relevant provided for.

The Directors are of the view that they have discharged their responsibilities as set out in this statement.

By Order of the Board



**Indrani Goonesekera**  
Deputy General Manager (Legal) /  
Board Secretary

Colombo, Sri Lanka  
15th February 2010

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

The Financial Statements of Hatton National Bank PLC (Bank) and the Consolidated Financial Statements of the Bank and its Subsidiaries as at 31st December 2009 are prepared in compliance with the Sri Lanka Accounting Standards issued by the Institute of Chartered Accountants of Sri Lanka, Companies Act No 7 of 2007, Sri Lanka Accounting and Auditing Standards Act No 15 of 1995, the Banking Act No 30 of 1988 and amendments thereto and the Listing Rules of the Colombo Stock Exchange. The Accounting Policies used in the preparation of the Financial Statements are appropriate and are consistently applied by the Group (material departures, if any, have been disclosed and explained in the notes to the Financial Statements). There are no departures from the prescribed Accounting Standards in their adoption. Comparative information has been reclassified wherever necessary to comply with the current presentation.

The significant accounting policies and estimates that involve a high degree of judgement and complexity were discussed with our External Auditors and the Audit Committee.

The Board of Directors and the Management of the Bank accept responsibility for the integrity and objectivity of these Financial Statements. The estimates and judgments relating to the Financial Statements were made on a prudent and reasonable basis, in order that the

Financial Statements reflect in a true and fair manner, the form and substance of transactions and that the Bank's state of affairs is reasonably presented. To ensure this, the Bank has taken proper and sufficient care in installing a system of internal control and accounting records, for safeguarding assets and for preventing and detecting frauds as well as other irregularities, which is reviewed, evaluated and updated on an ongoing basis. Our internal auditors have conducted periodic audits to provide reasonable assurance that the established policies and procedures of the Bank were consistently followed. However, there are inherent limitations that should be recognised in weighing the assurances provided by any system of internal controls and accounting.

The Financial Statements of the Group were audited by Messrs KPMG Ford, Rhodes, Thornton & Company ("KPMG"), Chartered Accountants, the independent auditors. Their report is given on page 149 of the Annual Report.

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

full and free access to the members of the Audit Committee to discuss any matter of substance.

The Audit Committee pre-approves the audit and non audit services provided by our external auditors, KPMG, in order to ensure that the provision of such services does not impair KPMG's independence.

We confirm that

- the Bank and its Subsidiaries have complied with all applicable laws, regulations and prudential requirements;
- there are no material non compliances ; and
- there are no material litigations that are pending against the Group other than those disclosed in the Notes 47 (e) to the Financial Statements in the Annual Report.



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



**Nihal Kekulawala**  
Chief Financial Officer

Colombo, Sri Lanka  
15th February 2010

## Audit Committee Report

### Committee Composition

The Audit Committee comprises of four Non Executive Directors, a majority of whom are independent including the Chairman. The Committee is chaired by Mr Ranjeevan Seevaratnam, who is a Fellow member of the Institute of Chartered Accountants of Sri Lanka and the Institute of Chartered Accountants in England and Wales.

The members of the Board appointed Audit Committee are;

**Mr Ranjeevan Seevaratnam**  
Chairman IND / NED

**Mr D H S Jayawardena**  
NED

**Ms P C Cooray**  
IND / NED

**Mr N G Wickremeratne**  
IND / NED  
(Appointed from 3rd September 2009)

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

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

### Meetings

The Audit Committee met six times during the year. Attendance by the Committee members at each of these meetings is given in the table on page 75 of the Annual Report. The Managing Director / Chief Executive Officer, Chief Financial Officer, External Auditor, Head of Internal Audit and the Assistant General Manager - Finance also attended these meetings by invitation.

### Financial Reporting

The Committee, as part of its responsibility to oversee the Bank's financial reporting process on behalf of the Board of Directors, has reviewed and discussed with the Management, the annual and the quarterly Financial Statements prior to their release, including the extent of compliance with the Sri Lanka Accounting Standards, the Companies Act No 7 of 2007, the Banking Act No 30 of 1988. Matters of special interest in the current environment and the processes that support certifications of the Financial Statements by the Bank's Chief Executive Officer and Chief Financial Officer were also brought up for discussion.

The Committee also confirmed with the Chief Financial Officer that financial reporting requirements

relating to the GDR listing have been complied with.

In addition to the above, the Committee specifically focused on evaluating the implications on the Financial Statements of the Bank due to any unresolved post migration issues relating to system migration (Finacle) which was completed by September 2009.

### Risks and Controls

During the year, the Committee reviewed the effectiveness of the Bank's internal control system and has reviewed quarterly reports on losses resulting from frauds or operational failures.

The Committee has reviewed the processes for identification, evaluation and management of all significant risks throughout the Bank and other Group entities. The Committee received and reviewed reports on all significant matters discussed by the Risk Committee.

### External Audit

The Audit Committee undertook the annual evaluation of the independence and objectivity of the External Auditor and the effectiveness of the audit process.

The Committee met with the External Auditor during the year to discuss their audit approach and procedures, including matters relating to the scope of the audit and Auditor's independence. The Lead Audit Partner is required to be rotated every five years, in order to ensure the independence of the Auditor.

The Committee reviewed the Management Letter issued by the External Auditor together with the management responses thereto.

The Audit Committee reviewed the Non-Audit Services provided by the External Auditor and was of the view that such services were not within the category of services identified as restricted under;

- 1 The guidelines issued by the Central Bank of Sri Lanka, for External Auditors, relating to their statutory duties in terms of section 39 of Banking Act No 30 of 1988 and as amended by Banking Act No 33 of 1995.

- 2 The Guidelines for Listed Companies on Audit and Audit Committees issued by the Securities and Exchange Commission of Sri Lanka.

The Letter of Representation issued to the External Auditor was tabled at the Audit Committee Meeting.

The Audit Committee has recommended to the Board of Directors the re-appointment of the External Auditor, KPMG Ford, Rhodes, Thornton & Company and fixed the Auditor's remuneration, for approval by the shareholders at the Annual General Meeting.

### Internal Audit

During the year, the Audit Committee reviewed the performance of the internal audit function, the findings of the audits completed and the Department's resource requirements including succession planning and also approved the internal audit plan.

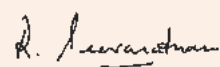
### Regulatory Compliance

The Committee reviewed the procedures established by Management for compliance with the requirements of regulatory bodies. Assistant General Manager - Risk and Compliance submitted to the Audit Committee on a quarterly basis, a report on the extent to which the Bank was in compliance with mandatory banking and statutory requirements. The committee also ensured the full compliance to the Colombo Stock Exchange Rule No 7.10 on Corporate Governance disclosure requirements and which is given on pages 58 to 75.

### Committee Evaluation

The annual evaluation of the Committee was conducted by the Non Executive Chairman, the Managing Director, the Chief Financial Officer, the Head of Internal Audit and the External Auditor in accordance with International best practices and was deemed to be satisfactory.

On behalf of the Audit Committee;



**R Seevaratnam**  
Chairman

Colombo, Sri Lanka  
15th February 2010

# Independent Auditors' Report



**KPMG Ford, Rhodes, Thornton & Co.**  
(Chartered Accountants)  
32A, Sir Mohamed Macan Markar Mawatha,  
P. O. Box 186,  
Colombo 00300,  
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## TO THE SHAREHOLDERS OF HATTON NATIONAL BANK PLC

### Report on the Financial Statements

We have audited the accompanying financial statements of Hatton National Bank PLC ("Company"), and the consolidated financial statements of the Company and its subsidiaries as at 31st December 2009, which comprise the balance sheet as at that date, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes as set out on pages 150 to 232 of this Annual Report.

### Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Sri Lanka Accounting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

### Scope of Audit and Basis of Opinion

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Sri Lanka Auditing Standards. Those standards require that we plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

We have obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purposes of our audit. We therefore believe that our audit provides a reasonable basis for our opinion.

### Opinion

In our opinion, so far as appears from our examination, the Company maintained proper accounting records for the year ended 31st December 2009 and the financial statements give a true and fair view of the Company's state of affairs as at 31st

December 2009 and its profit and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs as at 31st December 2009 and the profit and cash flows for the year then ended, in accordance with Sri Lanka Accounting Standards, of the Company and its subsidiaries dealt with thereby, so far as concerns the members of the Company.

### Report on Other Legal and Regulatory Requirements

1. These financial statements also comply with the requirements of Section 153(2) to 153(7) of the Companies Act No. 07 of 2007.

2. These financial statements present the information required by the Banking Act No. 30 of 1988.

*Ford Rhodes Thornton & Co.*

CHARTERED ACCOUNTANTS

15th February 2010  
Colombo, Sri Lanka.

## Income Statement

For the year ended 31st December	Note	BANK		GROUP	
		2009 Rs 000	2008 Rs 000	2009 Rs 000	2008 Rs 000
<b>INCOME</b>	9	<b>39,374,435</b>	<b>37,151,086</b>	<b>41,317,345</b>	<b>38,710,575</b>
Interest income	10	34,620,276	32,431,158	34,836,422	32,829,516
Less: Interest expenses	11	20,039,646	19,751,667	20,280,948	20,287,224
<b>Net interest income</b>		<b>14,580,630</b>	<b>12,679,491</b>	<b>14,555,474</b>	<b>12,542,292</b>
Foreign exchange profit		919,782	1,166,979	919,953	1,169,084
Fee and commission income	12	2,309,235	2,364,434	2,355,467	2,434,503
Dividend income	13	217,353	538,321	195,879	216,512
Other income	14	1,307,789	650,194	3,009,624	2,060,960
<b>Operating Income</b>		<b>19,334,789</b>	<b>17,399,419</b>	<b>21,036,397</b>	<b>18,423,351</b>
Less:					
<b>OPERATING EXPENSES</b>	15				
Personnel expenses	16	4,093,741	3,561,562	4,446,059	3,831,233
Premises, equipment and establishment expenses		2,848,503	2,421,673	2,648,960	2,184,135
Fee and commission expenses		107,794	52,990	317,022	49,859
Provision for employee retirement benefits	17	815,682	787,128	823,365	795,495
Provision for loan losses	18	708,227	1,159,238	708,227	1,159,238
Provision for fall in value of investments		2,038	253,840	2,038	259,535
Impairment of goodwill		-	-	5,199	-
Loans written off		285	372	285	372
Other expenses		4,841,000	4,377,968	5,926,098	5,651,957
		<b>13,417,270</b>	<b>12,614,771</b>	<b>14,877,253</b>	<b>13,931,824</b>
<b>PROFIT FROM OPERATIONS</b>		<b>5,917,519</b>	<b>4,784,648</b>	<b>6,159,144</b>	<b>4,491,527</b>
Share of profit / (loss) of associates (net of income tax)	19	-	-	7,680	(6,401)
<b>PROFIT BEFORE INCOME TAX</b>		<b>5,917,519</b>	<b>4,784,648</b>	<b>6,166,824</b>	<b>4,485,126</b>
Less: Income tax expense	20	1,565,867	1,565,668	1,613,464	1,599,300
<b>PROFIT FOR THE YEAR</b>		<b>4,351,652</b>	<b>3,218,980</b>	<b>4,553,360</b>	<b>2,885,826</b>
Attributable to:					
Equity holders of the Bank		4,351,652	3,218,980	4,483,277	2,830,538
Minority interest		-	-	70,083	55,288
<b>PROFIT FOR THE YEAR</b>		<b>4,351,652</b>	<b>3,218,980</b>	<b>4,553,360</b>	<b>2,885,826</b>
<b>BASIC EARNINGS PER SHARE (Rs)</b>	21	<b>18.47</b>	13.67	<b>19.03</b>	12.02
<b>DILUTED EARNINGS PER SHARE (Rs)</b>	21	<b>18.46</b>	13.67	<b>19.02</b>	12.02
<b>DIVIDEND PER SHARE (Rs)</b>		<b>*6.50</b>	4.00	<b>*6.50</b>	4.00

The Notes to the Financial Statements from pages 156 to 232 form an integral part of these Financial Statements.

\*Calculated on Interim dividend paid and final proposed, which is to be approved at the Annual General Meeting.



## Balance Sheet

As at 31st December	Note	BANK		GROUP	
		2009 Rs 000	2008 Rs 000	2009 Rs 000	2008 Rs 000
<b>ASSETS</b>					
Cash and cash equivalents	22	27,042,858	23,301,952	27,488,807	23,560,149
Statutory deposit with Central Banks	23	11,063,948	11,847,323	11,078,805	11,861,998
Government treasury bills		-	-	305,810	759,137
Dealing securities	24	39,485	71,868	687,731	81,419
Securities purchased under re-sale agreements		500,000	1,400,000	950,703	2,539,256
Non-current assets held for sale	25	-	1,455	2,875	1,455
Bills of exchange	26	1,476,044	2,186,868	1,476,044	2,186,868
Commercial papers		209,099	225,908	282,935	235,793
Lease rentals receivable within one year	27	3,931,110	4,449,827	3,931,110	4,449,827
Lease rentals receivable after one year	27	5,013,132	7,097,380	5,013,132	7,097,380
Loans and advances	28	159,184,398	161,073,463	156,391,674	159,233,389
Investment securities	29	53,959,680	25,915,717	55,847,723	26,970,786
Investments in Associates	30	203,806	132,326	226,129	143,700
Investment in Joint Venture	31	250,000	250,000	-	-
Investments in Subsidiaries	32	2,179,326	2,179,086	-	-
Investment properties	33	350,760	187,467	172,555	176,313
Property, plant and equipment	34	7,179,502	6,865,648	14,332,929	13,901,017
Intangible assets	35	675,272	727,598	710,009	753,384
Other assets	36	7,333,833	8,796,891	8,612,153	9,478,926
<b>Total Assets</b>		<b>280,592,253</b>	<b>256,710,777</b>	<b>287,511,124</b>	<b>263,430,797</b>
<b>LIABILITIES</b>					
Deposits from customers	37	210,506,805	186,769,862	210,363,145	186,614,541
Dividends payable	38	215,607	127,303	215,607	127,303
Securities sold under re-purchase agreements		8,684,999	8,799,953	9,413,416	9,649,139
Borrowings	39	8,581,089	15,401,290	8,584,401	15,401,290
Current tax liabilities		2,921,234	2,380,633	2,977,234	2,416,260
Bills payable		1,161,151	1,047,930	1,161,151	1,047,930
Subordinated debentures	40	2,673,192	2,754,851	2,653,192	3,734,851
Insurance provision - Life	41	-	-	1,853,513	1,360,505
Insurance provision - Non life	42	-	-	599,364	470,206
Deferred tax liabilities	43	939,253	872,402	938,366	872,664
Other liabilities	44	21,008,833	17,975,616	21,978,127	18,466,991
<b>Total Liabilities</b>		<b>256,692,163</b>	<b>236,129,840</b>	<b>260,737,516</b>	<b>240,161,680</b>
<b>EQUITY</b>					
Stated capital	46	5,084,084	5,059,390	5,084,084	5,059,390
Statutory reserve fund		1,260,000	982,707	1,260,000	982,707
Retained earnings		3,848,946	3,045,537	3,550,268	2,616,620
Other reserves		13,707,060	11,493,303	16,479,387	14,262,584
<b>Total Equity attributable to equity holders of the Bank</b>		<b>23,900,090</b>	<b>20,580,937</b>	<b>26,373,739</b>	<b>22,921,301</b>
Minority interest		-	-	399,869	347,816
<b>Total Equity</b>		<b>23,900,090</b>	<b>20,580,937</b>	<b>26,773,608</b>	<b>23,269,117</b>
<b>Total Liabilities and Equity</b>		<b>280,592,253</b>	<b>256,710,777</b>	<b>287,511,124</b>	<b>263,430,797</b>
Commitments and contingencies	47	63,027,220	68,065,957	63,039,700	68,087,091

The Notes to the Financial Statements from pages 156 to 232 form an integral part of these Financial Statements.

These Financial Statements are in compliance with the requirements of Companies Act No 7 of 2007.

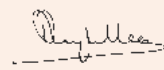


**Nihal Kekulawala**  
Chief Financial Officer

For and on behalf of the Board



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



**Rienzie T. Wijetilleke**  
Chairman



**Indrani Goonesekera**  
Deputy General Manager Legal /  
Board Secretary

## Statement of Changes in Equity

For the year ended 31st December 2009  
BANK

	Attributable to Equity Holders of the Bank							Minority Interest	Total	
	Stated Capital		Statutory Reserve Fund	Other Reserves						Retained Earnings
	Voting Shares	Non-Voting Shares		Capital Reserve	General Reserve	Repairs and Renovation Reserve	Exchange Equalisation Reserve			
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000			Rs 000
Balance as at 31st December 2007	2,881,387	2,178,003	821,707	3,001,440	6,782,353	6,700	-	2,747,440	-	18,419,030
Final dividend for 2007	-	-	-	-	-	-	-	(824,353)	-	(824,353)
Deferred tax liability for revaluation reserve [Note 43 (a)]	-	-	-	2,810	-	-	-	-	-	2,810
Profit for the year 2008	-	-	-	-	-	-	-	3,218,980	-	3,218,980
Interim dividend for 2008	-	-	-	-	-	-	-	(235,530)	-	(235,530)
Transfers during the year 2008	-	-	161,000	-	1,700,000	-	-	(1,861,000)	-	-
Balance as at 31st December 2008	2,881,387	2,178,003	982,707	3,004,250	8,482,353	6,700	-	3,045,537	-	20,580,937
Final dividend for 2008	-	-	-	-	-	-	-	(706,588)	-	(706,588)
Deferred tax liability for revaluation reserve [Note 43 (a)]	-	-	-	2,810	-	-	-	-	-	2,810
Profit for the year 2009	-	-	-	-	-	-	-	4,351,652	-	4,351,652
Interim dividend for 2009	-	-	-	-	-	-	-	(353,415)	-	(353,415)
Shares issued under ESOP	22,093	2,601	-	-	-	-	-	-	-	24,694
Transfers during the year 2009	-	-	277,293	-	2,217,647	(6,700)	-	(2,488,240)	-	-
Balance as at 31st December 2009	2,903,480	2,180,604	1,260,000	3,007,060	10,700,000	-	-	3,848,946	-	23,900,090

GROUP

	Attributable to Equity Holders of the Bank							Minority Interest	Total	
	Stated Capital		Statutory Reserve Fund	Other Reserves						Retained Earnings
	Voting Shares	Non-Voting Shares		Capital Reserve	General Reserve	Repairs and Renovation Reserve	Exchange Equalisation Reserve			
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000			Rs 000
Balance as at 31st December 2007	2,881,387	2,178,003	821,707	5,768,262	6,782,353	6,700	-	2,861,252	219,659	21,519,323
Final dividend for 2007	-	-	-	-	-	-	-	(824,353)	(15,002)	(839,355)
Deferred tax liability for revaluation reserve [Note 43 (a)]	-	-	-	2,810	-	-	-	-	-	2,810
Disposal of Subsidiaries	-	-	-	-	-	-	-	(154,287)	-	(154,287)
Investment in foreign Subsidiary	-	-	-	-	-	-	2,459	-	87,871	90,330
Profit for the year 2008	-	-	-	-	-	-	-	2,830,538	55,288	2,885,826
Interim dividend for 2008	-	-	-	-	-	-	-	(235,530)	-	(235,530)
Transfers during the year 2008	-	-	161,000	-	1,700,000	-	-	(1,861,000)	-	-
Balance as at 31st December 2008	2,881,387	2,178,003	982,707	5,771,072	8,482,353	6,700	2,459	2,616,620	347,816	23,269,117
Final dividend for 2008	-	-	-	-	-	-	-	(706,588)	(18,750)	(725,338)
Deferred tax liability for revaluation reserve [Note 43 (a)]	-	-	-	2,810	-	-	-	-	-	2,810
Disposal of Subsidiaries	-	-	-	-	-	-	-	(1,386)	-	(1,386)
Investment in foreign Subsidiary	-	-	-	-	-	-	3,046	-	981	4,027
Profit for the year 2009	-	-	-	-	-	-	-	4,483,277	70,083	4,553,360
Interim dividend for 2009	-	-	-	-	-	-	-	(353,415)	-	(353,415)
Shares issued under ESOP	22,093	2,601	-	-	-	-	-	-	-	24,694
Transfers during the year 2009	-	-	277,293	-	2,217,647	(6,700)	-	(2,488,240)	-	-
Pre acquisition portion of minority	-	-	-	-	-	-	-	-	(261)	(261)
Balance as at 31st December 2009	2,903,480	2,180,604	1,260,000	5,773,882	10,700,000	-	5,505	3,550,268	399,869	26,773,608

The Notes to the Financial Statements from page 156 to 232 form an integral part of these Financial Statements.

In accordance with Section 58 of Companies Act No 7 of 2007, share capital and share premium have been classified as stated capital. Statutory reserve fund represents the statutory requirement in terms of Section 20 (1) and (2) of the Banking Act No 30 of 1988.

Capital reserve relates to revaluation of freehold land and buildings carried out in 1989, 1993 and 2007 and includes the surplus on revaluation of those assets.

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

Exchange equalisation reserve consist of foreign exchange differences resulting from translation of foreign Subsidiary / Associate financial statements to functional currency of the Group (Sri Lankan Rupees)

Voting and non voting shares included under stated capital consist of share premium on shares issued of Rs 988 Mn and Rs 1,716 Mn respectively.

## Cash Flow Statement

For the year ended 31st December	BANK		GROUP	
	2009 Rs 000	2008 Rs 000	2009 Rs 000	2008 Rs 000
<b>Cash Flows from Operating Activities</b>				
Interest and commission receipts	32,045,976	33,787,646	32,119,597	33,869,362
Interest payments	(16,131,045)	(18,665,015)	(16,372,345)	(19,191,542)
Receipts from other operating activities	1,025,579	1,366,492	2,642,197	2,856,486
Cash payments to employees	(5,257,678)	(4,058,190)	(5,609,996)	(4,327,861)
Cash payments to suppliers	(2,097,494)	(1,849,312)	(1,745,903)	(1,463,871)
Recoveries from loans written off in previous years	7,283	7,224	7,283	7,224
Cash payments to other operating activities	(2,678,562)	(2,602,476)	(3,343,008)	(3,263,858)
<b>Operating Profit before Changes in</b>				
<b>Operating Assets and Liabilities [Note (a)]</b>	<b>6,914,059</b>	<b>7,986,369</b>	<b>7,697,825</b>	<b>8,485,940</b>
<b>(Increase) / Decrease in Operating Assets</b>				
Commercial papers and reverse repos	916,809	2,060,503	1,599,037	2,996,267
Deposits held for regulatory or monetary control purpose	783,375	1,558,533	783,193	1,543,858
Loans and advances	4,523,478	(15,209,555)	5,476,130	(14,899,487)
Other short term assets	4,317,018	(2,332,293)	3,763,223	(2,172,831)
	10,540,680	(13,922,812)	11,621,583	(12,532,193)
<b>Increase / (Decrease) in Operating Liabilities</b>				
Deposits from customers	22,567,117	10,861,340	22,578,778	10,798,976
Negotiable certificates of deposits	1,169,826	248,948	1,169,824	248,947
Other liabilities	(2,556,921)	(169,305)	(2,064,820)	(429,218)
	21,180,022	10,940,983	21,683,782	10,618,705
<b>Net Cash Generated from</b>				
<b>Operating Activities before Income Tax</b>	<b>38,634,761</b>	<b>5,004,540</b>	<b>41,003,190</b>	<b>6,572,452</b>
Income taxes paid	(955,605)	(457,614)	(983,976)	(525,964)
<b>Net Cash Generated from Operating Activities</b>	<b>37,679,156</b>	<b>4,546,926</b>	<b>40,019,214</b>	<b>6,046,488</b>
<b>Cash Flows from Investing Activities</b>				
Dividend receipts	202,365	509,666	180,891	187,857
Net proceeds from sale of dealing securities	275,701	254,282	12,012	(1,988,050)
Net purchase of investment securities	(25,230,971)	(4,615,290)	(25,902,385)	(4,704,203)
Purchase of property, plant and equipment	(1,071,026)	(1,353,675)	(1,163,844)	(1,373,369)
Purchase of intangible assets	(110,432)	(551,126)	(126,378)	(562,895)
Improvements to investment properties	(663)	-	(663)	(88)
Investment in Associate company	(12,860)	(56,121)	(12,860)	-
Net cash effect on investment in Subsidiary company [Note (b)]	(240)	-	471	-
Net cash effect on disposal of DNH Financial (Pvt) Ltd (former HNB Stockbrokers (Pvt) Ltd) [Note (c)]	-	-	43,474	-
Net cash effect on disposal of Subsidiary companies [Note (d)]	-	-	-	(32,599)
Net cash effect on investment in Joint Venture [Note (e)]	-	-	-	98,127
Proceeds from sale of property, plant and equipment	19,663	14,782	24,724	14,941
<b>Net Cash used in Investing Activities</b>	<b>(25,928,463)</b>	<b>(5,797,482)</b>	<b>(26,944,558)</b>	<b>(8,360,279)</b>
<b>Cash Flows from Financing Activities</b>				
Decrease in debentures	(127,627)	(1,910,295)	(1,127,629)	(1,895,295)
(Increase) / decrease of long term borrowings	(6,935,155)	8,266,998	(7,052,612)	9,471,822
Dividends paid	(971,699)	(962,901)	(990,451)	(977,909)
Proceeds from issue of shares under ESOP	24,694	-	24,694	-
<b>Net Cash Generated from / (used in) Financing Activities</b>	<b>(8,009,787)</b>	<b>5,393,802</b>	<b>(9,145,998)</b>	<b>6,598,618</b>
Net increase in cash and cash equivalents	3,740,906	4,143,246	3,928,658	4,284,827
Cash and cash equivalents at the beginning of the year	23,301,952	19,158,706	23,560,149	19,275,322
<b>Cash and Cash Equivalents at the End of the Year</b>	<b>27,042,858</b>	<b>23,301,952</b>	<b>27,488,807</b>	<b>23,560,149</b>

## > Cash Flow Statement

For the year ended 31st December	BANK		GROUP	
	2009 Rs 000	2008 Rs 000	2009 Rs 000	2008 Rs 000
<b>Note (a) Reconciliation of operating profit</b>				
Profit before taxation	5,917,519	4,784,648	6,166,824	4,485,126
Dividend income	(217,353)	(538,321)	(195,879)	(216,512)
Profit on sale of property, plant and equipment	(11,917)	(7,979)	(13,157)	(8,030)
Bad debts recovered	(736,571)	(296,019)	(736,571)	(296,019)
Depreciation of property, plant and equipment	579,993	479,721	722,872	613,845
Amortisation of intangible assets	166,636	91,446	175,765	102,017
Depreciation of investment properties	4,380	1,194	4,421	4,403
Bad debts written off	285	372	285	372
Provision for loan losses	708,227	1,159,238	708,227	1,159,238
(Gain) / loss on marked to market valuation	(17,451)	14,674	(25,696)	14,674
Provision for diminution in value of investment	2,038	253,840	2,038	259,535
(Profit) / loss from sale of dealing securities	(11,787)	154	(11,787)	154
Loss on FCBU revaluation	16,572	46,290	16,572	46,290
Profit from sale of subsidiaries	-	(154,287)	(67,659)	(77,113)
Recovery of unclaimed VAT written off	(200,309)	-	(200,309)	-
Recovery of Aquila investment	(216,674)	-	(216,674)	-
Discount accrual on treasury bills and bonds	(2,812,437)	(665,405)	(3,001,192)	(1,052,116)
Share of Associate (profit) / loss	-	-	(7,680)	6,401
Non life insurance reserve fund	-	-	622,166	609,476
Accrual for interest receivable	(2,071,098)	(342,541)	(2,071,098)	(342,541)
Accrual for interest payable	3,908,601	1,086,652	3,908,601	1,095,681
Accrual for expenses	1,905,405	2,072,692	1,912,557	2,081,059
Impairment of goodwill	-	-	5,199	-
<b>Operating Profit before Changes in Operating Assets and Liabilities</b>	<b>6,914,059</b>	<b>7,986,369</b>	<b>7,697,825</b>	<b>8,485,940</b>

### Note (b) Net cash effect on investment in Subsidiary company - Commercial Interlink Services Inc (o/a Delma Exchange Canada)

	2009 Rs 000
Cash and cash equivalents	711
Trade and other receivables	249
Property, plant and equipment	3,855
Trade and other payables	(9,774)
<b>Net identifiable assets and liabilities</b>	<b>(4,959)</b>
Goodwill on acquisition	5,199
Consideration paid in cash	(240)
Cash acquired	711
<b>Net cash inflow</b>	<b>471</b>

**Note (c) Net cash effect on disposal of DNH Financial (Pvt) Ltd  
[former HNB Stockbrokers (Pvt) Ltd]**

	2009 Rs 000
Property, plant and equipment	461
Reverse re-purchase agreements	1,137
Trade and other receivables	37,360
Deferred tax asset	1,214
Cash and cash equivalents	34,534
Retirement benefit obligation	(59)
Current taxation	(95)
Trade and other payables	(23,165)
<b>Net identifiable assets and liabilities</b>	<b>51,387</b>
Consideration received in cash	78,008
Cash disposed off	(34,534)
<b>Net cash inflow</b>	<b>43,474</b>

2008  
Rs 000

**Note (d) Net identifiable assets / liabilities of  
disposed Subsidiaries as at the date of disposal**

Property, plant and equipment	12,630
Intangible assets	6,971
Reverse re-purchase agreements	486,533
Investment securities	3,468,341
Trade and other receivables	183,767
Cash and cash equivalents	32,599
Employee retirement benefits	(3,563)
Payable under re-purchase agreements	(3,571,635)
Trade and other payables	(150,935)
Current and deferred taxation	(64,708)
<b>Net identifiable assets and liabilities</b>	<b>400,000</b>
Share of net assets of Acuity Securities Ltd since classified as long term investment	(150,000)
	<b>250,000</b>

**Note (e) Bank's share of net identifiable assets / liabilities of  
investment in Joint Venture as at the date of investment**

Property, plant and equipment	12,231
Intangible assets	2,735
Investment securities	887,269
Reverse re-purchase agreements	162,233
Trade and other receivables	383,596
Cash and cash equivalents	98,127
Employee retirement benefits	(2,518)
Payable under re-purchase agreements	(892,909)
Trade and other payables	(385,796)
Current and deferred taxation	(14,968)
<b>Net identifiable assets and liabilities</b>	<b>250,000</b>

The Notes to the Financial Statements from pages 156 to 232 form an integral part of these Financial Statements.

## Notes to the Financial Statements

### 1. REPORTING ENTITY

Hatton National Bank PLC ("Bank") is a public quoted company incorporated on 5th March 1970 with limited liability and domiciled in Sri Lanka. The registered office of the Bank is situated at No 479, T B Jayah Mawatha, Colombo 10. The shares of the Bank have a primary listing on the Colombo Stock Exchange, while the Global Depository Receipts (GDRs) issued by the Bank have a primary listing on the Luxemburg Stock Exchange.

The staff strength of the Bank as at 31st December 2009 is 4,302 (2008 - 4,395).

The Consolidated Financial Statements of the Bank for the year ended 31st December 2009 include the Bank and its Subsidiaries (together referred to as the "Group" and individually as "Group entities") and the Group's interest in its Associates and Joint Venture.

The Bank does not have an identifiable parent of its own.

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

#### 1.1 Principal Activities

##### 1.1.1 Bank

The principal activities of the Bank continued to be banking and related activities such as accepting deposits, corporate and retail banking, personal financial services, off shore banking, foreign currency operations, trade services, investment banking, development banking, rural finance, project finance, dealing in government securities etc.

##### 1.1.2 Subsidiaries

Name of Subsidiary	Principle Activities
HNB Assurance PLC	Insurance services
Sithma Development (Pvt) Ltd	Property development
Majan Exchange LLC	Provision of remittances and foreign currency related services
Commercial Interlink Services Inc (o/a Delma Exchange Canada)	Provision of remittances and foreign currency related services

##### 1.1.3 Associates

Name of Associate	Principle activities
Lanka Ventures PLC	Provision of venture capital services
Delma Exchange	Provision of remittances and foreign currency related services

##### 1.1.4 Joint Venture

The joint venture of the Bank is Acuity Partners (Pvt) Ltd and its principal activities are operating as an investment company and providing financial services.

### 2. BASIS OF PREPARATION

#### 2.1 Statement of Compliance

The Balance Sheet, Income Statement, Statement of Changes in Equity and Cash Flow Statement have been prepared in accordance with the Sri Lanka Accounting Standards laid down by the Institute of Chartered Accountants of Sri Lanka, and comply with the requirements of Companies Act No 7 of 2007 and Banking Act No 30 of 1988 and amendments thereto.

#### 2.2 Approval of Financial Statements by Directors

The Financial Statements were authorised for issue by the Board of Directors on 15th February 2010.

#### 2.3 Basis of Measurement

The Financial Statements have been prepared on the historical cost basis and applied consistently with no adjustments being made for inflationary factors affecting the Financial Statements, except for the following;

- Land and buildings are measured at cost at the time of acquisition and subsequently at revalued amounts, which are the fair values at the date of revaluation less accumulated depreciation and impairment losses, if any.
- Dealing securities are measured at market value.
- Non-current assets held for sale are measured at lower of its carrying amount and fair value less costs to sell.

## 2.4 Functional and Presentation Currency

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

## 2.5 Use of Estimates and Judgements

The preparation of Financial Statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected. Information about significant areas of estimation and uncertainty that have the most significant effect on the amounts recognised in the Financial Statements are described in Notes 2.5.1 to 2.5.5.

### 2.5.1 Provision for Loan Losses

In addition to the specific provisions for possible loan losses made on the basis of continuous review of all loans and advances to customers in accordance with the Sri Lanka Accounting Standard 23 "Revenue Recognition and Disclosures in the Financial Statements of Banks" and the directions issued by the Central Bank of Sri Lanka, the Bank evaluates the need for additional provisions for loans and advances based upon management's best estimate of recoverability. In estimating the recoverability the management makes judgments about the borrower's financial situation, the workout strategy and the net realisable value of any underlying collateral.

The general provisions cover loan losses inherent in portfolios with similar credit risk characteristics (portfolios of pawning, lease receivables and Shanthy Housing loans) when there is objective evidence to suggest that they contain impaired loans, but the individual impaired loans cannot yet be identified. In assessing the need for general provision for loan losses, management considers factors such as credit quality, portfolio size, concentrations, and economic factors. In order to estimate the required provisions, assumptions are made to define the way inherent losses are determined based on historical experience.

## 2.5.2 Classification of Dealing (Trading) and Investment Securities

In classifying securities as "Dealing" (Trading), the Bank has determined that it meets the description set out in Note 4.6.1.

In classifying securities as "Investment", the Bank has determined that it has both the positive intention and ability to hold the securities until their maturity date as required by Note 4.6.2.

## 2.5.3 Assessment of Impairment

The Bank assesses at each Balance Sheet date whether there is objective evidence that an asset or portfolio of assets is impaired. The recoverable amount of an asset or cash generating unit (CGU) is the greater of its value in use and its fair value less costs to sell.

In assessing value in use, the estimated future cash flows are discounted to present value using appropriate discount rates that reflects the current market assessments of the time value of money and risks specific to the asset.

The carrying value of goodwill is reviewed at each Balance Sheet date and is written down to the extent that it is no longer supported by probable future benefits. Goodwill is allocated to CGU for the purpose of impairment testing.

## 2.5.4 Employee Retirement Benefits

The liability as at Balance Sheet date was actuarially valued based on the assumptions set out in Note 45 (a) v.

## 2.5.5 Classification of Investment Property

Classification of investment property is based on the description set out in Note 4.11.

## 3. MATERIALITY AND AGGREGATION

Each material class of similar items is presented separately in the Financial Statements. Items of dissimilar nature or function are presented separately unless they are immaterial.

## 4. SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below have been applied consistently to all periods presented in these Financial Statements. The accounting policies of the Bank have been consistently applied by Group entities where applicable and deviations if any, have been disclosed accordingly.

## > Notes to the Financial Statements

### 4.1 Basis of Consolidation

#### 4.1.1 Subsidiaries

Subsidiaries are entities that are controlled by the Bank. Control exists when the Bank has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights, that presently are exercisable are taken into account. The financial statements of Subsidiaries are included in the Consolidated Financial Statements from the date that control effectively commences until the date that control effectively ceases.

The Minority Interest is presented in the Consolidated Balance Sheet within equity, separately from the equity attributable to the Equity Holders of the Bank. Minority Interest in the profit or loss of the Group is disclosed separately in the Consolidated Income Statement.

The Consolidated Financial Statements are prepared to common financial year end of 31st December. The accounting policies of Subsidiaries have been changed where ever necessary to align them with the policies adopted by the Bank.

The carrying amount of the investment at the date that such entity ceases to be a Subsidiary would be regarded as the cost on initial measurement of a financial asset in accordance with Sri Lanka Accounting Standard 22 "Accounting for Investments".

A list of Subsidiaries within the Group is provided in Note 32.

#### 4.1.2 Associates

Associates are entities in which the Bank has significant influence, but no control over the financial and operating policies. Significant influence is presumed to exist when the Bank holds between 20 and 50 percent of the voting power of another entity. The Associates are accounted for using the equity method and are recognised initially at cost. The Bank's investments include goodwill identified on acquisition, net of any accumulated impairment losses. The Consolidated Financial Statements include the Bank's share of the income and expenses and equity movements of the Associates, after adjustments being made to align the accounting policies with those of the Group from the date that significant influence effectively

commences until the date that significant influence effectively ceases.

When the Bank's share of losses exceeds its interest in the Associate, the carrying amount of that interest is reduced to nil and the recognition of further losses is discontinued except to the extent that Bank has an obligation or made payments on behalf of the Associate. If the Associate subsequently reports profits, the Bank resumes recognising its share of those profits only after its share of the profits equals the share of losses not recognised.

The Bank discontinues the use of the equity method from the date that it ceases to have significant influence over an Associate and re-classifies the investment as "Investment Securities" in accordance with Sri Lanka Accounting Standard 22 "Accounting for Investments".

Financial year end of Lanka Ventures PLC is 31st March. The Bank obtains a set of reviewed financial statements of the company as at 31st December which is in line with Group year end.

A list of Associates within the Group is provided in Note 30.

#### 4.1.3 Joint Venture

Joint Venture is an entity over whose activities the Bank has joint control, established by contractual arrangement and requiring unanimous consent for strategic, financial and operating decisions. The Bank recognises its interest in the Joint Venture using the line by line reporting format for proportionate consolidation method and is recognised initially at cost.

The Bank combines its share of each of the assets, liabilities, income and expenses of the Joint Venture with similar items, line by line in the Consolidated Financial Statements from the date that joint control commences, until the date joint control ceases.

Details of the Joint Venture are provided in Note 31.

#### 4.1.4 Transactions Eliminated on Consolidation

Intra-group balances and transactions, income, expenses and any unrealised gains arising from



intra-group transactions and transactions with Joint Venture are eliminated in preparing the Consolidated Financial Statements. Unrealised gains arising from transactions with Associates are eliminated to the extent of the Group's interest in the Associates against the investment in the Associate. Unrealised losses are eliminated in the same way as unrealised gains except that they are only eliminated to the extent that there is no evidence of impairment.

#### 4.2 Foreign Currency Translation

Transactions in foreign currencies are translated to Sri Lankan Rupees at the middle rate of exchange ruling at the dates of the transactions.

Monetary assets and liabilities denominated in foreign currencies at the Balance Sheet date are translated to Sri Lankan Rupees at the middle rate of exchange ruling at that date. Foreign exchange differences arising on the settlement or reporting of the Bank's monetary items at rates different from those which were initially recorded are dealt with in the Income Statement.

Non-monetary assets and liabilities denominated in foreign currency that are stated at historical cost at the Balance Sheet date are translated to Sri Lankan Rupees at the foreign exchange rates ruling at the date of the initial transaction.

The Financial Statements of foreign entities within the Group whose functional currency is different to presentation currency, (Sri Lankan Rupees) are translated to Sri Lankan Rupees using the following procedures.

Assets and liabilities are translated at the middle rate of exchange at the date of Balance Sheet.

Income and expenses are translated at the middle rate of exchange ruling during the period under consideration.

All resulting foreign exchange differences are recognised directly in equity.

The Income Statement and the Balance Sheet of the Foreign Currency Banking Unit is translated to Sri Lankan Rupees at the middle rate of exchange ruling at the Balance Sheet date.

Forward exchange contracts are valued at the forward market rates ruling on the date of the Balance Sheet. Resulting net unrealised gains and losses are dealt with through the Income Statement.

## ASSETS AND BASES OF THEIR VALUATION

### 4.3 Cash and Cash Equivalents

Cash and cash equivalents include cash in hand, balances with banks, placements with banks, money at call and short notice. They are brought to account at the face value or the gross value where appropriate.

### 4.4 Statutory Deposit with Central Banks

The Monetary Law Act requires that all commercial banks operating in Sri Lanka maintain reserves against all deposit liabilities denominated in Sri Lankan Rupees. The licensing regulations for Exchange Houses issued by the Central Bank of Oman require that all Exchange Houses maintain a deposit with the Central Bank of Oman.

The details of reserve requirements are given in Note 23.

### 4.5 Government of Sri Lanka Treasury Bills and Bonds

#### 4.5.1 Investment in Treasury Bills and Treasury Bonds Held for Dealing

Investments in treasury bills and treasury bonds in dealing portfolio are those investments that the Group acquires or incurs principally for the purpose of selling, or holds as part of a portfolio that is managed for short term profit. These investments are initially recognised and subsequently measured at market value in the Balance Sheet. Gains and losses on marked to market valuation are dealt with through the Income Statement.

#### 4.5.2 Securities Purchased under Re-sale Agreements

Securities purchased under re-sale agreements are recorded separately in the Financial Statements at cost. The difference between the purchase and sale price represents interest income and is recognised in the Income Statement over the period of the resale agreement.

### 4.6 Investments

An investment is an asset held by the Bank / Group for the accretion of wealth through distribution (such as interest, royalties, dividends and rentals) for capital appreciation or for other benefits to the Bank / Group such as those obtained through trading relationships.

## > Notes to the Financial Statements

### 4.6.1 Dealing (Trading) Securities

Dealing (trading) securities are those investments that are acquired or incurred principally for the purpose of selling or holding as part of a portfolio that is managed for short term profit. These investments are initially recognised at cost and subsequently measured at market value. Gains and losses on marked to market valuations are dealt with through the Income Statement.

The Bank's Subsidiary HNB Assurance PLC measures dealing securities at cost / market value whichever is lower.

### 4.6.2 Investment Securities

These are securities which are acquired and held for yield or capital growth in the medium / long term with the positive intent and ability to hold until maturity. Such securities are recorded at cost. Interest and dividend income are accrued. Changes in market values of these securities are not taken into account, unless there is considered to be a diminution in value which is other than temporary.

