Safe & Sound

"Our Capital Adequacy is one of the highest in the entire banking sector: the assurance of an institution that's safe and sound...."

In April 2012 Hatton National Bank PLC entered into an agreement with the German Development Finance Institution DEG to raise USD 25 Mn through an eight-year subordinated loan, which forms part of the Bank's tier II capital. DEG, a subsidiary of Germany's KfW, is one of the largest European development finance institutions for long-term project and company financing. Together with the USD 50 Mn raised from China Development Bank by way of a long term senior loan, HNB successfully raised USD 75 Mn from foreign sources during the year.

HNB also became the first Sri Lankan bank to obtain an international credit rating from Moody's Investors Services.

HNB has, for several years, been endorsed by prestigious international and local bodies for excellence in all disciplines including banking, human resources management, corporate governance and transparency. In 2012 the Bank had the distinction of being adjudged the 'Best Bank in Sri Lanka' by the prestigious Banker magazine. HNB was also recognised as the 'Best Retail Bank in Sri Lanka' by the Asian Banker for the fifth consecutive year in 2012.

Safe & Sound

HNB

HATTON NATIONAL BANK
Annual Report 2012

Your Partner in Progress

Financial Highlights
& Financial Goals / Performance

Deposits

Rs 341 Bn
+17.2%

Impaired Assets (Gross)

3.3%
Improved from
3.6% in 2011

PAT

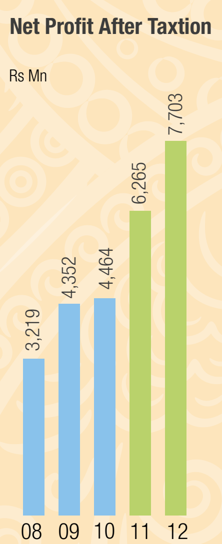
Rs 7.7 Bn
+23.0%

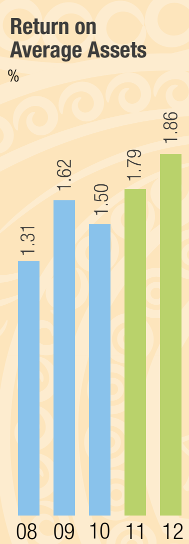
Loans & Receivables (Gross)

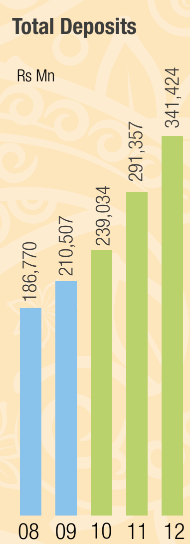
Rs 310 Bn
+18.0%

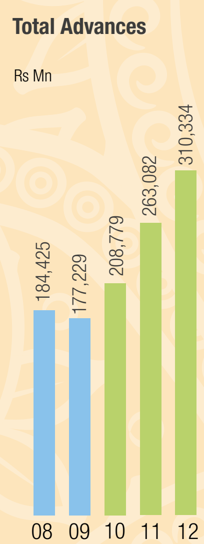
Cost/Net Income

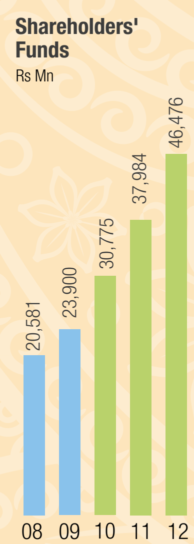
52.3%
Improved by 300 bps











Based on SLAS (previous GAAP)
Based on LKASs/SLFRSs.

	Bank 2012 Rs Mn	Bank 2011 Rs Mn		Bank % Change	Group 2012 Rs Mn	Group 2011 Rs Mn		Group % Change
Results For the Year								
Income	**51,559**	37,066	+	39.1	**55,160**	40,123	+	37.5
Net profit before income tax	**10,046**	8,388	+	19.8	**10,693**	9,056	+	18.1
Income tax on profits	**2,342**	2,123	+	10.3	**2,421**	2,156	+	12.3
Net profit after taxation	**7,703**	6,265	+	23.0	**8,271**	6,900	+	19.9
Gross Dividends	**3,378**	2,914	+	15.9	**3,378**	2,914	+	15.9
Profit available after appropriation	**4,325**	3,351	+	29.1	**4,893**	3,986	+	22.7
At the Year End								
Shareholders' funds (Capital and Reserves)	**46,476**	37,984	+	22.4	**51,624**	41,575	+	24.2
Deposits from customers	**341,424**	291,357	+	17.2	**340,848**	290,912	+	17.2
Gross loans and receivables	**310,334**	263,082	+	18.0	**309,300**	261,231	+	18.4
Total Assets	**446,302**	380,484	+	17.3	**459,399**	391,297	+	17.4
Information per ordinary share								
Earnings (Rs)	**19.36**	16.60	+	16.6	**21.19**	18.65	+	13.6
Dividends (Rs)	**8.50**	7.50	+	13.3				
Dividend Yield (%) - Voting	**5.74**	4.96	+	15.9				
Net asset value (Rs)	**116.99**	97.75	+	19.7	**129.96**	106.99	+	21.5
Market value (Rs) - Voting	**148.00**	151.30	-	2.2				
Market value (Rs) - Non voting	**112.50**	83.20	+	35.2				
Ratios								
Return on average shareholders' funds (%)	**18.24**	18.22	+	0.1	**17.41**	18.06	-	3.6
Price earning (Times) - Voting	**7.64**	9.11	-	16.1	**6.98**	8.11	-	13.9
Dividend cover (Times)	**2.28**	2.15	+	6.1	**2.45**	2.37	+	3.4
Capital Adequacy Ratios								
Tier 1(%) (Statutory minimum ratio required is 5%)	**13.85**	12.76			**14.10**	12.90		
Total capital (%) (Statutory minimum ratio required is 10%)	**16.63**	14.51			**16.94**	14.77		

Note: Information is based on LKASs/SLFRSs.

Results for last 5 years (Bank)	**2008**	**2009**	**2010**	**2011**	**2012**	**Medium Term Goals**
Return on Average Assets (%)	1.3	1.6	1.5	1.8	**1.9**	Over 1.8
Return on Average Shareholders' Funds (%)	16.5	19.6	17.4	18.2	**18.2**	Over 20.0
Cost / Net Income Ratio (Excl. Financial VAT) (%)	52.6	52.7	54.9	55.3	**52.3**	Below 50.0
Dividend per Share (Rs)	4.00	6.50	7.00	7.50	**8.50**	Over 4.00
Capital Adequacy						
Tier 1 Capital Ratio (%) (Statutory Minimum Ratio Required is 5%)	9.3	11.1	11.0	12.8	**13.9**	11.0
Total Capital Ratio (%) (Statutory Minimum Ratio Required is 10%)	11.4	13.2	12.6	14.5	**16.6**	13.5

Safe & Sound

“Safe” & “Sound”: Simple words can mean so much. At Hatton National Bank we are deeply proud of the vision and values that drive our success today. For over 120 years we have stood strong through times of change and turmoil; a tower of strength and a powerful partner to the thousands who have placed their trust in us for so long.

We pride ourselves on our fundamentals. Our core strength is reflected in all we do - the way we think and the way we bank. It is in our large capital power and resources, good governance and responsible leadership. It is the invisible yet vital back office engine that drives the smoothness of our operations…and the smile with which we welcome every customer we serve.

This is why we are one of Sri Lanka’s most trusted banking institutions.

We’re Safe and Sound.

Contents

KEY PAGES

Hatton National Bank believes in building partnerships that are long-term and designed to build value and create wealth.

VISION

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

MISSION

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

OUR VALUES

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

The fundamental strengths that keep us

Safe & Sound

capital strength

This year we became the only Sri Lankan bank to raise tier II funding from foreign sources.

READ MORE ON PAGES 56-60

We will continue to focus on deposits as a key source of funding our growing asset base while seeking alternate sources of funding to complement deposit growth. Our capital adequacy position is over 16% and places us among the strongest and best capitalised banks in Sri Lanka.

find out more >>

The fundamental strengths that keep us

Safe & Sound

We actively strive towards the creation of a culture of learning, one that is built on a firm foundation of knowledge, skills and attitude. In nurturing people, we effectively use training and development as a tool towards greater intellectual vitality. Our people are our greatest strength and the bedrock of our success.

training and innovation

"Our drive to ignite passion for learning and the spirit of innovation earned us the "Excellence in Training" award at Asia's Best Employer Awards..."

READ MORE ON PAGES 145-150

Over 120 years ago, we were established for the sole intention of serving the people, through partnering in their progress…

responsible leadership

READ MORE ON PAGES 6-183

Ours is a genuine commitment towards our customers, employees and all stakeholders. We are focused on playing a broader role in society. Responsible leadership is ingrained in how we do business because social stewardship defines who we are. Our strategic alignment of sustainable objectives with business objectives delivers a win-win, every time.

In the face of growing pressures on fund-based income, we have been exploring our options to secure sustainable income from multiple sources. This year we increased our contribution from fee and commission based sources and look to objectively grow this source in the medium term.

multiple resources

In 2012, our fee and commission income rose by a staggering 38%, as we strategically looked to augment our incomes through multiple sources...

READ MORE ON PAGES 31-32

smooth processes

This year we further streamlined our processes, deriving an improvement of 300bps on the cost to income ratio, which contracted to 52.3%...

READ MORE ON PAGES 31-32

Complexity and cost management is a core priority for us and we are aware of the need to maintain a disciplined approach to cost management. Simplification of processes, tight expense management and instituting a culture of continuous improvement and productivity have contributed positively to our business performance.

Safe & Sound

find out more >>

The fundamental
strengths
that keep us

Safe & Sound

Our governance structure and reporting framework were recognised as amongst the best - once again…

good governance

READ MORE ON PAGES 87-115

Governance is a fundamental component of our culture and business practice. It is the management framework that facilitates us to conduct business in a responsible and accountable manner, promoting credibility and soundness. In recognition of this, we received yet another Gold for Corporate Governance Disclosure at the Annual Report Awards 2012 organised by the Institute of Chartered Accountants of Sri Lanka (ICASL).

Safe & Sound

Getting it right.

MANAGEMENT INFORMATION

Chairperson's Statement

"A robust and forward thinking business strategy coupled with quality earnings and good governance enabled Hatton National Bank to place itself in the same league amongst the finest banking and financial service providers the world over. "

Dr Ranee Jayamaha
Chairperson

As another financial year of accomplishments comes to an end, it gives me great pleasure to welcome all of you to the forty fourth Annual General Meeting of Hatton National Bank PLC, and to present to you the audited Financial Statements and Annual Report for the year 2012.

Our shareholders will be pleased to note that, once again, this reporting period has been one of defining excellence for Hatton National Bank. Your Bank continued to sustain its position as the second largest private commercial bank in the country in terms of size and market capitalisation. A robust and forward thinking business strategy coupled with quality earnings and good governance enabled Hatton National Bank to place itself in the same league amongst the finest banking and financial service providers the world over. In 2012, your Bank was chosen by the prestigious "The Banker" Magazine of the UK as Sri Lanka's Best Bank. We are undoubtedly proud to be the recipient of this coveted accolade attributable to our ability to remain focused on our customers, employees, shareholders, and all other stakeholders as primary partners in our journey towards excellence.

Asia rises from the ashes of global economic disarray

With the ongoing sovereign debt crisis permeating and destabilising almost all of Europe, impending financial calamity cast a shadow of gloom on some of the largest economies and catalysed a considerable degree of uncertainty across the global financial services industry during 2012.

In the face of these recent incidents, Asia has risen much akin to the Phoenix that rises from the ashes, to lay claim to economic supremacy. Asia now has the potential to become the world's newest regional economic zone, a growth rate of 6% in 2012 and 2013 is pushing the region to a new frontier of economic output. When economic integration of the region is achieved, Asia will hold the reins to economic leadership as it is possibly the largest single market with seamless production across the area.

> "In the second half, the Bank proactively adapted itself to changes in the policy framework and financial markets while moving forward to seize opportunities in the real economy."

Sri Lanka continues to demonstrate resilience

2012 was an extraordinary year which, once again underscored the resilience of the Sri Lankan economy. Despite external and domestic challenges, the economy adjusted well to cautious policy measures enacted by the Government and Central Bank of Sri Lanka (CBSL), thereby retaining stability. It remained not only resilient but also diverse and creative, offering the banking and financial service sector many opportunities to leverage upon.

Consequent to the major growth momentum witnessed in 2010 and 2011 where policymakers allowed for rapid expansion, a mix of stringent policy measures aimed at macroeconomic stabilisation was adopted in early 2012. These measures aimed to overcome the challenges of a protracted recovery in the global economy as well as rapidly rising domestic credit. Accordingly, the ceiling of 18% placed on credit expansion by the CBSL supported the faster transmission of the tight monetary policy stance to the system while banks were encouraged to raise foreign funding to augment capital and their lending requirements. Although adverse weather conditions led to unfavourable supply side effects on inflation, effective demand management policies that were in place moderated aggregate demand thereby maintaining inflation at single digit levels. Consequently, economic growth declined approximately to an average 6.5 % during the year.

Chairperson's Statement

"Moreover, banks in syndication must enter the international capital markets for future fund raising to fuel growth. Long term, low cost capital secured in the international markets will enable the sector to manage capital mismatches in an era where long term advances will be the norm."

Banking that defines safe and sound

In the first half of the year, amidst difficulties and challenges brought in by the severe and complex international environment and despite uncertainties in the domestic markets, Hatton National Bank improved its operating strategies and measures whilst retaining a healthy growth. In the second half, the Bank proactively adapted itself to changes in the policy framework and financial markets while moving forward to seize opportunities in the real economy. We continued to optimise the credit structure and focused on developmental aspects within the leeway available to the Bank, and effectively adjusted our operations, while promoting innovation balanced with prudent risk management.

2012 was in fact a year in which your Bank geared itself for future growth in alignment with the national strategy. With fundamentals in place, Hatton National Bank stood on a firm foundation for future growth. Despite the tumultuous world economy and the inherently disturbed global FDI market, your Bank successfully partnered with two international banks to source and secure long-term senior debt and tier II capital.

Rated in 2012 by the International Rating Agency Moody's Investors Service, your Bank equipped itself with necessary conditions to enter global capital markets in recognition of the fact that sourcing capital from international investors would be critical for Sri Lanka's financial services sector to successfully meet USD 4,000 (USD 4k) per capita growth criteria by 2016, as well as to support growth beyond the USD 4k era. Therefore, safety and soundness beyond the USD 4k target is a priority, and let me assure you, as your Bank's Chairperson, we remain well attuned to lead and sustain this growth.

Call for collective focus on sustainable growth

It is critical that the banking and financial services sector is cognizant of the need for sustainable growth in the post USD 4k era and address issues pertaining to it well ahead of time. In the post USD 4k era, the sector will need to facilitate sophisticated and complicated demands of the economy, where advances will be of high value and long term in nature, while risk management will remain key. As an industry, we need to focus on adopting globally acceptable standards for risk mitigation and across the board, operationally. This is all the more pertinent in the post USD 4k, where expectations from the industry will be more on governance, compliance and risk mitigation. Therefore, the time is now right for us as an industry to prepare ourselves for adopting advanced Basel standards and international environmental guidelines and practices towards responsible lending.

Moreover, banks in syndication must enter the international capital markets for future fund raising to fuel growth. Long term, low cost capital secured in the international markets will enable the sector to manage capital mismatches in an era where long term advances will be the norm. This will also ensure that the industry is capable of sustaining growth in a more coordinated manner. On the domestic front, the sector must look to develop the capital market through the introduction of new instruments to capture opportunities for raising capital as and when the market becomes liquid. For operational purposes and to be cost efficient, the banking industry should agree to operate on shared systems / platforms and explore possibilities towards consolidation.

Propagating Safe and Sound banking through enterprise governance

As a systemically important bank and with globally spread client and correspondent relationships, Hatton National Bank is committed to pursuing its unchanging values. Sharing the Bank's greatest strengths with clients both local and international and meeting their diverse needs remains the Bank's key focus. The Bank has insight for tomorrow's business challenges and it is this insight that lends your Bank the ability to adopt prudent measures to deal with potential risks.

We consider governance a priority, and that has become a way of life. Embedded into every aspect of our business processes, we have simultaneously adopted mandatory corporate governance as well as enterprise governance. This holistic approach has created conducive platforms that propagate safety and soundness, and within this realm, we strive for honesty, transparency and accountability through policies and practices at every level.

Our approach is holistic and we have aligned strategic goals and effective management through an integrated framework. This assists towards focusing on both the value drivers that move the Banks' business forward and those that ensure adequate control. We account for successful infusion of conformance and performance measures to a conscious decision to take good governance seriously, recognising it as an imperative. Conformance and performance measures are not merely viewed as "policing" tools but an avenue for us as a corporate to work better and yield better.

Necessary changes were made in our governance and risk structures in 2012, in a bid to enhance our perspective of risk, regulation and compliance. Enterprise governance is embedded into the entire accountability framework of our organisation through the two dimensions of conformance and performance that are in balance. Whilst conformance covers issues such as Board structures and roles and executive remuneration, the performance dimension focuses on strategy and value creation. We continued to report to the CBSL in every sphere of the regulatory requirements and have readied for the proposed policies for financial sector stability in the medium term.

"As a systemically important bank and with globally spread client and correspondent relationships, Hatton National Bank is committed to pursuing its unchanging values."

Trust in core competence

Hatton National Bank in 2012 accomplished its mission of contributing to economic and social development on a countrywide basis by offering specialised and innovative financial solutions. During the year, the Bank concentrated on both wide horizons as well as granular detail. The opening of new markets put us on the growth path and this financial year has been one of seamless connectivity as we traversed all economic sectors, allowing customers across the socio-economic spectrum to leverage their potential. We are ardent believers that when commerce succeeds, livelihoods flourish and this is the core reason for our continued focus on the SME and micro sectors. We are connected to people through trusted networks, and continue to tap the growth potential of the country. That's why generations of Sri Lankans have placed their trust in Hatton National Bank and we believe that they will continue to do so.

Chairperson's Statement

"Hatton National Bank plays a responsible role in society. While contributing to sustainable growth, we attempt to make a difference to our customers, employees, investors, suppliers and the society at large."