Investments in treasury bills / bonds in the investment portfolio are initially measured at market value of bills / bonds at the date of purchase and the discount / premium accrued thereon.

On disposal of an investment the difference between net disposal proceeds and the carrying amount is recognised as income or expense.

### 4.6.3 Investments in Subsidiaries

Investments in Subsidiaries are stated at cost in the Bank's Financial Statements.

### 4.6.4 Investments in Associates

Investments in Associates are accounted for at cost in the Bank's Financial Statements and under the equity method in the Consolidated Financial Statements.

Under the equity method, the investments in Associates are initially accounted for at cost and the carrying amount is adjusted for post acquisition changes in the Bank's share of net assets of the Associates, less any impairment in the Bank's net investments in Associates.

### 4.6.5 Investment in Joint Venture

Investment in Joint Venture is accounted for at cost in the Bank's Financial Statements and under the proportionate consolidation method in the Consolidated Financial Statements.

### 4.7 Non-current Assets Held for Sale

Non-current assets that are expected to be recovered primarily through sale rather than through continuing use are classified as "Held for Sale" once identified that the carrying amount will be recovered principally through a sale transaction rather than through continuing use. These are assets which are available for immediate sale in their present condition, subject to only the terms that are usual and customary for sale of such assets and their sale is highly probable.

"Non-Current Assets Held for Sale" are presented separately on the face of the Balance Sheet at the lower of its carrying amount and fair value less costs to sell.

Assets classified as "Non-Current Assets Held for Sale" are neither amortised nor depreciated.

Impairment losses on initial classification as held for sale and subsequent gains and losses on remeasurement are recognised in the Income Statement.

### 4.8 Loans and Advances to Customers

Loans and advances to customers are stated in the Balance Sheet at the recoverable amount represented by the gross value of the outstanding balance adjusted for provision of loan losses and interest in suspense (interest which is not accrued to revenue).

#### 4.8.1 Non Performing Loans and Advances

The loans and advances are classified as Non Performing Advances (NPA) based on the criteria set out in Direction No 3 of 2008 dated 8th May 2008, issued by the Central Bank of Sri Lanka on "Classification of Loans and Advances, Income Recognition and Provisioning". Details of the criteria referred to above are given in Note 28 (c).

Provision for possible loan losses are made on the basis of a continuous review of all loans and advances to customers in accordance with the Sri Lanka Accounting Standard 23, "Revenue Recognition and Disclosures in the Financial

Statements of the Banks” and the Directions issued by the Central Bank of Sri Lanka and disclosed in the Financial Statements of the Bank.

#### 4.8.2 Foreclosed Properties

Foreclosed properties represent properties acquired in full or partial settlement of loans and advances up to 2001 and are yet to be disposed. From 2001 onwards this practice was discontinued whereby loans and advances in satisfaction of which properties are acquired, continue to be classified as non-performing loans and advances. These are accounted for at the lower of cost or market value on an individual property basis. The shortfall between the prevailing market value of the property and the related loan outstanding is recognised as a provision for loan losses in the Income Statement during the year of acquiring the said property in satisfaction of the loan. Any shortfall between the carrying amount of these properties and their respective market values identified subsequently is charged as a provision for loan losses in the Income Statement.

Subsequent recoveries on the disposal of the said properties are treated as provisions written back and any shortfall between capital outstanding and amount recovered if not provided is charged to the Income Statement. These properties are recorded under loans and advances until those are disposed off.

#### 4.8.3 Provision for Loan Losses

##### 4.8.3 (a) Specific Provisions for Loan Losses are Made as Follows:

In accordance with the Direction No 3 of 2008 dated 8th May 2008, issued by the Central Bank of Sri Lanka on “Classification of Loans and Advances, Income Recognition and Provisioning” specific provisions on NPA are made as follows.

Category of NPA Credit Quality	Minimum Specific Provision Requirement
Substandard	
Credit Cards	25%
Other Advances	20%
Doubtful	50%
Loss	100%

The provision made relates to all categories of loans and advances including pawning and leasing identified as substandard, doubtful and loss.

Where necessary, specific provisions have been made over and above the minimum percentages stipulated above, on a case by case basis.

#### 4.8.3 (b) General Provision

The amount of potential losses not specifically identified but which experience indicates are present in the portfolio of pawning, lease receivables and Shanthi Housing loans are recognised as a general provision in the Income Statement. Accordingly, a general provision of 0.1% of the total portfolio of pawning facilities, 2% of the lease receivables (net of specific provision) and 0.2% of the total portfolio of Shanthi Housing loans is made in the Income Statement.

The Direction issued by the Monetary Board of the Central Bank of Sri Lanka on 5th December 2006, in terms of Section 46 of the Banking Act No 30 of 1988, as amended, in "Requirements to Maintain a General Provision for Advances" requires all licensed commercial banks to maintain a general provision of 1% of the total on balance sheet performing loans and advances and on balance sheet overdue loans and advances, net of interest in suspense and credit facilities secured by cash deposits, gold or Government Securities with the same bank. This policy was reiterated by the Direction issued on 8th May 2008 on “ Classification of Loans and Advances, Income Recognition and Provisioning”. The general provision was commenced with a minimum of 0.1% provision as at 31st December 2006 and thereafter incremental provisions were being made on the same basis till 31st March 2009, with the view of meeting the total provision requirement of 1% not later than 31st March 2009.

Thereafter the said 1% provision is maintained on such loans and advances.

#### 4.8.4 Revenue Recognition on Non-Performing Loans

When an advance is classified as non performing, based on criteria set out in Direction No 3 of 2008 dated 8th May 2008 issued by the Central Bank of Sri Lanka on “Classification of Loans and Advances, Income Recognition and Provisioning” as explained in Note 28 (c), interest ceases to be accrued and is taken to income thereafter on cash basis.

Up to the date of issue of the amended Direction referred to above, interest ceased to be recognised on Loans and Advances when due capital and / or interest were in arrears for more than 90 days. Interest was taken to Income on cash basis thereafter.

## > Notes to the Financial Statements

### 4.8.5 Write-Off Policy

The Bank writes off a loan (net of any related loan loss provisions), when it determines that the loan is uncollectible. This determination is reached after considering information such as the occurrence of significant changes in the borrower's financial position such that the borrower can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure.

### 4.9 Finance Leases

Assets leased to customers which transfer substantially all the risks and rewards associated with ownership other than legal title, are classified as finance leases. Amounts receivable under finance leases are included under "Lease 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.

#### 4.9.1 Provision for Lease Receivables

Specific provision has been made in relation to identified non performing leases as stated above in Note 4.8.3 (a). In addition, a general provision has been made as stated above in Note 4.8.3 (b).

### 4.10 Intangible Assets

An intangible asset is an identifiable non monetary asset without physical substance held for use in the production or supply of goods or services, for rental to others or for administrative purposes.

#### 4.10.1 Basis of Recognition

An intangible asset is recognised if it is probable that the future economic benefits that are attributable to the asset will flow to the entity and the cost of the assets can be measured reliably.

##### 4.10.1 (a) Goodwill

Goodwill arising on the acquisition represents the excess of the cost of acquisition over the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities at the date of acquisition. Upon transition to revised Sri Lanka Accounting Standard 25 "Business Combinations", goodwill is no longer amortised. Instead, goodwill is tested for impairment annually and assessed for any indication of impairment at each reporting date to ensure that its carrying amount does not exceed

its recoverable amount. If an impairment loss is identified, it will be recognised immediately in the Income Statement.

The negative goodwill is recognised immediately in the Income Statement.

#### 4.10.1 (b) Software

All computer software costs incurred, licensed for use by the Group, which are not integrally related to associated hardware, which can be clearly identified, reliably measured and it's probable that they will lead to future economic benefits, are included in the Balance Sheet under the category intangible assets and carried at cost less accumulated amortisation and any accumulated impairment losses.

#### 4.10.2 Subsequent Expenditure

Expenditure incurred on software is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

#### 4.10.3 Amortisation

Intangible assets, except for goodwill, are amortised on a straight line basis in the Income Statement from the date when the asset is available for use, over the best estimate of its useful economic life. The estimated useful life of software is six years.

#### 4.10.4 Retirement and Disposal

An intangible asset is derecognised on disposal or when no future economic benefits are expected from its use and subsequent disposal.

### 4.11 Investment Properties

Investment properties are properties held either to earn rental income or for capital appreciation or both but not for sale in the ordinary course of business, used in the production or supply of goods or services or for administrative purposes.

#### 4.11.1 Basis of Recognition

Investment property is recognised if it is probable that future economic benefits that are associated with the investment property will flow to the Group and cost of the investment property can be reliably measured.

#### 4.11.2 Measurement

An Investment Property is measured initially at its cost. The cost of a purchased investment property comprises of its purchase price and any directly attributable expenditure. The cost of a self constructed investment property is its cost at the date when the construction or development is complete.

The Group applies the cost model for investment properties in accordance with Sri Lanka Accounting Standard 40 (Revised 2005) "Investment Property". Accordingly, land classified as investment properties are stated at cost less any accumulated impairment losses and buildings classified as investment properties are stated at cost less any accumulated depreciation and any accumulated impairment losses.

#### 4.11.3 Depreciation

Depreciation is provided on a straight line basis over the estimated life of the class of asset from the date of purchase up to the date of disposal.

##### Hatton National Bank PLC

Freehold buildings	2.5% per annum
[Refer Note 33 (a)]	

##### Sithma Development (Pvt) Ltd\*

Freehold buildings (Smart building)	2.5% per annum
[Refer Note 33 (b)]	

Plant, machinery and equipment integral to freehold buildings referred to above 20% per annum

##### \* Sithma Development (Pvt) Ltd

The HNB towers which is owned by Sithma Development (Pvt) Ltd ("Sithma"), is leased to occupants including the Bank. However, the ancillary services provided by Sithma Development (Pvt) Ltd to the occupants of HNB towers, is a significant component of the arrangement as a whole. Therefore, HNB towers is not classified as investment property in the financial statements of Sithma, but has been classified under property, plant and equipment in accordance with Sri Lanka Accounting Standard 40 (Revised 2005) "Investment Property".

#### 4.11.4 Derecognition

Investment properties are derecognised when disposed of, or permanently withdrawn from use because no future economic benefits are expected. Transfers are made to and from investment properties only when there is a change in use.

#### 4.12 Property, Plant and Equipment

Property, plant and equipment are tangible items that are held for servicing, or for administrative purposes and are expected to be used during more than one period.

##### 4.12.1 Basis of Recognition

Property, plant and equipment are recognised if it is probable that future economic benefits associated with the assets will flow to the Group and cost of the asset can be reliably measured.

##### 4.12.2 Measurement

An item of property, plant and equipment that qualifies for recognition as an asset is initially measured at its cost. Cost includes expenditure that is directly attributable to the acquisition of the asset and cost incurred subsequently to add to, replace part of, or service it. The cost of self constructed assets includes the cost of materials and direct labour, any other costs directly attributable to bringing the asset to a working condition for its intended use and the costs of dismantling and removing the items and restoring the site on which they are located. Purchased software that is integral to the functionality of the related equipment is capitalised as part of computer equipment.

##### 4.12.3 Cost Model

The Group applies cost model to property, plant and equipment except for freehold land and buildings and records at cost of purchase or construction together with any incidental expenses thereon less accumulated depreciation and any accumulated impairment losses.

##### 4.12.4 Revaluation Model

The Group applies the revaluation model to the entire class of freehold land and buildings. Such properties are carried at a revalued amount, being their fair value at the date of revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Freehold land and buildings of the Group are revalued every seven years on a roll over basis to ensure that the carrying amounts do not differ materially from the fair values at the Balance Sheet date. On revaluation of an asset, any increase in the carrying amount is credited directly to equity, under capital reserve or used to reverse a previous revaluation decrease relating to the same asset, which was charged to the Income Statement. In this circumstance, the increase is recognised as income to the extent of the previous write down. Any decrease in the carrying amount is recognised as an expense in

## > Notes to the Financial Statements

the Income Statement or debited directly to equity under revaluation reserve to the extent of any credit balance existing in the capital reserve in respect of that asset.

### 4.12.5 Subsequent Costs

The cost of replacing part of an item of property, plant and equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within that part will flow to the Group and its cost can be reliably measured. The costs of day to day servicing of property, plant and equipment are charged to the Income Statement as incurred.

### 4.12.6 Derecognition

The carrying amount of an item of property, plant and equipment is derecognised on disposal or when no future economic benefits are expected from its use or disposal. The gain or loss arising from the derecognition of an item of property, plant and equipment is included in Income Statement when the item is derecognised.

When replacement costs are recognised in the carrying amount of an item of property, plant and equipment, the remaining carrying amount of the replaced part is derecognised. Major inspection costs are capitalised. At each such capitalisation, the remaining carrying amount of the previous cost of inspections is derecognised.

### 4.12.7 Depreciation

The Group provides depreciation from the date the assets are available for use up to the date of disposal, at the following rates on a straight line basis over the periods appropriate to the estimated useful lives of the different types of assets, except for which are disclosed separately.

#### Hatton National Bank PLC and its Subsidiary Companies (except for Sithma Development (Pvt) Ltd)

	% per annum
Freehold buildings	2.5
Motor vehicles	25
Computer equipment	16.7
Office equipment	20
Furniture and fittings	10
Fixtures	10
Civil works (Majan Exchange LLC)	10
Improvements to leasehold buildings	over the lease period

Depreciation is not provided for freehold land.

#### Sithma Development (Pvt) Ltd

	% per annum
Freehold buildings - Sithma building	1
Generators, generator panels and associated power cables	2
Chillers, cooling towers and associated equipment	4
Lifts and escalator	4
Building management systems	4
Plant and machinery	20
Equipment	20
Motor vehicles	20

### 4.12.8 Capital Work-in-Progress

Capital work-in-progress is stated at cost. These are expenses of a capital nature directly incurred in the construction of buildings, major plant and machinery and system development, awaiting capitalisation.

### 4.12.9 Borrowing Costs

Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset have been capitalised as part of the cost of the asset in accordance with Sri Lanka Accounting Standard 20 "Borrowing Costs". Capitalisation of borrowing costs ceases when substantially all the activities necessary to prepare the qualifying asset for its intended use are completed.

### 4.13 Work-in-Progress - Residential Apartment Complex

Sithma Development (Pvt) Ltd commenced a project to develop a residential apartment complex. The expenses relating to this project are accounted for as work-in-progress until the completion of the project.

On completion, the value of apartments is transferred to inventories - residential apartment complex. Both work-in-progress and inventories are shown under other assets in the Balance Sheet.

### 4.14 Impairment

#### 4.14.1 Financial Assets

The Group assesses at each Balance Sheet date whether there is objective evidence that a financial asset is impaired. A financial asset is impaired and impairment losses are incurred if and only if, there is objective evidence of impairment as a result of one or more loss events

that occurred after the initial recognition of the asset and prior to the Balance Sheet date ("a loss event"), and that loss event or events have had an impact on the estimated realisable value of the asset.

The Group first assesses whether objective evidence of impairment exists for financial assets that are significant (except for loans and advance explained below).

For loans and advances, impairment loss is measured individually and collectively as explained in Note 4.8.3. When a loan is uncollectible, it is written off against the related provision. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of the amounts previously written off are included under "Other Income" in the Income Statement.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed by adjusting the impairment provision account. The amount of the reversal is recognised in the Income Statement.

#### 4.14.2 Non Financial Assets

Tangible and intangible assets (excluding deferred tax assets which are explained in Note 4.27.2) are written down to recoverable amount where their carrying value exceeds recoverable amounts.

The carrying values of property, plant and equipment are reviewed for impairment annually or when events or changes in circumstances indicate that the carrying value may not be recoverable. If such indications exist and where the carrying values exceed the estimated recoverable amount, the assets are written down to their recoverable amount. Impairment losses are recognised in the Income Statement unless it reverses a previous revaluation surplus for the same asset.

Assets with an indefinite useful life, including goodwill, are not subject to amortisation and are tested on an annual basis for impairment and additionally whenever an indication of impairment exists. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

The recoverable amount of an asset is the higher of its fair value less costs to sell or its value in use. Any decrease in the carrying value is recognised as an expense in the Income Statement in the reporting period in which the impairment loss occurs.

For assets that do not generate largely independent cash inflows, the recoverable amount is determined for the cash generating unit to which that asset belongs. Management judgement is applied to establish cash generating units. Each of these cash generating units is represented by an individual primary reporting segment, or a subdivision of a primary segment.

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

## LIABILITIES AND PROVISIONS

### 4.15 Deposits from Customers

Deposits include non interest bearing deposits, savings deposits, term deposits, deposits redeemable at call and certificates of deposit. They are brought to account at the gross value of the outstanding balance. Interest paid is charged to the Income Statement.

### 4.16 Dividends Payable

Provision for dividends is recognised at the time the dividend recommended and declared by the Board of Directors is approved by the Shareholders.

### 4.17 Borrowings

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

## > Notes to the Financial Statements

### 4.18 Securities Sold under Re-purchase Agreement

Securities sold under agreements to re-purchase are recorded separately in the Financial Statements. The difference between the sale and the purchase price represents interest expense, which is recognised in the Income Statement over the period of the re-purchase agreement.

### 4.19 Bills Payable and Other Liabilities

Bills Payable and Other Liabilities include all financial liabilities, interest, fees, expenses payable and securities purchased but not delivered. These liabilities are recorded at the cash value to be realised when settled.

### 4.20 Employee Retirement Benefits

#### 4.20.1 Defined Benefit Plan

A defined benefit plan is a post employment benefit plan other than a defined contribution plan.

#### 4.20.1 (a) Pension Fund

The Bank operates an approved Pension Fund to facilitate the following payments for permanent staff of the Bank:

- a) Pensions to retiring staff
- b) Benefits to staff who opted for the Optional Scheme for Pension introduced in 2005
- c) Gratuity

The gratuity would include both gratuity payments to pensionable staff who have not opted for optional scheme for pension introduced in 2005 in the event such staff member leaving before the age of 55 and satisfy the criteria as per Gratuity Act and gratuity payments for non pensionable staff who have satisfied the criteria as per Gratuity Act.

The Bank's obligation in respect of defined benefit pension plans is calculated by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods and discounting that benefit to determine its present value, then deducting the fair value of any plan assets. The discount rate is the yield at the reporting date on Government Bonds that have maturity dates approximating to the terms of the Bank's obligations. The calculation is performed by a qualified actuary using the Projected Unit Credit Method which is the method recommended by Sri Lanka

Accounting Standard 16 (Revised 2006) "Employee Benefits" (SLAS 16).

When the benefits of a plan are improved, the portion of the increased benefit relating to past service by employees is recognised in the Income Statement on a straight line basis over the average period until the benefits become vested. To the extent that the benefits vest immediately, the expense is recognised immediately in Income Statement.

In respect of actuarial gains and losses that arise in calculating the Bank's obligation in respect of a plan, to the extent that any cumulative unrecognised actuarial gain or loss exceeds 10% of the greater of the present value of the defined benefit obligation and the fair value of plan assets, that portion is recognised in Income Statement over the expected average remaining working lives of the employees participating in the plan. Otherwise, the actuarial gain or loss is not recognised.

Monthly provision is made by the Bank to the Pension Fund, based on a percentage of the gross salary of employees. The percentage of contributions are determined by the same actuary and retirement benefits are provided to all permanent staff. The Bank carries out an actuarial valuation of the Pension Fund in December each year to ascertain the full liability of the Fund. The valuation method used by the actuary to value the Fund is the "Projected Unit Credit Method", the method recommended by SLAS 16.

The demographic assumptions underlying the valuation are retirement age (55 yrs), early withdrawals from service and retirement on medical grounds, death before and after retirement etc.

The Subsidiaries do not operate pension funds.

#### **Transitional Provisions applied on first time adopting of Sri Lanka Accounting Standard 16 - (Revised 2006) "Employee Benefits" on 1st January 2008**

On first adopting the Standard, the Bank determined its transitional liability for defined benefit plans as at 1st January 2008. As the transitional liability was more than the liability that would have been recognised on 1st January 2008 under the entity's previous accounting policy, the Bank made an irrevocable choice to



recognise that increase in its defined benefit liability, as an expense on a straight line basis over a period of five years from 1st January 2008.

#### **4.20.1 (b) Widows', Widowers' and Orphans' Pension Fund**

The Bank operates a separate Widows', Widowers' and Orphans' Pension Scheme (WW & OP) which was established with effect from 1st September 1995. The contributions are from employees only.

The actuarial valuation of the Widows', Widowers' and Orphans' Pension Scheme is carried out by the same actuary who carried out the actuarial valuation of the Pension Fund using the same method and same assumptions detailed in Note 4.20.1 (a) above.

#### **4.20.1 (c) Majan Exchange LLC**

The Company's obligation in respect of non-Omani terminal benefits which is an unfunded defined benefit retirement plan, is made in accordance with Omani Labour Laws and is calculated by estimating the amount of future benefit that such employees have earned in return for their service in the current and prior periods. The obligation is calculated using the Projected Unit Credit Method and is discounted to its present value.

#### **4.20.2 Defined Contribution Plans**

A defined contribution plan is a post employment plan under which an entity pays fixed contributions into a separate entity and will have no legal or constructive obligation to pay a further amount. Obligations for contributions to defined contribution plans are recognised as expense in the Income Statement as and when they are due.

##### **4.20.2 (a) Employees' Provident Fund**

The Bank and employees contribute 12% and 8% respectively on the salary of each employee to the approved private Provident Fund while the Group entities and their employees contribute the same percentages to Employees' Provident Fund.

##### **4.20.2 (b) Employees' Trust Fund**

The Bank / Group contributes 3% of the salary of each employee to the Employees' Trust Fund.

##### **4.20.2 (c) Majan Exchange LLC**

In respect of Majan Exchange LLC, contributions to a defined contribution retirement plan for

Omani employees in accordance with the Omani Social Insurance Scheme are recognised as expense in the Income Statement as and when they are due.

#### **4.20.3 Gratuities**

No provision has been made in the Financial Statements of the Bank for gratuities to employees who have completed five or more years of service, payable under the Payment of Gratuity Act No 12 of 1983, as the Bank contributes for all permanent employees through its own non-contributory pension scheme which is in force.

Based on the Sri Lanka Accounting Standard 16 (Revised 2006) - "Employee Benefits" which became effective from financial years commencing after 1st July 2007, the Subsidiaries other than HNB Assurance PLC have adopted the Gratuity formula method while HNB Assurance PLC continues to apply actuarial valuation method. Accordingly provisions have been made based on the above methods.

The gratuity liabilities are not externally funded.

#### **4.20.4 Employee Share Ownership Plan**

The Employee Share Ownership Plan introduced in 2005 offered shares to executive and high rank officers of the Bank. The shares allotted to the respective employee under the plan would remain within the plan while the beneficial interest will be with the employee. At the time the employee leaves the Bank the difference between the issue price and the market price is paid to the employee. Therefore the said Employee Share Ownership Plan has no potential dilutive effect on the Earnings Per Share of the Bank.

#### **4.20.5 Employee Share Option Plan**

At the Annual General Meeting held on 28th March 2008 a resolution was passed to formulate an Employee Share Option Plan (ESOP) apart from the Employee Share Ownership Plan enabling the staff in the management rank and above of the Bank to take part in the voting and non voting ordinary shares of the Bank. The total number of share options available to the eligible employees per year will be 1.25% of shares issued by the Bank up to a maximum limit of 5% of the shares issued (both voting and non voting) by the Bank in 4 years. The benefits under ESOP will accrue to eligible employees of the Bank in any particular year only if the conditions set out in the ESOP are met.

## > Notes to the Financial Statements

An eligible employee will qualify to receive share options in a particular year by achieving a positive performance rating in the annual performance assessment. The amount of share options to be granted to each qualified eligible employee will depend on his / her seniority in the Bank. This employee share option plan has potential dilutive effect on the earnings of the Bank.

Details of share options are given in Note 46 (a) and (b).

### 4.21 Provisions

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

A provision for onerous contracts is recognised when the expected benefits to be derived by the Group from a contract are lower than the unavoidable cost of meeting its obligations under the contract. The provision is measured at the present value of the lower of the expected cost of terminating the contract and the expected net cost of continuing with the contract. Before a provision is established, the Group recognises any impairment loss on the assets associated with that contract.

Provisions for non performing loans and advances are made as set out in Note 4.8.3.

### 4.22 Operational Risk Events

Provisions for operational risk events are recognised for losses incurred by the Bank which do not relate directly to amounts of principal outstanding for loans and advances.

The amount recognised as a provision is the best estimate of the expenditure required to settle the present obligation as at the Balance Sheet date, taking into account the risks and uncertainties that surround the events and circumstances that affect the provision.

### 4.23 Commitments and Contingencies

All discernible risks are accounted for in determining the amount of all known liabilities. The Bank's share of any contingencies and capital commitments of a Subsidiary, Associate or Joint Venture for which the Bank is also liable severally or otherwise are also included with appropriate disclosures.

Contingent liabilities are possible obligations whose existence will be confirmed only by uncertain future events or present obligations where the transfer of economic benefit is not probable or cannot be reliably measured. Contingent liabilities are not recognised in the Balance Sheet but are disclosed unless they are remote.

### 4.24 Events after the Balance Sheet Date

All material and important events which occur after the Balance Sheet date have been considered and disclosed in Note 52.

### 4.25 Revenue Recognition

#### 4.25.1 Interest Income

Interest receivable is recognised on an accrual basis. Interest from loans and advances ceases to be accrued when they are classified as non performing as explained in Note 4.8.4. Interest on non performing loans and advances is accounted for on a cash basis. Interest on non performing loans and advances is credited to the "Interest in Suspense Account" which is netted in the Balance Sheet against the relevant loans and advances.

Interest income from investments is recognised on an accrual basis.

#### 4.25.2 Dividend Income

Dividend income is recognised in the Income Statement on an accrual basis when the Bank's right to receive the dividend is established.

#### 4.25.3 Lease Income

The excess of aggregate lease rentals receivable over the cost of the leased assets constitutes the total unearned lease income at the commencement of a lease. The unearned lease income is taken into income over the term of the lease commencing with the month in which the lease is executed in proportion to the declining receivable balance.

Gross earnings under finance leases in respect of lease rentals due, cease to be taken to revenue when they are in arrears for ninety days. Thereafter, such income is recognised on a cash basis.

#### 4.25.4 Discount on Bills of Exchange

Income on discounting bills of exchange is recognised proportionately over the period of the instrument.

**4.25.5 Trading Income**

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

**4.25.6 Fee and Commission Income**

Fees and commission income, including account servicing fees, investment management fees, sales commission, placement fees and syndication fees are recognised as the related services are performed.

**4.25.7 Profit / Loss from Sale of Property, Plant and Equipment**

Profit / loss from sale of property, plant and equipment is recognised in the period in which the sale occurs and is classified as other income.

**4.25.8 Profit / Loss from Sale of Investment Properties**

Any gains or losses on retirement or disposal of investment properties are recognised in the month of retirement or disposal.

**4.25.9 Rental Income**

Rental income is recognised on an accrual basis.

**4.26 Expenses****4.26.1 Interest Expenses and Other Expenses**

Interest payable and other expenses are recognised on an accrual basis.

**4.26.2 Lease Payments**

Payments made under operating leases are recognised in the Income Statement on a straight line basis over the term of the lease.

The future monthly commitments on operating leases are shown in Note 47 (b).

Minimum lease payments made under finance leases are apportioned between the finance expense and the reduction of the outstanding liability. The finance expense is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability. Contingent lease payments are accounted for by revising the minimum lease payments over the remaining

term of the lease when the lease adjustment is confirmed.

**4.26.3 Fee and Commission Expenses**

Fee and commission expenses are recognised on an accrual basis.

**4.27 Income Tax Expense**

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

**4.27.1 Current Tax**

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

Provision for taxation is based on the profit for the year adjusted for taxation purposes in accordance with the provisions of the Inland Revenue Act No 10 of 2006 and the amendments thereto at the rates specified in Note 20.

**4.27.2 Deferred Tax**

Deferred taxation is provided using the liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the tax base of assets and liabilities, which is the amount attributed to those assets and liabilities for tax purposes. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted by the reporting date.

Deferred tax liabilities are not recognised for the following temporary differences: The initial recognition of goodwill, the initial recognition of assets and liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit and differences relating to investments in Subsidiaries to the extent that they probably will not reverse in the foreseeable future.

Deferred tax assets, including those related to temporary tax effects of income tax losses and credits available to be carried forward, are

## > Notes to the Financial Statements

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

### 4.27.3 Offsetting

Current and deferred tax assets and liabilities are offset only to the extent that they relate to income taxes imposed by the same taxation authority, there is a legal right and intentions to settle on a net basis and it is allowed under the tax law of the relevant jurisdiction.

### 4.27.4 Withholding Tax on Dividends

Dividend distributed out of taxable profit of the local Subsidiaries 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 Subsidiaries and Associates in the Consolidated Financial Statements as a consolidation adjustment.

Withholding tax that arise from the distribution of dividends by the Bank are recognised at the same time as the liability to pay the related dividend is recognised.

### 4.27.5 Value Added Tax on Financial Services

The base for the computation of Value Added Tax on Financial Services is the accounting profit before income tax adjusted for the economic depreciation and emoluments of employees computed on prescribed rate.

## 4.28 Earnings per Share

The Group presents Basic and Diluted Earnings per Share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the Bank by the weighted average number of ordinary shares outstanding during the period. Diluted EPS is determined by adjusting the profit or loss attributable to the ordinary shareholders and the weighted average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares, which comprise share options granted to employees.

## 4.29 Segment Reporting

A segment is a distinguishable component of the Group that is engaged either in providing related products or services (business segment), or in providing products and services within a

particular economic environment (geographical segment), which is subject to risks and returns different from those of other business segments. For the purposes of segment reporting disclosures, the information is presented in respect of the Group's business segments, which is based on the Group's management and internal reporting structure. The Group comprises the following major business segments; banking, leasing, dealing, property and insurance.

Inter-segment pricing is determined on an arms length basis.

Measurement of segment assets, liabilities, segment revenue and results is based on the accounting policies set out above. Segment revenue results, assets and liabilities include items directly attributable to segments as well as those that can be allocated on a reasonable basis.

Unallocated items include depreciation and amortisation costs.

## 4.30 Cash Flow Statement

The Cash Flow Statement has been prepared using the "Direct Method" of preparing Cash Flows in accordance with the Sri Lanka Accounting Standard 9 "Cash Flow Statements". Cash and cash equivalents comprise short term, highly liquid investments that are readily convertible to known amounts of cash and are subject to an insignificant risk of changes in value. The cash and cash equivalent include cash in hand, balances with banks, placements with banks, money at call and short notice and money market funds.

## PRESENTATION

### 4.31 Offsetting Income and Expenses

Income and expenses are not offset unless required or permitted by accounting standards.

### 4.32 Offsetting Assets and Liabilities

Assets and liabilities are offset and the net amount reported in the Balance Sheet only where there is :

- a current enforceable legal right to offset the asset and liability; and
- an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously.

## 5. SIGNIFICANT ACCOUNTING POLICIES THAT ARE SPECIFIC TO THE BUSINESS OF THE SUBSIDIARY - HNB ASSURANCE PLC

### 5.1 Non-life Insurance Business

#### 5.1.1 Gross Written Premium

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

#### 5.1.2 Reinsurance Premium

Premiums ceded to reinsurers are recognised as an expense in accordance with the pattern of reinsurance services received. Reinsurance premiums are decided based on rates agreed with reinsurers.

#### 5.1.3 Unearned Premium

The unearned premium reserve represents the portion of the premiums net of outward reinsurance premiums written in the current year in respect of risks related to subsequent periods. Unearned premiums are calculated on the 1/24th basis in accordance with the Regulation of Insurance Industry Act No 43 of 2000.

#### 5.1.4 Unexpired Risk

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

#### 5.1.5 Net Deferred Acquisition Expenses

Acquisition expenses, representing commissions, which vary with and directly related to the production of business, are deferred and amortised over the period in which the related written premiums are earned. Reinsurance commission is also treated in the same manner within deferred acquisition costs.

#### 5.1.6 Premiums Receivables

Collectibility of premiums and other debts are reviewed on an on going basis. However, according to the Premium Payment Warranty (PPW) directive issued by the Insurance Board of Sri Lanka (IBSL), all policies are issued subject to PPW and are cancelled upon the expiry of 60 days

unless firm evidence is available on the subsequent collectability.

#### 5.1.7 Reinsurance Receivable

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.

If a reinsurance asset is impaired, the company reduces the carrying amount accordingly to recognise a loss in the Income Statement. A reinsurance asset is impaired if there is objective evidence, as a result of an event that occurred after the initial recognition of the reinsurance asset, that the company may not receive all or part of the amounts due to it under the terms of the contract, and the event has a reliably measurable impact on the amount that the company will receive from the reinsurer.

#### 5.1.8 Claims

Claims incurred include provisions for the estimated cost of claims and related handling expenses in respect of Incidents up to the year end, including those which have not been notified, net of salvage, anticipated reinsurance and other recoveries. Claims outstanding are assessed by review of individual claim files and estimating changes in the ultimate cost of settling claims.

The provision in respect of Claims Incurred But Not Reported (IBNR) and Claims Incurred But Not Enough Reported (IBNER) is actuarially valued to ensure a more realistic estimation of the future liability based on the past experience and trends. Actuarial valuations are performed on an annual basis.

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

### 5.2 Life Insurance Business

#### 5.2.1 Gross Written Premium

Premium from traditional life insurance contracts, including participating contracts and annuity

## > Notes to the Financial Statements

policies with life contingencies, are recognised as revenue when cash is received from the policyholder. Benefits and expenses are provided against such revenue to recognise profits over the estimated life of the policies.

### 5.2.2 Reinsurance Premium

Outward reinsurance premiums are recognised when payable. Reinsurance recoveries are credited to match the relevant gross claims.

### 5.2.3 Benefits, Losses and Expenses

Expenses on the life insurance revenue account relate to the acquisition and maintenance of life insurance business and include investment expenses not treated as a part of the capital cost of investment. Claims by death and maturity are charged against revenue on notification of death or on expiry of the term. The interim payments and surrenders are accounted for only at the time of settlement.

### 5.2.4 Actuarial Valuation for Long Term Insurance Provision

The directors agree to the long term insurance provision for the company at the year end on the recommendations of the independent consultant actuary following his annual investigation of the life insurance business. The actuarial valuation takes into account all liabilities and is based on assumptions recommended by the independent consultant actuary.

## 6. COMPARATIVE INFORMATION

The comparative information is re-classified wherever necessary to conform with the current year's presentation in order to provide a better presentation. The details of such re-classifications have been provided in Note 50.

## 7 DIRECTIONS ISSUED BUT NOT EFFECTIVE / APPLIED AS AT BALANCE SHEET DATE

The Central Bank of Sri Lanka issued Banking Act Direction No 9 of 2008 on 30th December 2008 on "Amendments to Directions on Classification of Loans Income Recognition and Provisioning". The following section of the direction has not become effective as at balance sheet date, hence not applied by the Bank in preparing these Financial Statements.

### 7.1 Classification of NPA Based on Aggregated Exposure

According to Section 1 of the above Direction, with effect from 1st January 2010 all credit facilities extended to a borrower should be classified as NPA when one or more of the credit facilities has

/ have been classified as NPA and if the aggregate amount of the outstanding of such NPA (excluding interest in suspense) exceeds 30% of the total credit facilities extended to such borrower (excluding interest in suspense).

## 8 NEW ACCOUNTING STANDARDS ISSUED BUT NOT EFFECTIVE AS AT BALANCE SHEET DATE

### 8.1 Sri Lanka Accounting Standard 44 "Financial Instruments: Presentation" and Sri Lanka Accounting Standard 45 "Financial Instruments: Recognition and Measurement"

The Institute of Chartered Accountants of Sri Lanka has issued the two new standards given below, which become effective for annual periods beginning on or after 1st January 2011. Accordingly these Standards have not been applied in preparing these Financial Statements as they are not effective for the year ended 31st December 2009.

- Sri Lanka Accounting Standard 44 "Financial Instruments: Presentation" (SLAS 44)
- Sri Lanka Accounting Standard 45 "Financial Instruments: Recognition and Measurement" (SLAS 45)

These Standards require application of fair value measurement techniques for financial instruments.

Two types of adjustments arise from the adoption of these Standards;

- Those concerning recognition and measurement of items in the financial statements; and
- Those concerning presentation and disclosure of items in the financial statements.

Recognition and measurement adjustments that arise as a result of the adoption of SLAS 45 will be recognised in retained earnings at the date of adoption. It will affect the reported profits or equity for period after that date. This Standard will be applied prospectively, and accordingly the comparatives will not be re-stated.

Presentation and disclosure adjustments do not impact equity or retained earnings other than a re-classification of financial instruments as equity or debt, and accounting for compound instruments with characteristics of both equity and debt instruments based on the substance of the contractual arrangement.

Sri Lanka Accounting Standard 45 – “Financial Instruments: Recognition and Measurement” provides the principles for recognising and measuring financial assets and financial liabilities, which are summarised below

#### Recognition

All financial assets and financial liabilities should be recognised in the balance sheet. Previously certain instruments, in particular derivatives, were held by enterprises without being reflected in the balance sheet.

#### Measurement

##### Financial Assets

- For the purpose of measuring a financial asset SLAS 45 requires the financial asset to be classified into the following four categories ; fair value through profit and loss (trading), originated loans and receivables (at amortised cost using effective interest method), available-for-sale (at fair value) and held to maturity (at amortised cost). The categorisation determines whether and where the re-measurement is recognised in the Bank’s Financial Statements.

##### Loan Impairment

- Loan impairment is recognised when objective evidence is available that a loss event has occurred and as a consequence the Bank will not likely receive all amounts owed to it. Loan impairment is calculated as the difference between the carrying amount of the loan and the present value of future expected cash flows associated with the loan discounted at the loan’s original effective interest rate.

This will be a significant change compared to the current method applied by the Bank for loan loss provisioning based on the direction issued by the Central Bank of Sri Lanka, which is primarily time based.

##### Derivative Financial Instruments and Hedging

- Derivatives are always categorised as trading and therefore measured at fair value with changes recorded in the income statement, unless the enterprise can establish that an effective hedging relationship exists.
- There are three types of hedging relationships under SLAS 45. These are the fair value hedge, the cash flow hedge and the hedge of a net investment in a foreign operation.

#### Financial Liabilities

- All financial liabilities are measured at amortised cost except certain financial liabilities which are at fair value.

The Bank is currently in the process of evaluating the potential effect of these Standards on its Financial Statements. However, the impact of the above requirements has not been quantified as at Balance Sheet date.

## 8.2 Sri Lanka Accounting Standard 39 “Share - based Payment”

The Institute of Chartered Accountants of Sri Lanka has issued Sri Lanka Accounting Standard 39 “Share - based Payment” (SLAS 39), but the revised effective date of the same (previously 1st January 2010) is yet to be confirmed and the Standard is yet to be published in gazette as required by the Sri Lanka Accounting and Auditing Standards Act . Accordingly, this Standard has not been applied in preparing these Financial Statements as it was not effective for the year ended 31st December 2009.

SLAS 39 introduces the requirement for the Bank to recognise an expense in respect of all share-based payment transactions (including expenses associated with transactions in which share options are granted to employees) determined with reference to the fair value of the equity instruments issued. The fair value of the equity instrument will be based on the market price and when market prices are not available, the fair value will be calculated using an appropriate valuation technique, based upon an arm’s length transaction between knowledgeable, willing parties.

#### Transitional Provisions

For a period of 3 years commencing from the effective date of this Standard, the Bank shall use Intrinsic value as described in the Standards, in valuing share based payment transactions, which are valued indirectly by reference to the fair value of the equity instruments granted.

For equity settled share based transactions, the Bank shall apply this Standard to grants of shares, share options or other equity instruments that were granted after the effective date.

For all grants of equity instruments to which SLAS 39 has not been applied (equity instruments issued on or before effective date), the Bank is required to disclose the information required by the Standard.

## > Notes to the Financial Statements

For the year ended 31st December	Bank		Group	
	2009 Rs 000	2008 Rs 000	2009 Rs 000	2008 Rs 000
<b>9 INCOME</b>				
Interest income (Note 10)	34,620,276	32,431,158	34,836,422	32,829,516
Foreign exchange profit	919,782	1,166,979	919,953	1,169,084
Fee and commission income (Note 12)	2,309,235	2,364,434	2,355,467	2,434,503
Dividend income (Note 13)	217,353	538,321	195,879	216,512
Other income (Note 14)	1,307,789	650,194	3,009,624	2,060,960
	<b>39,374,435</b>	<b>37,151,086</b>	<b>41,317,345</b>	<b>38,710,575</b>

### 10 INTEREST INCOME

Government securities	4,982,682	2,165,876	5,447,232	2,887,092
Placements with banks	865,307	1,533,516	865,307	1,533,516
Loans and advances to customers	28,526,791	28,379,876	28,178,799	27,998,077
Other interest income	245,496	351,890	345,084	410,831
	<b>34,620,276</b>	<b>32,431,158</b>	<b>34,836,422</b>	<b>32,829,516</b>

#### Notional Credit for Withholding Tax on Government Securities on Secondary Market Transactions

Section 137 of the Inland Revenue Act No 10 of 2006 provides that a company which derives interest income from the secondary market transactions in Government securities be entitled to a notional tax credit (being one ninth of the net interest income) provided such interest income forms part of the statutory income of the company for that year of assessment.

Accordingly, net income earned from secondary market transactions in Government securities for the year by the Bank / Group has been grossed up in the Financial Statements and the resulting notional tax credit amounted to Rs 332.07 Mn (2008 - Rs 32.6 Mn) for Bank and Rs 370.73 Mn (2008 - Rs 51.85 Mn) for Group.