Partnering alongside our customers, by being accessible, and committed towards addressing new markets with the promise of safety and soundness as a core deliverable, has enabled us to move closer to our customers, earning their trust and their conviction in our ability to transcend to the next level of value creation. This, we believe will be one of our core competencies in the years ahead, as we progressively move towards new phases of growth.

Responsible actions

Hatton National Bank plays a responsible role in society. While contributing to sustainable growth, we attempt to make a difference to our customers, employees, investors, suppliers and the society at large. We strive towards making sustainability as an integral part in everything we do.

Our operations are underpinned by strong ethics and good governance, long term relationships and committed staff delivering the corporate strategy, contributing to the national strategy, whilst helping to manage the social and environmental impact of our business.

We want to support our customers, create value for our shareholders and contribute to society as a whole. To achieve this, we engage closely with customers, employees, investors, suppliers and the public and strive to be open and transparent with increased possibilities of establishing frank and robust dialogue.

View of the future

As Sri Lanka's macroeconomic fundamentals have strengthened over time, the country is well on track to achieving its target of doubling the per capita income to USD 4k by 2016. As such, Hatton National Bank is now focusing on preparing to support the post USD 4k era.

As in the previous year, we will pursue the effective implementation of our strategic plan for the next two years. We will bank on new relationships through financing of public private partnerships and new infrastructure projects, and seek to expand in the areas where there is a stark deficiency, such as in the capacity of seed and venture capital in the Northern and Eastern provinces. We remain poised for growth and hope to align our product and service developments towards meeting the nation's vision for the "5 Hubs" concept promoting hub status in knowledge, energy, commercial, naval and aviation.

We will remain focused on our core banking activities as the prime driver of our business whilst strategic priorities under five core areas: achievement of operational excellence and cost optimisation, instilling a strong sales culture and deriving a higher fee based income, maintaining profitable balance sheet growth, the development of a competent, engaged and motivated team, and bringing focus to greater governance, transparency, compliance and corporate social responsibility. These will determine our future success and sustainability.

Appreciations

I would like to take this opportunity to thank my fellow Directors who have at all times extended their support and shared their valued expertise towards the betterment of the Bank. I also welcome Mr. Damien Fernando, Mr. Sujeewa Mudalige, Ms. Sanjeewani Jayawardena and Mr. Rusi Captain to the Board. My appreciations to the Management and Staff for their unstinted cooperation and for their tireless pursuit of the Bank's strategic expectations.

Our customers, who have stood by us for many decades have truly demonstrated the meaning of trust and 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, the Secretary to the Ministry of Finance and Economic Development Dr P B Jayasundera, 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 in this Bank. Your belief in its potential is a reflection of our passion to achieve.

We stay committed to serving 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.

Ranee Jayamaha
Chairperson

Colombo, Sri Lanka
21st February 2013

Chief Executive
Officer's Review

"Despite the challenging economic and policy context, and as a result of the acceleration of strategy implementation in line with the Bank's 3 year strategic plan, Hatton National Bank recorded a commendable performance during the year with marked indication of sustainable value creation for the medium term.."

Rajendra Theagarajah
Managing Director / CEO

Growth amidst challenges

Sri Lanka's economy in 2012 continued to battle in an effort to manage the challenges posed by a tumultuous global economy. As in the past, the national economy maintained resilience through cautious policy management and continued to be buoyed by infrastructure and economic vivacity.

For the financial services sector, the year was one defined by policy unpredictability largely due to the complex uncertainties surrounding the European economies. As the national policy makers attempted to circumvent the domino effects of the European economic meltdown on the local economy, the financial services sector faced continuous stress which required skillful navigation.

Safe on strategy

Nevertheless, our shareholders will be pleased to note that Hatton National Bank remained resolute in pursuing its strategic priorities for the year. The Bank continued to place concerted focus on achieving predetermined objectives under five core areas: achievement of operational excellence and cost optimisation, instilling a strong sales culture and deriving a higher fee based income, maintaining profitable balance sheet growth, development of a competent, engaged and motivated team, and bringing focus to greater governance, transparency, compliance and corporate social responsibility. During the financial year, we moved with progress towards realising these medium term strategies. I will elaborate on our successes and of course the challenges and shortcomings later on in this review.

From a strategic sector-wise perspective, we believe that Hatton National Bank took leadership in pursuing wider national goals including those that will pave the way towards the creation of a more dynamic and effervescent financial sector. Our successful pursuance of tier II and long term senior debt capital in international markets in 2012 demonstrates our intention and our capacity for future strategic growth. This not only provides stability to our strategic direction but also is a catalyst in reshaping the capabilities and credibility of the entirety of Sri Lanka's financial services sector.

"The Bank continued to place concerted focus on achieving predetermined objectives under five core areas: achievement of operational excellence and cost optimisation, instilling a strong sales culture and deriving a higher fee based income, maintaining profitable balance sheet..."

Sound on performance

Despite the challenging economic and policy context, and as a result of the acceleration of strategy implementation in line with the Bank's 3 year strategic plan, Hatton National Bank recorded commendable performance during the year with marked indication of sustainable value creation for the medium term.

I am pleased to report to you that your Bank posted a pre - tax profit growth of 19.8% and post - tax profit growth of 23%. The cumulative annual growth rate of 24% in post - tax profit for the five year period of 2008 - 2012 further substantiates the Bank's commendable sustainable performance. The Bank posted an after tax profit of Rs 7.7 Bn, whilst Group after tax profit stood at Rs 8.3 Bn.

On the income side, the Bank realised a positive impact on net income, fitting in well with the overall strategy for profitable balance sheet growth. However, during the year noticeable reduction of the CASA (current account saving account) ratio was evident largely due to rising domestic interest rates. Nevertheless, positive impact on net interest income was realised as asset re-pricing ably offset the impact of a lower CASA with margins effectively defended. Fee income increased by

Chief Executive Officer's Review

> "We also recognised the need to obtain funds from alternative sources and as such we were the first in the Sri Lankan banking sector to venture out and secure an international rating in a bid to secure funding from foreign sources."

a commendable 38% in 2012, propelled by growth in the card, remittance and current account business.

Despite marginal leeway to maintain an open position, forex contributed well to the overall performance of the Bank during the financial year with a commendable growth in returns. Notably, the performance of forex during the year is not attributable to, and has little reliance on the depreciation of the LKR in 2012.

From a capital market perspective, it is safe to say that 2012 was a bear year, although towards the final quarter, the CSE did regain some momentum. The Bank had prudently minimised its exposure to the stock market in 2011 / 2012 and therefore market loss was marginal.

The Bank witnessed a positive impact from loan loss recoveries as stringent measures to contract the Non Performing Advances (NPA) portfolio pushed the Gross NPA to under 4%, the lowest in the last decade. The Bank views this as an outstanding achievement especially from the perspective of the duality of the need to balance portfolio growth with portfolio quality.

The Bank's liquid asset ratio was defended at an average of 20% for much of the financial year, increasing to 22% at the end of the reporting period. The Bank has over the past few years been confronted by an above industry cost to income ratio. Although over the past two years we have effectively contracted the ratio, the target in 2012 was to contract by a further 5%. By identifying the top 5 cost contributors and tackling each diligently, I am pleased to report that we managed to better our target for the year as recorded under the previous accounting standards. Even with the changes under SLFRS, cost to income ratio for 2012 reduced by 300 bps to 52.3%.

On the funding front, we stayed ahead of the curve despite the credit ceiling imposed by Central Bank of Sri Lanka (CBSL). We also recognised the need to obtain funds from alternative sources and as such we were the first in the Sri Lankan banking sector to venture out and secure an international rating in a bid to secure funding from foreign sources. To do so, we worked with identified investors to raise well augmented long term senior and subordinated debt amounting to USD 75 Mn for a period of 5-8 years and successfully secured funds at costs below 5%. We also strengthened our tier I capital through the rights issue in 2011 in addition to the regular plough back of profits, profiling HNB as one of the strongest capitalised banks in the industry in 2011, in pursuance of long-term strategic goals. This position of balance sheet strength will provide us a solid foundation to pursue our strategic intentions in the years ahead.

During the financial year, in line with our strategic priority to further sharpen our governance and risk frameworks, we persisted towards embodying risk and governance frameworks across the entirety of the business in a cohesive and consistent manner. With the implementation of a strategic enterprise risk management framework, we hope to integrate scientific tools to achieve a better compliance and risk purview. In 2012, the major deliverable towards this was the new loan origination system, E-space. In addition, the new Asset Liability Management (ALM) and Fund Transfer Pricing (FTP) systems have become critical tools towards the assessment of asset and liability management.

New asset and liability management frameworks instituted during the year, and those that are yet to be implemented have been shaped by the regulatory framework of the CBSL, Codes of Best Practice outlined by the CSE and mainstay accounting bodies. We have however taken it upon ourselves to raise the bar and as such we have integrated aspects that are reflective of good practices which are over and above stated minimal requirements. The Bank's 'Whistle Blowing Policy', which was finalised during the reporting period, is representative of this, and is a critical improvement to what was otherwise a strong platform. Our augmentation of the CBSL framework for customer responsibility has resulted in the modulation of a Customer Charter that strongly embraces every aspect of fair banking.

We continued to re-orientate to a sales based culture and modulated the structure to be more efficient in facilitating sales. Our efforts towards developing and retaining the best team in the industry continued to draw fruition as we witnessed a marked improvement in retention. We were also able to manage staff costs in relation to inflation, thus increasing the derived efficiency of human resources. On the Human Resources front, the Bank was unable to finalise a collective agreement with the Ceylon Banks Employees Union in respect of banking assistants and allied grades. However payments to these staff based on discussions during the year were honoured and the Bank effected salary increments to all staff at junior executive level based on the collective agreement entered in to with the Officers Union of the Bank during the year.

Summing up, 2012 was one of exceptional performance where our strategy over the years to concentrate on core banking continued to pay dividends. In fact, we attribute this concerted focus on core business, a robust strategy and the quality of our earnings as the prime basis for Hatton National Bank gaining recognition as the Best Retail Bank in Sri Lanka during the 11th International Excellence in Retail Financial Services Awards Programme. Our shareholders will be doubly pleased to note that your Bank was also adjudged the "Bank of the Year 2012" in Sri Lanka by the prestigious UK based "The Banker" Magazine, placing Hatton National Bank at the helm of the global banking world.

"In 2012, the Bank's positioning was perceptively shifted to one of safety; our business model, now more than ever, reflects the trust of the public."

Adoption of the new accounting standards framework

The new Sri Lanka Accounting standards (SLFRS / LKAS) issued by the Institute of Chartered Accountants of Sri Lanka, which are in line with the International Financial Reporting Standards, became effective from 1 January 2012. Hatton National Bank has adopted these new standards successfully and we have presented to you, our first separate and consolidated financial statements under the new accounting framework in this Annual Report. We worked tirelessly throughout the year to ensure that the migration to the new accounting framework was handled in the most effective manner. The transformation from a primarily time based provisioning policy (applied in the past based on the directions issued by the Central Bank of Sri Lanka) to present value of future cashflows for individually significant loans and development of a collective impairment model based on incurred loss patterns for individually insignificant loans was a significant step taken by your Bank, based on the new accounting standards requirements. Your Bank will continue to enhance the internal reporting systems to support the requirements of the new reporting framework.

Sustainability through trust

Sustainability remained a core priority during the year, and as in the past, we focused on integrating

Chief Executive Officer's Review

sustainability into the business function. In fact, I can confidently say that the Bank in pursuing business continuity also simultaneously ensures the sustainability of people, environment and the national economy. In 2012, the Bank's positioning was perceptively shifted to one of safety; our business model, now more than ever, reflects the trust of the public. Our over-riding, sound risk frameworks, our enduring mechanisms and systems in place to protect and minimise risks to customers, coupled with the quality of our earnings is a reflection of the sustainability of our business. I reiterate that ours is a business model that is driven by long-term sustainability objectives where the safety of the banking public is at the highest of priorities.

In 2012, our sustainability strategy was intensified in the area of environmental citizenship, people progress and economic wealth creation. We deepened our outlook on green banking and made sound progress towards the modulation of an Environmental Management System which we are hopeful will come into full implementation organisation-wide by the end of the financial year 2015. Our 'Green Branch' concept was further extended and we are currently in the design stage of a state of the art green banking facility in Jaffna, taking into account lessons learnt from our green operations in Nittambuwa and the HNB Towers.

Our business strategy and sustainability strategy are aligned alongside the nation's development strategy. We catalyse economic activity in rural and urban under-served communities by creating capacities through the conversion of the non-bankable to empowered wealth creators. The United Nations Millennium Development Goals underpin our commitment towards community development especially in the areas of health, education and poverty alleviation through youth and women empowerment.

Global covenants and standards on labour and human rights as laid out by the International Labour

"In line with this we will accelerate electronic and mobile banking platforms as the front-runners of our accessibility strategy. Cost to income management will remain a priority and we will continue to focus our attention on further drilling down cost drivers with a view to contracting and curtailing the ratio to 47% by 2015."

Organisation are the premise on which we have built a fair and ethical workplace.

Our stakeholders will be interested to note that we lay equal emphasis on our social reporting process as we do to our financial reporting framework. We believe it is through sustainability reporting that we can induce inclusive engagement and responsiveness; and that is one of the key means by which we can validate the authenticity and transparency of our sustainability efforts. In 2012, to show our commitment to the sustainability reporting process, as we have done for the past two financial years, we submitted this report for a formal check against GRI Level A+ criteria to the Global Reporting Initiative (GRI).

We firmly believe that creating and upholding our stakeholders trust is the penultimate path to sustainable business. It is only by integrating the welfare of our shareholders and stakeholders in a meaningful and trusting manner that we can look to create wealth and support the national strategy. We look to you for your support, engage with us to create a better tomorrow. As a first step, your response to the feedback form attached to this report will greatly assist us towards enhancing our sustainability approach and reporting approach in the years ahead.

Future expectations

As we look to the year ahead, our expectations are to further perpetuate a sales culture across the organisation. In line with this we will accelerate electronic and mobile banking platforms as the front-runners of our accessibility strategy. Cost to income management will remain a priority and we will continue to focus our attention on further drilling down cost drivers with a view to contracting and curtailing the ratio to 47% by 2015. Raising medium to long-term debt at low cost will remain a focal agenda, as is the intention to mould the best and most engaged team in the industry.

In short, our future expectation will be to maintain our core strengths – continue to develop our capital power and resources, maintain good governance and be a responsible leader. We will continue to build trust as we have done for decades.

We will remain safe and sound.

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 Chairperson and my fellow Directors of the Board for their continuous and consistent support, encouragement, wisdom, input and guidance. Appreciations are due to the entire HNB team, who persevered and showed tremendous dedication at all levels to achieve not only our business targets for this year but also to stay attuned to the business strategy for the medium term. A big 'Thank You' to all of you.

In 2012, our Bank bade farewell to six senior stalwarts who collectively took away more than 200 years of experience. Our appreciations to Mr. Jayantha Perera, Mr. Nihal Kekulawala, Mr. Dulip Fernando, Mr. P. Sridharan, Mr.Reshanka Abayasekara and Ms. Indrani Goonesekera.

The future is ahead of us, the possibilities for us to change lives and our posterity by defining a new Sri Lanka is an open opportunity. As Sri Lanka's Bank of the Year, the onus is on us to be a steward of change.

Rajendra Theagarajah
Managing Director / CEO

Colombo, Sri Lanka
21st February 2013

Safe & Sound

Board of Directors

1. Dr Ranee Jayamaha
   Chairperson
   (Non-Executive Director) / H / N / R

2. Mr Rajendra Theagarajah
   Managing Director / Chief Executive Officer
   (Executive Director) / R

3. Ms Pamela C. Cooray
   (Non-Executive / Independent Director) / H / A

4. Mr N G Wickremeratne
   (Non-Executive / Independent Director) / H / A

5. Ms M A R C Cooray
   (Non-Executive / Independent Director) / N / R / A

6. Dr Willie W Gamage
   (Non-Executive / Independent Director) / H / N

H Member of HR & Remuneration Committee
N Member of Nomination Committee
R Member of Board Integrated Risk Management Committee
A Member of Audit Committee

Safe & Sound

Board of Directors

7. Dr L R Karunaratne
(Non-Executive / Independent Director) / N / R

8. Mr L U D Fernando
(Non-Executive / Independent Director)

9. Mr D T S H Mudalige
(Non-Executive / Independent Director) A

10. Miss D S C Jayawardena
(Non-Executive)

11. Mr R S Captain
(Non-Executive)

12. Ms K A L Thushari Ranaweera
Board Secretary

H Member of HR & Remuneration Committee
N Member of Nomination Committee
R Member of Board Integrated Risk Management Committee
A Member of Audit Committee

Board of Directors

DR RANEE JAYAMAHA - CHAIRPERSON
B.A. (Hons) (University of Ceylon, Peradeniya, Sri Lanka), MSc. (University of Stirling, U.K.), Ph.D (University of Bradford, U.K.), Duniv (University of Stirling, U.K.)

Appointed Director and Chairperson on 31st March 2011. She is the Chairperson of HNB Assurance PLC (with effect from 29th June 2012) and also of Sithma Development (Pvt) Ltd. Dr Jayamaha had been the Deputy Governor in charge of Financial System Stability of the Central Bank of Sri Lanka from 2004 up to her retirement at end of May 2009. She has over 37 years of extensive experience in the fields of economics, banking, finance, regulation and administration, having held a number of positions in the Central Bank and outside. She is currently an Advisor to His Excellency the President.

On release from the Central Bank, she has served as Secretary – Presidential Commission on Finance and Banking, Advisor – Financial Sector Reform Committee, Ministry of Finance and Special Advisor (Economic) – Common Wealth Secretariat, London, U.K.

She has been a Member of the Securities and Exchange Commission of Sri Lanka, the Insurance Board of Sri Lanka, the Chairperson of the Credit Information Bureau of Sri Lanka and the National Payments Council. Dr Jayamaha has been a Member of the Working Group on General Payment System Development of the Bank for International Settlements, Member of the Global Payments Forum, Member of the Advisory Panel of the G-8 Remittances Working Group and Member of the Expert Panel of the Safeguard Assessment Policy Review 2010 of the IMF. She had been providing advisory services to a number of international financial institutions and Central Banks in the Region.