For the year ended 31st December	Bank		Group	
	2009 Rs 000	2008 Rs 000	2009 Rs 000	2008 Rs 000
<b>11 INTEREST EXPENSES</b>				
Short term borrowings	1,257,908	2,266,358	1,338,037	2,307,369
Refinance borrowings	545,077	474,145	545,077	474,145
Deposits from customers	17,546,185	16,129,821	17,538,734	16,125,738
Subordinated debentures	387,455	578,197	555,069	778,380
Other interest expenses	303,021	303,146	304,031	601,592
	<b>20,039,646</b>	<b>19,751,667</b>	<b>20,280,948</b>	<b>20,287,224</b>

### 12 FEE AND COMMISSION INCOME

Fee income	9,500	6,213	25,071	25,066
Commission income	2,299,735	2,358,221	2,330,396	2,409,437
	<b>2,309,235</b>	<b>2,364,434</b>	<b>2,355,467</b>	<b>2,434,503</b>

### 13 DIVIDEND INCOME

Dealing securities	-	216	323	895
Investment securities - quoted	117,991	124,184	92,644	89,800
Investment securities - unquoted	99,362	413,921	102,912	125,817
	<b>217,353</b>	<b>538,321</b>	<b>195,879</b>	<b>216,512</b>



For the year ended 31st December	Bank		Group	
	2009 Rs 000	2008 Rs 000	2009 Rs 000	2008 Rs 000
<b>14 OTHER INCOME</b>				
Profit / (loss) from sale of dealing securities	11,787	(154)	11,787	(154)
Rent received	5,026	43,064	89,336	127,852
Rent received from investment properties	39,412	17,457	37,880	35,606
Insurance premium income	-	-	1,524,635	1,347,875
Bad debts recovered [Note 27 (c) and 28 (a)] *	736,571	296,019	736,571	296,019
Recovery of loans written off in previous years	7,283	7,224	7,283	7,224
Profit from sale of property, plant and equipment	11,917	7,979	13,157	8,030
Income received on sale of foreclosed properties	541	505	541	505
Gain on sale of Government Securities	-	7,971	12,870	38,476
Income on gold and silver trading	26,503	4,210	26,503	4,210
Profit from sale of Subsidiaries	-	154,287	67,659	77,113
Profit share from Visa Worldwide (Pvt) Ltd	637	123,489	637	123,489
Gain / (loss) on marked to market valuation of dealing securities	17,451	(14,674)	25,696	(14,674)
Recovery of investment in Aquila fund provided for in previous years	216,674	-	216,674	-
Recovery of VAT written off in previous years	200,309	-	200,309	-
Miscellaneous	33,678	2,817	38,086	9,389
	<b>1,307,789</b>	<b>650,194</b>	<b>3,009,624</b>	<b>2,060,960</b>

\* Bad debts recovered includes the write back of provision made against Kabool Lanka (Pvt) Ltd's loan exposure as explained in Note 28 (i).

## 15 OPERATING EXPENSES

Operating expenses, among others, include the following:

Legal expenses and professional fees	77,585	52,910	85,050	55,246
Depreciation of investment property	4,380	1,194	4,421	4,403
Depreciation of property, plant and equipment	579,993	479,721	722,872	613,845
Amortisation of intangible assets	166,636	91,446	175,765	102,017
Provision for operational risk event losses	60,083	14,180	60,083	14,180
Directors' emoluments	55,993	45,063	67,657	58,991
Auditors' remuneration [Note 15 (a)]	7,976	7,589	10,893	9,607
Advertising / product expenses	492,822	622,459	495,632	649,988
Donations	29,184	19,405	29,542	19,665
Loss on FCBU revaluation	16,572	46,290	16,572	46,290
Direct operating expenses on investment property	2,361	-	696	-

### 15(a) Auditors' Remuneration

Audit fees and expenses	5,817	4,715	8,463	6,104
Audit related fee and expenses	1,584	1,140	1,855	1,694
Non-audit services	575	1,734	575	1,809
	<b>7,976</b>	<b>7,589</b>	<b>10,893</b>	<b>9,607</b>

## 16 PERSONNEL EXPENSES

In addition to salaries, personnel expenses include the following :

Contribution to Employees' Provident Fund	299,570	260,842	319,533	278,078
Contribution to Employees' Trust Fund	74,885	65,223	79,767	69,473

Provision for employee retirement benefits is shown separately in Note 17.

## > Notes to the Financial Statements

For the year ended 31st December	Bank		Group	
	2009 Rs 000	2008 Rs 000	2009 Rs 000	2008 Rs 000
<b>17 PROVISION FOR EMPLOYEE RETIREMENT BENEFITS</b>				
Current service cost	315,365	325,443	315,365	325,443
Interest on obligation	747,129	606,634	747,129	606,634
Expected return on plan assets	(567,601)	(472,937)	(567,601)	(472,937)
Amortisation of actuarial losses and transitional liability	320,789	327,988	320,789	327,988
Provision made for gratuities	-	-	7,683	8,367
	<b>815,682</b>	<b>787,128</b>	<b>823,365</b>	<b>795,495</b>

On first time adoption of Sri Lanka Accounting Standard 16 (Revised 2006) "Employee Benefits" (SLAS 16), the transitional liability of the Bank as at 1st January 2008 was Rs 1,417.37 Mn. According to the transitional provisions provided in SLAS 16, the said deficit is amortised on a straight line basis over a period of 5 years, beginning from 2008. The charge for the year was Rs 283.47 Mn.

The Subsidiaries did not have transitional liabilities as at 1st January 2008.

For the year ended 31st December	Bank		Group	
	2009 Rs 000	2008 Rs 000	2009 Rs 000	2008 Rs 000
<b>18 PROVISION FOR LOAN LOSSES</b>				
Specific provision for loans and advances	665,845	596,034	665,845	596,034
General provision for pawning advances	785	4,346	785	4,346
General provision for housing advances	(891)	3,824	(891)	3,824
Statutory general provision for performing and overdue loans and advances	30,662	512,042	30,662	512,042
Total provision for loans and advances [Note 28 (a)]	696,401	1,116,246	696,401	1,116,246
Specific provision for bills of exchange [Note 26 (a)]	4,270	5,040	4,270	5,040
Specific provision for leases [Note 27 (c)]	59,702	74,487	59,702	74,487
General provision for leases [Note 27 (c)]	(52,146)	(36,535)	(52,146)	(36,535)
Total provision made during the year	708,227	1,159,238	708,227	1,159,238

### 19 SHARE OF PROFIT / (LOSS) OF ASSOCIATES (NET OF INCOME TAX)

Share of profit of Associates before income tax			11,392	18,907
Recognition of negative goodwill on Splendor Media			-	3,416
Income tax expense on share of profit of Associates			(3,712)	(28,724)
Share of profit / (loss) of Associates after income tax			7,680	(6,401)

### 20 INCOME TAX EXPENSE

#### Recognised in the Income Statement

#### 20(a) Current tax expense

Income tax on profits for the year [Note 20 (e)]	1,791,919	1,296,148	1,838,850	1,343,930
Over provision as per the taxes finalised for the years of assessments 2005 / 2006 and 2006 / 2007	(295,713)	-	(295,713)	(14,077)
Under provision in the previous years	-	-	3,029	-
	<b>1,496,206</b>	<b>1,296,148</b>	<b>1,546,166</b>	<b>1,329,853</b>

#### 20(b) Deferred tax expense

Deferred tax asset reversed during the year [Note 43 (b)]	3,189	241,331	1,414	241,331
Charge to deferred tax liability [Note 43 (a)]	66,472	28,189	65,884	28,116
	<b>69,661</b>	<b>269,520</b>	<b>67,298</b>	<b>269,447</b>
Total income tax expense	<b>1,565,867</b>	<b>1,565,668</b>	<b>1,613,464</b>	<b>1,599,300</b>

**20 INCOME TAX EXPENSE (CONTD.)**

For the year ended 31st December	Group	
	2009 Rs 000	2008 Rs 000
<b>20(c) Income tax on profits of Subsidiaries</b>		
HNB Assurance PLC	29,473	19,477
DNH Financial (Pvt) Ltd [Former HNB Stockbrokers (Pvt) Ltd]	-	3,179
Acuity Securities Ltd	-	16,879
<b>20(d) Income tax on profits of Joint Venture</b>		
Acuity Partners (Pvt) Ltd	17,458	8,247
<b>Total</b>	<b>46,931</b>	<b>47,782</b>

For the year ended 31st December	Bank		Group	
	2009 Rs 000	2008 Rs 000	2009 Rs 000	2008 Rs 000
<b>20(e) Reconciliation of Accounting Profit and Taxable Income</b>				
Profit before taxation	5,917,519	4,784,648	6,159,144	4,491,527
Disallowable expenses	9,539,995	10,190,445	9,678,027	10,343,881
Allowable expenses	(5,079,875)	(4,798,641)	(5,120,266)	(4,830,705)
Tax exempt income	(3,658,607)	(5,365,835)	(3,799,957)	(5,029,270)
Tax losses utilised [Note 20 (f)]	(1,459,754)	(989,870)	(1,505,102)	(1,019,392)
Tax loss incurred during the year	-	-	(21,305)	-
<b>Taxable income</b>	<b>5,259,278</b>	<b>3,820,747</b>	<b>5,390,541</b>	<b>3,956,041</b>
Of which,				
Taxable income at 35%	4,757,227	3,410,065	4,888,490	3,545,359
Taxable income at 20%	502,051	410,682	502,051	410,682
	<b>5,259,278</b>	<b>3,820,747</b>	<b>5,390,541</b>	<b>3,956,041</b>
Income tax provision for the year is made up of the following:				
Income tax at 35%	1,665,027	1,193,522	1,710,972	1,240,875
Income tax at 20%	100,410	82,136	100,410	82,136
	<b>1,765,437</b>	<b>1,275,658</b>	<b>1,811,382</b>	<b>1,323,011</b>
Social Responsibility Levy at 1.5%	26,482	20,490	27,468	20,919
<b>Income tax on profits for the year</b>	<b>1,791,919</b>	<b>1,296,148</b>	<b>1,838,850</b>	<b>1,343,930</b>
Effective tax rate	30.28%	27.09%	29.86%	29.92%
Effective tax rate of current tax expense [Note 20 (a)]	25.28%	27.09%	25.10%	29.61%
Effective tax rate of total income tax expense	26.46%	32.72%	26.20%	35.61%

**20(f) Tax Losses Brought Forward and Utilised during the Year**

Tax losses brought forward	-	728,332	311,973	1,069,827
Adjustments for brought forward tax losses	1,459,754	261,538	1,464,747	261,538
Loss incurred during the year	-	-	21,305	-
Tax losses utilised during the year [Note 20 (e)]	(1,459,754)	(989,870)	(1,505,102)	(1,019,392)
<b>Tax losses not utilised and carried forward</b>	<b>-</b>	<b>-</b>	<b>292,923</b>	<b>311,973</b>

**20(g) Hatton National Bank PLC**

The Bank's Domestic Banking Unit (DBU) is liable for taxation on its income from banking operations at the rate of 35% for the year (2008 - 35%). The taxable income of on shore operations of the Foreign Currency Banking Unit (FCBU) is liable for taxation at the rate of 35% for the year (2008 - 35%). The taxable income from off shore operations of FCBU is liable for taxation at the rate of 20% for the year (2008 - 20%).

The Bank has recorded a taxable income of Rs 5,259.28 Mn (2008 - Rs 3,820.75 Mn) during the year 2009. No cumulative tax losses were available for set off against future taxable income (after set off during the year) as at 31st December 2008 (2007 - Rs 728.332 Mn). This figure was based on provisional computation and subsequently the brought forward tax loss was increased by Rs 1,459.75 Mn (2008 - Rs 261.54 Mn). The said amount was fully utilised during 2009, accordingly the unutilised tax losses carried forward as at Balance Sheet date was nil.

## > Notes to the Financial Statements

### 20 INCOME TAX EXPENSE (CONTD.)

#### 20(h) HNB Assurance PLC

HNB Assurance PLC, is liable for income tax at the rate of 35% (2008 - 35%) on its taxable income. Provision has been made in the Financial Statements accordingly.

#### 20(i) Sithma Development (Pvt) Ltd

In accordance with the BOI agreement dated 28th December 1994, the profits and income of Sithma Development (Pvt) Ltd are exempt from taxation until Year of Assessment 2014 / 15. After the expiration of the said tax exempt period, the following options are available for the company for another 15 years;

- (a) Income tax payable for the Year of Assessment shall be computed at 2% of the turnover of the Company, or
- (b) The provisions of the Inland Revenue laws for the time being in force shall apply to the Company.

In the event of the Company elects option (a), no deferred tax liability will arise even after the expiration of the tax exempt period. The Company needs to make the election only 90 days prior to the expiration of the said tax exemption period after evaluating all tax implications prevailing at that time. Therefore, no provision has been made in the Financial Statements by the company for deferred tax liability which could arise after the tax exempt period in the event the company elects option (b).

#### 20(j) Acuity Partners (Pvt) Ltd

Acuity Partners (Pvt) Ltd, is liable for income tax at the rate of 35% (2008 - 35%) on its taxable income. Provision has been made in the Financial Statements accordingly.

### 21 EARNINGS PER SHARE

#### 21(a) Basic Earnings per Share

Basic Earnings per Share has been calculated by dividing the profit for the year attributable to Equity Holders of the Bank by the weighted average number of ordinary shares on issue (both voting and non-voting) during the year ended 31st December 2009, as per the requirements of the Sri Lanka Accounting Standard 34 - "Earnings per Share".

#### 21(b) Diluted Earnings per Share

The calculation of Diluted Earnings per Share as at Balance Sheet date was based on the profit attributable to Equity Holders of the Bank by the weighted average number of ordinary shares outstanding during 2009, after adjusting for the effects of all dilutive potential ordinary shares.

Since the average market value during 2008 was less than the allotment price, the options were anti-dilutive. As such no Diluted Earnings per Share was calculated for 2008 and Basic Earnings per Share was presented as Diluted Earnings per Share for 2008.

The details of the options exercised and expired under Employee Share Option Plan during the year are given in Note 46 (b).

For the year ended 31st December	Bank		Group	
	2009	2008	2009	2008
Profit attributable to Equity Holders of the Bank (Rs 000)	4,351,652	3,218,980	4,483,277	2,830,538
Weighted average number of ordinary shares during 2009 used as the denominator ('000) for Basic EPS	235,560	235,529	235,560	235,529
<b>Basic Earnings per Share (Rs)</b>	<b>18.47</b>	<b>13.67</b>	<b>19.03</b>	<b>12.02</b>
Profit attributable to Equity Holders of the Bank (Rs 000)	4,351,652	3,218,980	4,483,277	2,830,538
Weighted average number of ordinary shares during 2009 used as the denominator ('000) for Basic EPS	235,560	235,529	235,560	235,529
Weighted average number of shares under option ('000)	2,695	-	2,695	-
Weighted average number of shares that would have been issued at average market price ('000)	(2,538)	-	(2,538)	-
Weighted average number of ordinary shares during 2009 used as the denominator ('000) for Diluted EPS	235,717	235,529	235,717	235,529
<b>Diluted Earnings per Share (Rs)</b>	<b>18.46</b>	<b>13.67</b>	<b>19.02</b>	<b>12.02</b>

As at 31st December	Bank		Group	
	2009 Rs 000	2008 Rs 000	2009 Rs 000	2008 Rs 000
<b>22 CASH AND CASH EQUIVALENTS</b>				
Local currency in hand	4,682,423	3,110,975	4,697,637	3,111,823
Foreign currency in hand	388,270	409,082	388,270	416,458
Balances with local banks	43,367	50,964	388,177	217,262
Balances / placements with banks in foreign currency	9,703,739	12,542,554	9,789,664	12,542,554
Money at call and short notice	7,175,000	2,590,000	7,175,000	2,673,676
Placements with banks by FCBU	5,050,059	4,598,377	5,050,059	4,598,376
	<b>27,042,858</b>	<b>23,301,952</b>	<b>27,488,807</b>	<b>23,560,149</b>
<b>23 STATUTORY DEPOSIT WITH CENTRAL BANKS</b>				
Statutory deposit with Central Bank of Sri Lanka	11,063,948	11,847,323	11,063,948	11,847,323
Statutory deposit with Central Bank of Oman	-	-	14,857	14,675
	<b>11,063,948</b>	<b>11,847,323</b>	<b>11,078,805</b>	<b>11,861,998</b>

As required by the provisions of Section 93 of the Monetary Law Act, a cash balance is maintained with the Central Bank of Sri Lanka as explained in Note 4.4. The minimum cash reserve requirement on Rupee deposit liabilities was reduced to 7% with effect from 25th February 2009 (2008 - 7.75%). There are no reserve requirement for deposit liabilities of the Foreign Currency Banking Unit and foreign currency deposits liabilities in the Domestic Banking Unit.

Majan Exchange LLC is required to maintain a deposit of Omani Riyal 50,000 with the Central Bank of Oman (CB Oman) in accordance with its licensing regulations for exchange houses issued by the CB Oman. Interest is earned at the rate of 2% per annum.

## 24 DEALING SECURITIES

### 24(a) Quoted Shares Held by the Bank

As at 31st December	2009			2008			
	No of Ordinary Shares	Cost of Investment Rs 000	% of Total Cost	Market Value Rs 000	No of Ordinary Shares	Cost of Investment Rs 000	Market Value Rs 000
<b>Health Care</b>							
Lanka Hospitals PLC	2,078,142	52,265	99.74	39,485	2,078,142	52,265	24,938
<b>Telecommunications</b>							
Dialog Telekom PLC	50	1	-	-	50	1	-
<b>Trading</b>							
Odd lots and delisted shares		135	0.26	-		139	1
<b>Total</b>		<b>52,401</b>	<b>100.00</b>	<b>39,485</b>		<b>52,405</b>	<b>24,939</b>
Loss from marked to market valuation		(12,916)				(27,466)	
<b>Total Quoted Shares - Bank</b>		<b>39,485</b>		<b>39,485</b>		<b>24,939</b>	<b>24,939</b>

### 24(b) Government of Sri Lanka Treasury Bonds Held by the Bank

As at 31st December	2009		2008	
	Cost of Investment Rs 000	Market Value Rs 000	Cost of Investment Rs 000	Market Value Rs 000
Face Value				
-	-	-	49,830	46,929
Loss from marked to market valuation			(2,901)	-
<b>Total Government of Sri Lanka Treasury Bonds - Bank</b>			<b>46,929</b>	<b>46,929</b>

## > Notes to the Financial Statements

### 24 DEALING SECURITIES (CONTD.)

#### 24(c) Foreign Currency Bonds Held by the Bank As at 31st December

Face Value	Year of Maturity	Discounted Value (Rs 000)	2009		2008	
			Cost of Investment Rs 000	Market Value Rs 000	Cost of Investment Rs 000	Market Value Rs 000
-	-	-	-	-	253,840	-
Provision for diminution in value			-	-	(253,840)	-
Total Foreign Currency Bonds - Bank			-	-	-	-

#### 24(d) Quoted Shares Held by the Subsidiaries As at 31st December

	No of Ordinary Shares	2009			No of Ordinary Shares	2008	
		Cost of Investment Rs 000	% of Total Cost	Market Value Rs 000		Cost of Investment Rs 000	Market Value Rs 000
Hemas Holdings PLC	4,200	447	1.10	516	4,200	447	232
John Keells Holdings PLC	40,393	5,310	13.01	6,927	39,593	5,221	1,979
Dialog Telekom PLC	217,500	5,243	12.84	1,577	247,500	5,866	1,485
Asian Hotels & Properties PLC	35,500	1,426	3.49	3,355	19,500	890	483
Commercial Bank of Ceylon PLC	19,500	2,535	6.21	3,695	-	-	-
National Development Bank PLC	36,100	4,489	11.00	7,437	-	-	-
Royal Ceramics Lanka PLC	46,000	2,000	4.90	3,059	-	-	-
Stafford Hotels PLC	123,500	3,181	7.79	3,396	-	-	-
Chemical Industries (Colombo) PLC	63,600	3,882	9.51	4,007	-	-	-
ACL Cables PLC	36,700	2,055	5.03	2,817	-	-	-
Dipped Products PLC	19,500	1,829	4.48	1,677	-	-	-
Colombo Dockyard PLC	6,000	974	2.39	1,469	-	-	-
Hemas Power PLC	65,000	1,300	3.18	1,268	-	-	-
Cargills Ceylon PLC	12,000	712	1.75	783	-	-	-
Renuka Agri Foods PLC	318,300	716	1.75	716	-	-	-
Aitken Spence Hotels Holdings PLC	4,500	1,073	2.63	1,212	-	-	-
DFCC Bank	24,700	3,649	8.94	4,125	-	-	-
<b>Total</b>		<b>40,821</b>	<b>100.00</b>	<b>48,036</b>		<b>12,424</b>	<b>4,179</b>
Loss from marked to market valuation							(8,245)
<b>Total Quoted Shares - Subsidiaries</b>		<b>40,821</b>		<b>48,036</b>		<b>4,179</b>	<b>4,179</b>

#### As at 31st December

	2009		2008	
	Cost of Investment Rs 000	Market Value Rs 000	Cost of Investment Rs 000	Market Value Rs 000

#### 24 (e) Government of Sri Lanka Treasury Bills held through Joint Venture

Face Value	Year of Maturity	Discounted Value (Rs 000)		
Rs 510 Mn	2010	492,338		
Total Government of Sri Lanka Treasury bills - Joint Venture			492,338	492,338

#### 24(f) Government of Sri Lanka Treasury Bonds held through Joint Venture

Face Value	Year of Maturity	Discounted Value (Rs 000)		
Rs 113.00 Mn	2010	114,243		
Rs 0.16 Mn	2011	159		
Rs 0.23 Mn	2012	198		
Rs 0.49 Mn	2013	487		
Total Government of Sri Lanka Treasury Bonds - Joint Venture			115,087	115,122

**24 DEALING SECURITIES (CONTD.)****24(g) Dealing Securities - Summary**  
As at 31st December

	2009 Cost / Market Value Rs 000	2008 Cost / Market Value Rs 000
Total quoted shares - Bank [Note 24 (a)]	39,485	24,939
Total Government of Sri Lanka treasury bonds - Bank [Note 24 (b)]	-	46,929
Total foreign currency bonds - Bank [Note 24 (c)]	-	-
<b>Total Dealing Securities - Bank</b>	<b>39,485</b>	<b>71,868</b>
Total quoted shares - Subsidiaries [Note 24 (d)] *	40,821	4,179
Total Government of Sri Lanka treasury bills - Joint Venture [Note 24 (e)]	492,338	-
Total of Government of Sri Lanka treasury bonds - Joint Venture [ [Note 24 (f)]	115,087	5,666
Inter company adjustment	-	(294)
Total dealing securities - Bank	39,485	71,868
<b>Total Dealing Securities - Group</b>	<b>687,731</b>	<b>81,419</b>

\* HNB Assurance PLC carries it's dealing securities at cost or market value which ever is lower as explained in Note 4.6.1. Accordingly a gain of Rs 7.21 Mn had not been accounted for in the Consolidated Financial Statements.

**25 NON CURRENT ASSETS HELD FOR SALE**

As at 31st December	Bank		Group	
	2009 Carrying amount Rs 000	2008 Carrying amount Rs 000	2009 Carrying amount Rs 000	2008 Carrying amount Rs 000
Balance as at 1st January	1,455	1,455	1,455	1,455
Transferred to property, plant and equipment	(1,455)	-	(1,455)	-
Add : Additions	-	-	2,875	-
<b>Balance as at 31st December</b>	<b>-</b>	<b>1,455</b>	<b>2,875</b>	<b>1,455</b>

**25(a) Freehold Land**

	2009		2008	
	Extent (perches)	Cost of land Rs 000	Extent (perches)	Cost of land Rs 000
Land at No. 67/11, Kumaradola Rd, Monaragala	-	-	20	1,455
<b>Total - Bank</b>		<b>-</b>		<b>1,455</b>
Lot - x, Survey plan - 6448, off Edirisinghe Rd, Mirihana*	10	2,875	-	-
<b>Total - Group</b>		<b>2,875</b>		<b>1,455</b>

\* Value of the land (10 perches) amounted to Rs 5.75 Mn as at 12th November 2009. As this land is held by Acuity Partners (Pvt) Ltd, the Joint Venture, only 50% of the value is taken in to the Consolidated Financial Statements.

**26 BILLS OF EXCHANGE**

As at 31st December	Bank		Group	
	2009 Rs 000	2008 Rs 000	2009 Rs 000	2008 Rs 000
Inland bills	500,790	697,489	500,790	697,489
Import bills	587,266	668,588	587,266	668,588
Export bills	405,387	681,982	405,387	681,982
	1,493,443	2,048,059	1,493,443	2,048,059
Foreign Currency Banking Unit bills	287,850	436,355	287,850	436,355
	1,781,293	2,484,414	1,781,293	2,484,414
Less: Specific provision [Note 26 (a)]	(305,249)	(297,546)	(305,249)	(297,546)
	<b>1,476,044</b>	<b>2,186,868</b>	<b>1,476,044</b>	<b>2,186,868</b>

## > Notes to the Financial Statements

### 26 BILLS OF EXCHANGE (CONTD.)

As at 31st December	Bank		Group	
	2009 Rs 000	2008 Rs 000	2009 Rs 000	2008 Rs 000
<b>26(a) Movement in Provision for Bills of Exchange</b>				
Balance as at 1st January	297,546	300,967	297,546	300,967
Exchange rate variance on foreign currency provision	783	2,554	783	2,554
Specific provision made during the year (Note 18)	4,270	5,040	4,270	5,040
Transfer from / (to) loan loss provision*	2,650	(7,960)	2,650	(7,960)
Bills written off against provision	-	(3,055)	-	(3,055)
<b>Balance as at 31st December</b>	<b>305,249</b>	<b>297,546</b>	<b>305,249</b>	<b>297,546</b>

\* Specific provisions in excess of the bills outstanding of the respective customers as at 31st December 2008 was transferred to loan loss provisions made against the other exposures relating to those customers while specific provisions in respect of bills which were in loan loss provision were transferred to provision for bills of exchange in 2009.

General provision and interest in suspense for bills of exchange are included under general provision and interest in suspense for loans and advances in Note 28.

### 27 LEASE RENTALS RECEIVABLE

As at 31st December	Bank		Group	
	2009 Rs 000	2008 Rs 000	2009 Rs 000	2008 Rs 000
Gross lease rentals receivable	28,192,889	30,860,640	28,192,889	30,860,640
Initial rentals received	(92,363)	(110,774)	(92,363)	(110,774)
Lease rentals received	(16,469,523)	(15,577,672)	(16,469,523)	(15,577,672)
Total lease rentals receivable	11,631,003	15,172,194	11,631,003	15,172,194
Unearned lease income	(2,232,361)	(3,133,343)	(2,232,361)	(3,133,343)
Gross lease rentals receivable	9,398,642	12,038,851	9,398,642	12,038,851
Provisions for lease receivable				
Specific [Note 27 (c)]	(271,867)	(256,965)	(271,867)	(256,965)
General [Note 27 (c)]	(182,533)	(234,679)	(182,533)	(234,679)
<b>Net lease rentals receivable</b>	<b>8,944,242</b>	<b>11,547,207</b>	<b>8,944,242</b>	<b>11,547,207</b>
Lease rentals receivable within one year [Note 27 (a)]	3,931,110	4,449,827	3,931,110	4,449,827
Lease rentals receivable after one year [Note 27 (b)]	5,013,132	7,097,380	5,013,132	7,097,380
	8,944,242	11,547,207	8,944,242	11,547,207

#### 27(a) Lease Rentals Receivable within One Year

Total lease rentals receivable within one year from				
Balance Sheet date	5,597,641	6,506,189	5,597,641	6,506,189
Unearned lease income	(1,314,440)	(1,709,563)	(1,314,440)	(1,709,563)
Provision for lease receivable				
Specific [Note 27 (c)]	(271,867)	(256,965)	(271,867)	(256,965)
General	(80,224)	(89,834)	(80,224)	(89,834)
<b>Balance as at 31st December</b>	<b>3,931,110</b>	<b>4,449,827</b>	<b>3,931,110</b>	<b>4,449,827</b>

#### 27(b) Lease Rentals Receivable after One Year

Total lease rentals receivable after one year from				
Balance Sheet date	6,033,362	8,666,005	6,033,362	8,666,005
Unearned lease income	(917,921)	(1,423,780)	(917,921)	(1,423,780)
Provision for lease receivable - General	(102,309)	(144,845)	(102,309)	(144,845)
<b>Balance as at 31st December</b>	<b>5,013,132</b>	<b>7,097,380</b>	<b>5,013,132</b>	<b>7,097,380</b>

There were no lease rentals receivable beyond five years.



## 27 LEASE RENTALS RECEIVABLE (CONTD.)

## 27(c) Movement in Provision for Lease Rentals Receivable

As at 31st December	2009		2008	
	Rs 000 Specific	Rs 000 Specific	Rs 000 General	Rs 000 General
<b>Bank / Group</b>				
Balance as at 1st January	256,965	211,699	234,679	271,214
Additional provision / (reversal) made (Note 18)	59,702	74,487	(52,146)	(36,535)
Recoveries made during the year	(43,873)	(26,116)	-	-
Fully provided debts written off	(927)	(3,105)	-	-
<b>Balance as at 31st December</b>	<b>271,867</b>	<b>256,965</b>	<b>182,533</b>	<b>234,679</b>

## 28 LOANS AND ADVANCES

As at 31st December	Bank		Group	
	2009 Rs 000	2008 Rs 000	2009 Rs 000	2008 Rs 000
<b>Sri Lanka Rupee loans and advances</b>				
Overdrafts	32,264,298	35,393,588	31,467,898	34,553,514
Short term loans	9,704,994	7,074,630	9,704,994	7,074,630
Trust receipts	6,347,877	7,642,331	6,347,877	7,642,331
Packing credit loans	245,950	375,633	245,950	375,633
Staff loans	7,556,419	6,760,072	7,560,095	6,760,072
Term loans	46,862,149	48,489,400	44,862,149	47,489,400
Housing loans	17,539,677	18,084,738	17,539,677	18,084,738
Pawning advances	21,914,906	21,129,938	21,914,906	21,129,938
Foreclosed properties [Note 28 (g)]	26,099	29,076	26,099	29,076
	<b>142,462,369</b>	<b>144,979,406</b>	<b>139,669,645</b>	<b>143,139,332</b>
<b>Foreign currency loans and advances</b>				
Overdrafts	1,458,805	2,937,308	1,458,805	2,937,308
Short term loans	592,436	582,207	592,436	582,207
Trust receipts	2,478,198	1,189,593	2,478,198	1,189,593
Packing credit loans	4,586,532	4,762,474	4,586,532	4,762,474
Term loans	13,164,948	14,220,802	13,164,948	14,220,802
Housing loans	611,822	558,603	611,822	558,603
Foreclosed properties [Note 28 (g)]	450,627	445,112	450,627	445,112
	<b>23,343,368</b>	<b>24,696,099</b>	<b>23,343,368</b>	<b>24,696,099</b>
<b>Sri Lanka Rupee and foreign currency loans and advances</b>	<b>165,805,737</b>	<b>169,675,505</b>	<b>163,013,013</b>	<b>167,835,431</b>
Less:				
Specific provision for loans and advances	3,348,875	5,788,256	3,348,875	5,788,256
Specific provision for foreclosed properties [Note 28 (h)]	461,768	459,046	461,768	459,046
General provision for pawning advances	21,915	21,130	21,915	21,130
General provision for housing loans	35,838	36,729	35,838	36,729
Statutory general provision for performing and overdue / special mentioned loans and advances [Note 28 (b) ii]	1,076,818	1,046,156	1,076,818	1,046,156
<b>Total provision for loan losses [Note 28 (a)]</b>	<b>4,945,214</b>	<b>7,351,317</b>	<b>4,945,214</b>	<b>7,351,317</b>
Loans and advances after provision	160,860,523	162,324,188	158,067,799	160,484,114
Less: Interest in suspense [Note 28 (f)]	(1,676,125)	(1,250,725)	(1,676,125)	(1,250,725)
<b>Net loans and advances</b>	<b>159,184,398</b>	<b>161,073,463</b>	<b>156,391,674</b>	<b>159,233,389</b>
<b>28(a) Movement in Provision for Loan Losses</b>				
Balance as at 1st January	7,351,317	6,537,772	7,351,317	6,537,772
Exchange rate variance on foreign currency provision	87,577	142,538	87,577	142,538
Provision made during the year (Note 18)	696,401	1,116,246	696,401	1,116,246
Fully provided loans written off	(2,494,733)	(183,296)	(2,494,733)	(183,296)
Recoveries made during the year	(692,698)	(269,903)	(692,698)	(269,903)
Transfer (to) / from bills provision [Note 26 (a)]	(2,650)	7,960	(2,650)	7,960
<b>Balance as at 31st December</b>	<b>4,945,214</b>	<b>7,351,317</b>	<b>4,945,214</b>	<b>7,351,317</b>

## > Notes to the Financial Statements

### 28 LOANS AND ADVANCES (CONTD.)

As at 31st December	2009		2008	
	Rs 000	Rs 000	Rs 000	Rs 000
<b>28(b) Total Provision for Loan Losses - Bank / Group</b>				
<b>28(b) i Specific Provision</b>				
Bills of exchange [Note 26 (a)]	305,249		297,546	
Loans and advances	3,348,875		5,788,256	
Foreclosed properties	461,768		459,046	
Lease rentals receivable within one year [Note 27 (c)]	271,867	4,387,759	256,965	6,801,813
<b>28(b) ii General Provision</b>				
Loans and advances	57,753		57,859	
Lease rentals receivable within one year [Note 27 (a)]	80,224		89,834	
Lease rentals receivable after one year [Note 27 (b)]	102,309		144,845	
Statutory general provision for performing and overdue loans and advances	1,076,818	1,317,104	1,046,156	1,338,694
<b>Total provision [Note 26 (a), 27 (c) and 28 (a)]</b>		<b>5,704,863</b>		<b>8,140,507</b>

As explained in Note 4.8.3 (b), the Bank makes general provision for potential losses not specifically identified but which experience indicates are present in the portfolio of pawning, lease receivable and Shanthi Housing Loans. A further provision of Rs 30.7 Mn (2008 - Rs 512 Mn) was made during the year to meet the regulatory requirement. The total general provision of Rs 1,317.1 Mn (2008 - Rs 1,338.7 Mn) is 1% (2008 - 1%) of the total performing and overdue loans and advances, net of interest in suspense as at the Balance Sheet date and is equal to the regulatory requirement of 1% as at 31st December 2009 (2008 - 0.9%).

### 28(c) Non-performing Lending Portfolio

Loans, advances and finance leases are classified as non-performing as explained in Note 4.8.1. The criteria used for the classification of lending portfolio of the Bank as non performing is set out below. This is in accordance with the direction issued by the Central Bank of Sri Lanka on 8th May 2008 on "Classification of Loans and Advances, Income Recognition and Provisioning".

In accordance with Section 4(7)(I) of Banking Act Direction No. 3 of 2008, Banks shall reclassify Non Performing Loans and Advances (NPL) as Performing Loans and Advances (PLA) if interest and principal in arrears are paid in full by the borrower. However, this direction was replaced by Section 2 of Banking Act Direction No 9 of 2008 which relaxed the basis for reclassification of NPL to PLA even when a part of arrears was repaid. This direction which became effective from 31st December 2008 and was effective till 31st December 2009, has been subsequently extended to 31st December 2010 by the Direction No 6 of 2010. However, the Bank continues to apply the stringent policy of reclassification of NPA to PLA, only upon repayment of all arrears.

### 28(c) i CBSL Classification of Advances into Non-performing Lending Portfolio

Type of facility	Point of classification
Overdrafts	Outstanding balance in excess of sanctioned limit continuously for a period of 90 days or more
Credit facilities repayable in monthly installments	Three consecutive installments, principal and / or interest have not been paid
Credit facilities payable in quarterly / half yearly installments	An installment is not paid within 90 days from the due date
Credit facilities repayable in one installment at the end of a specific period or on due date (bullet payments)	Payment is not made within 90 days from the end of the agreed period or the due date.
Credit cards	Minimum payment is in arrears for 90 days from the due date

## 28 LOANS AND ADVANCES (CONTD.)

### 28(c) Non-performing Lending Portfolio (Contd.)

#### 28(c) ii Categorisation of Advances within Non-performing Lending Portfolio

Categorisation of NPA

Type of facility	Determinant	Overdue / special mention	Substandard	Doubtful	Loss
Overdrafts	Period that the outstanding is in excess of the sanctioned limit continuously	Equal to or more than 90 days but less than 180 days	Equal to 180 days or more but less than 360 days	Equal to or more than 360 days but less than 540 days	Equal to 540 days or more
Credit facilities repayable in monthly installments	No of installments, principal and / or interest due and unpaid	3 installments or more but less than 6 installments	6 installments or more but less than 12 installments	12 installments or more but less than 18 installments	Equal to 18 installments or more
Credit cards	No of days minimum payment is in arrears for from due date	90 days or more but less than 120 days	120 days or more but less than 180 days	180 days or more but less than 240 days	Equal to 240 days or more
Other credit facilities	No of days payments are in arrears from the due date	90 days or more but less than 180 days	180 days or more but less than 360 days	360 days or more but less than 540 days	Equal to 540 days or more

Provision for possible loan losses are made on the basis of a continuous review of all advances to customers, in accordance with the Sri Lanka Accounting Standard 23, "Revenue Recognition and Disclosures in Financial Statements of Banks" and the directions issued by the Central Bank of Sri Lanka and disclosed in the Financial Statements of the Bank, after considering the values of the collateral obtained against the respective non performing loans and advances.

Valuation of collateral is performed based on direction issued by the Central Bank of Sri Lanka as explained in Note 28 (c) iii.

#### 28(c) iii Valuation of Securities for Provisioning Purposes

As per an amendment to the directions issued by the Central Bank of Sri Lanka on 15th August 2003 (effective from 1st January 2004) under section 46 (A) of the Banking Act No 30 of 1988, as amended by Banking (Amendment) Act No 33 of 1995, the initial and progressive discounts that need to be applied to the forced sale value of immovable properties held as collateral are as follows.

At the time of first provisioning for a loan, only 75% of the Forced Sale Value (FSV) of the property based on a current professional valuation report is considered as the value of collateral (i.e. an initial haircut of 25% will be applied).

When an advance is transferred to the 'Loss' category, the following progressive discounts apply to the forced sale value of immovable property held as collateral, based on a current professional valuation report, depending on the time period for which it remains in the 'Loss' category.

No of years in loss category	% of FSV of immovable property that can be considered as the value of collateral
1 - 2 years	60
2 - 3 years	50
3 - 4 years	40

All immovable property held as collateral, relating to loans in the 'Loss' category for more than four years, are reviewed on a regular basis and discounted further at the discretion of management.

## > Notes to the Financial Statements

### 28 LOANS AND ADVANCES (CONTD.)

#### 28(d) Asset Quality - Bank / Group

As at 31st December	2009 Rs 000		2008 Rs 000	
Bills of exchange	381,105		335,268	
Loans and advances	11,092,486		12,090,566	
Foreclosed properties	476,726		474,188	
Lease rental receivable	523,916		656,074	
	12,474,233		13,556,096	
Less: Specific provisions				
Bills of exchange	305,249		297,546	
Loans and advances	3,348,875		5,788,256	
Foreclosed properties	461,768		459,046	
Lease rental receivable	271,867	4,387,759	256,965	6,801,813
		8,086,474		6,754,283
Less: Interest in suspense [Note 28 (f)]		(1,676,125)		(1,250,725)
Net non-performing lending portfolio		6,410,349		5,503,558
NPA ratio		6.15%		6.72%
NPA ratio (revised)		5.43%		6.24%

Net non-performing lending portfolio of Rs 6,410.3 Mn (2008 - Rs 5,503.6 Mn) is secured by immovable assets, movable assets and other registered securities, approved by the Central Bank of Sri Lanka for provisioning purposes. The values of the immovable properties are discounted for provisioning purposes as explained in Note 28 (c) iii.

NPA ratio (revised) refers to the NPA ratio of the Bank in the event the Bank had applied Section 2 of the Direction referred to in Note 28 (c).

#### 28(e) Credit Risk

##### 28(e) i Collateral Wise Analysis of Gross Non-performing Lending Portfolio

The Bank holds collateral against its lending portfolio in the form of mortgage interest over property, other registered securities and assets. Estimation of fair values / realisable values are based on the value of collateral assessed at the time of lending and generally are not updated except when a loan is individually assessed as non-performing.