MR RAJENDRA THEAGARAJAH - MANAGING DIRECTOR/CHIEF EXECUTIVE OFFICER
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 28 years in Banking including overseas assignments. Chairman of Acuity Partners (Private) Ltd and Acuity Securities Ltd. Director of Acuity Stockbrokers (Pvt) Ltd, HNB Assurance PLC, Sithma Development (Pvt) Ltd, Guardian Acuity Asset Management (Pvt) Ltd, Lanka Financial Services Bureau Ltd, Lanka Clear (Pvt) Ltd, Carson Cumberbatch PLC, Majan Exchange LLC, Oman and Colombo Stock Exchange. He was a past Chairman of Sri Lanka Banks' Association (Guarantee) Ltd, Financial Ombudsman Sri Lanka (Guarantee) Ltd, and Chairman of the Asian Bankers Association. Member of the Sri Lanka Accounting and Auditing Standards Monitoring Board, Committee Member of the Ceylon Chamber of Commerce, Vice Chairman of the Chartered Institute of Management Accountants (U.K.) Governing Board - Sri Lanka, Member of the Sri Lanka Auditing Quality Assurance Board and Council Member of the Sri Lanka Institute of Directors.

MS PAMELA C. COORAY - DIRECTOR
LL.B. (University of Ceylon, Peradeniya, Sri Lanka)

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

MR N G WICKREMERATNE - DIRECTOR
B.Sc (University of Ceylon, Peradeniya, Sri Lanka)

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

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

MS M A R C COORAY - DIRECTOR
B.A. (Hons,) (University of Ceylon, Peradeniya, Sri Lanka), M.Sc (Strathclyde University, U.K.)

Appointed Director in February 2010. She is a retired Deputy Governor of the Central Bank of Sri Lanka where she served for over 35 years. She is a Director of Ceylon Guardian Investment Trust PLC and Ceylon Investment PLC.

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

She has functioned as the Vice Chairperson of the Institute of Bankers of Sri Lanka for 5 years and has served on a number of Committees at national level covering a variety of subjects representing the Ministry of Finance and the Central Bank. She has also represented the Central Bank and the Ministry of Finance at various international meetings/seminars.

Mrs Cooray has been involved extensively in policy making and implementing projects and programmes especially in the area of regional development and microfinance. She has wide experience in negotiating loans with multilateral and other donors as well as bilateral trade agreements on behalf of the Government. Her articles / papers have been published in professional journals.

DR WILLIE W GAMAGE - DIRECTOR

B.Sc (University College of London, U.K.), M.Sc (University of Colombo), Ph.D (Rajarata University)

Appointed Director on 31st March 2011. Dr Willie W. Gamage currently serves as the Secretary to the Ministry of State Resources and Enterprises Development, while serving as the Chairman/CEO of the Strategic Enterprise Management Agency (SEMA).

He has over 30 years of wide experience in the public, private and non-governmental organisations, having served several such organisations in different capacities. He has extensive experience in formulating and implementing several projects on poverty alleviation, local economic development, promoting alternative energy generation and enhancing capacities in public enterprises.

Dr Gamage has also contributed immensely to the local and regional development initiatives in the areas of Rural Water Supply and Sanitation, Small Scale Fisheries Development, Community Development, Municipal Solid Waste Management, Rural Enterprise Development and Rural Housing Development.

DR L R KARUNARATNE - DIRECTOR

B.E (India), T.Eng (CEI), MIE (Lon), MBA (U.K.), Ph.D (U.K.), FIIM (HK), FCIOB

Dr Rohan Karunaratne, a Consultant Engineer, is the incumbent President of the Ceylon Institute of Builders (CIOB), engaged in developing the construction industry and construction builders in Sri Lanka. He is the Managing Director of A.K.K. Engineers (Pvt) Ltd., an Engineering Company specialised in building construction, civil engineering, water supply and waste water, construction of swimming pools and now in road construction, the Chairman of Associated Motor Finance Co Ltd and is also the Deputy Chairman of the International Institute of Management.

He has over 27 years of experience in civil engineering, building construction, engineering consultancy, construction training, lecturing in civil construction, designing and planning. He was the past Chairman of the National Construction Association of Sri Lanka and was the first Chairman of Human Resources Development (Pvt) Ltd and Advance Construction Training Academy.

Dr Karunaratne holds a Ph.D in Management and a MBA from the Sussex University (UK). He is an Engineering Graduate in Civil Engineering and an advanced Diploma holder in HIET (Chennai - India). He is a Fellow of the International Institute of Management and a Fellow of the Ceylon Institute of Builders.

MR L U D FERNANDO - DIRECTOR

CIMA (UK), MBA (Sri Jayawardenapura)

Mr L U D Fernando has over 29 years of experience in finance, life and non-life insurance, asset management and unit trusts, management of healthcare, food and beverages, manufacturing and in retail, in the mercantile sector. In his career he has held many positions including Board seats.

Mr Fernando is a Fellow Member of Chartered Institute of Management Accountants of United Kingdom and a Master of Business Administration of University of Sri Jayawardenapura.

MR D T S H MUDALIGE - DIRECTOR

FCA (Sri Lanka), FCMA (UK), FCCA (UK)

Mr Mudalige is a Partner of Pricewaterhouse Coopers, Chartered Accountants. He has served as a Commission Member of the Securities and Exchange Commission of Sri Lanka. He is a Member of the governing board of the Sri Lanka Accounting and Auditing Standards Monitoring Board of Sri Lanka (SLA & ASMB) and a Member of the Financial Systems Stability Consultative Commission of the Central Bank.

Mr Mudalige is the Chairman of the Audit Committee of the University of Colombo/School of Computing (appointed by the University Grants Commission) and has served as a Member of the governing boards of the Postgraduate Institute of Management (PIM) and the National Institute of Business Management (NIBM).

He is also the Vice President of the Confederation of Asia and Pacific Accountants. The Confederation includes the professional accountancy bodies of Asian and Pacific nations.

Mr Mudalige is a Fellow of the Institute of Chartered Accountants of Sri Lanka, Fellow of the Chartered Institute of Management Accountants (UK) and a Fellow of the Association of Chartered Certified Accountants (UK).

MISS D S C JAYAWARDENA - DIRECTOR

B.A. (Monash University, Australia), Certified Auditor (DNV-Norway), CIM – London, MCIM (U.K), Chartered Marketer

Miss D S C Jayawardena is a Director of Lanka Milk Foods (CWE) PLC., Lanka Dairies (Pvt) Ltd, Ambewela Livestock Company Ltd, Pattipola Livestock Company Ltd, Ambewela Products (Pvt) Ltd and Indo Lanka Exports (Pvt) Ltd, since 2009. She has worked as an Intern for the Clinton Foundation in 2008.

Miss Jayawardena holds a B.A. (Commercial Law, Criminology, Sociology) from the Monash University, Australia, Professional Certificate in Marketing (CIM), Diploma in Marketing (CIM) and a Professional Postgraduate Diploma in Marketing (CIM). She is also a Certified Auditor (DNV-Norway), a Member of the Chartered Institute of Marketing (UK) (MCIM) and a Chartered Marketer.

MR R S CAPTAIN - DIRECTOR

University of Miami, Florida

Mr R S Captain is the Managing Director of Austin Gloves (Ceylon) Ltd, CEI Plastics Ltd, Propertex Development Ltd, Paints and General Industries Ltd, Paints and General Industries (Exports) Ltd, Polypak Secco Ltd and Ranweli Ltd. He is also a Director of Agriland Ltd, Chemical Industries (Colombo) Ltd, Forest Creek Park Ltd, Body Bar Ltd, Horahena Investments Ltd, Palmland Ltd, Parkland Ltd, Polytex Garments Ltd and Randiya Farms Ltd.

Mr Captain has had his primary education at the Royal College and secondary education at Millfield, U.K. and the University of Miami, Florida.

Corporate Management

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

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

3 **C P Abeywickrema**
B.Com. (Special) Sri Lanka
Deputy General Manager - Development Banking

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

5 **J R P M Paiva**
B.A. (Hons) Ceylon
Deputy General Manager - Strategy and Compliance

Safe & Sound

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

7 **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

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

9 **P Sridharan**
Assistant General Manager - Premier and Electronic Banking

10 **A Ratnasabapathy**
F.P.M.A.
Assistant General Manager - Emerging Corporates

Corporate Management





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

12 **A P L Fernando**
M.B.A. (Colombo), F.I.B. (Sri Lanka), Dip. in Bank Mgmt.
Assistant General Manager - Recoveries and Credit Quality Management

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

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

15 **R J Thambirajah**
Assistant General Manager - SME, Metro and Colombo Region Branches

Safe & Sound

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

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

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

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

20 **S N Wijeratne**
M.B.A. (Sri J.), B.Sc. (IT) - UK
Chief Information Officer

Senior Management

1 K L Wijesooriya
LL.B (Sri Lanka)
Chief Manager - Remittances

2 V Vijayakumar
M.Sc. (I.T.) UK, A.I.B. (Sri Lanka), M.I.M.I.S. (Lond.), A.M.I.A.P. (Lond.), M.A.A.T. (Sri Lanka), M.B.C.S.
Chief Manager - IT Operations

3 P G Wilson
B.Sc. (Kelaniya), Dip. in I.T. (N.I.B.M.), M.C.S.E. - Security, M.C.T.S.
Chief Manager - Systems Security and Compliance

4 A Goonesekere
M.B.A. (Sri J.), F.C.A. (Sri Lanka), F.C.M.A. (Sri Lanka)
Chief Accountant

5 R B Warnakulasuriya
M.B.A. (Sri J.), B.Com. (Special) Kelaniya, M.A.A.T., A.I.C.M.
Chief Manager - Greater Colombo Region

6 V Ratnasabapathy
A.C.I.B. (Lond.)
Chief Manager - Credit Risk

7 U N I Elapata
B.A. (Hons) - Uni. of Texas (Austin)
Chief Manager - Card Centre

8 Ms R Prabhakaran
A.I.B. (Sri Lanka)
Chief Manager - Treasury/International Operations

9 Ms N M C P Wettasinha
Attorney-at-Law & Notary Public
Chief Manager - Legal

10 W J T Fernando
M.B.A. (Sri J), A.I.B. (Sri Lanka)
Chief Manager - North Western Region

11 A R Uduwela
M.B.A. (Sri J.), B.Sc. Special (Pera.)
Chief Manager - Operations

12 P H K S C Ranasinghe
B.Sc. (Eng.) Moratuwa, A.C.M.A. (UK)
Chief Manager - IT Strategy and Solutioning

13 S Udayakumar
D.B.A. (UK), B.Sc. (AM), F.C.M.I. (Lond.), M.S.L.I.M., Dip. in Busi. Mgmt. & Admin. (UK), M.C.P.M.(Sri Lanka), Dip. in Sales Mgmt. & Marketing (UK), A.I.T.D. (Sri Lanka)
Senior Manager - Audit (Branch Operations)

14 Ms M K Rambukwella
M.B.A. (Sri J.), M. Sc. (Pera.), B.A. (Hons) - (Pera.), A.C.I.M. (UK), M.S.L.I.M., A.M.I.T.D.(Sri Lanka)
Senior Manager - Learning and Development

15 Ms K Balasubramaniam
LL.B (Sri Lanka)
Senior Manager - Human Resource Management

16 H J A Ferdinando
Senior Manager - Centralised Operations

17 L S C L R Fernando
A.I.B. (Sri Lanka)
Senior Manager - SME

18 N M Kulatunga
M.B.A. (Sri J.), A.I.B. (Sri Lanka)
Senior Manager - Credit Administration

19 D S L Ferdinando
Adv. Dip. in Credit Mgmt. (IBSL)
Senior Manager - Corporate Account Relationship

20 W M C O Panditharatne
Senior Manager - Procurement and Logistics

21 R L Maheswaran
Senior Manager - Cinnamon Gardens

22 Ms G Arjuna
F.C.M.A. (UK), C.G.M.A.
Senior Manager - Personal Financial Services

23 N Y Liyanage
N.D.T. (Civil Eng.) - Moratuwa, P.G. Dip. in Project Mgmt. (Moratuwa), A.M.I.E. (Sri Lanka), M.S.S.E.(Sri Lanka)
Senior Manager - Premises and Engineering

24 P Parananthan
P.G. Exe.Dip. in Bank Mgmt. (IBSL)
Senior Manager - Pawning

25 A V Abeygunasekara
M.B.A. (Colombo), B.Sc. (Colombo), A.C.M.A. (UK)
Senior Manager - Treasury

26 Ms A F M Fernando
Senior Manager - Corporate Account Relationship

27 Ms A C De Silva Gallage
M.B.A. (Sri J.), B.B.A. (Special) - Colombo, A.C.M.A. (UK), C.G.M.A., C.P.A. (Australia), Dip. in Commerce (Uni. of PNG), I.C.A. - Licentiate,
Senior Manager - Head Office Branch

28 J K N M Perera
Regional Head - North Central Region

29 N R Somasiri
M.B.A. (Sri J.), B.Sc. (Colombo)
Senior Manager - Credit Supervision and Recoveries

30 B V F Mendis
Senior Manager - City Office

31 M K N S Perera
M.B.A. (Manipal)
Regional Head - Central Region

32 R M D J Ratnayake
M.B.A. (Wales)
Senior Manager - Priority Banking and Greenpath Branch

33 J N Rupasinghe
Senior Manager - Systems Implementation

34 C S Weerasinghe
M.B.A. (Sri J), M.C.I.M. (UK)
Senior Manager - Marketing and Communications

35 J C Ilangantileke
M.B.A (Manipal), B.A. (Hons) - Northumbria(UK), A.I.B. (Sri Lanka)
Senior Manager - Trade Services

36 A G R Dissanayake
B.B.A. (Colombo), A.C.M.A.(UK), C.F.A. (USA)
Senior Manager - Strategic Planning

37 P D H Muthukumarana
P.G. Dip. in IT(SLIIT), M.B.C.S. (UK), M.I.E.T. (UK), M.I.E.E.E.(USA)
Senior Manager - Software Development

38 B K Achan
M.Sc. (Bombay), B.Sc. (Hons) (Calcutta),C.A.I.I.B.(India)
Chief Representative Officer - Chennai

Management Discussion and Analysis

- Strong Sales culture & Profitable Balance Sheet Growth
- Operational Excellence and Cost Optimisation
- Higher Fee Income
- Governance, Transparency, Compliance and Social Responsibility
- Competent, Engaged and Motivated Team

CORE STRATEGIC PRIORITIES:

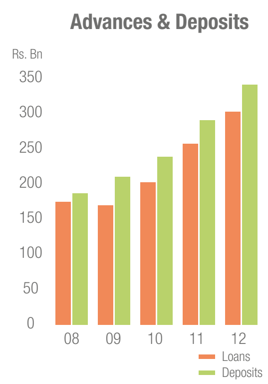
In the preceding financial year, five key priorities were formulated as the base for the Bank's strategic direction in the medium term. In the financial year 2012, the Bank continued to focus on realising these strategic objectives and priorities, moving with concerted focus towards the achievement of:

Focus on Strong Sales Culture and Profitable Balance Sheet Growth	The Bank looks to maximise efficient utilisation of funding and capital whilst ensuring strength and security of the business through prudent lending. Balance sheet growth is propelled by a strong sales drive whilst focusing on improving return on assets. The Bank will continue its efforts towards mobilisation of low cost deposits as a key sustainable source of funding whilst also exploiting other funding options.
Focus on Operational Excellence and Cost Optimisation	The Bank has adopted measures to further improve its cost to income ratio through streamlining of processes, adoption of new technology and instituting a cost management culture. This will continue to be a key area of focus in the years ahead.
Focus on higher Fee Income	With a view to diversify revenue streams, the Bank continued its focus on improving fee based income. This will continue to remain a key focus area going forward.
Focus on Governance, Transparency, Compliance and Responsibility	The Bank continues to strengthen its risk management framework, adhere to governance standards, comply with regulatory requirements, maintain highest levels of transparency through business philosophy and responsible reporting, whilst addressing broader responsibility towards society with regard to financial inclusion, access to finance and responsible lending.
Build a Competent, Engaged and Motivated Team	The HNB Team is the core of the Bank's business and they remain pivotal in implementing the Bank's strategy. The Bank will continue to invest in the Team towards skills development, leadership and promoting diversity whilst also looking for ways and means to encourage initiative and new thinking across all levels.

STRATEGY EXECUTION 2012:

Focus on Strong Sales Culture and Profitable Balance Sheet Growth:

- 18% growth in total loan book despite challenging business environment
- 32% growth in net interest income driven by increase in interest rates and portfolio growth
- Continuing to maintain above industry Net Interest Margins
- Improvement in asset quality amidst high rates of interest with gross Non Performing Advances (NPA) down to 3.32% from 3.60% and net NPA down to 0.86% from 1.06%
- Raising foreign funding totalling to USD 75Mn during the year in the form of senior debt and tier II funding at very attractive rates of interest



Management Discussion and Analysis

Focus on Operational Excellence and Cost Optimisation:

- Cost to income ratio improved by approximately 300bps to 52.3% during 2012.
- Implemented systems in the areas of credit rating, evaluation, regulatory support and asset and liability management.
- Streamlined several branch banking processes to improve efficiency of operations.
- Effective cost management containing controllable expenses.
- Developing a robust e-banking platform for effective deployment.

Higher Fee Income:

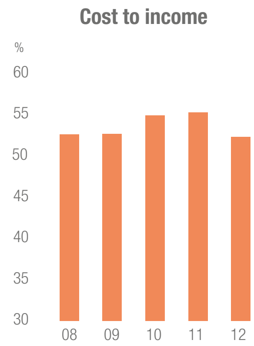
- Increase of 38% in fee and commission income driven by increase in fee income from card operation, current accounts and savings accounts due to automation of fee collection and revision of fees.

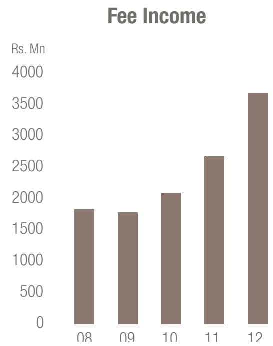
Focus on Governance, Transparency, Compliance and Responsibility:

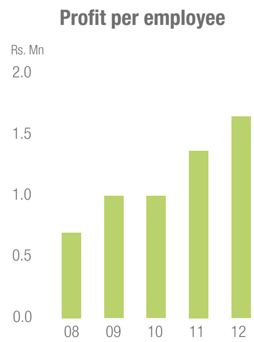
- Improved independency at Board level with 7 independent directors out of a total of 11 Board Members.
- Joint Gold Award for Corporate Governance Disclosure at the Annual Report Awards 2011 organised by the Institute of Chartered Accountants of Sri Lanka(ICASL).
- Bronze Award for Corporate Social Responsibility Reporting at the Annual Report Awards 2011 organised by the ICASL.
- In compliance with SLFRS requirements.