As at 31st December	2009		2008	
	Rs 000	%	Rs 000	%
Secured by immovable assets	8,905,849	71.40	7,538,668	55.61
Secured by movable assets	623,947	5.00	807,714	5.96
Secured by cash / shares	338,216	2.71	269,238	1.99
Other securities	1,707,107	13.68	1,480,810	10.92
Clean	812,967	6.52	3,332,377	24.58
Pawning	86,147	0.69	127,289	0.94
	12,474,233	100.00	13,556,096	100.00

**28 LOANS AND ADVANCES (CONTD.)**
**28(e) Credit Risk (Contd.)**
**28(e) ii Sector / Product Wise Analysis of Gross Lending Portfolio - Bank 2009**

The Bank monitors concentration of credit risk by sectors. An analysis of concentration of credit risk as at the Balance Sheet date is shown below:

Sector / Type of Loan	Overdrafts	Short Term	Medium Term	Long Term	Pawning	Leasing	Total	
	Rs 000	Loans Rs 000	Loans Rs 000	Loans Rs 000	Rs 000	Rs 000	Rs 000	%
Agriculture and fishing	3,732,097	3,423,359	3,948,907	5,627,242	-	1,044,203	17,775,808	10.15
Manufacturing	4,910,797	11,742,404	6,397,205	1,646,247	-	186,437	24,883,090	14.20
Tourism	2,547,010	1,233,348	3,564,879	3,962,657	-	310,300	11,618,194	6.63
Transport	411,868	594,295	885,143	829,108	-	2,844,678	5,565,092	3.18
Construction	5,017,161	3,377,520	8,022,185	14,681,988	-	295,461	31,394,315	17.92
Traders	9,043,564	6,047,128	2,514,654	2,809,181	-	849,160	21,263,687	12.14
New economy	322,333	304,632	2,358,963	239,930	-	511,206	3,737,064	2.13
Financial and business services	1,197,718	2,596,828	3,830,985	1,963,048	-	249,890	9,838,469	5.62
Infrastructure	1,408,241	639,812	274,010	1,373,305	-	123,345	3,818,713	2.18
Other services	4,200,352	4,591,650	2,163,813	5,909,034	-	2,863,655	19,728,504	11.26
Other customers	931,962	2,327,408	233,464	53,396	21,914,906	120,307	25,581,443	14.60
<b>Total</b>	<b>33,723,103</b>	<b>36,878,384</b>	<b>34,194,208</b>	<b>39,095,136</b>	<b>21,914,906</b>	<b>9,398,642</b>	<b>175,204,379</b>	<b>100.00</b>
Gross loans and advances (Note 28)							165,805,737	94.64
Gross lease rentals receivable (Note 27)							9,398,642	5.36
							175,204,379	100.00
The "other customers" category comprises the following advances:								
Credit card	-	1,942,243	-	-	-	-	1,942,243	7.59
Pawning	-	-	-	-	21,914,906	-	21,914,906	85.67
Others	931,962	385,165	233,464	53,396	-	120,307	1,724,294	6.74
<b>Total</b>	<b>931,962</b>	<b>2,327,408</b>	<b>233,464</b>	<b>53,396</b>	<b>21,914,906</b>	<b>120,307</b>	<b>25,581,443</b>	<b>100.00</b>

## > Notes to the Financial Statements

### 28 LOANS AND ADVANCES (CONTD.)

#### 28 (e) Credit risk (Contd.)

#### 28 (e) iii Sector / Product Wise Analysis of Gross Lending Portfolio - Bank 2008

Sector / Type of Loan	Overdrafts	Short Term	Medium Term	Long Term	Pawning	Leasing	Total	
	Rs 000	Loans Rs 000	Loans Rs 000	Loans Rs 000	Rs 000	Rs 000	Rs 000	%
Agriculture and fishing	5,921,750	3,094,402	2,694,610	2,758,908	-	1,119,857	15,589,527	8.58
Manufacturing	4,219,470	7,910,431	7,803,806	11,021,173	-	733,006	31,687,886	17.44
Tourism	244,010	6,944,717	1,608,905	1,467,829	-	355,338	10,620,799	5.84
Transport	219,031	1,999,214	3,267,776	3,481,841	-	3,116,956	12,084,818	6.65
Construction	10,405,496	2,261,075	7,845,405	19,455,073	-	365,158	40,332,207	22.20
Traders	8,857,546	217,479	3,727,024	3,138,370	-	1,152,665	17,093,084	9.41
New economy	155,546	735,745	546,334	497,405	-	365,771	2,300,801	1.27
Financial and business services	2,075,537	847,209	3,158,295	1,101,541	-	926,891	8,109,473	4.46
Infrastructure	555,764	871,490	992,623	994,812	-	831,586	4,246,275	2.34
Other services	5,305,438	286,994	774,248	772,530	-	2,868,132	10,007,342	5.51
Other customers	371,307	2,215,469	3,150,962	2,570,977	21,129,938	203,491	29,642,144	16.31
<b>Total</b>	<b>38,330,895</b>	<b>27,384,225</b>	<b>35,569,988</b>	<b>47,260,459</b>	<b>21,129,938</b>	<b>12,038,851</b>	<b>181,714,356</b>	<b>100.00</b>
Gross loans and advances (Note 28)							169,675,505	93.37
Gross lease rentals receivable (Note 27)							12,038,851	6.63
							181,714,356	100.00
The "other customers" category comprises the following advances:								
Credit card	-	2,119,969	-	-	-	-	2,119,969	7.15
Pawning	-	-	-	-	21,129,938	-	21,129,938	71.28
Others	371,307	95,500	3,150,962	2,570,977	-	203,491	6,392,237	21.56
<b>Total</b>	<b>371,307</b>	<b>2,215,469</b>	<b>3,150,962</b>	<b>2,570,977</b>	<b>21,129,938</b>	<b>203,491</b>	<b>29,642,144</b>	<b>100.00</b>

## 28 LOANS AND ADVANCES (CONTD.)

## 28(e) Credit Risk (Contd.)

## 28(e) iv Sector / Product Wise Analysis of Gross Lending Portfolio - Group 2009

Sector / Type of Loan	Overdrafts	Short Term	Medium Term	Long Term	Pawning	Leasing	Total	
	Rs 000	Loans Rs 000	Loans Rs 000	Loans Rs 000	Rs 000	Rs 000	Rs 000	%
Agriculture and fishing	3,732,097	3,423,359	3,948,907	5,627,242	-	1,044,203	17,775,808	10.31
Manufacturing	4,910,797	11,742,404	6,397,205	1,646,247	-	186,437	24,883,090	14.43
Tourism	2,547,010	1,233,348	3,564,879	3,962,657	-	310,300	11,618,194	6.74
Transport	411,868	594,295	885,143	829,108	-	2,844,678	5,565,092	3.23
Construction	4,240,920	3,377,520	8,022,185	12,681,988	-	295,461	28,618,074	16.60
Traders	9,043,564	6,047,128	2,514,654	2,809,181	-	849,160	21,263,687	12.33
New economy	322,333	304,632	2,358,963	239,930	-	511,206	3,737,064	2.17
Financial and business services	1,177,559	2,596,828	3,830,985	1,963,048	-	249,890	9,818,310	5.69
Infrastructure	1,408,241	639,812	274,010	1,373,305	-	123,345	3,818,713	2.21
Other services	4,200,352	4,591,650	2,167,489	5,909,034	-	2,863,655	19,732,180	11.44
Other customers	931,962	2,327,408	233,464	53,396	21,914,906	120,307	25,581,443	14.84
<b>Total</b>	<b>32,926,703</b>	<b>36,878,384</b>	<b>34,197,884</b>	<b>37,095,136</b>	<b>21,914,906</b>	<b>9,398,642</b>	<b>172,411,655</b>	<b>100.00</b>
Gross loans and advances (Note 28)							163,013,013	94.55
Gross lease rentals receivable (Note 27)							9,398,642	5.45
							172,411,655	100.00
The "other customers" category comprises the following advances:								
Credit card	-	1,942,243	-	-	-	-	1,942,243	7.59
Pawning	-	-	-	-	21,914,906	-	21,914,906	85.67
Others	931,962	385,165	233,464	53,396	-	120,307	1,724,294	6.74
<b>Total</b>	<b>931,962</b>	<b>2,327,408</b>	<b>233,464</b>	<b>53,396</b>	<b>21,914,906</b>	<b>120,307</b>	<b>25,581,443</b>	<b>100.00</b>

## > Notes to the Financial Statements

### 28 LOANS AND ADVANCES (CONTD.)

#### 28(e) Credit Risk (Contd.)

#### 28(e) v Sector / Product Wise Analysis of Gross Lending Portfolio - Group 2008

Sector / Type of Loan	Overdrafts	Short Term	Medium Term	Long Term	Pawning	Leasing	Total	
	Rs 000	Loans Rs 000	Loans Rs 000	Loans Rs 000	Rs 000	Rs 000	Rs 000	%
Agriculture and fishing	5,921,750	3,094,402	2,694,610	2,758,908	-	1,119,857	15,589,527	8.67
Manufacturing	4,219,470	7,910,431	7,803,806	11,021,173	-	733,006	31,687,886	17.62
Tourism	244,010	6,944,717	1,608,905	1,467,829	-	355,338	10,620,799	5.90
Transport	219,031	1,999,214	3,267,776	3,481,841	-	3,116,956	12,084,818	6.72
Construction	9,565,422	2,261,075	7,845,405	18,455,073	-	365,158	38,492,133	21.40
Traders	8,857,546	217,479	3,727,024	3,138,370	-	1,152,665	17,093,084	9.50
New economy	155,546	735,745	546,334	497,405	-	365,771	2,300,801	1.28
Financial and business services	2,075,537	847,209	3,158,295	1,101,541	-	926,891	8,109,473	4.51
Infrastructure	555,764	871,490	992,623	994,812	-	831,586	4,246,275	2.36
Other services	5,305,438	286,994	774,248	772,530	-	2,868,132	10,007,342	5.56
Other customers	371,307	2,215,469	3,150,962	2,570,977	21,129,938	203,491	29,642,144	16.48
<b>Total</b>	<b>37,490,821</b>	<b>27,384,225</b>	<b>35,569,988</b>	<b>46,260,459</b>	<b>21,129,938</b>	<b>12,038,851</b>	<b>179,874,282</b>	<b>100.00</b>
Gross loans and advances (Note 28)							167,835,431	93.31
Gross lease rentals receivable (Note 27)							12,038,851	6.69
							179,874,282	100.00
The "other customers" category comprises the following advances:								
Credit card	-	2,119,969	-	-	-	-	2,119,969	7.15
Pawning	-	-	-	-	21,129,938	-	21,129,938	71.28
Others	371,307	95,500	3,150,962	2,570,977	-	203,491	6,392,237	21.56
<b>Total</b>	<b>371,307</b>	<b>2,215,469</b>	<b>3,150,962</b>	<b>2,570,977</b>	<b>21,129,938</b>	<b>203,491</b>	<b>29,642,144</b>	<b>100.00</b>



**28 LOANS AND ADVANCES (CONTD.)**

As at 31st December	2009 Rs 000	2008 Rs 000
<b>28(f) Movement in Interest in Suspense - Bank / Group</b>		
Balance as at 1st January	1,250,725	924,583
Interest suspended	2,158,809	1,230,402
Amounts recovered	(1,699,867)	(846,689)
Interest written off	(33,542)	(57,571)
<b>Balance as at 31st December</b>	<b>1,676,125</b>	<b>1,250,725</b>

As a policy, the Bank seals off interest on non-performing loans and advances after one year of classification into the loss category. However, at the time of recovery, further interest on such advances is calculated from the date on which interest was sealed off.

**28(g) Movement in Foreclosed Properties - Bank / Group**

Balance as at 1st January	15,142	18,974
Disposals during the year	(2,977)	(8,282)
Exchange translation	183	568
Provision recoveries during the year	2,610	3,882
<b>Balance as at 31st December</b>	<b>14,958</b>	<b>15,142</b>
<b>The total of foreclosed properties and related provisions have been classified under loans and advances</b>		
Sri Lanka Rupee loans and advances	26,099	29,076
Foreign currency loans and advances	450,627	445,112
Specific provision for foreclosed properties [Note 28 (h)]	(461,768)	(459,046)
	<b>14,958</b>	<b>15,142</b>

**28(h) Movement in Provision for Foreclosed Properties - Bank / Group**

Balance as at 1st January	459,046	446,362
Exchange rate variance in foreign currency provision	5,332	16,566
Recoveries made during the year	(2,610)	(3,882)
<b>Balance as at 31st December</b>	<b>461,768</b>	<b>459,046</b>

**28(i) Loans and Advances to Kabool Lanka (Pvt) Ltd**

The Bank had an exposure of Rs 3.0 Bn to Kabool Lanka (Pvt) Ltd as at 29th December 2009, against which a provision of Rs 2.8 Bn had been made by the Bank as at that date. The assets jointly owned by the Bank and Bank of Ceylon and acquired through legal process were subsequently acquired by the Government under the provisions of Land Acquisition Act. The banks had lodged their claim for compensation.

On 29th December 2009, the Bank received treasury bonds redeemable in 18 months amounting to Rs 570.6 Mn (presented under Note 29 (e) - Investment Securities - Government of Sri Lanka Treasury Bonds held by the Bank) as the full and final settlement from the Government.

Accordingly, after setting off the net exposure against the provision made in the Financial Statements, Rs 368 Mn has been written back to Income Statement (presented under Note 14 - Other Income).

## > Notes to the Financial Statements

### 29 INVESTMENT SECURITIES

#### 29(a) Quoted Shares Held by the Bank

As at 31st December	2009			2008		
	No of Ordinary Shares	Cost of Investment Rs 000	Market Value Rs 000	No of Ordinary Shares	Cost of Investment Rs 000	Market Value Rs 000
Ceylinco Insurance PLC	50,000	8,750	6,713	50,000	8,750	7,250
Commercial Bank of Ceylon PLC	1,430,574	95,813	271,809	1,430,574	95,813	95,848
DFCC Bank	16,054,570	911,399	2,681,113	16,054,570	911,399	838,851
Distilleries Company of Sri Lanka PLC	1,481,500	11,158	155,928	1,481,500	11,158	74,816
		1,027,120	3,115,563		1,027,120	1,016,765
Provision made during the year		(2,038)	-		-	-
<b>Total Quoted Shares - Bank</b>		<b>1,025,082</b>	<b>3,115,563</b>		<b>1,027,120</b>	<b>1,016,765</b>

#### 29(b) Quoted Units in Unit Trusts held by the Bank

As at 31st December	2009			2008		
	No of Units	Cost of Investment Rs 000	Market Value Rs 000	No of Units	Cost of Investment Rs 000	Market Value Rs 000
Namal Acuity Value Fund	3,000,000	150,000	149,250	-	-	-
<b>Total Quoted Units in Unit Trusts - Bank</b>		<b>150,000</b>	<b>149,250</b>			

Based on the assessment carried out by the Board of Directors during 2009, the Bank has made a provision for permanent diminution in market value in respect of shares held in Ceylinco Insurance PLC. There were no other indication of permanent diminution in market value of investment securities, except as explained above.

#### 29(c) Unquoted Shares Held by the Bank

As at 31st December	2009			2008		
	No of Ordinary Shares	Cost of Investment Rs 000	Directors' Valuation Rs 000	No of Ordinary Shares	Cost of Investment Rs 000	Directors' Valuation Rs 000
Browns' Group Motels Ltd	50,000	500	500	50,000	500	500
Credit Information Bureau of Sri Lanka	5,300	530	530	5,300	530	530
Fitch Rating Lanka Ltd	62,500	625	625	62,500	625	625
Lanka Clear (Pvt) Ltd	2,200,000	22,000	22,000	2,200,000	22,000	22,000
Lanka Financial Services Bureau	225,000	2,250	2,250	225,000	2,250	2,250
S.W.I.F.T.	21	2,051	2,051	21	2,051	2,051
Dialog Telekom PLC						
Rated cumulative redeemable preference shares	540,000,000	540,000	540,000	648,000,000	648,000	648,000
Acuity Securities Ltd *	7,498,500	74,985	74,985	7,498,500	74,985	74,985
Magpek Exports Ltd	359,000	14,360	-	359,000	14,360	-
Metal Recyclers Colombo Ltd	69	3	-	69	3	-
Provision for diminution in market value **		(14,363)			(14,363)	
<b>Total Unquoted Shares - Bank</b>		<b>642,941</b>	<b>642,941</b>		<b>750,941</b>	<b>750,941</b>

\* Bank holds 49.99% of Acuity Securities Ltd, while Acuity Partners (Pvt) Ltd a joint venture between the Bank and DFCC Bank holds 50.01% of the same. Bank classified its investment in Acuity Securities Ltd as investment securities in view that Bank cannot exercise significant influence on the activities of Acuity Partners (Pvt) Ltd, which being a joint venture would require unanimous consent for strategic, financial and operating decisions.

\*\* As shares of Magpek Exports Ltd and Metal Recyclers Colombo Ltd have been de-listed, the market values are shown as nil. Provision of Rs 14.4 Mn for diminution in market value has been made in the Financial Statements.

**29 INVESTMENT SECURITIES (CONTD.)**
**29(d) Sri Lanka Development Bonds and Sovereign Bonds Held by the Bank**

As at 31st December			2009	2008
Face Value	Year of Maturity	Discounted Value (Rs 000)	Cost of Investment Rs 000	Cost of Investment Rs 000
Rs 5,720 Mn	2010	5,720,000		
Rs 2,974 Mn	2011	2,974,400		
Rs 649 Mn	2012	649,380		
<b>Total Sri Lanka Development Bonds and Sovereign Bonds - Bank</b>			<b>9,343,780</b>	<b>10,848,000</b>

**29(e) Government of Sri Lanka Treasury Bonds Held by the Bank**

As at 31st December			2009	2008	2008	
Face Value	Year of Maturity	Discounted Value Rs 000	Cost of Investment Rs 000	Market Value Rs 000	Cost of Investment Rs 000	Market Value Rs 000
Rs 4,450 Mn	2010	4,412,944				
Rs 3,131 Mn*	2011	3,128,600				
Rs 251 Mn	2013	256,594				
<b>Total Government of Sri Lanka Treasury Bonds - Bank</b>			<b>7,798,138</b>	<b>8,098,828</b>	<b>3,410,918</b>	<b>3,244,451</b>

\* Refer Note No 28 (i) for the details regarding the settlement received from Government.

**29(f) Government of Sri Lanka Treasury Bills and CBSL Securities Held by the Bank**

Face Value	Year of Maturity	Discounted Value Rs 000	2009	2008
Rs 35,180 Mn	2010	34,498,745		
<b>Total Government of Sri Lanka Treasury Bills and CBSL Securities - Bank</b>			<b>34,498,745</b>	<b>34,663,641</b>
			<b>9,269,519</b>	<b>9,304,510</b>

**29(g) Other Long Term Investments Held by the Bank**

As at 31st December		2009		2008	
		Cost	Directors' Valuation	Cost	Directors' Valuation
		Rs 000	Rs 000	Rs 000	Rs 000
Long term non-negotiable bonds maturing on 14.11.2016		489,000	489,000	489,000	489,000
People's Leasing Co. Ltd. - securitised notes trust 20		-	-	22,917	22,917
People's Leasing Co. Ltd. - securitised notes trust 29		11,994	11,994	52,302	52,302
Sampath Leasing securitised notes		-	-	45,000	45,000
<b>Total Other Long Term Investments - Bank</b>		<b>500,994</b>	<b>500,994</b>	<b>609,219</b>	<b>609,219</b>

## > Notes to the Financial Statements

### 29 INVESTMENT SECURITIES (CONTD.)

#### 29(h) Quoted Shares Held through Joint Venture

As at 31st December

	No of Ordinary Shares	2009 Cost of Investment Rs 000	Market Value Rs 000	No of Ordinary Shares	2008 Cost of Investment Rs 000	Market Value Rs 000
John Keells Holdings PLC	4,680	22	803	4,680	22	234
Hayleys PLC	7,491	558	1,281	7,491	558	644
<b>Total Quoted Shares - Joint Venture</b>		<b>580</b>	<b>2,084</b>		<b>580</b>	<b>878</b>

#### 29(i) Unquoted Units in Unit Trusts Held by the Subsidiaries

As at 31st December

	No of Units	2009 Cost of Investment Rs 000	No of Units	2008 Cost of Investment Rs 000
Namal Optima	1,000,000	10,000	1,000,000	10,000
Cey Bank	4,000,000	40,000	1,500,000	15,000
<b>Total Unquoted Units in Unit Trusts - Subsidiaries</b>		<b>50,000</b>		<b>25,000</b>

#### 29(j) Quoted Debentures Held by the Subsidiaries

As at 31st December

	No of Debentures	2009 Cost of Investment Rs 000	Market Value Rs 000	No of Debentures	2008 Cost of Investment Rs 000	Market Value Rs 000
DFCC Bank (Rs 1000/- each)	10,000	10,000	10,000	10,000	10,000	10,000
Seylan Bank PLC (Rs 100/- each)	100,000	10,000	10,000	100,000	10,000	10,000
Sampath Bank PLC	250,000	25,000	25,000	250,000	25,000	25,000
Singer (Sri Lanka) PLC (Rs 100/- each)	250,000	24,000	24,000	240,000	24,000	24,000
Bank of Ceylon	200,000	20,000	20,000	200,000	20,000	20,000
Nations Trust Bank PLC	17,000	17,000	17,000	-	-	-
<b>Total Quoted Debentures - Subsidiaries</b>		<b>106,000</b>	<b>106,000</b>		<b>89,000</b>	<b>89,000</b>

#### 29(k) Unquoted Debentures Held by the Subsidiaries

As at 31st December

	No of Debentures	2009 Cost of Investment Rs 000	No of Debentures	2008 Cost of Investment Rs 000
Singer (Sri Lanka) PLC (Rs 100/- each)	50,000	5,000	50,000	5,000
Seylan Bank PLC (Rs 100/- each)	150,000	15,000	150,000	15,000
Senkadagala Finance Co Ltd (Rs 1000/-each)	40,000	40,000	-	-
<b>Total Unquoted Debentures - Subsidiaries</b>		<b>60,000</b>		<b>20,000</b>

**29 INVESTMENT SECURITIES (CONTD.)**

As at 31st December

	2009		2008	
	Cost of Investment Rs 000	Market Value Rs 000	Cost of Investment Rs 000	Market Value Rs 000
<b>29(l) Government of Sri Lanka Treasury Bonds Held by the Subsidiaries and through Joint Venture</b>				
Face Value		Discounted Value (Rs 000)		
		Year of Maturity		
Rs 461 Mn		2010	452,004	
Rs 110 Mn		2011	112,535	
Rs 413 Mn		2012	369,443	
Rs 794 Mn		2013	654,044	
Rs 10 Mn		2015	8,452	
<b>Total Government of Sri Lanka Treasury Bonds - Subsidiaries and Joint Ventures</b>	<b>1,596,478</b>		<b>1,724,195</b>	<b>845,504</b>
				<b>824,413</b>

**29(m) Investment Securities Summary**

As at 31st December

	2009 Cost of Investment Rs 000	2008 Cost of Investment Rs 000
Total quoted shares - Bank [Note 29 (a)]	1,025,082	1,027,120
Total quoted units - Bank [Note 29 (b)]	150,000	-
Total unquoted shares - Bank [Note 29 (c)]	642,941	750,941
Total Sri Lanka development bonds and sovereign bonds - Bank [Note 29 (d)]	9,343,780	10,848,000
Total Government of Sri Lanka treasury bonds - Bank [Note 29 (e)]	7,798,138	3,410,918
Total Government of Sri Lanka treasury bills and CBSL securities - Bank [Note 29 (f)]	34,498,745	9,269,519
Total other long term investments - Bank [Note 29 (g)]	500,994	609,219
<b>Total Investment Securities - Bank</b>	<b>53,959,680</b>	<b>25,915,717</b>
Total quoted shares - Joint Venture [Note 29(h)]	580	580
Net asset value adjustment on Acuity Securities*	74,985	74,985
Total unquoted units - Subsidiaries [Note 29(i)]	50,000	25,000
Total quoted debentures - Subsidiaries [Note 29(j)]	106,000	89,000
Total unquoted debentures - Subsidiaries [Note 29(k)]	60,000	20,000
Total Government of Sri Lanka treasury bonds - Subsidiaries and Joint Venture [Note 29(l)]	1,596,478	845,504
Total investment securities - Bank	53,959,680	25,915,717
<b>Total Investment Securities - Group</b>	<b>55,847,723</b>	<b>26,970,786</b>

\* Bank's share holding in Acuity Securities Ltd after the share transfer to Acuity Partners (Pvt) Ltd, is accounted for at cost in Bank's books while accounted for at net assets value at the date of share transfer in Group.

Based on the internal assessment carried out by the Board of Directors as at 31st December 2009, no provisions other than those disclosed in Note 29 (a) and (c) was required for permanent diminution in value of investment securities of the Bank.

**29(n) Assets Pledged as Security**

Out of the treasury bills and bonds classified as dealing and investment securities the following amount is pledged as security for re-purchase agreements entered into by the Bank / Group.

As at 31st December	Bank		Group	
	2009 Rs 000	2008 Rs 000	2009 Rs 000	2008 Rs 000
Treasury bills	6,223,727	6,845,339	6,487,507	8,214,165
Treasury bonds	2,461,272	2,060,713	2,971,980	4,121,600
	<b>8,684,999</b>	<b>8,906,052</b>	<b>9,459,487</b>	<b>12,335,765</b>

## > Notes to the Financial Statements

### 30 INVESTMENTS IN ASSOCIATES

As at 31st December

	Principal Activity	Holding	2009		2008			
			Cost of Investment Rs 000	Market Value Rs 000	Cost of Investment Rs 000	Market Value Rs 000		
<b>30(a) Bank</b>								
<b>30(a) i Quoted</b>								
Lanka Ventures PLC * (10,036,250 ordinary shares)	Venture Capital	20.07%	132,326	180,653	20.07%	132,326	60,218	
			<b>132,326</b>	<b>180,653</b>			<b>132,326</b>	<b>60,218</b>

\* Refer Note 52 (b) for the status of the Bank's investment in Lanka Ventures PLC, subsequent to Balance Sheet date.

	Principal Activity	Holding	2009		2008		
			Cost of Investment Rs 000	Directors' Valuation Rs 000	Cost of Investment Rs 000	Directors' Valuation Rs 000	
<b>30(a) ii Unquoted</b>							
Browns Engineering (Pvt) Ltd (2,056,000 ordinary shares)	Engineering	32.63%	20,560	-	32.63%	20,560	-
Delma Exchange (simple limited partnership)	Dealing in foreign exchange	20.00%	71,480	71,480	-	-	-
Provision for diminution in value			(20,560)		(20,560)		
			<b>71,480</b>	<b>71,480</b>			
<b>Total for the Bank [30 (a) i and 30 (a) ii]</b>			<b>203,806</b>		<b>132,326</b>		

#### Browns Engineering (Pvt) Ltd

Browns Engineering (Pvt) Ltd is under liquidation and the Bank's investment in this company has been fully provided for.

#### Delma Exchange

Delma Exchange is a limited liability partnership incorporated in Abu Dhabi and the Bank holds 20% of this partnership.

As at 31st December	Quoted Investments		Unquoted Investments		Total	
	2009	2008	2009	2008	2009	2008
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
<b>30(b) Group</b>						
Investment in Associate companies (at cost)	132,326	132,326	71,730	250	204,056	132,576
Negative goodwill on acquisition recognised in Income Statement	5,830	5,830	3,416	3,416	9,246	9,246
Group share of Associate company retained profits						
Balance as at 1st January	922	26,937	956	-	1,878	26,937
Current year's share of profits after tax	13,284	(10,961)	(5,605)	1,144	7,679	(9,817)
Exchange effect on revaluation of investment	-	-	3,270	-	3,270	-
Dividends received during the year	-	(15,054)	-	(188)	-	(15,242)
<b>Group Investment in Associate companies (equity basis)</b>	<b>152,362</b>	<b>139,078</b>	<b>73,767</b>	<b>4,622</b>	<b>226,129</b>	<b>143,700</b>

#### Splendor Media (Pvt) Ltd (Splendor Media)

The Bank's fully owned subsidiary Sithma Development (Pvt) Ltd (Sithma) holds 25% in Splendor Media. Accordingly Splendor Media has been accounted for as an Associate of Sithma.

The Board of Directors carried out an internal assessment of impairment as at 31st December 2009 and concluded that there was no indication of impairment of this investment.

### 30(c) Summarised Financial Information of Associates

As at 31st December	Lanka Ventures PLC		Splendor Media (Pvt) Ltd		Delma Exchange	
	2009 Rs 000	2008 Rs 000	2009 Rs 000	2008 Rs 000	2009 Rs 000	2008 Rs 000
Revenue	117,874	128,817	61,199	211,965	7,925	-
Expenses	(53,816)	(43,481)	(36,933)	(204,556)	(55,351)	-
<b>Profit / (loss)</b>	<b>64,058</b>	<b>85,336</b>	<b>24,266</b>	<b>7,409</b>	<b>(47,426)</b>	<b>-</b>
Current assets	302,989	329,256	88,280	88,479	312,295	-
Non current assets	461,321	497,476	646	630,018	18,358	-
<b>Total assets</b>	<b>764,310</b>	<b>826,732</b>	<b>88,926</b>	<b>718,497</b>	<b>330,653</b>	<b>-</b>
Current liabilities	3,721	131,735	54,596	70,575	3,447	-
Non current liabilities	1,435	2,031	320	45	882	-
<b>Total liabilities</b>	<b>5,156</b>	<b>133,766</b>	<b>54,916</b>	<b>70,620</b>	<b>4,329</b>	<b>-</b>

**31 INVESTMENT IN JOINT VENTURE**

 Bank  
 As at 31st December

	Principal Activity	Holding	2009		2008		
			Cost of Investment Rs 000	Directors' Valuation Rs 000	Cost of Investment Rs 000	Directors' Valuation Rs 000	
<b>Unquoted</b>							
Acuity Partners (Pvt) Ltd	Financial services	50%	250,000	250,000	50%	250,000	250,000
<b>Total for the Bank</b>			<b>250,000</b>	<b>250,000</b>		<b>250,000</b>	<b>250,000</b>

Bank's interest in Acuity Partners (Pvt) Ltd include:

	2009 Rs 000	2008 Rs 000
Assets	1,199,570	1,181,066
Liabilities	915,811	928,590
Income	151,750	133,196
Expenses	100,960	123,791
Tax	18,124	6,941

**32 INVESTMENTS IN SUBSIDIARIES**

Bank

**32(a) Quoted**

As at 31st December

	Principal Activity	Holding	2009		2008		
			Cost of Investment Rs 000	Market Value Rs 000	Cost of Investment Rs 000	Market Value Rs 000	
HNB Assurance PLC (22,494,750 shares)	Insurance	60%	149,965	1,113,490	60%	149,965	416,153
<b>Total Quoted</b>			<b>149,965</b>			<b>149,965</b>	

**32(b) Unquoted**

As at 31st December

	Principal Activity	Holding	2009		2008		
			Cost of Investment Rs 000	Directors' Valuation Rs 000	Cost of Investment Rs 000	Directors' Valuation Rs 000	
Sithma Development (Pvt) Ltd (206,000,000 ordinary shares)	Property Development	100%	1,973,000	1,973,000	100%	1,973,000	1,973,000
Majan Exchange LLC (200,000 shares)	Dealing in foreign exchange	40%	56,121	56,121	40%	56,121	56,121
Commercial Interlink Services Inc (o/a Delma Exchange Canada) (950 shares)	Dealing in foreign exchange	95%	240	240			
<b>Total Unquoted</b>			<b>2,029,361</b>			<b>2,029,121</b>	
<b>Total for the Bank [32 (a) and 32 (b)]</b>			<b>2,179,326</b>			<b>2,179,086</b>	

Bank together with 40% shareholding in Majan Exchange LLC and management control over the activities of the company can govern the financial and operating policies of the company. Accordingly the investment in Majan Exchange LLC has been classified as investment in Subsidiary.

Bank acquired 95% stake in Commercial Interlink Services Inc (o/a of Delma Exchange Canada) on 23rd April 2009.

**Amount recognised as at acquisition date**

	Rs 000
Assets	4,815
Liabilities	9,774
Goodwill	5,199

The Bank acquired Commercial Interlink Services Inc (o/a of Delma Exchange Canada) with the intention to achieve synergies by integrating this company with Group's business. The resultant goodwill on acquisition has been written off during the year.

The loss incurred by Commercial Interlink Services Inc (o/a of Delma Exchange Canada) for the period ended 31st December 2009 amounted to Rs 8.05 Mn.

If the acquisition date was at the beginning of the period the Group profit would have been less by Rs 4.01 Mn.

## > Notes to the Financial Statements

### 33 INVESTMENT PROPERTIES

As at 31st December	Bank		Group	
	2009 Rs 000	2008 Rs 000	2009 Rs 000	2008 Rs 000
<b>Cost</b>				
Balance as at 1st January	195,505	195,505	242,587	242,499
Transferred from property, plant and equipment	173,335	-	-	-
Improvements	663	-	663	88
<b>Balance as at 31st December</b>	<b>369,503</b>	<b>195,505</b>	<b>243,250</b>	<b>242,587</b>
<b>Accumulated depreciation</b>				
Balance as at 1st January	8,038	6,844	66,274	61,871
Transferred from property, plant and equipment	6,325	-	-	-
Charge for the year	4,380	1,194	4,421	4,403
<b>Balance as at 31st December</b>	<b>18,743</b>	<b>8,038</b>	<b>70,695</b>	<b>66,274</b>
<b>Net book value as at 31st December</b>	<b>350,760</b>	<b>187,467</b>	<b>172,555</b>	<b>176,313</b>

#### 33(a) Valuation of Investment Properties - Bank

As at 31st December 2009	Building sq.ft	Extent Perches	Cost / Carrying Amount			Fair Value		
			Land (Cost) Rs 000	Building (WDV) Rs 000	Total Rs 000	Land Rs 000	Building Rs 000	Total Rs 000
23 & 23 1/1, Independence Avenue, Colombo 7.	10,800	105.00	37,081	39,174	76,255	393,800	43,200	437,000
479 T B Jayah Mawatha, * Colombo 10.	Land	112.96	75,781	-	75,781	451,840	-	451,840
21, 21A, 23 & 25, * Janadhipathi Mawatha, Colombo 1.	Land	26.62	34,889	-	34,889	39,930	-	39,930
10, Sri Uttarananda Mawatha, ** Colombo 03	49,500	40.00	72,000	91,835	163,835	80,000	99,000	179,000
			219,751	131,009	350,760	965,570	142,200	1,107,770

#### 33(b) Valuation of Investment Properties - Group

As at 31st December 2009	Building sq.ft	Extent Perches	Cost / Carrying Amount			Fair Value		
			Land (Cost) Rs 000	Building (WDV) Rs 000	Total Rs 000	Land Rs 000	Building Rs 000	Total Rs 000
23 & 23 1/1, Independence Avenue, Colombo 7.	10,800	105.00	37,081	39,174	76,255	393,800	43,200	437,000
Smart building, 21, 21A, 23 & 25, Janadhipathi Mawatha, Colombo 1.	41,688	-	-	96,300	96,300	-	138,970	138,970
			37,081	135,474	172,555		182,170	575,970



### 33 INVESTMENT PROPERTIES (CONTD.)

#### 33(b) Valuation of Investment Properties - Group (Contd.)

The fair value of the investment properties are based on market valuations carried out as at 31st December 2009 by Messrs J M J Fernando, FIV (Sri Lanka), K C B Condegama, AIV (Sri Lanka), members of the Institute of Valuers of Sri Lanka, who are independent valuers not connected with the Bank. The Bank carries investment properties at cost. Since the fair values of the investment properties were above the carrying value, the Board of Directors concluded there was no impairment in investment properties.

\* Land situated at No 479, T B Jayah Mw, Colombo 10 on which HNB Towers is built, and No 21, 21A, 23 and 25 Janadhipathi Mawatha, Colombo 01 are leased to Sithma Development (Pvt) Ltd by the Bank and the Bank receives ground rent. Accordingly, these lands have been classified as investment property in the Balance Sheet of the Bank. However, according to Sri Lanka Accounting Standard 40 "Investment Property" (SLAS 40), the said lands are treated as property, plant and equipment in the Consolidated Balance Sheet, since these are leased to a Group entity. Accordingly, the revaluation impact of such property has not been adjusted in the Group since the classification is a consolidation adjustment.

\*\* Building situated at No 10, Sri Uttarananda Mw, Colombo 03 is leased out to HNB Assurance PLC and Royal Ceramics Lanka PLC. Accordingly this building is classified as investment property in the Balance Sheet of the Bank. However, according to SLAS 40, the said building is treated as property, plant and equipment in the Group Balance Sheet, since Group uses a significant portion of the building for use in the production or supply of goods and services.

### 34 PROPERTY, PLANT AND EQUIPMENT

Bank	Leasehold Buildings	Freehold Land and Buildings	Computer Equipment	Equipment Furniture and Fixtures	Motor Vehicles	Capital Work-in Progress	2009 Total	2008 Total
	Note 34 (c) Rs 000	Note 34 (b) Rs 000	Note 34 (a) Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
<b>Cost / Valuation</b>								
as at 1st January	952,101	4,724,096	1,889,893	2,337,949	201,750	222,155	10,327,944	9,180,412
Transferred to investment property *	-	(173,335)	-	-	-	-	(173,335)	-
Additions and improvements	95,669	131,557	320,347	283,033	36,108	204,312	1,071,026	1,353,672
Disposals during the year	(5,149)	-	(57,459)	(46,636)	(16,202)	-	(125,446)	(122,086)
Transferred from non current assets held for sale (Note 25)	-	1,455	-	-	-	-	1,455	-
Transferred from capital work-in-progress	13,021	164,131	645	24,865	-	(202,662)	-	(84,054)
Transferred to intangible assets	-	-	-	-	-	(3,878)	(3,878)	-
<b>Cost / Valuation as at 31st December</b>	<b>1,055,642</b>	<b>4,847,904</b>	<b>2,153,426</b>	<b>2,599,211</b>	<b>221,656</b>	<b>219,927</b>	<b>11,097,766</b>	<b>10,327,944</b>
<b>Accumulated depreciation</b>								
as at 1st January	501,011	69,039	1,093,157	1,701,720	97,369	-	3,462,296	3,097,854
Transferred to investment property*	-	(6,325)	-	-	-	-	(6,325)	-
Charge for the year	101,036	37,903	214,736	184,417	41,901	-	579,993	479,721
Disposals during the year	(4,345)	-	(55,724)	(41,858)	(15,773)	-	(117,700)	(115,279)
<b>Accumulated depreciation as at 31st December</b>	<b>597,702</b>	<b>100,617</b>	<b>1,252,169</b>	<b>1,844,279</b>	<b>123,497</b>	<b>-</b>	<b>3,918,264</b>	<b>3,462,296</b>
<b>Net book value as at 31st December 2009</b>	<b>457,940</b>	<b>4,747,287</b>	<b>901,257</b>	<b>754,932</b>	<b>98,159</b>	<b>219,927</b>	<b>7,179,502</b>	<b>-</b>
<b>Net book value as at 31st December 2008</b>	<b>451,090</b>	<b>4,655,057</b>	<b>796,736</b>	<b>636,229</b>	<b>104,381</b>	<b>222,155</b>	<b>-</b>	<b>6,865,648</b>

## > Notes to the Financial Statements

### 34 PROPERTY, PLANT AND EQUIPMENT (CONTD.)

Group	Leasehold Buildings	Freehold Land and Buildings	Computer Equipment	Equipment Furniture and Fixtures	Civil Works	Motor Vehicles	Capital Work-in-Progress	2009 Total	2008 Total
	Note 34 (c)	Note 34 (b)							
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
<b>Cost / Valuation</b>									
as at 1st January	949,041	9,961,651	1,969,755	4,503,787	2,269	210,370	225,823	17,822,696	16,886,257
Acquisition of Subsidiary	769	-	639	904	-	-	-	2,312	-
Additions and improvements	114,608	131,769	353,871	310,187	839	48,258	204,312	1,163,844	1,785,344
Disposals	(8,210)	-	(64,454)	(52,643)	-	(23,471)	-	(148,778)	(160,169)
Transferred to intangible assets	-	-	-	-	-	-	(3,878)	(3,878)	-
Re-classified to other assets	-	-	-	-	-	-	-	-	(604,682)
Transferred from non current assets held for sale	-	1,455	-	-	-	-	-	1,455	-
Transferred from capital work-in-progress	13,021	164,131	3,637	24,865	419	-	(206,073)	-	(84,054)
Transferred to Acuity Partners (Pvt) Ltd and Acuity Stockbrokers (Pvt) Ltd from DNH Financial (Pvt) Ltd (former HNB Stockbrokers (Pvt) Ltd)	6,752	-	-	2,628	-	1,608	-	10,988	-
Disposal of DNH Financial (Pvt) Ltd (former HNB Stockbrokers (Pvt) Ltd)	-	-	(1,475)	(478)	-	-	-	(1,953)	-
Effect of movement in exchange rates	95	-	186	162	20	-	65	528	-
<b>Cost / Valuation as at 31st December</b>	<b>1,076,076</b>	<b>10,259,006</b>	<b>2,262,159</b>	<b>4,789,412</b>	<b>3,547</b>	<b>236,765</b>	<b>220,249</b>	<b>18,847,214</b>	<b>17,822,696</b>
<b>Accumulated Depreciation</b>									
as at 1st January	497,951	213,250	1,134,033	1,972,177	41	104,227	-	3,921,679	3,448,453
Acquisition of Subsidiary	64	-	135	93	-	-	-	292	-
Transferred to Acuity Partners (Pvt) Ltd and Acuity Stockbrokers (Pvt) Ltd from DNH Financial (Pvt) Ltd (former HNB Stockbrokers (Pvt) Ltd)	5,060	-	-	2,220	-	814	-	8,094	-
Charge for the year	104,931	94,607	229,702	246,732	314	46,586	-	722,872	613,845
Disposals during the year	(7,406)	-	(60,943)	(46,614)	-	(22,248)	-	(137,211)	(140,619)
Disposal of DNH Financial (Pvt) Ltd (former HNB Stockbrokers (Pvt) Ltd)	-	-	(1,198)	(295)	-	-	-	(1,493)	-
Effect of movement in exchange rates	11	-	29	14	(2)	-	-	52	-
<b>Accumulated Depreciation as at 31st December</b>	<b>600,611</b>	<b>307,857</b>	<b>1,301,758</b>	<b>2,174,327</b>	<b>353</b>	<b>129,379</b>	<b>-</b>	<b>4,514,285</b>	<b>3,921,679</b>
<b>Net book value as at 31st December 2009</b>	<b>475,465</b>	<b>9,951,149</b>	<b>960,401</b>	<b>2,615,085</b>	<b>3,194</b>	<b>107,386</b>	<b>220,249</b>	<b>14,332,929</b>	<b>-</b>
<b>Net book value as at 31st December 2008</b>	<b>451,090</b>	<b>9,748,401</b>	<b>835,722</b>	<b>2,531,610</b>	<b>2,228</b>	<b>106,143</b>	<b>225,823</b>	<b>-</b>	<b>13,901,017</b>

\* Building situated at No 10, Sri Uttarananda Mw, Colombo 3 was transferred to investment property in the Bank as it is now held primarily for generation of rent.

As set out in Note 4.12.4, the Bank / Group had revalued its freehold land and buildings as at 1st January 2007, by professionally qualified independent valuers. The revaluation was carried out by taking into account the observable prices in active market or recent market transactions on arm's length term. The revaluation surplus, amounting to Rs 2,778.7 Mn / Rs 5,545.5 Mn had been credited to the revaluation reserve account in respect of Bank / Group respectively in 2007. An impairment loss of Rs 87.76 Mn was recognised in that year in respect of freehold land and buildings based on revaluation of such properties.

Based on the assessment of potential impairment carried out internally by the Board of Directors as at 31st December 2009, no provision was required to be made in the Financial Statements as at Balance Sheet date.