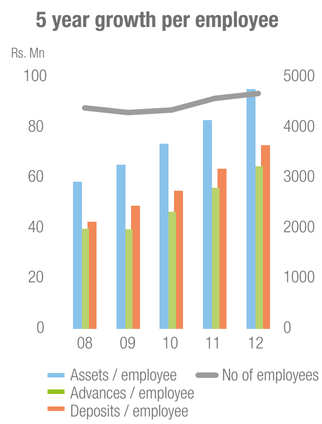
Build a Competent, Engaged and Motivated Team:

- Below 3% attrition rate.
- 20% growth in profit per employee in 2012.









CORPORATE BANKING

Focus for 2012:

Maintain portfolio growth and health despite global challenges

Key highlights:

Portfolio growth – 15%

NPL ratio further improved to 3.7% despite challenging environment

Focus for 2013:

Consolidate growth whilst further strengthening risk assessments

For Corporate Banking 2012 proved to be a resilient year. Commendable performance outpaced the negatives from the global economic front and the resulting multiplier effects on the Sri Lankan economy. Largely, the success of Corporate Banking during the year was attributable to the manifold strategies undertaken by the Bank towards the maintenance of portfolio growth and health targets. Additionally, a concerted focus towards investing in the sectors which were part of the Nation's vision has paid consistent dividends over the past three years.

The ensuing crisis in the European markets had direct and detrimental effects on many of Sri Lanka's large-scale exporters. As buying power declined in key export markets, demand for produce from Sri Lanka contracted. Additionally, as the LKR weakened against the USD during the course of the year, increasing pressures on trade also discouraged the demand for credit. Overall, appetite for credit in the system began ebbing in 2012 whilst interest rate volatility during the year further aggravated the situation. Nevertheless, the Bank continued to maintain a sustainable growth momentum, in line with articulated regulatory objectives for credit growth with corporate banking expanding its book by 15% as at end of 2012.

Focus on rapidly evolving sectors such as tourism which saw renewed growth over and above the strong growth witnessed in 2010 and 2011 enabled the Bank to fuse its strategic business interest in the development of tourism infrastructure with the national goal of 2.5 Mn tourists by 2016.

Power generation continued to be a core area of focus as in previous financial years with particular interest in sources of alternative energy generation. As such in 2012, the Bank supported a number of hydropower generation plants through project financing. The Bank's continued interest in the sector has been precipitated by the growing global, socio-economic debate on the need for green energy. The Bank has over the years laid emphasis on garnering a greater level of involvement in the energy sector specifically as it has been recognised as a strategic value driver in the years ahead.

Likewise, the Bank continued to focus on infrastructure development, in a bid to enhance its share of business from the sector. Infrastructure development has become a national priority under an accelerated development plan. Nation-wide projects in road development, water and sanitation, flood management and infrastructure development were undertaken. Interest in real estate development spiked in 2011 and 2012 remained a very positive year for this sector with a number of key property developments commissioning construction of iconic properties to enhance Colombo's skyline. The value of construction over the next 3–5 years is expected to accelerate, driven by multiple development and infrastructure projects. Moreover, the increased role of private sector participation in infrastructure development enabled the Bank to service a more diverse range of capital needs including project –wise leasing requirements.

These three sectors viz tourism, power and infrastructure development collectively enabled the Bank to circumvent the general sluggishness in economic activity that prevailed during the reporting period and promoted momentum in the loan book. During the year, the Bank committed to lend approximately Rs 28 Bn to the above sectors and approximately 28% of this amount was disbursed in 2012.

Largely, the success of Corporate Banking during the year was attributable to the manifold strategies undertaken by the Bank towards the maintenance of portfolio growth and health targets.

Management Discussion and Analysis

In 2012, through corporate banking, the Bank continued to take a larger percentage of trade business on board, financing trade requirements and opportunities from across the country. Whilst global opportunities also presented means for potential expansion in terms of the scope of business and market expansion, the Bank viewed these opportunities with cautious optimism, in view of the global economic downturn. Going forward, however, in the face of global economic revival, these are opportunities that the Bank will further pursue.

In the period under review, the Bank further strengthened the credit assessment process to a risk based analysis of each industry, thereby shifting away from the more conventional approach of assessing potential customers' business against a broader analysis of the industry and its viability in the context of local and global challenges. Astute yet innovative strategies, a focus on quality, enhanced monitoring, controls and continuous, prudent evaluations were the hallmark for Corporate Banking operations during the year under review.

SMALL & MEDIUM ENTERPRISE (SME) BANKING

Focus for 2012:

Establishment of regional SME cells to accelerate the flow of credit

Key highlights:

Loan book expansion of 23%

Focus for 2013:

Conceptualisation and development of a master plan to give strategic direction to the business over the medium term

Today's SME clients are tomorrow's emerging corporates. The SME sector receives pre-eminence in the nation's plans as the driver of sustainable economic growth and the Bank too has deployed much of its resources to the SME client base. The development of Sri Lankan capital markets over the next decade will give access to markets to these nascent entrepreneurships, which hitherto were constrained by inadequate funding and the general banking sector hesitation to lend to new business ventures.

2012 was a year of sustained growth for the Bank in the SME sector despite the prevailing limitations of a high interest rate scenario. During the financial year the Bank disbursed a sum in excess of Rs 22 Bn as SME credit against the targeted Rs 19.6 Bn for the year. Notably, utilisation patterns changed during the year as a result of the rise in interest rates, pressurising the existing borrowers. As an outcome of this same scenario of high interest rates, the Bank witnessed the SME NPA slide during the year to 6.7% from 5.1% a year earlier.

The Bank's overall commitment to SME has seen the loan book for SME credit grow at a sustainable rate to a value of Rs 62 Bn by the end of the financial year. The Bank is hopeful of expanding its reach to cater to a greater proportion of SMEs in the medium term especially in cognizance of the opportunities arising from the shift of exposure of international banks present in Sri Lanka as they align their operations and exposures to strategic requirements.

The Bank leveraged the SME Development Partner (SMEDP) initiative during the year, as in the past, to yield satisfactory returns with momentum of growth maintained. Although the opportunities to benefit from external refinancing schemes were low, the Bank raised USD 25 Mn in 2012, in the form of tier II capital from Deutsche Investitions - und Entwicklungsgesellschaft mbH (DEG) of Germany to finance the SME sector. Strategic partnerships with the FCCISL continued to create greater awareness of the Bank's SME offer and during the year new alliances were forged to enlarge the base of potential SME customers. Collaboration with SLECIC in the form of an offer of post and pre-shipment

2012 was a year of sustained growth for the Bank in the SME sector despite the prevailing limitations of a high interest rate scenario.

finance will serve to further enhance the scope of the SME product in the upcoming financial year.

Operationally, SME banking received a significant boost during the year. Contrary to the rapid branch expansion in 2011, the Bank looked to a more operationally efficient model. As such during the year, the Bank established SME "cells" in each region, whilst utilising existing resources, to augment the SME offer. This has effectively enhanced the capabilities and the capacities for SME transactions and given focus from a regional perspective to drive and accelerate the flow of credit. The augmented resources of the "cells" have enabled the Bank to empower the credit evaluation process with significant authority delegated for credit approval. Therefore, the new cell structure has enabled the Bank to prudently decentralise portfolio management.

SME specific programmes were conducted in Buttala, Trincomalee, and Batticaloa as localised programmes to further explore and expand the market in 2012. The Bank has been serving the SME sector from its inception and will continue its support in promoting the sector to become a major partner in contributing towards achieving national economic goals. In view of this the Bank will embark on the development of a master plan for the SME sector in the financial year ahead, with a concerted intention to grow the sector and assist it to enlarge its role in the national economy.

ISLAMIC BANKING

Focus for 2012:

Launch an Islamic Banking product to the market as an alternative form of banking

Focus for 2013:

Introduce a range of innovative, new products that are currently not available in Sri Lanka

The Bank launched Islamic Banking in 2012 to cater to the rapidly growing market in Sri Lanka. As an outcome of the evident demand for Islamic banking products, the Bank during the reporting period conceptualised and brought together resources to commission the unit.

"Al Najah", was launched by the Bank to serve its Islamic Banking clients with a special banking unit located at the Bank's head office at HNB Towers. The unit is fully equipped and is led by a team that is well trained and experienced in the area of Islamic Banking. Though centralised at the head office, the Islamic Banking Unit enables customers from across the Bank's network to efficiently network and operate with seamless integration through the Bank's core banking system.

Islamic Banking is a range of financial services that are based and implemented in compliance with Shari'ah principles. Institutions in the sector need to ensure that principles of fairness and justice govern their activity; that there is no interest component in any area of the business, that there is no contractual uncertainty and all financing/banking options are ethical and socially responsible in nature. Basically, the system strives to achieve a win-win for all stakeholders in the most transparent and socially acceptable manner and provides customers with the option of choosing a product or service in harmony with their individual expectations. As such, the Bank's Islamic Banking Unit provides depositors with profit sharing savings and investment options that provide depositors with a Shari'ah based return on their investments. For Business and Personal customers seeking financing, the Bank offers a range of trade related services, leasing, home financing, working capital financing and other personal financial services.