**34 PROPERTY, PLANT AND EQUIPMENT (CONTD.)**
**34(a) Computer Equipment - Bank**

	Additions Prior to 1st July 2000 Rs 000	Additions After 1st July 2000 Rs 000	2009 Total Rs 000	2008 Total Rs 000
Rate of depreciation	25.00%	16.67%		
Cost as at 1st January	576,821	1,313,072	1,889,893	1,449,516
Additions and improvements	-	320,347	320,347	340,069
Transferred from capital work-in-progress	-	645	645	149,159
Sub category transfers	-	-	-	(721)
Disposals during the year	-	(57,459)	(57,459)	(48,130)
<b>Cost as at 31st December</b>	<b>576,821</b>	<b>1,576,605</b>	<b>2,153,426</b>	<b>1,889,893</b>

**34(b) Freehold Land and Buildings - Bank**

	Buildings Sq.ft.	Extent (perches)	Cost / Valuation of Land Rs 000	Cost / Valuation of Buildings Rs 000	Total Value Rs 000	Accumulated Depreciation Rs 000	Net Book Value 2009 Rs 000	Net Book Value 2008 Rs 000
<b>Within Colombo City Limits</b>								
<b>Bambalapitiya Branch</b> 285, Galle Road, Colombo 4.	14,801	20.00	80,000	107,264	187,264	9,304	177,960	173,515
<b>Borella Branch</b> 53/1, D S Senanayake Mawatha, Borella.	9,750	28.00	98,122	52,000	150,122	4,103	146,019	147,265
<b>Centralised Operations Building</b> 90, Vinayalankara Mawatha, Colombo 10.	10,250	249.00	996,000	36,088	1,032,088	2,729	1,029,359	1,030,152
<b>City Office</b> 16, Janadhipathi Mawatha, Colombo 1.	49,911	84.00	252,000	71,363	323,363	6,607	316,756	316,404
<b>Grandpass Branch</b> 182, St Joseph Street, Colombo 14.	9,440	24.00	36,000	23,712	59,712	1,896	57,816	58,018
<b>Gunasinghepura Pay Office and Stores</b> 11, Mohandiram's Road, Colombo 12.	6,990	37.53	112,600	17,764	130,364	1,453	128,911	127,648
<b>Former Head Office Building *</b> 10, Sri Uttarananda Mawatha, Colombo 03.	49,500	40.00	-	-	-	-	-	167,010
<b>Panchikawatta Branch</b> 168, Panchikawatta Road, Colombo 10.	8,000	23.67	101,538	22,378	123,916	490	123,426	120,639
<b>Pettah Branch</b> 149-151, Main Street, Colombo 11.	13,535	13.03	85,000	46,269	131,269	4,302	126,967	127,562
<b>Pettah Extension Office</b> 88, Main Street, Colombo 11.	6,848	6.29	47,100	18,211	65,311	1,339	63,972	64,432
<b>Sea Street Branch</b> 60, Sea Street, Colombo 11.	9,000	6.93	48,500	24,830	73,330	2,068	71,262	71,602
<b>Wellawatte Branch</b> 102, Galle Road, Wellawatte.	17,560	36.05	140,000	50,087	190,087	4,095	185,992	187,300
<b>Total freehold land and buildings within Colombo City Limits</b>			<b>1,996,860</b>	<b>469,966</b>	<b>2,466,826</b>	<b>38,386</b>	<b>2,428,440</b>	<b>2,591,547</b>

\* Transferred to investment properties in 2009

## > Notes to the Financial Statements

### 34 PROPERTY, PLANT AND EQUIPMENT (CONTD.)

#### 34(b) Freehold Land and Buildings - Bank (Contd)

	Buildings Sq.ft.	Extent (perches)	Cost/ Valuation of Land Rs 000	Cost/ Valuation of Buildings Rs 000	Total Value Rs 000	Accumulated Depreciation Rs 000	Net Book Value 2009 Rs 000	Net Book Value 2008 Rs 000
<b>Outside Colombo City Limits</b>								
<b>Akkaraipattu Branch</b> 1, Main Street, Akkaraipattu.	8,805	17.00	20,400	16,285	36,685	1,192	<b>35,493</b>	35,150
<b>Ambalangoda Branch</b> 94/1, New Galle Road, Ambalangoda.	5,282	32.56	31,000	12,339	43,339	1,006	<b>42,333</b>	42,333
<b>Anuradhapura Branch</b> 30, Maithripala Senanayake Mawatha, Anuradhapura.	9,980	25.59	48,083	14,134	62,217	1,210	<b>61,007</b>	60,062
<b>Badulla Branch</b> 15, 15 1/1, Udayaraja Mawatha, Badulla.	5,550	27.75	26,200	12,978	39,178	950	<b>38,228</b>	35,543
<b>Boralesgamuwa Branch</b> 24, Maharagama Road, Boralesgamuwa.	5,500	30.34	33,375	15,686	49,061	1,224	<b>47,837</b>	48,214
<b>Dambulla Branch</b> 622, Anuradhapura Road, Dambulla.	6,862	94.50	42,525	16,479	59,004	1,178	<b>57,826</b>	57,946
<b>Galle Branch</b> 3, Wakwella Road, Galle.	7,271	13.80	41,000	22,690	63,690	1,928	<b>61,762</b>	62,458
<b>Gampaha Branch</b> 150, Colombo Road, Gampaha.	16,685	25.00	24,959	105,442	130,401	231	<b>130,170</b>	24,959
<b>Gampola Branch</b> 12, Kandy Road, Gampola.	5,604	11.88	14,920	11,736	26,656	1,092	<b>25,564</b>	24,794
<b>Gampola Bare Land</b> 142,144,146, Kandy Road, Gampola.	Bare land	17.05	28,027	-	28,027	-	<b>28,027</b>	-
<b>Hatton Branch</b> 78, Dambulla Road, Hatton.	10,141	69.48	35,179	14,518	49,697	1,183	<b>48,514</b>	48,569
<b>Mount Bungalow</b> 7, Mount Road, Hatton.	5,088	160.00	16,000	7,496	23,496	578	<b>22,918</b>	21,624
<b>Ja-Ela Branch</b> 73, Old Negombo Road, Ja-Ela.	4,918	19.00	11,400	13,097	24,497	1,118	<b>23,379</b>	23,661
<b>Jaffna Branch</b> 181/5C, Ponnambalam Road, Jaffna.	Bare land	80.00	1,993	34	2,027	9	<b>2,018</b>	2,020
<b>Kandy Branch</b> 1, Dalada Veediya, Kandy.	29,196	57.65	432,375	237,455	669,830	9,380	<b>660,450</b>	663,089

## 34 PROPERTY, PLANT AND EQUIPMENT (CONTD.)

## 34(b) Freehold Land and Buildings - Bank (Contd.)

	Buildings Sq.ft.	Extent (perches)	Cost/ Valuation of Land Rs 000	Cost/ Valuation of Buildings Rs 000	Total Value Rs 000	Accumulated Depreciation Rs 000	Net Book Value 2009 Rs 000	Net Book Value 2008 Rs 000
<b>Kahawatte Branch</b> 77 2A, Main Street, Kahawatte.	8,331	16.14	12,100	33,665	45,765	2,229	<b>43,536</b>	42,694
<b>Kegalle Branch</b> Main Street, Kegalle.	Bare Land	48.70	15,600	-	15,600	-	<b>15,600</b>	15,600
<b>Kuliyapitiya Branch</b> 225, Main Street, Kuliyapitiya.	4,506	31.80	15,150	17,322	32,472	1,072	<b>31,400</b>	25,378
<b>Kurunegala Branch</b> 6, St. Anne's Street, Kurunegala.	9,600	36.25	32,375	82,464	114,839	3,578	<b>111,261</b>	70,235
<b>Mannar Branch</b> 68, Main Street, Mannar.	5,466	23.00	619	14,587	15,206	1,440	<b>13,766</b>	4,772
<b>Marawila Branch</b> 534, Chilaw Road, Marawila.	7,352	43.80	19,545	16,535	36,080	1,336	<b>34,744</b>	34,390
<b>Maskeliya Branch</b> 9, New Town, Maskeliya.	4,757	20.32	4,100	31,933	36,033	956	<b>35,077</b>	11,276
<b>Matale Branch</b> 660, Trincomalee Road, Matale.	8,493	22.80	13,700	28,019	41,719	1,900	<b>39,819</b>	31,731
<b>Matara Branch</b> 29, Anagarika Dharmapala Mawatha, Matara.	9,580	26.00	22,000	33,995	55,995	2,408	<b>53,587</b>	54,351
<b>Mount Lavinia Branch</b> 100, Galle Road, Mount Lavinia.	12,674	22.66	34,000	34,124	68,124	3,030	<b>65,094</b>	64,621
<b>Minuwangoda Branch</b> 115A, Minuwangoda Road, Ekala.	3,538	20.51	20,044	5,658	25,702	141	<b>25,561</b>	25,702
<b>Monaragala Bare Land</b> No 67/11, Kumaradola Road, Monaragala.	Bare Land	20.00	1,455	-	1,455	-	<b>1,455</b>	-
<b>Nawalapitiya Branch</b> 92, Gampola Road, Nawalapitiya.	3,900	7.00	6,400	6,959	13,359	642	<b>12,717</b>	12,774
<b>Negombo Branch</b> 18, Rajapakse Broadway, Negombo.	5,440	8.88	36,579	18,430	55,009	1,588	<b>53,421</b>	53,729
<b>Nittambuwa Branch</b> 22, Kandy Road, Nittambuwa.	5,840	12.30	49,624	9,106	58,730	834	<b>57,896</b>	58,179

## > Notes to the Financial Statements

### 34 PROPERTY, PLANT AND EQUIPMENT (CONTD.)

#### 34(b) Freehold Land and Buildings - Bank (Contd.)

	Buildings Sq.ft.	Extent (perches)	Cost/ Valuation of Land Rs 000	Cost/ Valuation of Buildings Rs 000	Total Value Rs 000	Accumulated Depreciation Rs 000	Net Book Value 2009 Rs 000	Net Book Value 2008 Rs 000
<b>Nochchiyagama Branch</b> 10, Puttalam Road, Nochchiyagama.	9,890	40.00	10,000	16,298	26,298	1,347	<b>24,951</b>	25,463
<b>Nugegoda Branch</b> 181, High Level Road, Nugegoda.	11,560	19.50	58,500	71,752	130,252	6,782	<b>123,470</b>	125,524
<b>Nuwara Eliya Branch / Bungalow</b> 42, Queen Elizabeth Drive, Nuwara Eliya.	13,507	149.03	41,700	24,449	66,149	2,065	<b>64,084</b>	64,151
<b>Pussellawa Branch</b> 409/9A, Pussellawa Road, Pussellawa.	6,163	15.90	10,599	18,684	29,283	304	<b>28,979</b>	10,132
<b>Ratnapura Branch</b> 21 & 23, Senanayake Mawatha, Ratnapura.	3,805	27.70	24,879	10,714	35,593	504	<b>35,089</b>	24,232
<b>Trincomalee Branch</b> 59, Ahambaram Road, Trincomalee.	6,802	33.91	24,137	21,919	46,056	4,705	<b>41,351</b>	36,497
<b>Welimada Branch</b> 35, Nuwara Eliya Road, Welimada.	4,415	14.37	20,746	7,853	28,599	197	<b>28,402</b>	28,598
<b>Wattala Branch</b> 270, 270/1, Negombo Road, Wattala.	8,090	53.00	60,589	34,366	94,955	2,894	<b>92,061</b>	93,059
<b>Total freehold land and buildings outside Colombo City Limits</b>			1,341,877	1,039,201	2,381,078	62,231	<b>2,318,847</b>	2,063,510
<b>Total freehold land and buildings</b>			3,338,737	1,509,167	4,847,904	100,617	<b>4,747,287</b>	4,655,057

### 34 PROPERTY, PLANT AND EQUIPMENT (CONTD.)

#### 34(c) Leasehold Buildings

As at 31st December	Bank 2009			Group 2009			Bank 2008	Group 2008
	Cost of Buildings Rs 000	Accumulated Depreciation Rs 000	Net Book Value Rs 000	Cost of Buildings Rs 000	Accumulated Depreciation Rs 000	Net Book Value Rs 000	Net Book Value Rs 000	Net Book Value Rs 000
Up to 1 year	2,377	2,290	87	2,377	2,290	87	57,106	57,106
01 - 05 years	218,256	154,133	64,123	238,690	157,042	81,648	86,778	86,778
05 - 10 years	743,134	403,005	340,129	743,134	403,005	340,129	129,220	129,220
10 - 15 years	80,318	33,471	46,847	80,318	33,471	46,847	7,086	7,086
15 - 20 years	11,557	4,803	6,754	11,557	4,803	6,754	-	-
Above 20 years	-	-	-	-	-	-	170,900	170,900
	<b>1,055,642</b>	<b>597,702</b>	<b>457,940</b>	<b>1,076,076</b>	<b>600,611</b>	<b>475,465</b>	<b>451,090</b>	<b>451,090</b>

#### 34 (d) Fully Depreciated Property, Plant and Equipment

The initial cost of fully depreciated property, plant and equipment as at 31st December 2009, which are still in use as at Balance Sheet date.

As at 31st December	2009 Rs 000	2008 Rs 000
Motor vehicles	37,523	53,685
Leasehold building	209,795	188,308
Computer equipment	1,285,773	757,156
Equipment, furniture and fixtures	670,153	688,787

#### 34(e) Temporarily Idle Property, Plant and Equipment

There were no temporarily idle property, plant and equipment as at 31st December 2009.

#### 34(f) Property, Plant and Equipment Retired from Active Use

The carrying amount of property, plant and equipment which are retired from active use and not classified as held for sale as at 31st December 2009 is Rs 18.7 Mn (2008 - Rs 0.2 Mn).

As at 31st December	2009 Rs 000	2008 Rs 000
Computer equipment	10,595	-
Equipment, furniture and fixtures	8,078	199
	<b>18,673</b>	<b>199</b>

## > Notes to the Financial Statements

### 35 INTANGIBLE ASSETS

As at 31st December	Bank		Group	
	2009 Rs 000	2008 Rs 000	2009 Rs 000	2008 Rs 000
<b>Cost</b>				
Balance as at 1st January	1,284,761	649,581	1,337,891	700,575
Additions and improvements during the year	110,432	551,126	126,378	567,912
Transferred from capital work-in-progress	3,878	84,054	3,878	84,054
Acquisition of Subsidiary	-	-	2,399	-
Disposal of Subsidiaries	-	-	(2,708)	(14,650)
Transferred to Acuity Partners (Pvt) Ltd and Acuity Stockbrokers (Pvt) Ltd from DNH Financial (Pvt) Ltd (former HNB Stockbrokers (Pvt) Ltd)	-	-	2,307	-
Effect of movement in exchange rates	-	-	296	-
<b>Balance as at 31st December</b>	<b>1,399,071</b>	<b>1,284,761</b>	<b>1,470,441</b>	<b>1,337,891</b>
<b>Accumulated amortisation</b>				
Balance as at 1st January	557,163	465,717	584,503	490,165
Amortisation for the year	166,636	91,446	175,765	102,017
Acquisition of Subsidiary	-	-	360	-
Disposal of Subsidiaries	-	-	(1,247)	(7,675)
Transferred to Acuity Partners (Pvt) Ltd and Acuity Stockbrokers (Pvt) Ltd from DNH Financial (Pvt) Ltd (former HNB Stockbrokers (Pvt) Ltd)	-	-	1,004	-
Effect of movement in exchange rates	-	-	47	-
<b>Balance as at 31st December</b>	<b>723,799</b>	<b>557,163</b>	<b>760,432</b>	<b>584,507</b>
<b>Net book value as at 31st December</b>	<b>675,272</b>	<b>727,598</b>	<b>710,009</b>	<b>753,384</b>

As stated in Note 4.10.1 (b), all computer software costs incurred by the Bank / Group which are not integrally related to associated hardware have been classified as intangible assets.

### 36 OTHER ASSETS

As at 31st December	Bank		Group	
	2009 Rs 000	2008 Rs 000	2009 Rs 000	2008 Rs 000
Deposits, prepayments and interest receivable	3,917,093	4,364,369	3,490,806	3,911,928
Items in transit	2,041,296	938,998	2,041,296	938,998
Claims receivable	94,809	538,602	119,507	625,077
VAT recoverable	566,427	419,575	569,987	424,032
Related party receivable - exchange houses	39,977	98	3,720	-
Items held for use	155,481	677,233	157,223	678,690
Inventory - WIP - residential apartment complex*	-	-	938,591	604,682
Other debtors	518,750	1,858,016	1,291,023	2,295,519
	<b>7,333,833</b>	<b>8,796,891</b>	<b>8,612,153</b>	<b>9,478,926</b>

\* Rs 6.8 Mn has been charged as provision in the Consolidated Financial Statements for impairment of inventory - WIP - residential apartment complex.

### 37 DEPOSITS FROM CUSTOMERS

As at 31st December	Bank		Group	
	2009 Rs 000	2008 Rs 000	2009 Rs 000	2008 Rs 000
<b>Local Currency Deposits</b>				
Current account deposits	15,090,759	12,748,863	15,038,532	12,688,239
Savings deposits	66,080,330	54,544,453	66,080,282	54,543,448
Time deposits	80,572,001	75,828,902	80,544,751	75,801,651
Certificates of deposit	5,439,817	4,269,993	5,439,817	4,269,993
	<b>167,182,907</b>	<b>147,392,211</b>	<b>167,103,382</b>	<b>147,303,331</b>
<b>Foreign Currency Deposits</b>				
Current account deposits	1,191,309	1,522,500	1,191,309	1,522,500
Savings deposits	14,715,443	14,178,854	14,710,532	14,174,831
Time deposits	27,417,146	23,676,297	27,357,922	23,613,879
	<b>43,323,898</b>	<b>39,377,651</b>	<b>43,259,763</b>	<b>39,311,210</b>
<b>Total Deposits</b>	<b>210,506,805</b>	<b>186,769,862</b>	<b>210,363,145</b>	<b>186,614,541</b>
Deposits from non-bank customers	210,469,638	185,006,660	210,325,978	184,851,339
Deposits from banks	24,533	371,570	24,533	371,570
Deposits from finance companies	12,634	1,391,632	12,634	1,391,632
	<b>210,506,805</b>	<b>186,769,862</b>	<b>210,363,145</b>	<b>186,614,541</b>



**38 DIVIDENDS PAYABLE**

As at 31st December	Bank		Group	
	2009 Rs 000	2008 Rs 000	2009 Rs 000	2008 Rs 000
Balance as at 1st January	127,303	30,321	127,303	30,321
Final dividends declared in the prior year	706,588	824,353	706,588	824,353
Interim dividends declared during the year	353,415	235,530	353,415	235,530
Dividends paid	(971,699)	(962,901)	(971,699)	(962,901)
<b>Balance as at 31st December</b>	<b>215,607</b>	<b>127,303</b>	<b>215,607</b>	<b>127,303</b>

**38(a) Proposed Final Dividend**

Board of Directors have recommended the payment of final dividend of Rs 5.00 per share for the year ended 31st December 2009 (2008 final - Rs 3.00 per share), which is to be approved at the Annual General Meeting to be held on 31st March 2010. In accordance with Sri Lanka Accounting Standard No 12 (Revised 2005), "Events after the Balance Sheet Date", this proposed final dividend has not been recognised as a liability as at 31st December 2009. Under the Inland Revenue Act No 10 of 2006, a withholding tax of 10% has been imposed on dividends declared. An interim dividend of Rs 1.50 per share (2008 - Rs 1.00) was paid for the shareholders on 17th November 2009. Final dividends for the year 2009 amounts to Rs 1,179,649 Mn (2008 - Rs 706.588 Mn).

**38(b) Compliance with Section 56 and 57 of Companies Act No 7 of 2007**

As required by Section 56 of the Companies Act No 07 of 2007, the Board of Directors of the Bank satisfied the solvency test in accordance with the section 57, prior to recommending the final dividend. A statement of solvency completed and duly signed by the directors on 15th February 2010 has been audited by Messrs KPMG Ford, Rhodes, Thornton & Co.

As at 31st December	Bank		Group	
	2009 Rs 000	2008 Rs 000	2009 Rs 000	2008 Rs 000
<b>39 BORROWINGS</b>				
Call and time deposits from banks	686,400	7,142,474	686,400	7,142,474
Refinance borrowings	6,447,826	6,424,054	6,447,826	6,424,054
Borrowings from foreign banks	1,446,863	1,834,762	1,446,053	1,834,762
Borrowings from local banks	-	-	4,122	-
	<b>8,581,089</b>	<b>15,401,290</b>	<b>8,584,401</b>	<b>15,401,290</b>

**40 SUBORDINATED DEBENTURES**

Balance as at 1st January	2,754,851	4,560,852	3,734,851	5,525,852
Debentures issued	-	89,705	-	89,705
Interest capitalised *	45,968	104,294	45,968	104,294
Debentures redeemed **	(127,627)	(2,000,000)	(1,127,627)	(1,985,000)
<b>Balance as at 31st December</b>	<b>2,673,192</b>	<b>2,754,851</b>	<b>2,653,192</b>	<b>3,734,851</b>

\* Interest payable on zero coupon debentures have been added to the debenture value.

\*\* On 10th September 2009 Rs 127.6 Mn worth of debentures were redeemed by the Bank, while on 15th December 2009 Rs 1 Bn worth of debentures were redeemed by Sithma Development (Pvt) Ltd.

HNB Assurance PLC a subsidiary of the Bank holds 483,845 debentures amounting to Rs 20 Mn.

## > Notes to the Financial Statements

### 40 SUBORDINATED DEBENTURES (CONTD.)

#### 40(a) Terms and Conditions of Unsecured, Subordinated, Redeemable Debentures issued are as follows

##### 40(a) i Year of Issuance 2002

Number of debentures of Rs 100 each	1,132,240
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Six types of debentures were included in the above issue, with fixed or floating interest rate options as follows.

##### Redemption period 10 Years

Fixed p.a.	14.20%
Effective annual yield p.a.	14.70%
Floating p.a.	6 months TB+1.25%
Redeemable on	10th September 2012
Amount (Rs 000)	113,224

The floating rate is based on the six month treasury bill rate with a cap of 17% p.a. and a floor of 12% p.a. These debentures are listed on the Colombo Stock Exchange.

##### 40(a) ii Year of Issuance 2006

Number of debentures of Rs 100 each	11,200,000
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Five types of debentures were included in the above issue, with fixed or floating interest rate options as follows.

Redemption Period	6 Year	7 Year	8 Year	15 Year	18 Year
Fixed p.a.				11.00%	11.25%
Effective annual yield p.a.				11.00%	11.00%
Floating p.a.	6 months TB + 2.25%	6 months TB + 2.25%	6 months TB + 2.25%		
Redeemable on	31st March 2012	31st March 2013	31st March 2014	31st March 2021	31st March 2024
Amount (Rs 000)	262,500	250,000	300,000	159,150	298,613

The above floating rate is based on the six month treasury bill rate with a cap of 16% p.a. and a floor of 8% p.a. These debentures are listed on the Colombo Stock Exchange.

##### 40(a) iii Year of Issuance 2007

Number of debentures of Rs 100 each	12,000,000
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Two types of debentures were included in the above issue with fixed rates.

##### Redemption Period 10 years 15 years

Fixed p.a.	16.00%	16.75%
Effective annual yield p.a.	16.00%	16.75%
Redeemable on	31st July 2017	31st July 2022
Amount (Rs 000)	500,000	700,000

These debentures are listed on the Colombo Stock Exchange.

#### 40 SUBORDINATED DEBENTURES (CONTD.)

40 (a) Terms and Conditions of Unsecured, Subordinated, Redeemable Debentures issued are as follows (Contd.)

40(a) iv Year of Issuance		2008				
Number of debentures of Rs 100 each		897,040				
Five types of debentures were included in the above issue with fixed or floating interest rate options as follows.						
Redemption period	5 year	7 year	10 year	10 year	15 year	
Fixed p.a.				16.00%	16.75%	
Effective annual yield p.a.				16.00%	16.75%	
Floating p.a.	1 year TB + 1.00%	1 year TB + 1.25%	1 year TB + 1.50%			
Redeemable on	4th June 2013	4th June 2015	4th June 2018	4th June 2018	4th June 2023	
Amount (Rs 000)	89,705	*	*	*	*	

These debentures are pending listing on the Colombo Stock Exchange.

\* No debentures were issued under these types.

40(a) v The above debentures will, in the event of the winding of the Bank, be subordinated to the claims of depositors and all other creditors of the Bank.

The Bank has not had any defaults of principal, interest or other breaches with respect to its subordinated liabilities during 2009 and 2008.

#### 41 INSURANCE PROVISION - LIFE

The insurance provision - life balance represents the life fund of the Subsidiary HNB Assurance PLC, which is carrying out life and 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 insurance provision - life as at 31st December 2009 was made by Mr M Poopalanathan, AIA, of Messrs Actuarial and Management Consultants (Pvt) Ltd for and on behalf of HNB Assurance PLC. The life fund stands at Rs 1,853.5 Mn as at 31st December 2009 (2008 - Rs 1,360.5 Mn) and in the opinion of the Actuary this amount is adequate to cover the liabilities pertaining to the long term insurance business of HNB Assurance PLC, as per the actuary's report dated 28th January 2010.

#### 42 INSURANCE PROVISION - NON-LIFE

Insurance provision non-life represents the following which are included in the financial statements of HNB Assurance PLC., subsidiary of the Bank, as required by the Statement of Recommended Practice of the Institute of Chartered Accountants of Sri Lanka (ICASL) and in accordance with the regulation of Insurance Industry Act No 43 of 2000.

As at 31st December	Group		Group	
	2009 Rs 000	2009 Rs 000	2008 Rs 000	2008 Rs 000
Unearned premium				
Gross		626,056		502,351
Reinsurance		(202,352)		(171,203)
Net		423,704		331,148
Deferred acquisition expenses		(4,644)		(6,735)
Unexpired risk reserve		9,244		7,470
		428,304		331,883
Claims outstanding - Gross	151,825		124,678	
Claims incurred but not reported - Gross	19,235	171,060	13,645	138,323
<b>Total</b>		<b>599,364</b>		<b>470,206</b>

## > Notes to the Financial Statements

### 43 DEFERRED TAX LIABILITIES

As at 31st December	Bank		Group	
	2009 Rs 000	2008 Rs 000	2009 Rs 000	2008 Rs 000
Deferred tax liabilities [Note 43 (a)]	967,604	903,942	968,494	905,420
Deferred tax assets [Note 43 (b)]	(28,351)	(31,540)	(30,128)	(32,756)
	939,253	872,402	938,366	872,664

#### 43(a) Deferred Tax Liabilities

	2009		Bank		2009		Group		2008	
	Temporary Difference Rs 000	Tax Effect Rs 000	Temporary Difference Rs 000	Tax Effect Rs 000	Temporary Difference Rs 000	Tax Effect Rs 000	Temporary Difference Rs 000	Tax Effect Rs 000	Temporary Difference Rs 000	Tax Effect Rs 000
Balance as at 1st January	2,582,693	903,942	2,510,184	878,563	2,588,134	905,420	2,520,378	881,705		
Originating during the year	189,919	66,472	80,538	28,189	188,240	65,884	80,331	28,116		
Deferred tax liabilities attributable to revaluation surplus charged to equity	(8,029)	(2,810)	(8,029)	(2,810)	(8,029)	(2,810)	(8,029)	(2,810)		
Adjustment for deferred tax on disposal of subsidiaries and investment in joint venture	-	-	-	-	-	-	(4,546)	(1,591)		
	2,764,583	967,604	2,582,693	903,942	2,768,345	968,494	2,588,134	905,420		

#### Deferred Tax Liability Charged Directly to Equity

According to Sri Lanka Accounting Standard No 14 (Revised 2005) "Income Taxes", deferred tax shall be charged or credited directly to equity if the tax relates to items that are credited or charged, in the same or in a different period, directly to equity.

Accordingly, the deferred tax liability arising on revaluation of property, plant and equipment of Rs 17,547 Mn was charged directly to revaluation reserve in the Statement of Changes in Equity in 2007. Reversals of Rs 2.810 Mn each in 2008 and in 2009 have been made to the revaluation reserve in the Statement of Changes in Equity from deferred tax liability. The reversal of deferred tax liability to revaluation reserve results from the excess depreciation resulting from the revaluation of property, plant and equipment that took place in 2007.

No deferred tax liability has been recognised for Sithma Development (Pvt) Ltd, in view of the tax holiday enjoyed by the company. The details have been given in Note 20 (i).

#### 43(b) Deferred Tax Asset

	2009		Bank		2009		Group		2008	
	Temporary Difference Rs 000	Tax Effect Rs 000	Temporary Difference Rs 000	Tax Effect Rs 000	Temporary Difference Rs 000	Tax Effect Rs 000	Temporary Difference Rs 000	Tax Effect Rs 000	Temporary Difference Rs 000	Tax Effect Rs 000
Balance as at 1st January	90,114	31,540	779,631	272,871	93,587	32,756	783,104	274,087		
Deferred tax asset recognised / (reversed) on general provisions	(9,111)	(3,189)	38,814	13,585	(4,040)	(1,414)	38,814	13,585		
Deferred tax on disposal of DNH Financial (Pvt) Ltd (former HNB Stockbrokers (Pvt) Ltd)	-	-	-	-	(3,469)	(1,214)	-	-		
Deferred tax asset recognised on adjustment for opening tax losses	-	-	261,539	91,539	-	-	261,539	91,539		
Reversal of deferred tax asset during the year	-	-	(989,870)	(346,455)	-	-	(989,870)	(346,455)		
	81,003	28,351	90,114	31,540	86,078	30,128	93,587	32,756		

#### 43(c) Deductible Temporary Difference - General Provision

Recognition of deferred tax asset relating to temporary differences arising from general provisions as at Balance Sheet date was limited to 6.15% (2008 - 6.72%). In management's view the Bank's NPA ratio of 6.15% as at Balance Sheet date is an indicator of deferred tax asset which could be recovered in the future periods in respect of the deductible temporary difference arising from general provision.

#### 43(d) Unused Tax Losses

No unused tax losses were brought forward in 2009 (2008 - Rs 728.3 Mn). During the year the adjustment made to the brought forward tax loss was Rs 1,459.7 Mn (2008 - Rs 261.5 Mn). The said tax losses have been fully utilised during the year. As such no deferred tax asset has been recognised against unutilised tax losses as at 31st December 2009.

**44 OTHER LIABILITIES**

As at 31st December	Bank		Group	
	2009 Rs 000	2008 Rs 000	2009 Rs 000	2008 Rs 000
Cheques sent on clearing	1,709,760	1,095,532	1,709,760	1,095,532
Accrued expenditure and interest	14,629,131	11,206,990	14,722,944	11,264,913
Claims payable	7,871	152,249	7,871	152,249
Margins	909,731	1,563,113	909,731	1,563,113
Refundable deposits and advances*	-	-	191,323	25,373
Balance held o/a of Pension Fund	2,053,398	1,204,378	2,053,398	1,204,378
Balance held o/a of Widows' / Widowers' and Orphans' Pension Fund (WW&OP)	467,970	371,027	467,970	371,027
Balance held o/a of Employees' Provident Fund (EPF)	24,813	57,194	24,813	57,195
Provision for retiring benefits	-	-	22,878	16,851
Payable to vendors for lease equipments	181,703	120,476	181,703	121,464
Other creditors	1,024,456	2,204,657	1,685,736	2,594,896
	<b>21,008,833</b>	<b>17,975,616</b>	<b>21,978,127</b>	<b>18,466,991</b>

\*Refundable deposits and advances includes the advances taken from customers on account of the apartments in the Residential Apartments Complex which is developed by Sithma Development (Pvt) Ltd.

**45 EMPLOYEE RETIREMENT BENEFITS****45(a) Pension Fund**

An actuarial valuation of the Pension Fund was carried out as at 31st December 2009 by Mr M Poopalanathan, AIA, Messrs Actuarial and Management Consultants (Pvt) Ltd, a firm of professional actuaries. The valuation method used by the actuaries to value the Fund is the "Projected Unit Credit Method", the method recommended by the Sri Lanka Accounting Standard No 16 (Revised 2006) "Employee Benefits".

Accordingly, the Bank contributes on the following basis for the employees to the Pension Fund:

Pensionable Employees - 24.34%

Employees who opted for the Optional Scheme - 23%

The assets of the Fund, which are independently administered by the Trustees as per the provision of the Trust Deed are held separately from those of the Bank.

No additional provision has been made in the Financial Statements of the Bank for gratuities to employees who have completed five or more years of service payable under the payment of Gratuity Act No 12 of 1983 as the Bank contributes for all permanent employees to its own non-contributory pension scheme, which is in force.

**45(a) i Amounts Recognised in the Balance Sheet are as follows**

As at 31st December	2009 Rs 000	2008 Rs 000
Present value of unfunded obligation	-	-
Present value of funded obligation	6,927,747	6,496,902
<b>Total present value of obligations</b>	<b>6,927,747</b>	<b>6,496,902</b>
Fair value of plan assets	(5,977,832)	(4,338,509)
<b>Present value of net obligations</b>	<b>949,915</b>	<b>2,158,393</b>
Unfunded amortisation of transitional liability	-	(283,475)
Unfunded amortisation of increase in deficit from previous year	-	(7,025)
Less: Unrecognised net obligations	(949,915)	(1,867,893)
<b>Recognised liability for defined benefit obligations</b>	<b>-</b>	<b>-</b>

## > Notes to the Financial Statements

### 45 EMPLOYEE RETIREMENT BENEFITS (CONTD.)

#### 45(a) Pension Fund (Contd.)

##### 45(a) ii Plan Assets Consist of the Following As at 31st December

	2009 Rs 000	2008 Rs 000
Equity securities and debentures	245,868	1,370,952
Government bond	3,327,393	1,860,316
Balance with HNB PLC	2,053,398	812,687
Fixed deposits	250,040	-
Other investments	101,133	229,225
Interest receivable	-	72,952
Tax payable	-	(7,623)
	<b>5,977,832</b>	<b>4,338,509</b>

Plan assets for 2009 was as at 31st December 2009 while for 2008 it was as at 31st October 2008 since the actuarial valuation was carried out based on 31st October 2008 balances.

#### 45(a) iii Movement in the Present Value of Defined Benefit Obligations

	2009 Rs 000	2008 Rs 000
Liability for defined benefit obligations as at 1st January	6,496,902	5,275,079
Actuarial (gains) / losses	(371,379)	595,537
Benefits paid by the plan	(260,270)	(305,922)
Current service cost and interest cost	1,062,494	932,208
Liability for defined benefit obligations as at 31st December	<b>6,927,747</b>	<b>6,496,902</b>

#### 45(a) iv Movement in Plan Assets

	2009 Rs 000	2008 Rs 000
Fair value of plan assets brought forward	4,338,509	3,857,705
Contributions paid into plan	1,106,182	481,234
Benefits paid by the plan	(260,270)	(305,922)
Actuarial gains / (losses)	225,810	(595,537)
Expected return on plan assets	567,601	901,029
Fair value of plan assets as at 31st December	<b>5,977,832</b>	<b>4,338,509</b>

#### 45(a) v Actuarial Assumptions

	2009	2008
Discount rate as at 31st December	10.50%	11.50%
Expected return on plan assets as at 1st January	11.50%	15.00%
Future salary increases	10.01%	11.12%
Future pension increases	Nil	Nil
Increase in cost of living allowance	Nil	Nil

Assumptions regarding future mortality are based on 1967 - 70 mortality table and a (90) annuitants table (males and females) issued by the Institute of Actuaries.

The overall expected long term rate of return on assets is 11.5%.

The demographic assumptions underlying the valuation are retirement age (55 yrs), early withdrawals from service and retirement on medical grounds, death before and after retirement, etc.

#### 45 EMPLOYEE RETIREMENT BENEFITS (CONTD.)

##### 45 (a) Pension Fund (Contd.)

##### 45 (a) vi Historical Information

As at 31st December	2008 Rs 000	2007 Rs 000
Present value of the defined benefit obligation	6,496,902	5,275,079
Fair value of plan assets	(4,338,509)	(3,857,705)
Deficit in the plan	2,158,393	1,417,374

##### 45 (b) Widows', Widowers' and Orphans' Pension Fund

The results of the actuarial valuation of the Widows', Widowers' and Orphans' Pension Scheme indicates that the actuarial present value of the promised benefit is Rs 176.9 Mn and that the fair value of the fund assets is Rs 466.8 Mn resulting in a past service surplus of Rs 289.9 Mn (2008 - Rs 199.02 Mn) in the Widows', Widowers' and Orphans' Pension Scheme as at 31st December 2009.

No contribution is made by the Bank and the members contribution during the period amounted to Rs 37.5 Mn.

#### 46 STATED CAPITAL

In accordance with Section 58 of Companies Act No 7 of 2007, which became effective from 3rd May 2007, share capital and share premium have been classified as stated capital.

As at 31st December	2009 Rs 000	2008 Rs 000
<b>Voting ordinary shares</b>		
As at 1st January		
189,329,400 (2008 - 189.3 Mn) voting ordinary shares	2,881,387	2,881,387
Issue of shares under ESOP		
191,215 voting ordinary shares	22,093	-
As at 31st December		
189,520,615 (2008 - 189.3 Mn) voting ordinary shares	2,903,480	2,881,387
<b>Non-voting ordinary shares</b>		
As at 1st January		
46,200,000 (2008 - 46.2 Mn) non-voting ordinary shares	2,178,003	2,178,003
Issue of shares under ESOP		
49,532 non-voting ordinary shares	2,601	-
As at 31st December		
46,249,532 (2008 - 46.2 Mn) non-voting ordinary shares	2,180,604	2,178,003
Stated Capital as at 31st December	5,084,084	5,059,390

The non-voting shares rank pari passu in respect of all rights with the ordinary shares of the Bank except voting rights on resolutions passed at general meetings. If the Bank fails to pay dividends for three consecutive years, these shares will automatically be converted into voting ordinary shares.

Voting and non voting shares included under stated capital consist of share premium on shares issued of Rs 988 Mn and Rs 1,716 Mn respectively.

## > Notes to the Financial Statements

### 46 STATED CAPITAL (CONTD.)

#### 46(a) Employee Share Ownership Plan

Employee Share Ownership Plan was introduced in 2005 where shares were offered to the executive employees of the Bank.

No shares were allotted under the Employee Share Ownership Plan in 2009 and the loan outstanding as at 31st December 2009 amounts to Rs 136.518 Mn. The amount released to the employees who left the service in 2009 is Rs 23.16 Mn.

#### 46(b) Employee Share Option Plan

Type of share	Number of options brought forward	Number of options allocated	Number of options expired	Number of options exercised	Number of options remaining	Allotment price Rs	Weighted average share price Rs
Voting	2,246,902	Nil	92,489	191,215	1,963,198	115.54	120.69
Non voting	548,282	Nil	22,607	49,532	476,143	52.51	59.88

No financial assistance is granted to the employees in order to purchase shares.

The share options received at a particular grant can be exercised only after one year from the grant date. However if an employee retires during the year in which he or she has been granted the options, may exercise the options prior to retirement.

The outstanding options can be exercised within four years from the end of retention period (ended on 27th March 2009) or at retirement, resignation or death whichever occurs first. The remaining contractual life of share options is 3 years and 2 months.

### 47 COMMITMENTS AND CONTINGENCIES - BANK AND GROUP

In the normal course of business, the Bank makes various commitments and incurs certain contingent liabilities with legal recourse to its customers and would be party to litigation due to its operations. No material losses are anticipated as a result of these transactions.

#### 47(a) Capital Commitments

Capital expenditure approved by the Board of Directors for which provision has not been made in the accounts amount to approximately Rs 251 Mn.

As at 31st December	Bank		Group	
	2009 Rs 000	2008 Rs 000	2009 Rs 000	2008 Rs 000
Approved and contracted for	250,958	532,167	250,958	590,257
Approved and not contracted for	-	-	-	14,186
	250,958	532,167	250,958	604,443



**47 COMMITMENTS AND CONTINGENCIES - BANK AND GROUP (CONTD.)****47 (b) Future Monthly Commitments on Operating Leases - Bank**

As at 31st December	2009 Rs 000	2008 Rs 000
1 - 5 years	6,960	10,254
6 - 10 years	17,591	5,550
11 - 15 years	798	1,231
16 - 20 years	278	-
	<b>25,627</b>	<b>17,035</b>

**47 (c) Irrevocable Commitments - Bank**

Commitments as at Balance Sheet date that cannot be revoked at the discretion of the Bank without the risk of incurring significant penalty or expense amounted to Rs 29,749 Mn (2008 - Rs 28,765 Mn).

**47 (d) Contingent Liabilities**

As at 31st December	2009 Rs 000	2008 Rs 000
Acceptances	4,040,195	11,304,696
Documentary credits	9,505,450	8,933,960
Guarantees	20,244,879	19,831,166
Bills for collection	6,062,584	8,145,443
Interest rate swap	2,940	4,391
	<b>39,856,048</b>	<b>48,219,656</b>
Forward exchange contracts	23,171,172	19,846,301
<b>Total - Bank</b>	<b>63,027,220</b>	<b>68,065,957</b>
Contingent liabilities Subsidiaries	12,480	-
Group's share of Associate's contingent liabilities	-	21,134
<b>Total Contingencies - Group</b>	<b>63,039,700</b>	<b>68,087,091</b>

Unrecognised pension fund deficit amounted to Rs 950 Mn as at 31st December 2009.

**47 (e) Litigation against the Bank**

- 1 HC (Civil) Case No 132/2001 (i), a depositor's claim for damages against Habib Bank AG Zurich Sri Lanka Branch (HBZ) for setting off a customer liability with a deposit - the Bank substituted with acquisition of HBZ business operations.\*
- 2 HC (Civil) Case No 277/2007 MR a claim for damages for dishonour of Bank Draft due to a technical issue and for closure of current account.
- 3 Labour Tribunal Cases Nos 03/148/99, 13/884/2000, ADDL./2404/2002, 23/7957/2002, 26/02/2004, 26/122/2004, 27/1725/2007, 31/126/2007, 32/83/2007, 13/53/2007, 3/18/2008, 13.04/2009, 32/82/2009, 10/96/2009 and 19/2009.
- 4 L T Appeal Cases No: 18/2009 filed by Mr B D Niroshan before the High Court of Kandy.
- 5 L T Appeal Case No: 82/2008 filed by Mr S Ramakumar before the High Court Badulla.
- 6 Supreme Court Leave to Appeal Application No 170/2008 vs K M Mohan.

\* Judgement delivered on 12th January 2010, dismissing the action of the plaintiff.

Based on the above information available on the current status of the above cases, the Bank is not in a position to quantify the potential financial impact if any, as at the Balance Sheet date. Further, the Bank confirms that there is no case which is not disclosed above which would have a material impact on the financial position of the Bank.

## > Notes to the Financial Statements

### 47 COMMITMENTS AND CONTINGENCIES - GROUP AND BANK (CONTD.)

#### 47(f) Tax assessments against the Bank

The following tax assessments are outstanding, against which the Bank has duly appealed.

- (i) VAT on financial services for 2003 and 2004, taxes amounting to Rs 247 Mn, on Assessment Nos VATFS/06/0312/06, VATFS/U6/0401/01, VATFS/J6/0402/02, VATFS/U6/0403/03, VATFS/U6/0404/04 and VATFS/U6/0405/05 (pursuant to the determination made by the Board of Review on the appeal made for VAT on financial services for the year 2003 the Bank has made an application requiring the Board of Review to state a case).
- (ii) PAYE taxes amounting to Rs 407 Mn. on Assessments Nos 8018210, 8202714, and 8364152 for the years 2003, 2004 and 2005 respectively.
- (iii) VAT on financial services for 2006 taxes amounting to Rs 437.7 Mn, on Assessments Nos VATFS/BFSU/2009/110 to VATFS/BFSU/2009/113.
- (iv) VAT on financial services for 2007 taxes amounting to Rs 1,330.6 Mn, on Assessments Nos VATFS/BFSU/2009/131 to VATFS/BFSU/2009/142.
- (v) VAT for the year 2005 taxes amounting to Rs 10.5 Mn, on Assessments Nos 8865223 and 8865224.
- (vi) VAT for the year 2009 taxes amounting to Rs 11.8 Mn, on Assessment No 8882823.
- (vii) Income tax for the Year of Assessment 2004 / 05 amounting to Rs 57.2 Mn, on Assessment No 8598463.
- (viii) Income tax for the Year of Assessment 2007 / 08 amounting to Rs 167.7 Mn, on Assessment No 8888417.

The Bank is of the view that the above assessments will not have any material impact on the Financial Statements.

### 48 RELATED PARTY DISCLOSURES

The Bank carries out transactions in the ordinary course of its business with parties who are defined as related parties in Sri Lanka Accounting Standard 30 (Revised 2005) "Related Party Disclosures", the details of which are reported below. The pricing applicable to such transactions is based on the assessment of risk and pricing model of the Bank and is comparable with what is applied to transactions between the Bank and its unrelated customers.

#### 48(a) Parent and Ultimate Controlling Party

The Bank does not have an identifiable parent of its own.

#### 48(b) Transactions with Key Management Personnel (KMP)

According to Sri Lanka Accounting Standard 30 (Revised 2005) "Related Party Disclosures", Key Management Personnel are those having authority and responsibility for planning, directing and controlling the activities of the entity. Accordingly, the Directors of the Bank (including executive and non-executive Directors) and their immediate family members have been classified as KMP of the Bank.

Immediate family member is defined as spouse or dependent. Dependent is defined as anyone who depends on the respective Director for more than 50% of his / her financial needs.

As the Bank is the ultimate parent of its Subsidiaries listed out in Note 32, and the Board of Directors of the Bank have the authority and responsibility for planning, directing and controlling the activities of the Group, the Directors of the Bank and their immediate family members have been identified as the KMP of the Group.

Therefore, officers who are only directors of the Subsidiaries and not of the Bank have been classified as KMP of that respective Subsidiary only.

**48 RELATED PARTY DISCLOSURES (CONTD.)****48(b) i Compensation to KMP**

	Bank	Group
Short term employment benefits (Rs 000)	50,092	50,312
Post employment benefits (Rs 000)	5,901	5,901
	55,993	56,213
Benefits under Employee Share Option Plan		
Voting (No of shares)	38,083	38,083
Non-voting (No of shares)	9,293	9,293
Benefits under Employee Share Ownership Plan		
Non-voting (No of shares)	46,815	46,815

In addition to their salaries, Bank also provides non cash benefits to KMP and contributes to a post employment defined benefit plan on behalf of the Executive Director.

**48(b) ii Credit Card Facilities to KMP**

	As at 31st December 2009	
	Limit Rs 000	Outstanding Balance Rs 000
Mr Rienzie T. Wijetilleke (Chairman)	500	199
Mr Rajendra Theagarajah (Managing Director / CEO)	500	-
Mr D H S Jayawardena *	10,500	682
Mr M V Theagarajah	500	8
Mr R K Obeyesekere	500	80
Ms Pamela C. Cooray	500	58
Mr Ranjeevan Seevaratnam	310	-
Mr N G Wickremeratne **	900	300

\* Rs 500,000/= clean and the balance is secured by cash deposits.

\*\* Director appointed on 1st July 2009. To be regularised during the year.

**48(b) iii Facilities Granted to KMP**

Name of Director	As at 31st December 2009		Security
	Aggregate Limit Rs 000	Amount of Accommodation Outstanding Rs 000	
Mr Rienzie T. Wijetilleke (Chairman)	1,803	1,020	Cash deposit
Mr M V Theagarajah	4,600	870	Cash deposit
Mr Ranjeevan Seevaratnam	1,500	295	Cash deposit
Mr N G Wickremeratne	180	84	Shares and Cash Deposit

No losses have been recorded against loan balances outstanding during the period with KMP and no specific provisions have been made for loan losses on balances with KMP and their immediate family members as at the Balance Sheet date.

**48(b) iv Deposits held by KMP with the Bank**

As at Balance Sheet date the aggregate deposits (including Treasury Bills and Repos) held by the KMP with the Bank are as follows:

SLRs '000	150,970
USD '000	162
GBP '000	490
Euro '000	143

## > Notes to the Financial Statements

### 48(c) Transactions with / between Subsidiaries

Details of the Subsidiaries are given in Note 32.

#### 48(c) i HNB Assurance PLC

HNB Assurance PLC (“Assurance”), is a Subsidiary of the Bank.

The details of the transactions with the Bank are as follows.

(a) Assurance held deposits and current accounts with the Bank amounting to Rs 122.35 Mn as at 31st December 2009 (2008 - Rs 140.26 Mn). The Company also held debentures of the Bank amounting to Rs 20.0 Mn as at 31st December 2009 (2008 - Rs 20.0 Mn).

(b) A summary of transactions of Assurance with the Group are given below:

Transaction Type	HNB Rs 000	SITHMA Rs 000
Premium received	34,093	8,785
Claims incurred	7,288	7,236
Interest received	10,153	-
Rent paid	13,581	-
Commission paid	51,995	-
Dividend paid	28,118	-

#### 48(c) ii Sithma Development (Pvt) Ltd

Sithma Development (Pvt) Ltd (“Sithma”) is a wholly owned Subsidiary of the Bank.

(a) The details of its borrowing transactions with the Bank are as follows:

Type of Facility	Rate of Interest	As at 31st December 2009		Security
		Limit Rs 000	Outstanding Rs 000	
Overdraft	2% above the one year *WATB. to be reviewed every 6 months.	1,000,000	776,240	Registered primary floating mortgage for Rs 2,000 Mn over land and building at No 479, T B Jayah Mw, Colombo 10.
Term Loan	1.5% above the 6 month treasury bill rate (gross). To be reviewed every 6 months (24 months grace period) Interest payable	2,000,000	2,000,000  15,780	A primary mortgage bond for Rs 2,000 Mn over immovable property at No 479, T B Jayah Mw, Colombo 10. (Standing concurrent to existing primary concurrent mortgage bond)

\*WATB - Weighted Average Treasury Bill rate

(b) A summary of other transactions of Sithma with the Group are given below:

Transaction Type	HNB Rs 000	HNB ASSURANCE Rs 000
Rent income received	612,000	-
Consultancy fee received	2,380	-
Refundable deposit received	500,000	-
Insurance premium paid	-	8,785
Overdraft interest paid	147,070	-
Term loan interest paid	187,400	-
Ground rent paid	3,750	-

**48 (c) iii Majan Exchange LLC**

Majan Exchange LLC (Majan) is a 40% owned Subsidiary of the Bank.

Majan maintains a current account with the Bank and the balance as at 31st December 2009 amounted to Rs 389,000/=. The Bank has made an advance payment to Majan to the value of Rs 12.3 Mn.

**48 (c) iv Commercial Interlink Services Inc (o/a of Delma Exchange Canada)**

Commercial Interlink Services Inc (o/a of Delma Exchange Canada) is a 95% owned Subsidiary of the Bank.

The Company maintains a current account with the Bank and the balance as at 31st December 2009 amounted to Rs 421,000/=. The Bank has made an advance payment to Delma Canada to the value of Rs 23.9 Mn.

**48(d) Transactions with Associates****48(d) i Lanka Ventures PLC**

Lanka Ventures PLC is a 20.07% owned Associate of the Bank.

Lanka Ventures PLC has term deposits and debentures of Rs 14.9 Mn (2008 - Rs 33.5 Mn) placed with the Bank as at 31st December 2009, in respect of which interest amounting to Rs 4.0 Mn (2008 - Rs 6.8 Mn) has been paid by the Bank for the financial year 2009.

**48(d) ii Delma Exchange**

Delma Exchange is a 20% owned Associate of the Bank.

Delma Exchange maintains current accounts with the Bank and the balance as at 31st December 2009 amounted to Rs 9.8 Mn.

**48(d) iii Splendor Media (Pvt) Ltd**

Splendor Media (Pvt) Ltd is a 25% owned Associate of Sithma, a fully owned Subsidiary of the Bank.

The Bank and Sithma have paid Rs 24.78 Mn (2008 - Rs. 27.95 Mn) and Rs 0.44 Mn (2008 - nil) respectively net of rebate received to Splendor Media (Pvt) Ltd as commission against advertising channeled through that company.

**48(e) Transactions with Joint Venture - Acuity Partners (Pvt) Ltd**

Acuity Partners (Pvt) Ltd has a current account with the Bank with a balance of Rs 192,455 (2008 - Rs 7,770) as at 31st December 2009 and has paid bank charges of Rs 130,000 (2008 - Rs 6,000).

**48(f) Transactions with Other Related Entities**

Other Related Entities are those which are controlled or significantly influenced, directly or indirectly by KMP of the Bank. Significant influence is presumed to be established if a KMP of the Bank has more than 20% shareholding in an entity, unless otherwise rebutted by the respective KMP. Further, significant influence is also established if in the view of a KMP, he / she has the ability to influence the operating and financial policies of an entity even in the absence of 20% shareholding.

The transactions of the Bank with other related entities are disclosed in Note 48 (f) i, ii and iii.

## > Notes to the Financial Statements

### 48 RELATED PARTY TRANSACTIONS (CONTD)

#### 48(f) i Lending Transactions with Other Related Entities by the Bank

Company	Name of Director (Relationship)	Nature of Transaction	Aggregate Amount of Accommodation as at 31st December 2009		Security	
			Limit (Rs Mn)	Outstanding (Rs Mn)		
Stassen Exports (Pvt) Ltd	Mr D H S Jayawardena (Chairman / Shareholder) Mr R K Obeyesekere (Director / Shareholder)	Overdraft I	2,253.50	2,306.59	Cash deposits, quoted company shares and inventories	
		Overdraft II	695.00			
		Letters of Credit	15.00			
		Letters of Guarantee	100.00			
		Forex Forward Contracts	172.50			
		Negotiation of Documentary Bills	(15.44)			
<b>Total</b>		<b>3,236.00</b>	<b>2,426.69</b>			
Stassen International (Pvt) Ltd	Mr D H S Jayawardena (Chairman) Mr R K Obeyesekere (Director)	Overdraft	34.00	16.04	Cash deposits, quoted company shares and inventories	
		Letters of Credit	70.00	15.41		
		Letters of Guarantee	125.00	61.71		
		Negotiation of Documentary Bills	(46.33)	46.33		
		<b>Total</b>	<b>229.00</b>	<b>139.49</b>		
Milford Exports (Ceylon) (Pvt) Ltd	Mr D H S Jayawardena (Chairman / Shareholder) Mr R K Obeyesekere (Director / Shareholder)	Overdraft	0.50	-	Quoted company shares and inventories	
		Letters of Credit	2.00	-		
		Letters of Guarantee	40.00	13.32		
		<b>Total</b>	<b>42.50</b>	<b>13.32</b>		
Madulsima Plantations PLC	Mr D H S Jayawardena (Chairman) Mr R K Obeyesekere (Director)	Overdraft I	50.00	95.62	Quoted company shares, mortgage over leasehold property, inventories and cash deposits	
		Overdraft II	70.00			
		Standby Overdraft	33.00			
		Letters of Guarantee	3.75			
		Term Loan I	46.66			
		Term Loan II	17.35			
		<b>Total</b>	<b>220.76</b>			<b>162.38</b>
Stassen Natural Foods (Pvt) Ltd	Mr D H S Jayawardena (Chairman) Mr R K Obeyesekere (Director)	Letters of Credit	6.00	1.17	Quoted company shares	
		Letter of Guarantee	15.00	15.00		
		Negotiation of Documentary Bills	(5.43)	5.43		
		Temporary Negotiation of Documentary Bills	0.60	-		
		<b>Total</b>	<b>21.60</b>	<b>21.60</b>		
		Browns Beach Hotels PLC	Mr D H S Jayawardena (Chairman) Mr M V Theagarajah (Director)	Letters of Guarantee		0.21
<b>Total</b>	<b>0.21</b>			<b>0.21</b>		
Lanka Milk Foods (CWE) PLC	Mr D H S Jayawardena (Chairman) Mr R K Obeyesekere (Director)	Overdraft	300.00	235.70	Quoted company shares, immovable property (leasehold), and plant & machinery	
		Letters of Credit	550.00	-		
		Letters of Guarantee	30.00	47.46		
		Letter of Guarantee II	(20.00)	-		
<b>Total</b>	<b>880.00</b>	<b>283.16</b>				
Lanka Dairies (Pvt) Ltd	Mr D H S Jayawardena (Chairman) Mr R K Obeyesekere (Director)	Overdraft	200.00	109.93	Quoted company shares and cash deposits	
		Letter of Credit	100.00	-		
		Letters of Guarantee	-	1.16		
		<b>Total</b>	<b>300.00</b>	<b>111.09</b>		
Ambewela Products (Pvt) Ltd	Mr D H S Jayawardena (Chairman) Mr R K Obeyesekere (Director)	Overdraft	10.00	*10.11	Quoted company shares, immovable property (leasehold), and plant and machinery * Due to month end interest. Pending transfer of funds - since regularised	
		Letters of Credit	50.00	-		
		<b>Total</b>	<b>60.00</b>	<b>10.11</b>		

## 48 RELATED PARTY TRANSACTIONS (CONTD)

## 48(f) i Lending Transactions with Other Related Entities by the Bank (Contd.)

Company	Name of Director (Relationship)	Nature of Transaction	Aggregate Amount of Accommodation as at 31st December 2009		Security
			Limit (Rs Mn)	Outstanding (Rs Mn)	
Ambewela Livestock Company Ltd	Mr D H S Jayawardena (Chairman) Mr R K Obeyesekere (Director)	Overdraft	50.00	31.83	Quoted company shares, immovable property (leasehold), and plant & machinery
		Letters of Credit	10.00	-	
		<b>Total</b>	<b>60.00</b>	<b>31.83</b>	
Pattipola Livestock Company Ltd	Mr D H S Jayawardena (Chairman) Mr R K Obeyesekere (Director)	Overdraft	50.00	28.08	Quoted company shares, immovable property (leasehold), and plant & machinery
		Letters of Credit	10.00	-	
		<b>Total</b>	<b>60.00</b>	<b>28.08</b>	
Distilleries Company of Sri Lanka PLC	Mr D H S Jayawardena (Chairman) Mr R K Obeyesekere (Director)	Standby Overdraft	120.00	-	Quoted company shares and cash deposits
		Letters of Credit	400.00	298.75	
		Letters of Guarantee	3.07	3.07	
		<b>Total</b>	<b>523.07</b>	<b>301.82</b>	
Periceyl (Pvt) Ltd	Mr D H S Jayawardena (Chairman) Mr R K Obeyesekere (Director)	Standby Overdraft	(25.00)	-	Quoted company shares and cash deposits
		Letters of Credit	25.00	14.05	
		Letters of Guarantee	1.70	1.70	
		<b>Total</b>	<b>26.70</b>	<b>15.75</b>	
Balangoda Plantations PLC	Mr D H S Jayawardena (Chairman) Mr R K Obeyesekere (Director)	Overdraft	45.00	2.95	Immovable property (leasehold), and cash deposits
		Development Loan	0.99	0.99	
		Letters of Guarantee	7.70	7.70	
		<b>Total</b>	<b>53.69</b>	<b>11.64</b>	
Texpro Industries Ltd	Mr D H S Jayawardena (Chairman)	Overdraft	18.83	*18.99	cash deposit, Immovable property / machinery and Inventories
		Bank Guarantee	0.89	0.89	
		<b>Total</b>	<b>19.72</b>	<b>19.88</b>	
		Overdraft US\$ Mn	0.15	0.12	* Excess temporary. Since Regularized
		Letter of Credit US\$ Mn	1.60	0.84	
		Export Loans US\$ Mn	(1.60)	0.16	
		Bill Purchase US\$ Mn	(0.30)	0.15	
		Term Loans US\$ Mn	0.02	0.02	
		Term Loans US\$ Mn	0.07	0.07	
		<b>Total US\$ Mn</b>	<b>1.84</b>	<b>1.36</b>	
Falcon Commodities (Pvt) Ltd	On the date the accommodation was granted, Mr D H S Jayawardena had significant influence [through the shareholding of Stassen Exports (Pvt) Ltd] in Falcon Commodities (Pvt) Ltd, which was since disposed	Overdraft / Import Bills	Cancelled	313.21	Cash deposits and inventories Accommodation granted to Falcon Commodities (Pvt) Ltd continues to be classified as Nonperforming. The outstanding of Rs 326.41 Mn as at 31st December 2009 and the unsecured net exposure is fully covered by the capital provisioning of Rs 248.12 Mn made in previous years
		Overdraft (Habib Bank AG Zurich Ltd)	-	13.20	
		<b>Total</b>	<b>Nil</b>	<b>326.41</b>	

## > Notes to the Financial Statements

### 48 RELATED PARTY TRANSACTIONS (CONTD.)

#### 48(f) i Lending Transactions with Other Related Entities by the Bank (Contd.)

Company	Name of Director (Relationship)	Nature of Transaction	Aggregate Amount of Accommodation as at 31st December 2009		Security
			Limit (Rs Mn)	Outstanding (Rs Mn)	
Elpitiya Plantations PLC	Subsidiary of Aitken Spence Plantation Management Ltd	Overdraft	50.00	*50.35	Inventories, immovable property, absolute ownership of the equipment / vehicles leased and cash deposits * Excess temporary. Since Regularized
		Letters of Guarantee	1.00	1.00	
		Commercial Paper / Money Mkt Loan	100.00	100.00	
		Revolving Loan	10.00	10.00	
		Term Loan	10.50	10.50	
		Term Loan	9.02	9.02	
		Term Loan	4.99	4.99	
		E-friends Loan	6.83	6.83	
		Leases	12.81	12.81	
		<b>Total</b>	<b>205.15</b>	<b>205.50</b>	
A E N Palm Oil Processing (Pvt) Ltd	Subsidiary of Aitken Spence PLC in which Mr D H S Jayawardena is the Chairman	Term Loan	30.78	30.78	Immovable property (leasehold) and Inventories
		Short Term Export Loan	33.00	-	
		Negotiation of Documentary Bills	(33.00)	-	
		Term Loan	(10.00)	2.50	
		<b>Total</b>	<b>63.78</b>	<b>33.28</b>	
Aitken Spence Hotel Holdings PLC	Subsidiary of Aitken Spence PLC in which Mr D H S Jayawardena is the Chairman	Term Loan	623.24	623.24	Corporate Guarantee
		Overdraft	20.00	-	
		<b>Total</b>	<b>643.24</b>	<b>623.24</b>	
Aitken Spence Resources (Pvt) Ltd	Subsidiary of Aitken Spence PLC in which Mr D H S Jayawardena is the Chairman	Letters of Guarantee	0.75	0.75	Corporate Guarantee
		<b>Total</b>	<b>0.75</b>	<b>0.75</b>	
Aitken Spence Hotel Managements (Pvt) Ltd	Subsidiary of Aitken Spence Hotel Holdings PLC which is a Subsidiary of Aitken Spence PLC in which Mr D H S Jayawardena is the Chairman	Overdraft	10.00	-	Corporate Guarantee
		<b>Total</b>	<b>10.00</b>	-	
Neptune Ayurvedic Village (Pvt) Ltd	Subsidiary of Aitken Spence Hotel Holdings PLC which is a Subsidiary of Aitken Spence PLC in which Mr D H S Jayawardena is the Chairman	Overdraft	10.00	-	Corporate Guarantee
		<b>Total</b>	<b>10.00</b>	-	
Hethersett Hotels Ltd	Subsidiary of Aitken Spence Hotel Holdings PLC which is a Subsidiary of Aitken Spence PLC in which Mr D H S Jayawardena is the Chairman	Term Loan	11.98	11.98	Corporate Guarantee
		Overdraft	15.00	1.19	
		<b>Total</b>	<b>26.98</b>	<b>13.17</b>	



## 48 RELATED PARTY TRANSACTIONS (CONTD.)

## 48(f) i Lending Transactions with Other Related Entities by the Bank (Contd.)

Company	Name of Director (Relationship)	Nature of Transaction	Aggregate Amount of Accommodation as at 31st December 2009		Security
			Limit (Rs Mn)	Outstanding (Rs Mn)	
Ace Containers (Pvt) Ltd	Subsidiaries of Aitken Spence PLC in which Mr D H S Jayawardena is the Chairman	Interchangeable Limit within 6 companies			Corporate Guarantee
Ace Distriparks (Pvt) Ltd		Overdraft	70.00	54.15	
Ace Container Repair (Pvt) Ltd		Letters of Credit	(70.00)	12.75	
Ace Freight Management (Pvt) Ltd		Letters of Guarantee	(70.00)	20.55	
Ace Haulage (Pvt) Ltd		<b>Total</b>	<b>70.00</b>	<b>*87.45</b>	
Ace Container Terminal (Pvt) Ltd					
Aitken Spence Garments Ltd	Subsidiary of Aitken Spence PLC in which Mr D H S Jayawardena is the Chairman	Overdraft	(25.00)	-	Immovable property, Corporate Guarantee, quoted company shares and inventories
		Letters of Guarantee	0.43	*1.44	
		<b>Total</b>	<b>0.43</b>	<b>1.44</b>	
		Overdrafts US\$ Mn	0.25	0.13	
		Letters of Credit US\$ Mn	1.50	0.37	
	Short Term Export Loan US\$ Mn	(1.50)	1.10	*Enhanced limit of Rs 2 Mn since approved	
	<b>Total US\$ Mn</b>	<b>1.75</b>	<b>1.60</b>		
Cowrie Investments (Pvt) Ltd	Subsidiary of Aitken Spence Hotel Holdings PLC which is a Subsidiary of Aitken Spence PLC in which Mr D H S Jayawardena is the Chairman	Overdraft US\$ Mn	2.00	1.15	Immovable property (leasehold)
		Term Loan US\$ Mn	1.27	1.27	
		<b>Total US\$ Mn</b>	<b>3.27</b>	<b>2.42</b>	
Ace Power Embilipitiya (Pvt) Ltd	Subsidiary of Aitken Spence PLC in which Mr D H S Jayawardena is the Chairman	Overdraft	200.00	344.31	Immovable property and machinery
		Syndicated Overdraft	(250.00)		
		Letter of Guarantee	33.50		
		<b>Total</b>	<b>233.50</b>	<b>377.81</b>	
		Overdraft US\$ Mn	0.62	0.16	
		Overdraft US\$ Mn	1.63		
		Standby Letter of Credit US\$ Mn	0.13	-	
		Term Loan US\$ Mn	0.13	0.13	
		Term Loan US\$ Mn	0.56	0.56	
		<b>Total US\$ Mn</b>	<b>3.07</b>	<b>0.85</b>	
Elpitiya Lifestyle Solutions (Pvt) Ltd	Subsidiary of Elpitiya Plantation PLC	Overdraft	4.00	3.95	Immovable property (leasehold), plant & machinery and Corporate Guarantee
		<b>Total</b>	<b>4.00</b>	<b>3.95</b>	
ADS Resorts (Pvt) Ltd	Subsidiary of Aitken Spence Hotel International Ltd	Term Loan US\$ Mn	2.53	2.53	Immovable property
		<b>Total US\$ Mn</b>	<b>2.53</b>	<b>2.53</b>	
Unique Resorts (Pvt) Ltd	Subsidiary of Aitken Spence Hotel International Ltd	Term Loan US\$ Mn	15.05	15.05	Immovable property
		<b>Total US\$ Mn</b>	<b>15.05</b>	<b>15.05</b>	
Kandalama Hotels Ltd	Subsidiary of Aitken Spence Hotel Holdings PLC	Overdraft	20.00	-	Corporate Guarantee
		<b>Total</b>	<b>20.00</b>	-	
CBD Exports Ltd	Mr R K Obeyesekere (Managing Director)	Letters of Guarantee	10.00	-	Quoted company shares
		<b>Total</b>	<b>10.00</b>		

## > Notes to the Financial Statements

### 48(f) ii Other Business Transactions with Other Related Entities by the Bank

Company	Name of Director (Relationship)	Nature of Transaction	Amount (Rs Mn)
Madulsima Plantation PLC	Mr D H S Jayawardena (Chairman) Mr R K Obeyesekere (Director)	Lease of holiday bungalow at Bogawantalawa	2.07
Lanka Bell (Pvt) Ltd	Mr D H S Jayawardena (Chairman)	Telecommunication charges	25.06
Sri Lanka Insurance Corporation Ltd (Ceased to be a related entity w.e.f. 5th June 2009)	Mr D H S Jayawardena (Chairman) Mr R K Obeyesekere (Deputy Chairman)	Insurance Premiums Claims lodged	27.05 15.23
Lanka Financial Services Bureau Ltd	Mr Rajendra Theagarajah (Chairman)	Subscription paid	2.78
Hatton National Bank Retirement Pension Fund	Mr Rajendra Theagarajah (Trustee)	Investment in term deposits Investment in HNB debentures Balance held by the Bank on behalf of the fund Interest Paid Contributions made in 2009	239.61 33.78 2,053.40 209.66 815.62
Hatton National Bank Employee Provident Fund	Mr Rajendra Theagarajah (Trustee)	Investment in term deposits Investment in Repos Balance held by the Bank on behalf of the fund Investment in HNB Shares - Voting - Non-voting Interest paid	200.00 2,853.58 24.81 2.08 8.73 330.29
Widows', Widowers' and Orphans' Pension Fund	Mr Rajendra Theagarajah (Trustee)	Balance held by the Bank on behalf of the fund Interest Paid	647.97 69.51
Acuity Partners (Pvt) Ltd	Mr Rajendra Theagarajah (Director)	Bank charges received Current account balance as at year end	0.13 0.19
Acuity Securities Ltd	Mr Rajendra Theagarajah (Director)	Interest paid Interest received Commission received Current account balance as at year end	0.63 15.40 0.82 4.90
Acuity Stockbrokers (Pvt) Ltd	Mr Rajendra Theagarajah (Director)	Agent commission received Bank charges received Current account balance as at year end	4.50 0.41 40.32
DNH Financial (Pvt) Ltd (Former HNB Stockbrokers (Pvt) Ltd. This company ceased to be a Subsidiary of Acuity Partners (Pvt) Ltd from 8th October 2009)	Mr Rajendra Theagarajah (Director)	Interest paid Interest received Current account balance as at year end Deposit balance as at year end	0.36 0.36 38.00 10.80

**48 (f) iii Business Transactions with Other Related Entities by the Group**

Company	Name of Director (Relationship)	Nature of Transaction	Amount (Rs Mn)
<b>Sithma Development (Pvt) Ltd</b>			
Acuity Securities Ltd	Mr Rajendra Theagarajah (Director)	Lease rentals received	0.54
<b>DNH Financial (Pvt) Ltd (Former HNB Stockbrokers (Pvt) Ltd. This company ceased to be a Subsidiary of Acuity Partners (Pvt) Ltd from 8th October 2009)</b>			
	Mr Rajendra Theagarajah (Director)	Lease rentals received	0.65
<b>Sri Lanka Insurance Corporation Ltd (Ceased to be a related party w.e.f. 5th June 2009)</b>			
	Mr D H S Jayawardena (Chairman)	Debenture interest paid	179.34
	Mr R K Obeyesekere (Director)	Debenture redeemed	1,000.00
Lanka Bell (Pvt) Ltd	Mr D H S Jayawardena (Chairman)	Telecommunication charges	0.01
<b>HNB Assurance PLC</b>			
Acuity Securities Ltd	Mr Rajendra Theagarajah (Director)	Premiums received	0.20
		Claims paid	0.19
		Interest received	8.39
		Investments (REPO)	126.64
<b>DNH Financial (Pvt) Ltd (Former HNB Stockbrokers (Pvt) Ltd. This company ceased to be a Subsidiary of Acuity Partners (Pvt) Ltd from 8th October 2009)</b>			
	Mr Rajendra Theagarajah (Director)	Premiums received	0.37
		Claims paid	0.43
<b>Stassen Exports (Pvt) Ltd</b>			
	Mr D H S Jayawardena (Chairman)	Insurance premium received	12.17
	Mr R K Obeyesekere (Director)	Claims paid	8.37
<b>Stassen International (Pvt) Ltd</b>			
	Mr D H S Jayawardena (Chairman)	Insurance premium received	0.89
	Mr R K Obeyesekere (Director)	Claims paid	0.28
<b>Stassen Natural Food (Pvt) Ltd</b>			
	Mr D H S Jayawardena (Chairman)	Insurance premium received	0.25
	Mr R K Obeyesekere (Director)		
<b>Sri Lanka Insurance Corporation Ltd (Ceased to be a related entity w.e.f. 5th June 2009)</b>			
	Mr D H S Jayawardena (Chairman)	Insurance premium received	1.86
	Mr R K Obeyesekere (Deputy Chairman)	Co-insurance claims received	1.55

**> Notes to the Financial Statements****48 (f) iii Business Transactions with Other Related Entities by the Group (Contd.)**

Company	Name of Director (Relationship)	Nature of Transaction	Amount (Rs Mn)
Ceylon Garden Coir (Pvt) Ltd	Mr D H S Jayawardena (Chairman) Mr R K Obeyesekere (Director)	Insurance premium received	0.10
Milford Exports (Ceylon) (Pvt) Ltd	Mr D H S Jayawardena (Chairman) Mr R K Obeyesekere (Director)	Insurance premium received	0.03
Aitken Spence Garments Ltd	Subsidiary of Aitken Spence PLC in which company Mr D H S Jayawardena is the Chairman	Insurance premium received	0.44
Elpitiya Plantation PLC	Subsidiary of Aitken Spence Plantation Management Ltd	Insurance premium received Claims paid	0.29 0.02
Ambewela Livestock Company Ltd	Mr D H S Jayawardena (Chairman) Mr R K Obeyesekere (Director)	Insurance premium received	0.03
Ambewela Products (Pvt) Ltd	Mr D H S Jayawardena (Chairman)	Insurance premium received	0.05
Beruwela Distillery (Pvt) Ltd	Mr D H S Jayawardena (Director) Mr R K Obeyesekere (Director)	Insurance premium received	0.16
Distilleries Company of Sri Lanka PLC	Mr D H S Jayawardena (Chairman) Mr R K Obeyesekere (Director)	Insurance premium received Claims paid	18.55 1.30
Lanka Bell (Pvt) Ltd	Mr D H S Jayawardena (Chairman)	Insurance premium received Claims paid	0.74 0.22
Periceyl (Pvt) Ltd	Mr D H S Jayawardena (Chairman) Mr. R K Obeyesekere (Director)	Insurance premium received	0.19
Texpro Industries Ltd	Mr D H S Jayawardena (Chairman)	Insurance premium received	0.58

## 49 MATURITY ANALYSIS

### 49(a) Bank

An analysis of the total assets and liabilities of the Bank as at 31st December, based on the remaining period at the Balance Sheet date to the respective contractual maturity dates, is given below:

	Up to 3 Months Rs 000	3 to 12 Months Rs 000	1 to 3 Years Rs 000	3 to 5 Years Rs 000	More Than 5 Years Rs 000	Total 2009 Rs 000
<b>Interest earning assets</b>						
Cash and short term funds	7,175,000	-	-	-	-	7,175,000
Balances with foreign banks which are interest bearing	14,753,798	-	-	-	-	14,753,798
Securities purchased under resale agreements	500,000	-	-	-	-	500,000
Commercial papers	209,099	-	-	-	-	209,099
Investment securities - bonds and debentures	25,414,851	19,228,832	6,752,381	256,593	489,000	52,141,657
Bills of exchange	1,434,941	41,103	-	-	-	1,476,044
Loans and advances	62,303,642	25,079,151	34,165,182	13,760,987	23,875,436	159,184,398
Lease rentals receivable	1,137,067	2,794,043	4,320,031	693,101	-	8,944,242
	112,928,398	47,143,129	45,237,594	14,710,681	24,364,436	244,384,238
<b>Non interest earning assets</b>						
Cash and short term funds	5,114,060	-	-	-	-	5,114,060
Statutory deposit with CBSL	11,063,948	-	-	-	-	11,063,948
Dealing securities - shares	39,485	-	-	-	-	39,485
Investments - quoted	-	-	-	-	1,175,082	1,175,082
Investments - unquoted	-	180,000	360,000	-	102,941	642,941
Investment in Associate companies	-	-	-	-	203,806	203,806
Investment in Joint Venture company	-	-	-	-	250,000	250,000
Investment in Subsidiary companies	-	-	-	-	2,179,326	2,179,326
Intangible assets	-	-	-	-	675,272	675,272
Investment properties	-	-	-	-	350,760	350,760
Property, plant and equipment	-	-	-	-	7,179,502	7,179,502
Other assets	6,584,119	209,320	540,394	-	-	7,333,833
	22,801,612	389,320	900,394	-	12,116,689	36,208,015
<b>Total assets</b>	135,730,010	47,532,449	46,137,988	14,710,681	36,481,125	280,592,253
<b>Percentage 31st Dec 2009</b>	<b>48.37</b>	<b>16.94</b>	<b>16.44</b>	<b>5.24</b>	<b>13.00</b>	<b>100</b>
Percentage 31st Dec 2008	50.13	12.71	11.20	10.60	15.36	100

## > Notes to the Financial Statements

### 49 MATURITY ANALYSIS (CONTD.)

#### 49(a) Bank (Contd.)

	Up to 3 Months Rs 000	3 to 12 Months Rs 000	1 to 3 Years Rs 000	3 to 5 Years Rs 000	More Than 5 Years Rs 000	Total 2009 Rs 000
<b>Interest bearing liabilities</b>						
Deposits from customers*	132,091,672	44,678,921	8,875,944	2,988,014	5,590,186	194,224,737
Borrowings - money at call	-	686,400	-	-	-	686,400
Borrowings - refinance	58,550	733,195	1,411,367	1,087,116	3,157,598	6,447,826
Borrowings - foreign banks	1,446,863	-	-	-	-	1,446,863
Repo agreements	5,771,701	2,913,298	-	-	-	8,684,999
Subordinated debentures	-	-	375,724	639,704	1,657,764	2,673,192
	139,368,786	49,011,814	10,663,035	4,714,834	10,405,548	214,164,017
<b>Non-interest bearing liabilities</b>						
Deposits from customers	16,282,068	-	-	-	-	16,282,068
Dividend payable	215,607	-	-	-	-	215,607
Bills payable	1,161,151	-	-	-	-	1,161,151
Current tax liability	-	2,921,234	-	-	-	2,921,234
Deferred tax liability	-	-	-	-	939,253	939,253
Other liabilities	14,455,552	-	-	6,553,281	-	21,008,833
Shareholders' funds	-	-	-	-	23,900,090	23,900,090
	32,114,378	2,921,234	-	6,553,281	24,839,343	66,428,236
<b>Total liabilities and shareholders' funds</b>	<b>171,483,164</b>	<b>51,933,048</b>	<b>10,663,035</b>	<b>11,268,115</b>	<b>35,244,891</b>	<b>280,592,253</b>
<b>Percentage 31st Dec 2009</b>	<b>61.11</b>	<b>18.51</b>	<b>3.80</b>	<b>4.02</b>	<b>12.56</b>	<b>100</b>
<b>Percentage 31st Dec 2008</b>	<b>59.76</b>	<b>22.78</b>	<b>2.51</b>	<b>2.44</b>	<b>12.51</b>	<b>100</b>

\* Upto 3 months deposits include the Bank's Savings Deposit Base of Rs 80.8 billion (2008 - Rs 68.7 billion)

#### 49(b) Group

	Up to 3 Months Rs 000	3 to 12 Months Rs 000	1 to 3 Years Rs 000	3 to 5 Years Rs 000	More Than 5 Years Rs 000	Total 2009 Rs 000
<b>Interest earning assets</b>						
Cash and short term funds	7,175,000	-	-	-	-	7,175,000
Balances with foreign banks which are interest bearing	14,839,723	-	-	-	-	14,839,723
Statutory deposit with Bank of Oman	-	-	-	-	14,857	14,857
Securities purchased under resale agreements	950,703	-	-	-	-	950,703
Government of Sri Lanka treasury bills	18,919	286,891	-	-	-	305,810
Commercial papers	231,121	51,814	-	-	-	282,935
Dealing securities	82,838	523,741	358	488	-	607,425
Investment securities						
- bonds and debentures	25,514,409	19,586,278	7,365,859	940,137	497,452	53,904,135
Bills of exchange	1,434,941	41,103	-	-	-	1,476,044
Loans and advances	61,506,594	25,081,196	34,166,668	13,760,987	21,876,229	156,391,674
Lease rentals receivable	1,137,067	2,794,043	4,320,031	693,101	-	8,944,242
	112,891,315	48,365,066	45,852,916	15,394,713	22,388,538	244,892,548
<b>Non interest earning assets</b>						
Cash and short term funds	5,474,084	-	-	-	-	5,474,084
Statutory deposit with CBSL	11,063,948	-	-	-	-	11,063,948
Dealing securities	80,306	-	-	-	-	80,306
Investments - quoted	580	-	-	-	1,175,082	1,175,662
Investments - unquoted	-	180,000	385,000	-	202,926	767,926

## 49 MATURITY ANALYSIS (CONTD.)

## 49(b) Group (Contd.)

	Up to 3 Months Rs 000	3 to 12 Months Rs 000	1 to 3 Years Rs 000	3 to 5 Years Rs 000	More Than 5 Years Rs 000	Total 2009 Rs 000
Investment in Associate companies	-	-	-	-	226,129	226,129
Intangible assets	-	-	-	-	710,009	710,009
Investment properties	-	-	-	-	172,555	172,555
Property, plant and equipment	-	-	-	-	14,332,929	14,332,929
Non current assets held for sale	-	2,875	-	-	-	2,875
Other assets	6,860,011	992,944	682,933	36,977	39,288	8,612,153
	23,478,929	1,175,819	1,067,933	36,977	16,858,918	42,618,576
<b>Total assets</b>	<b>136,370,244</b>	<b>49,540,885</b>	<b>46,920,849</b>	<b>15,431,690</b>	<b>39,247,456</b>	<b>287,511,124</b>
<b>Percentage - 31/12/2009</b>	<b>47.43</b>	<b>17.23</b>	<b>16.32</b>	<b>5.37</b>	<b>13.65</b>	<b>100</b>
Percentage - 31/12/2008	48.33	12.70	10.91	10.30	17.76	100
<b>Interest bearing liabilities</b>						
Deposits from customers	132,308,530	44,539,630	8,801,944	2,893,014	5,590,186	194,133,304
Borrowings - money at call	-	686,400	-	-	-	686,400
Borrowings - refinance	58,550	733,195	1,411,367	1,087,116	3,157,598	6,447,826
Borrowings - local banks	4,122	-	-	-	-	4,122
Borrowings - foreign banks	1,446,053	-	-	-	-	1,446,053
Repo agreements	6,493,968	2,919,448	-	-	-	9,413,416
Subordinated debentures	-	-	375,724	632,204	1,645,264	2,653,192
	140,311,223	48,878,673	10,589,035	4,612,334	10,393,048	214,784,313
<b>Non- interest bearing liabilities</b>						
Deposits from customers	16,229,841	-	-	-	-	16,229,841
Dividend payable	215,607	-	-	-	-	215,607
Bills payable	1,161,151	-	-	-	-	1,161,151
Long term insurance fund	-	-	-	-	1,853,513	1,853,513
Non-life insurance reserves	-	-	599,364	-	-	599,364
Current tax liability	-	2,977,234	-	-	-	2,977,234
Deferred tax liability	-	-	-	-	938,366	938,366
Other liabilities	14,403,856	294,814	208,207	6,553,281	517,969	21,978,127
Shareholders' funds	-	-	-	-	26,773,608	26,773,608
	32,010,455	3,272,048	807,571	6,553,281	30,083,456	72,726,811
<b>Total liabilities and shareholders' funds</b>	<b>172,321,678</b>	<b>52,150,721</b>	<b>11,396,606</b>	<b>11,165,615</b>	<b>40,476,504</b>	<b>287,511,124</b>
<b>Percentage - 31/12/2009</b>	<b>59.94</b>	<b>18.14</b>	<b>3.96</b>	<b>3.88</b>	<b>14.08</b>	<b>100</b>
Percentage - 31/12/2008	58.13	22.52	2.83	2.69	13.83	100

## > Notes to the Financial Statements

### 50 COMPARATIVE INFORMATION

The following comparative figures have been reclassified in the 2009 Financial Statements to maintain comparability of financial statements in order to provide a better presentation.

#### 50(a)

	As disclosed Rs 000	Bank	Adjustment Rs 000	Group	
		Reclassified Rs 000		As disclosed Rs 000	Reclassified Rs 000
Income	37,165,915	37,151,086	(14,829)	38,725,404	38,710,575
Other income	665,023	650,194	(14,829)	2,075,789	2,060,960
Loans written off	-	372	372	-	372
Other expenses	4,393,169	4,377,968	(15,201)	5,667,158	5,651,957

50(a) i Loss on sale of dealing securities of Rs 0.154 Mn and loss on marked to market revaluation of dealing securities of Rs 14.675 Mn has been reclassified as other income since the corresponding figures for current year amounts to a gain on sale of dealing securities and a gain on marked to market revaluation of dealing securities.

50 (a) ii Loans written off of Rs 0.372 Mn included under other expenses have been reclassified.

#### 50(b)

	As disclosed Rs 000	Bank	Adjustment Rs 000	Group	
		Reclassified Rs 000		As disclosed Rs 000	Reclassified Rs 000
Bills of exchange	1,958,505	2,186,868	228,363	1,958,505	2,186,868
Loans and advance	161,301,826	161,073,463	(228,363)	159,461,752	159,233,389

Bills of exchange amounting to Rs 228 Mn included under loans and advances have been reclassified as bills of exchange.

#### 50 (c)

	As disclosed Rs 000	Bank	Adjustment Rs 000	Group	
		Reclassified Rs 000		As disclosed Rs 000	Reclassified Rs 000
Lease rentals receivable within one year	4,392,233	4,449,827	57,594	4,392,233	4,449,827
Lease rentals receivable after one year	7,096,976	7,097,380	404	7,096,976	7,097,380
Other assets	7,414,284	8,796,891	1,382,607	8,096,318	9,478,926
Other liabilities	16,535,011	17,975,616	1,440,605	17,026,386	18,466,991

Lease debtors amounting to Rs 57.998 Mn included under other assets has been reclassified as lease rental receivable while other assets of Rs 1,440.605 Mn included under other liabilities have been reclassified as other assets.

#### 50 (d)

	Group		
	As disclosed Rs 000s	Reclassified Rs 000s	Adjustment Rs 000s
Cash and cash equivalents	23,559,937	23,560,149	212
Borrowings	15,401,078	15,401,290	212

Cash balance of Rs. 0.212 Mn included with borrowings was reclassified as cash and cash equivalents from borrowings.

#### 50(e)

	Group		
	As disclosed Rs 000s	Reclassified Rs 000s	Adjustment Rs 000s
Commitments and contingencies	68,065,957	68,087,091	21,134

Share of Associate company contingencies was included with commitments and contingencies of the Group.

Comparative information in the Cash Flow Statement has been amended based on the reclassified figures as disclosed above.



## 51 SEGMENT REPORTING

Segment information is presented in respect of the Group's business segments. The Group's primary format for segment reporting is based on business segments.

The business segments are determined based on the Group's management and internal reporting structure.

Business segments - Group	Banking		Leasing		**Dealing		Property		Insurance		Eliminations		Consolidated /Unallocated	
	2009 Rs 000	2008 Rs 000	2009 Rs 000	2008 Rs 000	2009 Rs 000	2008 Rs 000	2009 Rs 000	2008 Rs 000	2009 Rs 000	2008 Rs 000	2009 Rs 000	2008 Rs 000	2009 Rs 000	2008 Rs 000
Revenue from external customers :														
Interest	32,413,563	29,818,921	-	-	116,047	430,976	-	-	441,507	325,870	1,865,305	2,253,749	34,836,422	32,829,516
Exchange / premium	919,782	1,166,979	-	-	265	132	-	-	1,529,064	1,355,360	-	-	2,449,111	2,522,471
Lease / brokerage	-	-	1,961,078	2,312,051	77,965	51,331	-	-	-	-	(1,961,078)	(2,312,051)	77,965	51,331
Commissions / rent	2,254,246	2,364,319	-	-	10,961	854	112,112	138,165	-	-	-	-	2,377,319	2,503,338
Other	1,507,808	1,171,288	-	-	42,003	31,616	-	169	12,118	1,629	14,599	(400,783)	1,576,528	803,919
Total revenue from external customers	37,095,399	34,521,507	1,961,078	2,312,051	247,241	514,909	112,112	138,334	1,982,689	1,682,859	(81,174)	(459,085)	41,317,345	38,710,575
Inter-segment revenue	317,958	317,528	-	-	1,538	16,140	615,609	564,299	55,364	44,496	-	-	990,469	942,463
Total revenue	37,413,357	34,839,035	1,961,078	2,312,051	248,779	531,049	727,721	702,633	2,038,053	1,727,355	(81,174)	(459,085)	42,307,814	39,653,038
Segment result	5,230,808	3,697,857	1,437,720	1,659,152	38,511	62,170	178,527	87,319	266,293	196,852	(89,657)	(478,068)	7,062,202	5,225,282
Unallocated expenses													(903,058)	(733,755)
Profit from operations													6,159,144	4,491,527
Income from associates													7,680	(6,401)
Income tax expense													(1,613,464)	(1,599,300)
Profit for the period													4,553,360	2,885,826
Minority interests													(70,083)	(55,288)
Profit for the Equity Holders of the Bank													4,483,277	2,830,538
Segment assets	253,475,512	226,023,311	8,944,242	11,547,207	1,345,982	1,312,520	8,347,215	8,032,850	3,671,702	2,799,471	(2,940,870)	(1,988,089)	272,843,783	247,727,270
Investment in associates													226,129	143,700
Unallocated assets													14,441,212	15,559,827
Total assets													287,511,124	263,430,797
Segment liabilities	219,989,802	200,472,039	8,944,242	11,547,207	962,719	931,094	3,788,244	3,541,914	2,840,851	2,123,356	(2,972,535)	(1,996,503)	233,553,323	216,619,107
Unallocated liabilities													27,184,193	23,542,573
Total liabilities													260,737,516	240,161,680
Cash flows from operating activities	35,038,949	(977,494)	2,640,209	5,524,422	15,282	(73,279)	55,354	(280,080)	759,098	650,645	1,510,322	1,202,274	40,019,214	6,046,488
Cash flows from investing activities	(25,928,465)	(5,797,484)	-	-	25,791	6,881	(796)	(3,458)	(734,363)	(572,745)	(306,725)	(1,993,474)	(26,944,558)	(8,360,280)
Cash flows from financing activities	(8,009,787)	5,393,802	-	-	-	210,807	-	-	(47,906)	(38,089)	(1,088,305)	1,032,098	(9,145,998)	6,598,618
Capital expenditure	1,181,806	1,904,610	315	188	39,012	47,723	796	3,464	69,013	48,903	(58)	348,456	1,290,884	2,353,344
Depreciation	583,255	479,770	1,118	1,145	11,693	20,841	110,414	109,860	26,933	20,123	(6,120)	(13,491)	727,293	618,248
Amortisation	165,347	89,724	1,289	1,722	1,013	3,636	79	79	8,279	6,856	(242)	-	175,765	102,017

\*\*Stock broking, Securities dealings, Remittances and Foreign currency related services.

## > Notes to the Financial Statements

### 52 EVENTS OCCURRING AFTER THE BALANCE SHEET DATE

There are no events occurring after the Balance Sheet date which require adjustments to or disclosure in the Financial Statements, other than those disclosed below:

#### 52(a) Proposed dividends

Refer Note No 38 (a)

#### 52(b) Disposal of Lanka Ventures PLC

HNB sold 10,036,250 ordinary shares held in Lanka Ventures PLC (LVL), an associate with 20.07% shareholding, to Acuity Partners (Pvt) Ltd (Acuity), a joint venture investment banking company of HNB and DFCC Bank (DFCC) for Rs 18 per share (market price) on 18th January 2010.

LVL has made a separate announcement relating to this transaction wherein it has been disclosed that Acuity has also purchased 58% shareholding in LVL which was held by DFCC at the same price on the same day. Accordingly, HNB's ownership in LVL has now increased to an indirect shareholding of 39% through the joint venture Acuity, consequent to these transactions.

This transaction is a further step in establishing Acuity Group as a fully fledged investment bank.

### 53 DIRECTORS' RESPONSIBILITY STATEMENT

The Board of Directors of the Bank is responsible for the preparation and presentation of these Financial Statements. Please refer to page 146 for the statement of the Directors' Responsibility for Financial Reporting.

## Capital Adequacy

Capital adequacy is a measure of a commercial bank's ability to withstand the associated risks of its business.

Regulators find it necessary that every bank holds adequate capital to absorb unexpected losses as a going concern, while they price their products and services to take care of expected losses. Capital Adequacy Ratio (CAR) is measured on the basis of credit, market and operational risks under Basel II. Keeping with the international standards of Basel Committee on Banking Regulations and Supervisory Practices, Sri Lanka has been following Basel II CAR calculation from January 2008 after conducting parallel calculations in 2007.

### AVAILABLE CAPITAL

Basel II accord recognises three capital elements, namely Tier I, Tier II and Tier III capital.

Tier I capital includes paid up ordinary share capital, paid up non cumulative, non redeemable preference shares, share premium, statutory reserve fund, published retained earnings, general and other reserves (except asset revaluation reserve).

Tier II capital includes 50% of asset revaluation reserves (created by revaluations carried out in every seven years) general provision for advances, hybrid debt / equity instruments and approved subordinated term debts. Tier II capital cannot exceed Tier I capital and subordinated debt cannot exceed 50% of the Tier 1 capital.

Tier III capital will consist only of short term debt instruments and will be used for calculation of market risk only. Tier III is subject to a maximum

of 250% of Tier 1 capital after meeting the credit and operational risk.

Equity investments in unconsolidated banking and financial subsidiaries and investments in capital of other banks / financial associates are deducted from capital in arriving at the capital base. Sri Lankan banks are required to maintain a minimum total risk weighted capital ratio of 10% in respect of Domestic Banking Unit (DBU) together with the Foreign Currency Banking Unit (FCBU) operations.

### RISK ASSESSMENT

In order to determine the credit risk applicable for capital adequacy ratio, all assets are risk weighted with a view to provide a broad indication of credit risk. According to Basel II guidelines the advances portfolio is segregated for credit risk computation mainly on the type of counterparty. Total portfolio is classified as claims on banks, corporates, financial institutions and retail etc. Off balance sheet transactions are converted to credit equivalents, using a credit conversion factor, before being allocated a risk weighting.

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

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

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

Credit, operational and market risk will be calculated based on Standardised Approach, Basic Indicator Approach and Standard Measurement Method respectively and advanced approach would be adopted from 2013. However the banks have the discretion of adopting the advanced approach at an earlier date.

## > Capital Adequacy

CAPITAL BASE As at 31st December	2009 (Rs Mn)	2008 (Rs Mn)
<b>TIER I</b>		
Voting ordinary shares	2,903	2,881
Non voting ordinary shares	2,181	2,178
Statutory reserve fund	1,260	983
Published retained earnings	3,849	3,046
General and other reserves	10,700	8,489
Less: Deductions from Tier 1 capital (Note 1)	(1,332)	(1,345)
Eligible Tier 1 Capital	19,561	16,232
<b>TIER II</b>		
50% of approved asset revaluation reserves (Note 2)	1,042	1,042
General provision for loan losses	1,317	1,339
Approved subordinated term debt	2,455	2,577
Tier II Capital	4,814	4,958
Less: Deductions from Tier II capital (Note 1)	(1,195)	(1,195)
Eligible Tier II capital	3,619	3,763
Capital Base	23,180	19,995
Risk adjusted capital ratios		
Tier 1 (Eligible Tier 1 capital / Total risk adjusted balances) *	11.10	9.25
Total (Capital base / Total risk adjusted balances) **	13.16	11.40

\* Statutory minimum 5%      \*\* Statutory minimum 10%

### RISK ADJUSTED ON - BALANCE SHEET EXPOSURE

Rupees Million	Balance		Risk Weights	Risk Adjusted Balance	
	2009	2008		2009	2008
As at 31st December			(%)		
<b>Exposures</b>					
- To Central Government and CBSL	64,164	37,067	-	-	-
- To banks	22,420	19,843	20 - 150	4,682	4,907
- To financial institutions	1,739	6,263	20 - 150	891	3,876
- To corporates	64,910	65,523	20 - 150	62,997	64,925
- To retail sector (excluding claims secured by residential properties)	38,056	39,703	75 - 100	30,466	31,306
- Secured on residential property mortgages	19,798	20,748	50 - 100	10,333	11,324
- Non performing advances	6,865	5,432	50 - 150	7,433	6,413
- Other exposures	3,431	1,213	20 - 150	3,431	1,213
- Cash and cash items in the process of collection	6,707	4,571	0 - 20	327	210
- Other assets	13,867	13,884	100	13,867	13,884
Total assets	241,957	214,247		134,427	138,058

## RISK ADJUSTED OFF - BALANCE SHEET EXPOSURE

Rupees Million

As at 31st December	Amount of Off-Balance Sheet Items 2009	Credit Conversion Factor (%)	Credit Equivalent Amount 2009	Risk Weights (%)	Risk Adjusted Balance 2009	Risk Adjusted Balance 2008
Financial guarantees, bank acceptances and other guarantees	6,643	100	6,643	0 - 100	6,421	5,720
Performance related guarantees and warranties and stand by LCs related to particular transactions	10,832	50	5,416	0 - 100	5,416	4,461
Shipping guarantees, documentary letter of credit and trade related acceptances	14,119	20	2,824	0 - 100	2,824	4,223
Other commitments with an original maturity of						
< one year	14,866	0 - 20	25	0 - 100	25	36
> one year	725	50	362	0 - 100	362	31
Foreign exchange contracts	23,171	2 - 5	463	0 - 100	463	397
Interest rate contracts	1,460	0.5 - 7	102	0 - 100	102	195
<b>Total off- balance sheet exposures</b>	<b>71,816</b>		<b>15,835</b>		<b>15,613</b>	<b>15,063</b>

## CAPITAL CHARGE FOR MARKET RISK

Rupees Million

As at 31st December	Capital Charge		Risk Adjusted Balance	
	2009	2008	2009	2008
Interest rate	-	0.5	-	5
Equity	7.9	5.0	79	50
Foreign exchange and gold	46.3	55.5	463	555
<b>Total risk adjusted balance for market risk</b>	<b>54.2</b>	<b>61.0</b>	<b>542</b>	<b>610</b>

## CAPITAL CHARGE FOR OPERATIONAL RISK

Rupees Million

As at 31st December	Capital Charge		Risk Adjusted Balance	
	2009	2008	2009	2008
Average gross income	17,066.4	14,437.7		
15% of average gross income	2,560.0	2,165.7		
<b>Total risk adjusted balance for operational risk</b>	<b>2,560.0</b>	<b>2,165.7</b>	<b>25,600</b>	<b>21,657</b>

Total risk adjusted balances (credit risk,  
market risk, operational risk)

176,182 175,388

## NOTES

(1) Deductions

	Tier 1		Tier II	
	2009	2008	2009	2008
Additional investment in Sithma Development (Pvt) Ltd	450	450	450	450
Employee share option plan	137	150	-	-
Others	745	745	745	745
<b>Total deductions</b>	<b>1,332</b>	<b>1,345</b>	<b>1,195</b>	<b>1,195</b>

(2) Revaluation reserves approved by CBSL is Rs 2,084 Mn.

(3) The capital adequacy computation has been indicated for the Bank only.

## Income Statement in US Dollars

For the year ended 31st December	Bank		Group	
	2009 US\$ 000	2008 US\$ 000	2009 US\$ 000	2008 US\$ 000
<b>INCOME</b>	<b>344,182</b>	<b>328,771</b>	<b>361,166</b>	<b>342,571</b>
Interest income	302,625	287,002	304,514	290,527
Less: interest expenses	175,172	174,794	177,281	179,533
<b>Net interest income</b>	<b>127,453</b>	<b>112,208</b>	<b>127,233</b>	<b>110,994</b>
Foreign exchange profit	8,040	10,327	8,042	10,346
Fee and commission income	20,185	20,924	20,590	21,544
Dividend income	1,900	4,764	1,712	1,916
Other income	11,432	5,754	26,308	18,238
<b>OPERATING INCOME</b>	<b>169,010</b>	<b>153,977</b>	<b>183,885</b>	<b>163,039</b>
Less:				
<b>OPERATING EXPENSES</b>				
Personnel costs	35,784	31,518	38,864	33,905
Premises, equipment and establishment expenses	24,900	21,431	23,155	19,328
Fee and commission expenses	942	469	2,771	441
Provision for employee retirement benefits	7,130	6,966	7,197	7,040
Provision for loan losses	6,191	10,259	6,191	10,259
Provision for fall in value of investments	18	2,246	18	2,297
Impairment of Goodwill	-	-	46	-
Loans written off	2	3	2	3
Other expenses	42,316	38,743	51,802	50,017
	<b>117,283</b>	<b>111,635</b>	<b>130,046</b>	<b>123,290</b>
<b>PROFIT FROM OPERATIONS</b>	<b>51,727</b>	<b>42,342</b>	<b>53,839</b>	<b>39,748</b>
Share of profit / (loss) of associates (net of income tax)	-	-	67	(57)
<b>PROFIT BEFORE INCOME TAX</b>	<b>51,727</b>	<b>42,342</b>	<b>53,906</b>	<b>39,691</b>
Less: income tax expense	13,688	13,855	14,104	14,153
<b>PROFIT FOR THE YEAR</b>	<b>38,039</b>	<b>28,487</b>	<b>39,802</b>	<b>25,538</b>
Attributable to:	-	-	-	-
Equity holders of the Bank	38,039	28,487	39,189	25,049
Minority interest	-	-	613	489
<b>PROFIT FOR THE YEAR</b>	<b>38,039</b>	<b>28,487</b>	<b>39,802</b>	<b>25,538</b>
<b>BASIC EARNINGS PER SHARE (US\$)</b>	<b>0.16</b>	<b>0.12</b>	<b>0.17</b>	<b>0.11</b>
<b>DILUTED EARNINGS PER SHARE (US\$)</b>	<b>0.16</b>	<b>0.12</b>	<b>0.17</b>	<b>0.11</b>
<b>DIVIDEND PER SHARE (US\$)</b>	<b>0.06</b>	<b>0.04</b>	<b>0.06</b>	<b>0.04</b>

Exchange rate of US\$ 1 was Rs 114.40 as at 31st December 2009 (Rs 113.00 as at 31st December 2008)

The Income Statement given on this page is solely for the convenience of the shareholders, bankers, investors, customers and other users of Financial Statements and do not form part of the audited Financial Statements.

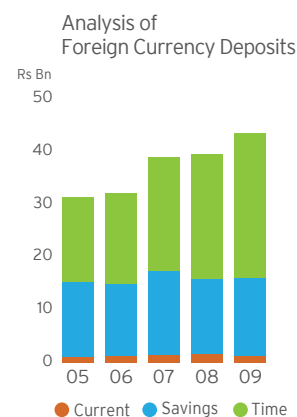
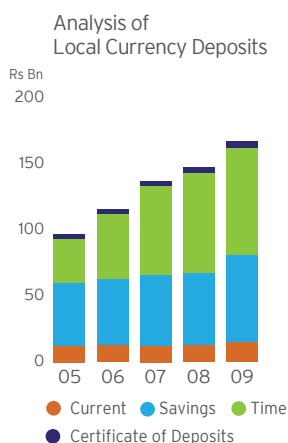
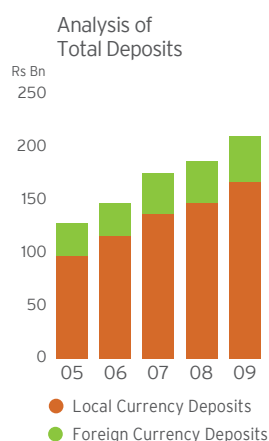
## Balance Sheet in US Dollars

As at 31st December	Bank		Group	
	2009 US\$ 000	2008 US\$ 000	2009 US\$ 000	2008 US\$ 000
<b>ASSETS</b>				
Cash and cash equivalents	236,389	206,212	240,287	208,497
Statutory deposit with Central Banks	96,713	104,843	96,843	104,973
Government treasury bills	-	-	2,673	6,718
Dealing securities	345	636	6,012	721
Securities purchased under re-sale agreements	4,371	12,389	8,310	22,471
Non-current assets held for sale	-	13	25	13
Bills of exchange	12,902	19,353	12,903	19,353
Commercial papers	1,828	1,999	2,473	2,087
Lease rentals receivable within one year	34,363	39,379	34,363	39,379
Lease rentals receivable after one year	43,821	62,809	43,821	62,809
Loans and advances	1,391,472	1,425,429	1,367,060	1,409,145
Investments securities	471,676	229,343	488,179	238,679
Investments in Associates	1,781	1,171	1,977	1,272
Investments in Joint Venture	2,185	2,212	-	-
Investments in Subsidiaries	19,050	19,284	-	-
Investment properties	3,066	1,659	1,508	1,560
Property, plant and equipment	62,758	60,758	125,288	123,018
Intangible assets	5,903	6,439	6,206	6,667
Other assets	64,107	77,849	75,281	83,884
<b>Total Assets</b>	<b>2,452,730</b>	<b>2,271,777</b>	<b>2,513,209</b>	<b>2,331,246</b>
<b>LIABILITIES</b>				
Deposits from customers	1,840,094	1,652,831	1,838,839	1,651,456
Dividends payable	1,885	1,127	1,885	1,126
Securities sold under re-purchase agreements	75,918	77,876	82,285	85,390
Borrowings	75,010	136,295	75,038	136,295
Current tax liabilities	25,535	21,067	26,025	21,383
Bills payable	10,150	9,274	10,150	9,274
Subordinated debentures	23,367	24,379	23,192	33,052
Insurance provision - life	-	-	16,202	12,040
Insurance provision - non life	-	-	5,239	4,161
Deferred tax liabilities	8,210	7,720	8,203	7,723
Other liabilities	183,644	159,076	192,116	163,425
<b>Total Liabilities</b>	<b>2,243,813</b>	<b>2,089,645</b>	<b>2,279,174</b>	<b>2,125,325</b>
<b>EQUITY</b>				
Stated capital	44,441	44,773	44,441	44,773
Statutory reserve fund	11,014	8,696	11,014	8,696
Retained earnings	33,645	26,952	31,034	23,156
Other reserves	119,817	101,711	144,051	126,218
<b>Total Equity attributable to equity holders of the Bank</b>	<b>208,917</b>	<b>182,132</b>	<b>230,540</b>	<b>202,843</b>
Minority interest	-	-	3,495	3,078
<b>Total Equity</b>	<b>208,917</b>	<b>182,132</b>	<b>234,035</b>	<b>205,921</b>
<b>Total Liabilities and Equity</b>	<b>2,452,730</b>	<b>2,271,777</b>	<b>2,513,209</b>	<b>2,331,246</b>
<b>Commitments and Contingencies</b>	<b>550,937</b>	<b>602,354</b>	<b>551,046</b>	<b>602,541</b>

Exchange rate of US\$ 1 was Rs 114.40 as at 31st December 2009 (Rs 113.00 as at 31st December 2008)

## Analysis of Deposits

	2005 Rs 000	2006 Rs 000	2007 Rs 000	2008 Rs 000	2009 Rs 000
<b>Local Currency Deposits</b>					
Current	12,511,256	12,635,473	12,482,701	12,748,863	15,090,759
Savings	47,380,753	50,697,086	53,565,590	54,544,453	66,080,330
Time	33,587,699	48,869,303	66,836,282	75,828,902	80,572,001
Certificate of deposit	3,634,393	3,348,716	4,021,045	4,269,993	5,439,817
	97,114,101	115,550,578	136,905,618	147,392,211	167,182,907
<b>Foreign Currency Deposits</b>					
Current	1,013,589	1,188,634	1,348,573	1,522,500	1,191,309
Savings	14,166,198	13,600,463	15,784,655	14,178,854	14,715,443
Time	15,989,793	17,217,780	21,620,727	23,676,297	27,417,146
	31,169,580	32,006,877	38,753,955	39,377,651	43,323,898
<b>Total Deposits</b>	128,283,681	147,557,455	175,659,573	186,769,862	210,506,805
Refinance	2,711,810	3,582,587	5,749,624	6,424,054	6,447,826
<b>Total deposits and refinance</b>	130,995,491	151,140,042	181,409,197	193,193,916	216,954,631

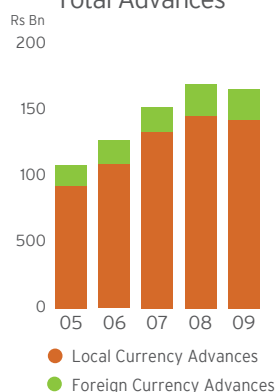




## Analysis of Advances

	2005 Rs 000	2006 Rs 000	2007 Rs 000	2008 Rs 000	2009 Rs 000
<b>Local Currency Advances</b>					
Overdrafts	22,952,834	27,455,224	33,776,672	35,393,588	32,264,298
Short term loans	5,366,187	5,636,464	5,129,706	7,074,630	9,704,994
Trust receipts	5,193,080	6,876,898	7,097,272	7,642,331	6,347,877
Packing credit	523,517	618,787	763,188	375,633	245,950
Term loans	58,657,612	68,451,741	86,692,434	94,493,224	93,899,250
	92,693,230	109,039,114	133,459,272	144,979,406	142,462,369
<b>Leasing facilities</b>					
Leasing facilities	9,261,500	12,036,467	13,772,361	12,038,851	9,398,642
<b>Total local currency advances</b>	<b>101,954,730</b>	<b>121,075,581</b>	<b>147,231,633</b>	<b>157,018,257</b>	<b>151,861,011</b>
<b>Foreign currency advances</b>					
Foreign currency advances	15,381,438	18,412,257	18,988,347	24,696,099	23,343,368
<b>Total advances</b>	<b>117,336,168</b>	<b>139,487,838</b>	<b>166,219,980</b>	<b>181,714,356</b>	<b>175,204,379</b>

Analysis of Total Advances



Analysis of Advances by Type



- Leasing - 5%
- Overdrafts - 19%
- Short Term Loans - 6%
- Trust Receipts - 5%
- Packaging Credit - 3%
- Term Loans - 62%

Analysis of Advances by Security



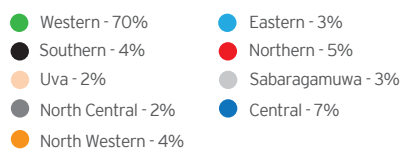
- Secured by cash, quoted shares and other readily realisable assets - 17%
- Secured by mortgage over immovable assets - 42%
- Secured by mortgage over movable assets - 14%
- Others (clean and third party guarantees) - 27%

## Province-wise Analysis of Deposits and Advances

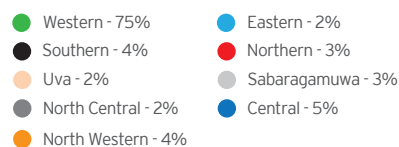
As at 31st December 2009

Province	No of Branches	Deposits (Rs Mn)	%	Advances Including Leasing (Rs Mn)	%	Deposit Utilisation %
Western	91	145,402	70	132,306	75	91
Southern	17	8,156	4	7,263	4	89
Uva	10	4,308	2	3,082	2	72
North Central	6	3,706	2	3,148	2	85
North Western	14	9,046	4	7,208	4	80
Eastern	11	7,332	3	4,180	2	57
Northern	9	11,265	5	4,669	3	41
Sabaragamuwa	10	6,644	3	4,591	3	69
Central	18	14,648	7	8,757	5	60
<b>Total</b>	<b>186</b>	<b>210,507</b>	<b>100</b>	<b>175,204</b>	<b>100</b>	<b>83</b>

Province-wise Deposits



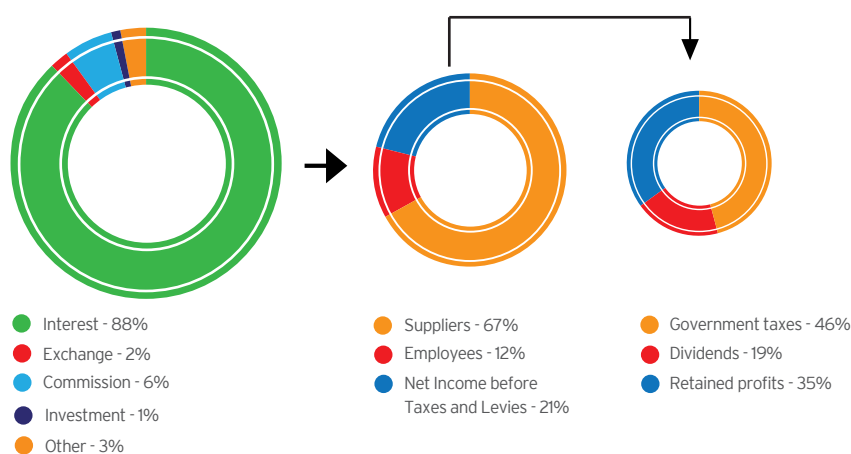
Province-wise Advances



## Sources and Utilisation of Income

	2005 Rs 000	2006 Rs 000	2007 Rs 000	2008 Rs 000	2009 Rs 000
<b>SOURCES OF INCOME</b>					
Interest	14,129,874	18,451,961	26,250,038	32,431,158	34,620,276
Exchange	646,460	772,825	1,114,313	1,166,979	919,782
Commission	1,663,545	1,795,340	2,081,569	2,364,434	2,309,235
Dividend	65,050	76,983	125,142	538,321	217,353
Other	410,385	396,586	423,656	650,194	1,307,789
<b>Total</b>	<b>16,915,314</b>	<b>21,493,696</b>	<b>29,994,718</b>	<b>37,151,086</b>	<b>39,374,435</b>
<b>UTILISATION OF INCOME</b>					
<b>Employees</b>					
Salaries and other payment to staff	2,741,656	3,164,917	3,657,112	4,348,690	4,909,423
<b>Suppliers</b>					
Interest paid	7,280,851	9,797,449	15,189,698	19,751,667	20,039,646
Other expenses	4,841,335	4,529,175	5,544,177	6,488,202	6,266,571
	12,122,186	14,326,624	20,733,875	26,239,869	26,306,217
Net income before Government Taxes and Levies	2,051,472	4,002,154	5,603,731	6,562,527	8,158,795
<b>Government</b>					
Income Tax, SRL, NBT, VAT, Debit Tax (incl. Deferred Tax)	360,310	1,781,665	2,581,275	3,343,547	3,807,143
<b>Shareholders</b>					
Dividends	471,059	588,824	824,353	942,118	1,533,064
Retained profits	1,220,103	1,631,666	2,198,103	2,276,862	2,818,588
<b>Total</b>	<b>16,915,314</b>	<b>21,493,695</b>	<b>29,994,718</b>	<b>37,151,086</b>	<b>39,374,435</b>

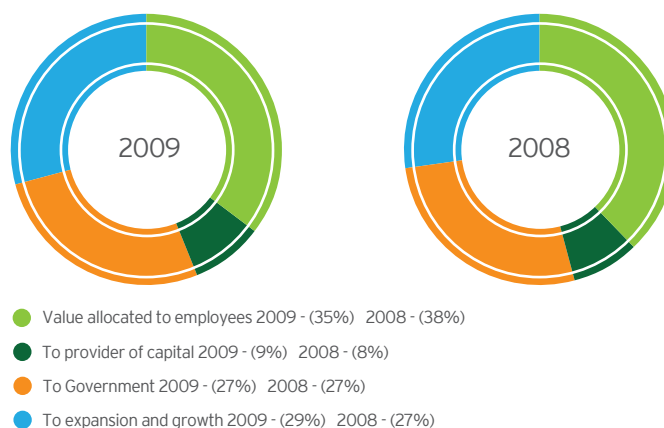
Sources and Utilisation of Income



## Value Added Statement

	2009 Rs 000	%	2008 Rs 000	%	
<b>Value Added</b>					
Income earned by providing banking services	38,593,147		36,265,814		
Cost of services	24,844,943		24,254,430		
Value added by banking services	13,748,204		12,011,384		
Non-banking income	781,288		885,272		
Provision for fall in value of investments	(2,038)		(253,840)		
Provision for bad debts	(708,227)		(1,159,238)		
	13,819,227		11,483,578		
<b>Value allocated to employees</b>					
Salaries, wages and other benefits	4,909,423	36	4,348,690	38	
<b>To providers of capital</b>					
Dividends to shareholders	1,533,064	11	942,118	8	
<b>To Government</b>					
Value Added Tax	2,193,577		1,768,012		
Income Tax	1,496,206		1,296,148		
Debit Tax	10,845		8,074		
Nation Building Tax	36,691				
Stamp Duty	163				
	3,737,482	27	1,793	3,074,027	27
<b>To expansion and growth</b>					
Retained income	2,818,588	20	2,276,862	20	
Depreciation and amortization	751,009	5	572,361	5	
Deferred taxation	69,661	1	269,520	2	
	13,819,227	100	11,483,578	100	

Analysis of Value Addition



## Quarterly Statistics

For the three months ended	2009				2008			
	December 31st	September 30th	June 30th	March 31st	December 31st	September 30th	June 30th	March 31st
<b>Balance Sheet Data</b>								
<b>(Rs Mn)</b>								
Total assets	280,592	268,639	266,971	260,969	256,711	249,684	238,982	232,465
Loans, leases and bills	176,986	180,471	174,829	178,040	184,198	170,176	165,623	164,734
Deposits	210,507	203,934	201,366	193,338	186,770	182,846	178,184	175,589
Shareholders' funds	23,900	22,557	21,649	20,638	20,581	20,158	19,167	18,347
Average assets	274,616	267,805	263,970	258,840	253,198	244,333	235,724	232,686
<b>Income Statement Data</b>								
<b>(Rs 000)</b>								
Net interest income	3,795,833	3,695,411	3,629,465	3,459,921	3,471,691	3,196,399	2,979,458	3,031,943
Foreign exchange profit	201,711	240,847	261,460	215,764	315,906	271,267	294,999	284,807
Other income	694,801	856,333	925,254	621,418	682,142	876,747	1,100,091	597,950
Total revenue	4,692,345	4,792,591	4,816,179	4,297,103	4,469,739	4,344,413	4,374,548	3,914,700
Provision for loan losses	331,379	(66,094)	(166,446)	(70,780)	(283,877)	(156,496)	(246,004)	(177,214)
Non-interest expenses	(3,308,864)	(3,246,588)	(3,101,588)	(3,051,718)	(3,088,923)	(2,777,930)	(3,023,260)	(2,565,048)
Provision for income tax	(44,150)	(572,375)	(537,820)	(411,522)	(438,886)	(420,083)	(285,582)	(421,117)
Net profit after tax	1,670,710	907,534	1,010,325	763,083	658,053	989,904	819,702	751,321
<b>Ordinary Share Information</b>								
Market price per share (Rs)	V	NV	V	NV	V	NV	V	NV
High	175.00	107.00	168.00	87.00	129.00	55.00	98.00	47.50
Low	150.00	80.00	116.00	48.75	72.00	34.00	68.00	32.00
Closing	170.25	104.75	164.00	86.00	120.00	51.00	78.00	38.00
V - Voting NV - Non Voting								
Book value per ordinary share (Rs)	101.37	95.77	91.92	87.62	87.38	85.58	81.38	77.90
<b>Financial measures</b>								
<b>Profitability</b>								
Return on average								
Shareholders' equity (annualized) (%)	19.57	16.54	16.77	14.81	16.51	17.76	16.75	16.35
<b>Productivity</b>								
Non interest expenses to total revenue (%)	70.52	67.74	64.40	71.02	69.11	63.94	69.11	65.52
<b>Capital</b>								
<b>Risk weighted capital ratios</b>								
Tier 1 (%)	11.10	9.87	9.79	8.84	9.25	8.53	9.12	8.03
Total (Tier 1+2) (%)	13.16	11.93	11.85	10.93	11.40	10.60	11.59	10.40
<b>Asset quality</b>								
Provision for credit losses (net of recovery)								
to average loans (%)	(0.19)	0.04	0.09	0.04	0.16	0.09	0.15	0.11

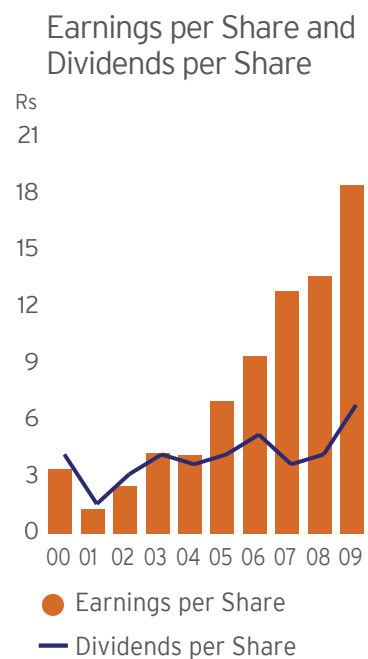
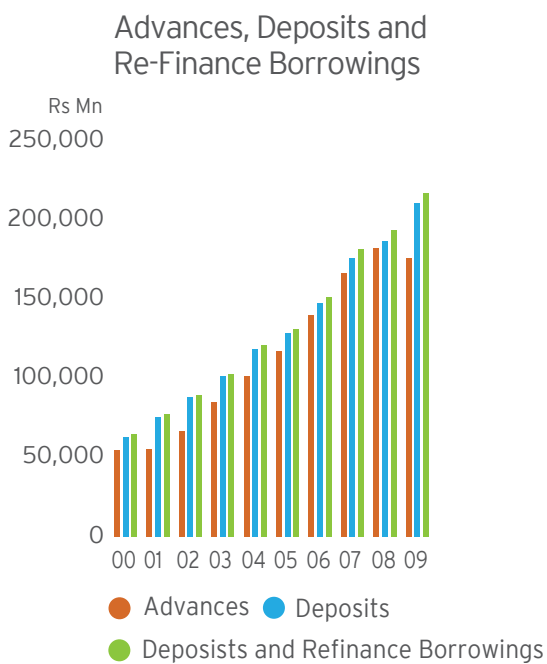
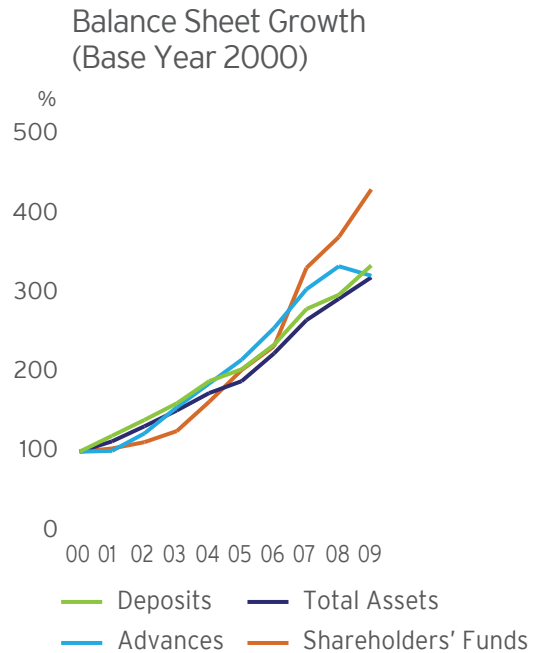
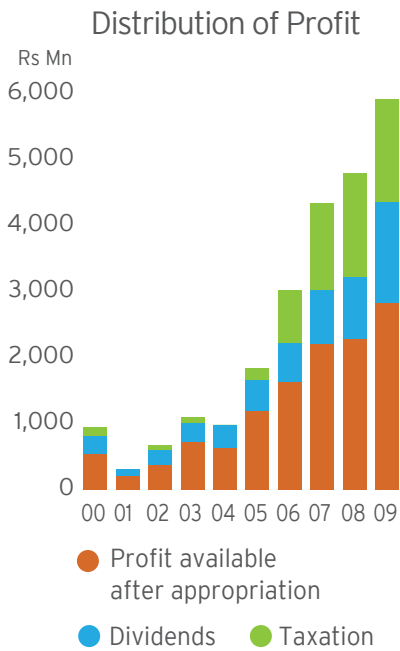
## Ten Year Statistical Summary

Year ended 31st December (Rs Mn)	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
<b>OPERATING RESULTS</b>										
Income	9,641	11,564	11,799	14,831	14,087	16,915	21,494	29,995	37,151	39,374
Interest income	7,940	9,336	9,399	11,537	11,469	14,130	18,452	26,250	32,431	34,620
Interest expense	5,281	7,201	6,258	6,909	5,962	7,281	9,797	15,190	19,752	20,040
Exchange income	364	516	382	506	662	646	773	1,114	1,167	920
Other income	1,337	1,712	2,018	2,788	1,956	2,139	2,269	2,630	3,553	3,834
Operating expenses	3,411	4,061	4,873	6,830	7,175	7,785	8,677	10,470	12,615	13,417
Profit before income tax	949	301	669	1,092	950	1,850	3,019	4,335	4,785	5,918
Income tax on profit	149	(2)	80	83	(26)	195	799	1,312	1,566	1,566
Profit after taxation	800	303	589	1,008	976	1,655	2,220	3,022	3,219	4,352
<b>LIABILITIES AND SHAREHOLDERS' FUNDS</b>										
Customer deposits	62,758	75,599	87,884	101,026	118,524	128,284	147,557	175,660	186,770	210,507
Refinance borrowings	1,655	1,565	1,659	1,764	2,066	2,712	3,583	5,750	6,424	6,448
Other liabilities	17,540	15,999	19,354	23,161	22,787	23,464	31,687	32,472	42,064	38,798
Deferred taxation	155	215	304	387	350	314	314	606	872	939
Shareholders' funds	5,548	5,753	6,235	6,993	9,052	11,239	12,930	18,419	20,581	23,900
<b>Total</b>	<b>87,656</b>	<b>99,131</b>	<b>115,436</b>	<b>133,331</b>	<b>152,780</b>	<b>166,012</b>	<b>196,070</b>	<b>232,906</b>	<b>256,711</b>	<b>280,592</b>
<b>ASSETS</b>										
Bills of exchange	4,546	3,153	2,690	2,412	2,077	2,027	1,911	2,069	2,187	1,476
Loans and advances	47,240	50,473	62,152	75,326	88,594	101,609	119,997	144,985	161,073	159,184
Lease rentals receivable	2,969	2,898	4,032	5,085	6,838	8,864	11,552	13,289	11,547	8,944
Cash, short term funds and statutory										
Deposit with Central Bank of Sri Lanka	14,875	17,377	21,479	21,119	25,013	24,400	30,200	32,565	35,149	38,107
Property, plant and equipment	2,273	2,509	2,781	3,414	3,387	3,059	2,908	6,083	6,866	7,180
Other assets	15,752	22,722	22,302	25,975	26,870	26,053	29,502	33,915	39,888	65,701
<b>Total</b>	<b>87,656</b>	<b>99,132</b>	<b>115,436</b>	<b>133,331</b>	<b>152,780</b>	<b>166,012</b>	<b>196,070</b>	<b>232,906</b>	<b>256,711</b>	<b>280,592</b>
<b>RATIOS</b>										
Return on average shareholders funds (%)	15	5	10	15	12	16	18	19	17	20
Income growth (%)	25	20	2	26	(5)	20	27	40	24	6
Return on average assets (%)	1.0	0.3	0.6	0.8	0.7	1.0	1.2	1.4	1.3	1.6
Dividend cover (times)	3.1	3.1	2.8	3.5	2.8	3.5	3.8	3.7	3.4	2.8
Advance to deposits and refinance (%)	85	73	78	81	81	86	88	88	90	78
Property, plant and equipment to										
Shareholders funds (%)	41	44	45	49	37	27	22	33	33	30
Total assets to shareholders funds (times)	16	17	19	19	17	15	15	13	12	12
<b>(As specified in the Banking Act No 30 of 1988)</b>										
Capital funds to liabilities including										
Contingent liabilities (%)	1.2	1.2	1.2	1.0	1.0	1.0	1.0	1.3	1.2	1.1
Liquid assets to liabilities (%)	25	28	32	27	25	24	22	22	22	29
<b>SHARE INFORMATION</b>										
Market Value per Share (Rs)										
-Voting	46.25	52.00	79.00	69.00	57.00	112.50	155.75	122.50	69.75	170.25
-Non voting	36.75	36.00	47.00	36.75	32.75	41.50	70.00	53.25	32.00	104.75
Earnings per Share (Rs)	12.31	4.66	8.24	14.10	9.75	14.05	18.86	12.83	13.67	18.47
Earnings per Share (Adjusted) (Rs) *	3.39	1.29	2.50	4.28	4.14	7.02	9.42	12.82	13.66	18.46
Price Earnings Ratio	3.76	11.15	9.59	4.89	5.84	8.01	8.26	9.55	5.10	9.22
Net Assets per Share (Adjusted) (Rs) **	23.53	24.40	26.45	29.66	38.39	47.67	54.84	78.12	87.29	101.37
Dividend per Share (Rs)	4.00	1.50	3.00	4.00	3.50	4.00	5.00	3.50	4.00	6.50
Gross Dividends (Rs Mn)	260	98	215	286	350	471	589	824	942	1,533
<b>OTHER INFORMATION</b>										
No of employees	4,119	4,137	4,280	4,203	4,180	4,259	4,287	4,334	4,395	4,302
No of customer centres	117	123	137	138	142	148	151	167	177	186
No of student banking centres	101	122	144	151	152	152	152	152	152	153
No of other financial centres	104	110	110	110	110	113	113	114	114	115

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

\*\* Net Assets per share has been computed for the total number of shares issued as at 31st December 2009.

## Ten Year Graphical Review



## Segmental Analysis

### Business Segments

	Banking		Leasing		Dealings*		Property		Insurance		Total	
	2009	2008	2009	2008	2009	2008	2009	2008	2009	2008	2009	2008
Interest	32,659,198	30,119,107	-	-	116,426	439,625	-	-	453,759	342,561	33,229,383	30,901,293
Exchange	919,782	1,166,979	-	-	265	132	-	-	(94)	1,973	919,953	1,169,084
Lease, premium and brokering	-	-	1,961,078	2,312,051	78,334	57,879	-	-	1,572,270	1,381,192	3,611,682	3,751,122
Commission and Rent	2,309,235	2,364,433	-	-	10,961	1,797	727,721	702,464	-	-	3,047,917	3,068,694
Other	1,525,142	1,188,516	-	-	42,793	31,616	-	169	12,118	1,629	1,580,053	1,221,930
<b>Total Revenue</b>	<b>37,413,357</b>	<b>34,839,035</b>	<b>1,961,078</b>	<b>2,312,051</b>	<b>248,779</b>	<b>531,049</b>	<b>727,721</b>	<b>702,633</b>	<b>2,038,053</b>	<b>1,727,355</b>	<b>42,388,988</b>	<b>40,112,123</b>

\*Stock broking, Securities dealings, Remittances and Foreign currency related services.

Segmental Analysis of Revenue - 2009



- Banking and Leasing - 92%
- Dealing - 1%
- Insurance - 5%
- Property - 2%

- Interest - 78%
- Exchange - 2%
- Leasing - 5%
- Premium, Brokering Income - 4%
- Commission - 7%
- Other - 4%

Segmental Analysis of Revenue - 2008



- Banking and Leasing - 93%
- Dealing - 1%
- Insurance - 4%
- Property - 2%

- Interest - 76%
- Exchange - 3%
- Leasing - 6%
- Premium, Brokering Income - 4%
- Commission - 8%
- Other - 3%



## Share and Debenture Information

### 1. STOCK EXCHANGE LISTING

The issued ordinary shares of Hatton National Bank PLC are listed with the Colombo Stock Exchange. The audited Income Statement for the year ended 31st December 2009 and the audited Balance Sheet of the Bank as at date have been submitted to the Colombo Stock Exchange within three months of the Balance Sheet date.

Stock exchange code for Hatton National Bank PLC shares is "HNB". Reuter code of Hatton National Bank PLC is "HNBL"

### 2. ORDINARY SHAREHOLDERS

#### SHARE INFORMATION - VOTING

There were 4,169 registered Voting Shareholders as at 31st December 2009 (2008 - 4,120) distributed as follows:

	Resident			Non-Resident			Total		
	No of share-holders	No of shares	%	No of share-holders	No of shares	%	No of share-holders	No of shares	%
1 - 1,000	2,561	845,836	0.66	31	12,054	0.02	2,592	857,890	0.46
1,001 - 10,000	1,086	3,641,057	2.83	32	106,406	0.18	1,118	3,747,463	2.01
10,001 - 100,000	374	10,783,570	8.37	18	414,650	0.72	392	11,198,220	6.00
100,001 - 1,000,000	41	9,878,258	7.67	7	3,026,760	5.22	48	12,905,018	6.91
Over 1,000,000	13	103,631,138	80.47	6	54,377,706	93.86	19	158,008,844	84.62
	4,075	128,779,859	100.00	94	57,937,576	100.00	4,169	186,717,435	100.00

#### ANALYSIS OF SHAREHOLDERS

Resident / Non-Resident	31st December 2009			31st December 2008		
	No of Shareholders	No of Shares	%	No of Shareholders	No of Shares	%
Resident	4,075	128,779,859	68.97	4,050	123,792,656	73.69
Non-Resident	94	57,937,576	31.03	70	44,205,454	26.31
Total	4,169	186,717,435	100.00	4,120	167,998,110	100.00

Individuals / Institutions	31st December 2009			31st December 2008		
	No of Shareholders	No of Shares	%	No of Shareholders	No of Shares	%
Individuals	3,923	18,866,761	10.10	3,904	17,483,158	10.41
Institutions	246	167,850,674	89.90	216	150,514,952	89.59
Total	4,169	186,717,435	100.00	4,120	167,998,110	100.00

As at 31st December 2009 the average size of holding of ordinary shareholding was 44,787 voting shares. (31st December 2008 - 40,776 voting shares)

As per the rule No. 8.7 (h) of Colombo Stock Exchange, percentage of public holding as at 31st December 2009 was 64 approximately.

## > Share and Debenture Information

### SHARE INFORMATION - NON VOTING

There were 11,252 registered Non Voting Shareholders as at 31st December 2009 (2008 - 11,920) distributed as follows:

	No of share-holders	Resident No of shares	%	No of share-holders	Non-Resident No of shares	%	No of share-holders	Total No of shares	%
1 - 1,000	7,014	2,304,637	5.68	49	18,958	0.33	7,063	2,323,595	5.02
1,001 - 10,000	3,678	9,902,237	24.43	43	153,020	2.68	3,721	10,055,257	21.74
10,001 - 100,000	409	9,755,358	24.06	13	233,660	4.09	422	9,989,018	21.60
100,001 - 1,000,000	40	9,443,488	23.29	3	1,739,800	30.47	43	11,183,288	24.18
Over 1,000,000	1	9,133,274	22.53	2	3,565,100	62.43	3	12,698,374	27.46
	11,142	40,538,994	100.00	110	5,710,538	100.00	11,252	46,249,532	100.00

### ANALYSIS OF SHAREHOLDERS

Resident / Non-Resident	31st December 2009			31st December 2008		
	No of Shareholders	No of Shares	%	No of Shareholders	No of Shares	%
Resident	11,142	40,538,994	87.65	11,813	42,948,032	92.96
Non-Resident	110	5,710,538	12.35	107	3,251,968	7.04
Total	11,252	46,249,532	100.00	11,920	46,200,000	100.00

Individuals / Institutions	31st December 2009			31st December 2008		
	No of Shareholders	No of Shares	%	No of Shareholders	No of Shares	%
Individuals	11,032	24,182,823	52.29	11,709	26,069,049	56.43
Institutions	220	22,066,709	47.71	211	20,130,951	43.57
Total	11,252	46,249,532	100.00	11,920	46,200,000	100.00

As at 31st December 2009 the average size of holding of ordinary shareholding was 4,110 non-voting shares. (31st December 2008 - 3,876 non-voting shares)

As per the rule No. 8.7 (h) of Colombo Stock Exchange, percentage of public holding as at 31st December 2009 was 96 approximately.

### 3. SHARE TRADING

	2009	2008
<b>Voting Shares</b>		
Number of transactions	3,984	1,942
Number of shares traded (Mn)	35.1	2.6
Rank (As per CSE)	33	119
Value of shares traded (Rs Mn)	5,635.5	287.6
Rank (As per CSE)	4	47
<b>Non-Voting Shares</b>		
Number of transactions	14,138	6,691
Number of shares traded (Mn)	26.3	7.7
Value of shares traded (Rs Mn)	1,859.9	387.4

#### 4. DIVIDENDS

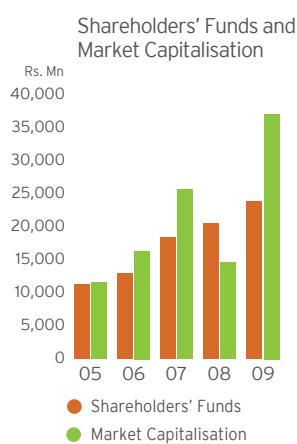
	2009	2008
Interim (Rs)	1.50 Paid in November 2009	1.00
Final (Rs)	5.00 Proposed to be paid in April 2010	3.00 Paid in April 2009

#### 5. EARNINGS

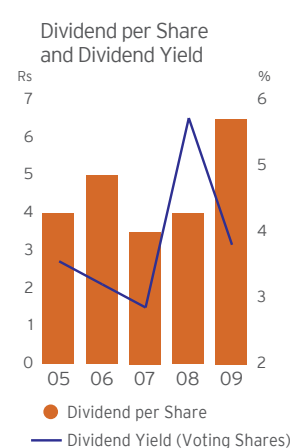
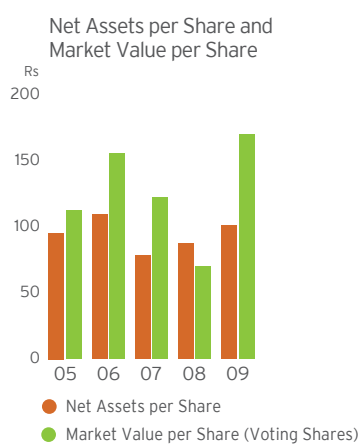
	2009	2008
Earnings Per Share (Rs)	18.47	13.67
Price Earnings Ratio (Times)	9.22	5.10

#### 6. MARKET VALUE

	Highest Rs	Lowest Rs	Year End Rs
2005 - Voting	148.00	51.75	112.50
- Non Voting	65.75	32.25	41.50
2006 - Voting	161.00	100.00	155.75
- Non Voting	74.25	39.00	70.00
2007 - Voting	225.00	90.00	122.50
- Non Voting	120.00	35.00	53.25
2008 - Voting	135.00	65.00	69.75
- Non Voting	57.50	31.00	32.00
2009 - Voting	175.00	68.00	170.25
- Non Voting	107.00	32.00	104.75



\* HNB Market Capitalisation includes both Voting and Non voting shares



#### 7. MARKET CAPITALISATION AS AT 31ST DECEMBER

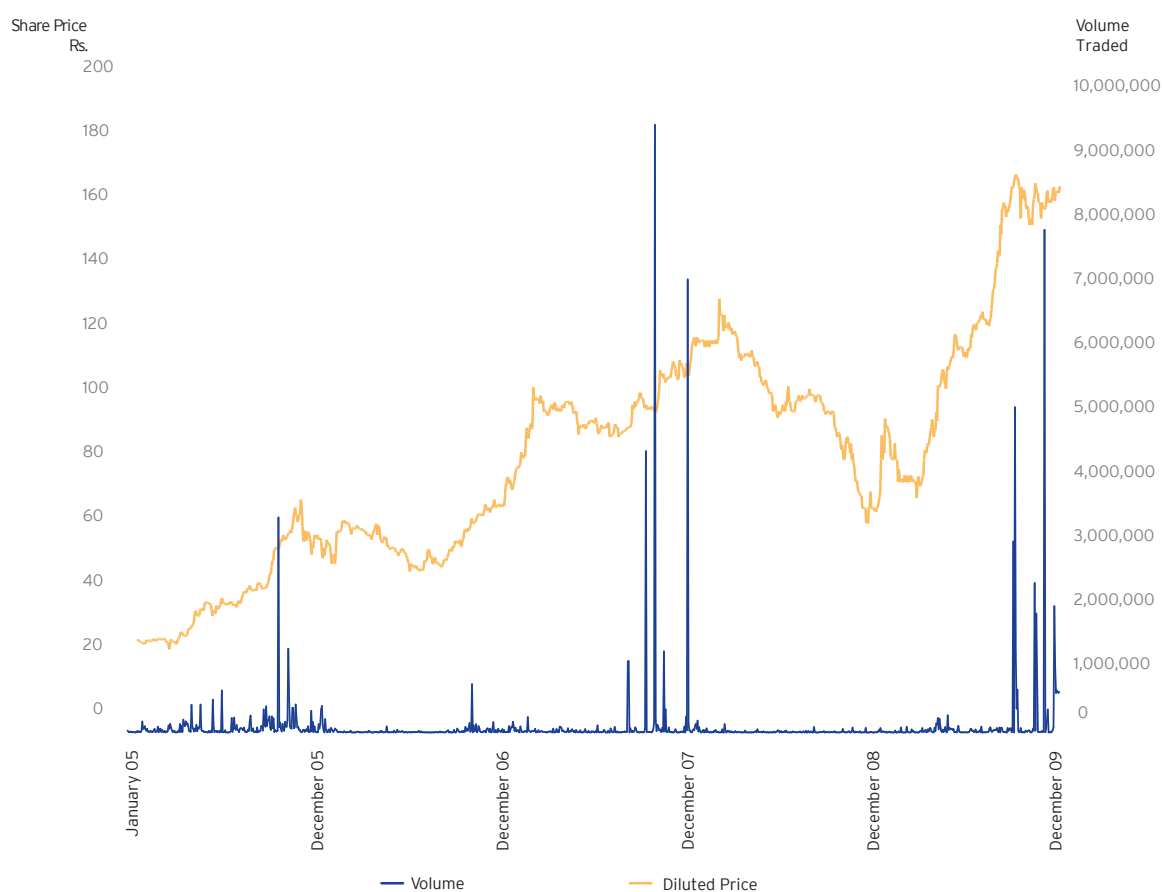
	Capital & Reserves Rs Mn	* HNB Market Capitalisation Rs Mn	CSE Market Capitalisation Rs Mn	HNB Market Capitalisation as a % of CSE Market Capitalisation	CSE Market Capitalisation Ranking
2005	11,239	11,608	584,040	1.99	10
2006	12,930	16,361	834,763	1.95	10
2007	18,419	25,653	820,652	3.13	6
2008	20,581	14,684	488,813	3.00	7
2009	23,900	32,266	1,092,138	2.95	8

\* HNB Market Capitalisation includes only Voting shares

## > Share and Debenture Information

### 8. 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	1,177,647,000
2007	Bonus	1:1	117,764,700	1,177,647,000	2,355,294,000
2009	Shares issued under ESOP		240,747	24,693,906	2,379,987,906
	<b>Total</b>		<b>235,770,147</b>	<b>2,379,987,906</b>	



## 20 MAJOR SHAREHOLDERS (VOTING) OF THE BANK AS AT 31ST DECEMBER 2009

Name	% on total capital	No. of Shares 2009	No. of Shares 2008
1. Deutsche Bank Trust Company Americas	15.00	35,329,400	35,329,400
2. CBD Exports Limited	6.53	15,384,600	15,384,600
3. Milford Exports (Ceylon) Limited	6.53	15,373,050	15,373,050
4. Stassen Exports Limited	5.66	13,324,850	13,324,850
5. Brown and Company Limited	5.36	12,612,690	17,158,690
6. Panchalingam Associates (Pvt) Limited	5.19	12,232,942	12,232,942
7. Sri Lanka Insurance Corporation Limited (Life fund)	4.90	11,533,832	11,533,832
8. Sonetto Holdings Limited	3.59	8,445,206	8,445,206
9. Distilleries Company of Sri Lanka Limited	2.53	5,961,708	5,961,708
10. Employees Provident Fund	2.42	5,700,000	-
11. Standard Finance Limited	2.25	5,300,020	11,240,720
12. Goldman Sachs & Co S/A Artha Master Fund Ltd	1.50	3,515,000	-
13. HSBC International Nominees Ltd - MSNY - Bay Pond Partners	1.42	3,342,600	-
14. Bank of Ceylon No 1 Account	1.13	2,665,200	-
15. FI-CIBLUX S/A Batterymarch Global Emerging Market Fund	1.12	2,648,000	-
16. The Ceylon Investment PLC A/c No 2	0.64	1,500,000	-
17. HSBC International Nominees Ltd - MSNY - Bay Pond Investors	0.47	1,097,500	-
18. Employees Trust Fund Board	0.44	1,038,246	427,146
19. Mercantile Investments Ltd	0.43	1,004,000	-
20. Mr Yonmerenne Simon Hewage Indra Kumar Silva	0.42	1,000,000	-
Sub total	67.44	159,008,844	146,412,144
* Unregistered Shares	1.19	2,803,180	21,331,290
Balance held by 4,149 voting shareholders (Total voting shareholders - 4,169)	11.75	27,708,591	21,585,966
Total voting shares	80.38	189,520,615	189,329,400
Shares held by 11,252 Non voting shareholders	19.62	46,249,532	46,200,000
Total No of Ordinary shares	100.00	235,770,147	235,529,400

\*As at 31st December 2008 approximately 21,331,290 shares purchased by certain foreign investors during the period October 2007 - February 2008, through the Central Depository Systems (Pvt) Ltd of the Colombo Stock Exchange, were pending registration. Bank was awaiting sufficient information / documents, in order to satisfy that the investments conformed to the provisions of the Banking Act / regulations thereunder and other statutory provisions, prior to registering and recognising the investors as shareholders. That was to ensure that the Bank did not become a party to any violation of statutory obligations. As at 31st December 2009 the number of shares pending registration was 2,803,180. As at the date of the Annual Report, the number of shares pending registration is NIL.

## > Share and Debenture Information

### 20 MAJOR SHAREHOLDERS (NON VOTING) OF THE BANK AS AT 31ST DECEMBER 2009

Name	% on total capital	No. of Shares 2009	No. of Shares 2008
1. Legalinc Trustee Services (Pvt) Limited	3.88	9,133,274	9,133,274
2. Perching LLC S/A Averbach Grauson & Co	0.92	2,168,100	-
3. Fast Gain International Ltd	0.59	1,397,000	-
4. Questnet Ltd	0.38	888,300	-
5. Mr Ajith Lasantha Devasurendra	0.38	888,100	-
6. DFCC Bank A/c 1	0.34	797,600	797,600
7. Mellon-Frontaura Global Frontier Fund LLC	0.30	697,500	707,500
8. Distilleries Company of Sri Lanka Limited	0.29	675,132	675,132
9. Deutsche Bank AG as Trustee for Namal Acuity Value Fund	0.21	489,800	-
10. Mr Weerahennedige Kingsley Valentine Mazenod Fernando & Mrs Kurukulasuriya Weerasinghe Shirani Helen Fernando	0.19	458,800	816,900
11. Mr Sinnathamby Visuvanathan	0.19	440,000	440,000
12. Hatton National Bank PLC - A/c No 2	0.14	338,638	338,638
13. Asian Alliance Insurance PLC - A/c 02 (Life Fund)	0.13	303,400	-
14. Waldock Mackenzie Ltd / Mr H M S Abdulhussein	0.13	300,200	-
15. Seylan Bank PLC - Hiniduma Liyanage Lakpriya Manoharan Nanayakkara	0.10	242,200	-
16. Mr Dickowita Kankanamge Weeratunga & Mr Dickowita Kankanamge Athula Kithsiri Weeratunga	0.10	237,760	537,760
17. Miss Shanika Antoinette Fernando	0.09	224,800	312,700
18. Lanka Synthetic Fibre Co. Limited	0.09	220,000	220,000
19. Mr Jayampathi Divale Bandaranayake	0.09	216,600	-
20. Sri Lanka Insurance Corporation Ltd - General Fund	0.09	202,994	202,994
Sub total	8.62	20,320,198	14,182,498
Balance held by 11,232 Non-voting shareholders (Total Non-voting shareholders - 11,252)	11.00	25,929,334	32,017,502
Total Non-voting shares	19.62	46,249,532	46,200,000
Shares held by 4,169 voting shareholders	79.2	186,717,435	167,998,110
Unregistered voting Shares	1.19	2,803,180	21,331,290
Total voting shares	80.38	189,520,615	189,329,400
Total No. of Ordinary shares	100.00	235,770,147	235,529,400

## HNB DEBENTURES 2002

### i) Market Value

12 months ended 31st December

These debentures have not traded for the period ended 31st December 2009

### ii) Interest Income

12 months ended 31st December

	2009		2008	
	Coupon Interest %	Yield of comparable Govt. Security %	Coupon Interest %	Yield of comparable Govt. Security %
10 year Fixed Rate (14.20% p.a.)	14.20	17.33	14.20	19.61
10 year Floating Rate (6 months TB +1.25% p.a.)*	12.00	17.33	17.00	19.61

\* The floating rate debentures have a cap of 17.00% p.a. and a floor of 12.00% p.a.

For an investment of Rs 100/-. The above rupee coupon interest rates are applicable for the next interest payment due on the 15th of August 2010.

## HNB DEBENTURES 2006

### i) Market Value

12 months ended 31st December

These debentures have not traded for the period ended 31st December 2009

### ii) Interest Income

12 months ended 31st December

	2009		2008	
	Coupon Interest %	Yield of comparable Govt. Security %	Coupon Interest %	Yield of comparable Govt. Security %
6 year Floating Rate (6 months TB + 2.25% p.a.) *	10.87	10.90	16.00	19.61
7 year Floating Rate (6 months TB + 2.25% p.a.) *	10.87	10.90	16.00	18.34
8 year Floating Rate (6 months TB + 2.25% p.a.) *	10.87	11.63	16.00	17.65
15 year Fixed Rate (11.00% p.a.)	11.00	N/T	11.00	N/T
18 year Fixed Rate (11.25% p.a.)	11.25	11.05	11.25	16.78

\* The floating rate debentures have a cap of 16.00% p.a. and a floor of 8.00% p.a.

N/T - Not Traded for the period ended 31st December

For an investment of Rs 100/-. The above rupee coupon interest rates are applicable for the next interest payment due on the 30th of June 2010.

## > Share and Debenture Information

### HNB DEBENTURES 2007

#### i) Market Value

12 months ended 31st December

These debentures have not traded for the period ended 31st December 2009

#### ii) Interest Income

12 months ended 31st December

	2009		2008	
	Coupon Interest %	Yield of comparable Govt. Security %	Coupon Interest %	Yield of comparable Govt. Security %
10 year Fixed Rate (16.00% p.a.)	16.00	12.10	16.00	17.18
15 year Fixed Rate (16.75% p.a.)	16.75	N/T	16.75	16.78

N/T - Not Traded for the period ended 31st December

For an investment of Rs 100/-. The above rupee coupon interest rates are applicable for the next interest payment due on the 30th of June 2010.

### HNB DEBENTURES 2008

#### i) Market Value

12 months ended 31st December

These debentures were not listed as at 31st December 2009

#### ii) Interest Income

12 months ended 31st December

	2009		2008	
	Coupon Interest %	Yield of comparable Govt. Security %	Coupon Interest %	Yield of comparable Govt. Security %
5 year Floating Rate (one year TB + 1.00% p.a.)	13.93	10.46	19.45	18.38
7 year Floating Rate (one year TB + 1.25% p.a.)	14.18	12.02	19.70	17.65
10 year Floating Rate (one year TB + 1.50% p.a.)	14.43	12.10	19.95	16.49
10 year Fixed Rate (16.00% p.a.)	16.00	12.10	16.00	16.49
15 year Fixed Rate (16.75% p.a.)	16.75	11.05	16.75	16.78

For an investment of Rs 100/-. The above rupee coupon interest rates are applicable for the next interest payment due on the 30th of June 2010.

### Ratios

	2009	2008
Debenture to Equity Ratio (%)	11.00	13.00
Debenture Interest Cover (times)	16.27	9.28
Liquid Assets Ratio (%)	29.22	22.49



# Glossary

## A ACCRUAL BASIS

Recognising the effects of transactions and other events when they occur without waiting for receipt or payment of cash or cash equivalent.

## ASSOCIATE

An associate is an entity, including an unincorporated entity such as a partnership, over which the investor has significant influence and that is neither a subsidiary nor an interest in a joint venture.

## B BIS SURPLUS

The total Capital Adequacy in excess of the minimum stipulated by Basel International Standards and as modified to suit local requirements by the Central Bank of Sri Lanka.

## C CAPITAL ADEQUACY RATIO

The percentage of risk-adjusted assets supported by capital as defined under the framework of risk-based capital standards developed by the Bank for International Settlements (BIS) and as modified to suit local requirements by the Central Bank of Sri Lanka.

## CAPITAL RESERVE

Capital Reserves consist of revaluation reserves arising from revaluation of properties owned by the Bank and Reserve Fund set aside for specific purposes defined under the Banking Act, No 30 of 1988 and shall not be reduced or impaired without the approval of the Monetary Board.

## CASH EQUIVALENTS

Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

## COMMITMENT TO EXTEND CREDIT

Credit facilities available to clients either in the form of loans, bankers' acceptances and other, on-balance sheet financing, or through off-balance sheet products such as guarantees and letters of credit.

## CONTINGENT LIABILITIES

Conditions or situations at the balance sheet date, the financial effect of which are to be determined by the future events which may or may not occur.

## COST INCOME RATIO

Operating expenses as a percentage of net income.

## COST METHOD

Cost method is a method of accounting for an investment whereby the

investment is recognised at cost. The investor recognises income from the investment only to the extent that the investor receives distributions from accumulated profits of the investee arising after the date of acquisition. Distributions received in excess of such profits are regarded as a recovery of investment and are recognised as a reduction of the cost of the investment.

## COST-PUSH INFLATION

A continuous increase in average price levels due to an increase in production costs.

## D DEFERRED TAX

Sum set aside in the financial statements for taxation that may become payable in a financial year other than the current financial year.

## DIVIDEND COVER

Profit after tax divided by gross dividends. This ratio measures the number of times dividend is covered by the current year's distributable profits.

## DIVIDEND YIELD

Dividend earned per share as a percentage of its market value.

## DOCUMENTARY LETTERS OF CREDIT (L/Cs)

Written undertakings by a bank on behalf of its customers, authorising a third party to draw on the bank up to a stipulated amount under specific terms and conditions. Such undertakings are established for the purpose of facilitating international trade.

## E EARNINGS PER SHARE (EPS)

Profit attributable to ordinary shareholders, divided by the number of ordinary shares in issue.

## EFFECTIVE TAX RATE

Provision for taxation excluding deferred taxation divided by the profit before tax.

## EQUITY METHOD

The equity method is a method of accounting whereby the investment is initially recognised at cost and adjusted thereafter for the post-acquisition changes in the investor's share of net assets of the investee. The profit or loss of the investor includes the investor's share of the profit or loss of the investee.

## F FAIR VALUE

Fair Value is the amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction.

## FOREIGN EXCHANGE INCOME

The realised gain recorded when assets or liabilities denominated in foreign currencies are translated into Sri Lankan Rupees on the balance sheet date at prevailing rates which differ from those rates in force at inception or on the previous balance sheet date. Foreign exchange income also arises from trading in foreign currencies.

## G GENERAL PROVISIONS

General provisions are established for leasing transactions, housing loans, pawning advances and others for anticipated losses on aggregate exposures where credit losses cannot yet be determined on an individual facility basis.

## GROSS DIVIDENDS

The portion of profit inclusive of tax withheld distributed to shareholders.

## GROUP

A group is a parent and all its subsidiaries.

## GUARANTEES

Primarily represent irrevocable assurances that a bank will make payments in the event that its customer cannot meet his / her financial obligations to third parties. Certain other guarantees represent non-financial undertakings such as bid and performance bonds.

## I IMPAIRMENT

This occurs when recoverable amount of an asset is less than its carrying amount.

## INTANGIBLE ASSET

An identifiable non-monetary asset without physical substance held for use in the production / supply of goods / services or for rental to others or for administrative purposes.

## INTEREST MARGIN

Net interest income as a percentage of average interest earning assets.

## INTEREST SPREAD

This represents the difference between the average interest rate earned and the average interest rate paid on funds.

## J JOINT CONTROL

Joint control is the contractually agreed sharing of the control over an economic activity, and exists only when the strategic financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control.

## > Glossary

- JOINT VENTURE**  
A joint venture is a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control.
- K KEY MANAGEMENT PERSONNEL**  
Key Management Personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly.
- L LIQUID ASSETS**  
Assets that are held in cash or in a form that can be converted to cash readily, such as deposits with other banks, bills of exchange and treasury bills.
- LOAN LOSS PROVISION**  
Please refer Provision for Bad and Doubtful Debts below.
- M MARKET CAPITALISATION**  
Number of ordinary shares in issue multiplied by the market value of each share at the year end.
- MARKET RISK**  
This refers to the possibility of loss arising from changes in the value of a financial instrument as a result of changes in market variables such as interest rates, exchange rates, credit spreads and other asset prices.
- N NET ASSET VALUE PER SHARE**  
Shareholders' Funds divided by the number of ordinary shares in issue.
- NET-INTEREST INCOME**  
The difference between what a bank earns on assets such as loans and securities and what it pays on liabilities such as deposits, refinance funds and inter-bank borrowings.
- NON-PERFORMING ADVANCES**  
All loans are classified as non-performing when a payment is 90 days in arrears.
- NON-PERFORMING ADVANCES COVER (NPA COVER)**  
Cumulative loan provision as a percentage of total Non-Performing Advances (net of Interest in Suspense).
- NPA RATIO**  
Total non-performing advances (net of Interest in Suspense) divided by total advances portfolio (net of Interest in Suspense).
- O OPERATIONAL RISK**  
This refers to the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events.
- P PARENT**  
A parent is an entity that has one or more subsidiaries.
- PRICE EARNINGS RATIO (P/E RATIO)**  
Market price of an ordinary share divided by earnings per share (EPS).
- PROVISION FOR BAD AND DOUBTFUL DEBTS**  
A charge to income which is added to the allowance for loan losses. Specific provisions are established to reduce the book value of specific assets (primarily loans) to estimated realisable values.
- R RETURN ON AVERAGE ASSETS (ROA)**  
Net income expressed as a percentage of average total assets, used along with ROE, as a measure of profitability and as a basis of intra-industry performance comparison.
- RETURN ON AVERAGE EQUITY (ROE)**  
Net income, less preferred share dividends if any, expressed as a percentage of average ordinary shareholders' equity.
- REVENUE RESERVE**  
Reserves set aside for future distribution and investment.
- REPURCHASE AGREEMENT**  
This is a Contract to sell and subsequently repurchase government securities at a given price on a specified future date.
- REVERSE REPURCHASE AGREEMENT**  
Transaction involving the purchase of government securities by a bank or dealer and resale back to the seller at a given price on a specific future date.
- RISK-ADJUSTED ASSETS**  
Used in the calculation of risk-based capital ratios. The face amount of lower risk assets is discounted using risk weighting factors in order to reflect a comparable risk per rupee among all types of assets. The risk inherent in off-balance sheet instruments is also recognised, first by adjusting notional values to balance sheet (or credit) equivalents and then by applying appropriate risk weighting factors.
- RIGHTS ISSUE**  
Issue of shares to the existing shareholders at an agreed price, generally lower than market price.
- S SEGMENT REPORTING**  
Segment reporting indicates the contribution to the revenue derived from business segments such as banking operations, leasing operations, stock broking and securities dealings, property and insurance.
- SHARE PREMIUM**  
Amount paid by a shareholder, over and above the par value of a share.
- SHAREHOLDERS' FUNDS**  
Shareholders' funds consist of stated capital plus capital and revenue reserves.
- SUBSIDIARY**  
A subsidiary is an entity, including an unincorporated entity such as a partnership, that is controlled by another entity (known as the parent).
- SWAPS (CURRENCY)**  
The simultaneous purchase of an amount of a currency for spot settlement and the sale of the same amount of the same currency for forward settlement. Alternatively a simultaneous spot sale and forward purchase of a currency.
- T TIER 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**  
Total Capital is the sum of Tier 1 Capital and Tier 2 Capital.
- V VALUE ADDED**  
Value added is the wealth created by providing banking services less the cost of providing such services. The value added is allocated among the employees, the providers of capital, to government by way of taxes and retained for expansion and growth.

## Notice of Meeting

Notice is hereby given that the Forty First (41st) Annual General Meeting of the Hatton National Bank PLC is convened on Wednesday the Thirty First (31st) of March 2010 at the Auditorium on Level 22 of “HNB Towers” at No: 479, T B Jayah Mawatha, Colombo 10, at 10.00 in the forenoon when the following Ordinary Business will be transacted.

To receive and consider the Annual Report of the Board of Directors along with the Financial Statements of the Bank for the year ended 31st December 2009, the Auditors’ Report thereon.

To declare a final dividend of Rs 5.00 per share for the year 2009, to the shareholders as recommended by the Directors.

To re-elect Mr N G Wickremeratne who retires at the Annual General Meeting, a Director of the Bank in terms of Article 93 of the Articles of Association of the Bank.

To re-elect Mrs M A R C Cooray who retires at the Annual General Meeting, a Director of the Bank in terms of Article 93 of the Articles of Association of the Bank.

To re-elect Mr D H S Jayawardena who retires by rotation at the Annual General Meeting, a Director of the Bank in terms of Article 87 of the Articles of Association of the Bank.

To re-appoint Mr R T Wijetilleke who retires at the Annual General Meeting, having attained the age of 70 years, a Director of the Bank and to adopt the following resolution :-

### Resolution

“That Mr Rienzie Theobald Wijetilleke who has attained the age of 70 years on 10th November 2009, be and is hereby re-appointed a Director of the Bank in terms of Section 211 of the Companies Act No 7 of 2007 and it is hereby declared that the age limit of 70 years referred to in Section 210 of the Companies Act, shall not apply to the said Director”.

To re-appoint Mr M V Theagarajah who retires at the Annual General Meeting, having attained the age of 78 years, a Director of the Bank and to adopt the following resolution :-


### Resolution

“That Mr Manickam Vallipuram Theagarajah who has attained the age of 70 years on 13th October 2001, be and is hereby re-appointed a Director of the Bank in terms of Section 211 of the Companies Act No 7 of 2007 and it is hereby declared that the age limit of 70 years referred to in Section 210 of the Companies Act, shall not apply to the said Director”.

To re-appoint the Auditors for the ensuing year and to authorise the Directors to fix their remuneration.

To authorise the Directors to determine payments for the year 2010 for charitable and other purposes.

By Order Of The Board



**INDRANI GOONESEKERA**  
DGM (LEGAL) / BOARD SECRETARY

Colombo, Sri Lanka.  
15th February 2010

### Notes :

1. A member entitled to attend or attend and vote at the meeting is entitled to appoint a proxy to attend or attend and vote as the case may be, in his stead.
2. A proxy need not be a member of the Company. The Form of Proxy is enclosed.
3. The completed Form of Proxy should be deposited with the Board Secretary at the Registered Office of the Company at “HNB Towers”, Level 19, No 479, T B Jayah Mawatha, Colombo 10, not less than 48 hours before the time appointed for holding the meeting.



## Form of Proxy (Voting)

I/We ..... of ..... being a \*member / members of the Hatton National Bank PLC, hereby appoint ..... of ..... or failing him / her Rienzie Theobald Wijetilleke or failing him Rajendra Theagarajah, or failing him Don Harold Stassen Jayawardena, or failing him Manickam Vallipuram Theagarajah, or failing him Rajpal Kumar Obeyesekere or failing him Pamela Christine Cooray, or failing her Ranjeevan Seevaratnam or failing him Nirmala Gihan Wickremeratne or failing him Mirihana Arachchige Rose Chandralatha Cooray, as \*my / our proxy, to represent \*me / us and to vote for \*me / us on \*my / our behalf on the resolutions (including the under mentioned) at the Forty First (41st) 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 31st day of March, 2010 at 10.00 in the forenoon and at any adjournment thereof and at every poll which may be taken in consequence thereof :

To declare a dividend of Rs. 5.00 per share	In favour	
	Against	
To re-elect Mr N G Wickremeratne, a Director of the Bank	In favour	
	Against	
To re-elect Mrs M A R C Cooray, a Director of the Bank	In favour	
	Against	
To re-elect Mr D H S Jayawardena, a Director of the Bank	In favour	
	Against	
To re-appoint Mr R T Wijetilleke, a Director of the Bank	In favour	
	Against	
To re-appoint Mr M V Theagarajah, a Director of the Bank	In favour	
	Against	
To re-appoint Auditors for the ensuing year / authorise the Directors to fix their remuneration.	In favour	
	Against	
To authorise the Directors to determine payments for charitable and other purposes	In favour	
	Against	

Mark your preference with “✓”

Signed this ..... day ..... 2010.

Signature/s .....

.....

Please provide the details :	
Shareholder’s NIC No / Company Registration No	.....
Folio No / Number of Shares held	.....
Proxy holder’s NIC No (if not a Director)	.....

Note - See reverse hereof for instructions to complete the proxy

\* Delete inappropriate words

## > Form of Proxy (Voting)

### INSTRUCTIONS TO COMPLETE PROXY

1. The full name and the registered address of the shareholder appointing the proxy should be legibly entered in the Form of Proxy, duly signed and dated.
2. The completed Proxy should be deposited with the Board Secretary, at the Registered Office of the Company at No 479, T B Jayah Mawatha, Colombo 10, not less than 48 hours before the time appointed for holding the Meeting.
3. The Proxy shall -
  - (a) in the case of an individual be signed by the shareholder or by his attorney, and if signed by an attorney, a notarially certified copy of the Power of Attorney should be attached to the completed Proxy if it has not already been registered with the Company.
  - (b) in the case of a company or corporate body, either be under its Common Seal or signed by its attorney or by an officer on behalf of the Company or corporate body in accordance with the Articles of Association or the Constitution of that Company or corporate body.

The Company may, but shall not be bound to, require evidence of the authority of any such attorney or officer.
  - (c) in the case of joint-holders, the first joint-holder has the power to sign the proxy without the concurrence of the other joint-holder/s.
4. Every alteration or addition to the Proxy must be duly authenticated by the full signature of the shareholder, signing the Proxy. Such signature should as far as possible be placed in proximity to the alteration or addition intended to be authenticated.

## Form of Proxy (Non - Voting)

I/We ..... of  
 ..... being a  
 \*member / members of the Hatton National Bank PLC, hereby appoint .....  
 ..... of .....  
 ..... or failing him / her Rienzie Theobald Wijetilleke or  
 failing him Rajendra Theagarajah or failing him Don Harold Stassen Jayawardena, or failing him Manickam Vallipuram  
 Theagarajah, or failing him Rajpal Kumar Obeyesekere or failing him Pamela Christine Cooray, or failing her Ranjeevan  
 Seevaratnam or failing him Nirmala Gihan Wickremeratne or failing him Mirihana Arachchige Rose Chandralatha Cooray, as \*my  
 / our proxy, to represent \*me / us at the Forty First (41st) 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 31st day of March, 2010 at 10.00 in the  
 forenoon and at any adjournment thereof :

Signed this ..... day ..... 2010.

Signature/s .....

.....

Please provide the details :	
Shareholder’s NIC No / Company Registration No	.....
Folio No / Number of Shares held	.....
Proxy holder’s NIC No (if not a Director)	.....

Note - See reverse hereof for instructions to complete the proxy

\* Delete inappropriate words

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3. The Proxy shall -
  - (a) in the case of an individual be signed by the shareholder or by his attorney, and if signed by an attorney, a notarially certified copy of the Power of Attorney should be attached to the completed Proxy if it has not already been registered with the Company.
  - (b) in the case of a company or corporate body, either be under its Common Seal or signed by its attorney or by an officer on behalf of the Company or corporate body in accordance with the Articles of Association or the Constitution of that Company or corporate body.

The Company may, but shall not be bound to, require evidence of the authority of any such attorney or officer.
  - (c) in the case of joint-holders, the first joint-holder has the power to sign the proxy without the concurrence of the other joint-holder/s.
4. Every alteration or addition to the Proxy must be duly authenticated by the full signature of the shareholder, signing the Proxy. Such signature should as far as possible be placed in proximity to the alteration or addition intended to be authenticated.



# Investor Feedback Form

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

Chief Financial Officer,  
 Hatton National Bank Limited,  
 No. 479, T.B. Jayah Mawatha (Darley Road)  
 Colombo 10.  
 Sri Lanka  
 Email : nihanke@hnb.lk

Name : \_\_\_\_\_

Permanent Mailing Address : \_\_\_\_\_  
 \_\_\_\_\_

Contact Numbers - (Tel) : \_\_\_\_\_  
 Country Code Area Code Number

- (Fax) : \_\_\_\_\_  
 Country Code Area Code Number

E-mail : \_\_\_\_\_

Name of Company : \_\_\_\_\_  
 (If Applicable)

Designation : \_\_\_\_\_  
 (If Applicable)

Company Address : \_\_\_\_\_  
 (If Applicable) \_\_\_\_\_

Queries / Comments

Please tick (✓) the appropriate box

	Yes	No
Would you like to receive soft copies of the HNB annual and interim reports via e-mail?	<input type="checkbox"/>	<input type="checkbox"/>
Would you like to receive news and press releases of HNB via e-mail?	<input type="checkbox"/>	<input type="checkbox"/>
Would you like to receive any information on our products / services?	<input type="checkbox"/>	<input type="checkbox"/>



# Corporate Information

## NAME OF COMPANY

HATTON NATIONAL BANK PLC

## LEGAL FORM

A public limited liability Company incorporated on 5th March 1970 under the Laws of the Republic of Sri Lanka. The Company was re-registered under the Companies Act No 7 of 2007 on 27th September 2007. It is a Licensed Commercial Bank under the Banking Act.

## COMPANY REGISTRATION NUMBER

PQ 82 (previous PBS 613)

## ACCOUNTING YEAR END

31st December

## STOCK EXCHANGE LISTING

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

Global Depository Receipts of the Company are listed on the Luxembourg Stock Exchange.

## REGISTERED OFFICE

No 479, T B Jayah Mawatha (Darley Road),  
P O Box 837, Colombo 10,  
SRI LANKA

## HEAD OFFICE

"HNB Towers",  
No 479, T B Jayah Mawatha (Darley Road),  
P O Box 837, Colombo 10,  
SRI LANKA

Cable Address : HATNABANK  
Telephone Nos 2664664, 2662772, 4764764  
Fax Nos 2662814, 2662832 International - 2446523  
Telex Nos 21259 Hatnbk Ce, 2166 Haynfx Ce  
Swift : Bic Code - HBLILKLX  
e-mail : moreinfo@hnb.net  
Web : www.hnb.net

## CREDIT RATINGS

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

## BOARD OF DIRECTORS

Mr Rienzie T. Wijetilleke (Chairman)  
Mr Rajendra Theagarajah (Managing Director / CEO)  
Mr D H S Jayawardena  
Mr M V Theagarajah  
Mr R K Obeyesekere  
Ms Pamela C. Cooray  
Mr Ranjeevan Seevaratnam  
Mr N G Wickremeratne

## BOARD SECRETARY

Ms Indrani Goonesekera  
Attorney-at-Law & Notary Public

## BOARD AUDIT COMMITTEE

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

## BOARD INTEGRATED RISK MANAGEMENT COMMITTEE

Mr M V Theagarajah (Chairman)  
Mr Rienzie T. Wijetilleke  
Mr R K Obeyesekere  
Mr R Theagarajah - MD / CEO  
Mr J D N Kekulawala - CFO  
Mr D P N Rodrigo - AGM (Risk and Compliance)

## BOARD NOMINATION COMMITTEE

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

## BOARD REMUNERATION COMMITTEE

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

## ASSOCIATE COMPANIES

<b>Lanka Ventures PLC.*</b>	20.07%
Venture Capital	
* (The shareholding of 20.07% in Lanka Ventures PLC sold to Acuity Partners (Pvt) Ltd on 19th January 2010)	

<b>Delma Exchange</b>	20.00%
Remittances and Foreign Currency Related Services	

<b>Browns Engineering (Pvt) Ltd</b>	32.63%
Construction and Engineering	

## JOINT VENTURE COMPANIES

<b>Acuity Partners (Pvt) Ltd</b>	50.00%
Financial Services	

## SUBSIDIARY COMPANIES

<b>HNB Assurance PLC</b>	60.00%
Insurance Services	

<b>Sithma Development (Pvt) Ltd</b>	100.00%
Property Development	

<b>Majan Exchange LLC</b>	40.00%
Remittances and Foreign Currency Related Services	

<b>Commercial Interlink Services Inc</b>	95.00%
(O/A of Delma Exchange Canada) Remittances and Foreign Currency Related Services	

## AUDITORS

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

## INVESTOR INFORMATION

Institutional Investors, Stock Brokers and Security Analysts requiring financial information should contact the Chief Financial Officer at:  
"HNB Towers", Level 16,  
No 479, T B Jayah Mawatha, (Darley Road),  
Colombo 10,  
SRI LANKA.

Telephone : 2662705, 2664705  
Fax : 2662815  
e-mail : nihalke@hnb.lk



**HATTON NATIONAL BANK PLC**

"HNB Towers",  
No. 479, T B Jayah Mawatha, (Darley Road),  
Colombo 10,  
Sri Lanka.  
[www.hnb.net](http://www.hnb.net)