All operations of the Islamic Banking Unit are in accordance with the Central Bank of Sri Lanka guidelines and are in conformity with the Shari'ah principles. This ensures that the fund management operations and earnings of the Unit are segregated and distinct from the conventional banking activity. The Bank appointed a Shari'ah advisory panel comprising of well-respected and eminent Shari'ah scholars.

The unit has successfully garnered a growing client-base and achieved much success within a short span of ten months of commercial operation ending December 2012. The Unit has the potential to grow exponentially in the years ahead to become a significant contributor to the Bank's bottom line.

In the medium term, the Unit will look to play a meaningful role in the marketplace through the introduction of a range of innovative products and services.

The Unit will look to embrace technology for innovation as well as to make interactions with the customer more convenient, whilst also ensuring that its service offer is on par with or supersedes the service delivery of the conventional financial service providers. The onus therefore will be to innovate, to differentiate and create value.

Growing with Hatton National Bank

"The Abans Group retails a massive portfolio of products and services from household electric and electronic appliances to pharmaceuticals and environmental services. This expansion took over thirty years to accomplish and Hatton National Bank has been a strong partner in our progress for much of that time. The Bank has helped us grow in numerous ways, and their personalized attention, flawless service and friendly approach have been a strong support to the business operations we manage today…"

Aban Pestonjee
Chairperson,
The Abans Group

Management Discussion and Analysis

PERSONAL FINANCIAL SERVICES

Focus for 2012:

Maintain momentum of growth across all personal financial services and products

Key highlights:

16.5% growth in portfolio size

Improvement in NPA ratio to 2.2%

Focus for 2013:

Propagate access to finance through multi-channels as a means to national wealth creation

As a Bank that has from its inception been driven by the needs of its retail customer base, the Bank's personal financial needs portfolio comprises products that cover a spectrum of retail banking services designed to meet a broad range of financial needs. In 2012, the Bank persisted towards its strategic objectives by focusing on the realisation of strong penetration of retail banking services across the nation whilst maintaining lending portfolio quality. In living up to its positioning of being a "partner in progress", the Bank continued in its effort to enhance accessibility and penetration across the nation, with financial solutions and financial literacy programmes that have enabled Hatton National Bank to truly justify its market position as a leader.

In recognition of this leadership, the Bank in the year under review won the Best Retail Bank in Sri Lanka Award for the year 2011, for the 5th consecutive year. The Bank received the award at 'The International Excellence in Retail Financial Services 2012 Awards ceremony', held in conjunction with the region's most prestigious retail banking event, the Excellence in Retail Financial Services Convention, held in Singapore.

The award was bestowed upon Hatton National Bank in recognition of its market leadership among private sector commercial banks in housing loans, leasing and consumer lending in Sri Lanka's growing market. The awards programme, administered by The Asian Banker and judged by prominent global bankers, consultants and academics, is the most prestigious of its kind. A stringent three-month evaluation process based on balanced and transparent scorecards is used to determine the winners.

Network development

During the financial year, the Bank followed a strategy of consolidation and efficiency enhancement in terms of network development. Unlike in the previous three financial years where accelerated network development was evident, in 2012, the Bank focused on studying the existing network infrastructure with a view to further consolidate efficiencies and profitability at branch level.

In 2012, the Bank increased its network to 247 customer centres across Sri Lanka. During the year, seven new customer centres were added to the network in Wadduwa, Mulliyawalai, Kurumankadu, Pamunugama, Mallavi, Weligama and Batapola providing greater access to customers. From a network expansion perspective, the Bank shifted its focus to the Southern province in 2012, having provided considerable access to the Northern and Eastern provinces over the past three financial years. Assessment of the potential areas for network expansion was based on the capability of the Bank to build the lives of people in each geography and its capacity to contribute towards GDP expansion. Given that the Southern province appears to be the next best area for GDP expansion – second only to the Western province – the Bank took the initiative to further expand into the Southern province during the year. With focus on reaping greater efficiencies, the Bank judiciously evaluated the cost efficiency of branch expansion to optimise network development.

From a network management perspective, the Bank continued to invest in the development of its teams, developing young leaders to fuel the Bank's network across the nation. Through continuous efforts in business process re-engineering, the Bank has enhanced the efficiency of its network and is working towards lowering its cost to income ratio. The Bank's KPI wizard provides an on-going analysis of key indicators such as profitability, productivity, NPA and cost to income. The network structure fosters decentralisation with regional management giving focus and leadership whilst branch units are empowered to drive the business from an operational perspective. This balance of centralisation and decentralisation optimises the Bank's efforts towards catering to the specific needs of individual customers in a personalised manner.

During the year, the Bank expanded the offer of extended banking hours to Kotahena, Wellawatte and Pettah.

The Bank will augment its branch offering by providing extended-hour banking across all regions. This will entail the operation of seven day banking branches, Sunday banking centres, and the commencement of specialist centres that focus on a limited number of financial services for the retail customer. Whilst 2012 was essentially a year wherein the Bank consolidated its brick and mortar model, the Bank is cognizant of the fact that the future of Sri Lanka's banking lies in the success of an electronic banking model.

Automated Teller Machine (ATM) Penetration

The Bank, during the year under review, remained committed to its strategy of improving accessibility by aggressively expanding the Bank's electronic delivery channels, specifically through enhanced penetration of the ATM network. The network caters not only to the Bank's own debit and credit card holders, but also for all VISA, and Master Card credit and debit cardholders.

The Bank's network of ATMs reached the 410th mark during the year with the installation of the ATM in Weligama. Bank also collaborates with Sampath Bank to collectively enhance ATM accessibility to both Banks' customer bases, significantly increasing accessibility to over 670 ATM points. HNB's ATM network averages over one hundred and fifty thousand transactions per day and facilitates customers with a number of transaction options beyond cash withdrawal, including fund transfers, utility bill payment facilities, credit card payments, cheque book requisitions, current account statement requests amongst others.

In 2012, the Bank persisted towards its strategic objectives by focusing on the realisation of strong penetration of retail banking services across the nation whilst maintaining lending portfolio quality.

As at the end of the financial year under review, the Bank's owned ATM network included 337 on-site (at customer centre premises), and 70 off-site ATMs spread across the island as well as three drive-thru ATMs located at the Bank's Head Office, "HNB Towers" and at its Priority Banking Centre.

Electronic and Mobile Banking

E Banking remains one of the strategic priorities for the Bank in view of its focus on Generation Z as the focal audience over the next decade. Embracement of technology and an imminent move away from the brick and mortar branch business models will persuade the Bank to provide a sophisticated electronic banking solution in the future. As of now, and in the year under review, the Bank has been readying itself to offer these alternate banking channels to customers. It is currently engaged in enhancing its electronic and mobile banking platforms.

The Bank's Internet Banking Service, "Virtual Branch" continued to garner increased traffic and transactions during the year with over 260,000 financial transactions valued at exceeding Rs 6,000 Mn completed during the year. The integration of the Virtual Branch to Finacle Internet Banking served as a secure platform for increased transaction processing and the Bank witnessed a 43% increase in transactions and a 71% increase in the number of users.

Dual authentication was further reinforced during the year as a security enhancement measure in addition to account related transaction security. The Bank also introduced an array of payees for online utility payments for the convenience of the e-banking customer base.

Innovations in Mobile Banking have transformed the mobile phone into a personal banking assistant for our customers. The usage of SMS and Mobile Banking evidenced a growth of 122% during the year.

The Bank also introduced an EDI (Electronic Data Interchange) system facilitating electronic fund transmission from business to business mainly assisting the wholesalers. Retailers are able to make the deposits at any HNB branch which is instantly updated on the wholesaler's core system. This enables instant validations and provides delivery orders thereby

Management Discussion and Analysis

reducing enormous manual work at the wholesale outlets. This product has grown in popularity and is being rolled out to all major wholesale establishments.

The Bank will continue to enrich and enhance the range of facilities offered by these platforms whilst aggressively raising awareness and penetrating market with a view to effectively augmenting traditional channels in the medium term.

Deposit Mobilization

Over the past six months a price war was witnessed in relation to term deposit mobilisation in the industry. The Bank continued to maintain a moderate approach towards interest rates, yet capitalising on its wide network of customer centres, to achieve a strong growth of around 35% in term deposits.

Minor savings accounts schemes, making use of our school banking units as a delivery channel, are designed to inculcate the savings habit in children. The Bank recorded a significant growth in this product. However, the wide gap between savings and term deposit interest rates posed a challenge to the industry as a whole and deposits shifted from low interest to high yield products. Nevertheless due to the established low cost deposit brands the Bank was successful in recording a CASA ratio (Current Accounts and Savings Accounts) of 39% as at end of December 2012.

Personal selling efforts by the staff in the branch network, continued process improvements, offering greater convenience and accessibility to customers as well as other alternate delivery channels, added value to the Bank's savings deposit mobilisation initiatives.

Overall, local currency deposits grew by around Rs 34 Bn, a growth of 13.5%, whilst Foreign Currency deposits showed a growth of USD 53 Mn, an increase of over 12% for the year.

The Bank will continue to focus on improving its CASA ratio and match deposit mobilisation efforts in line with the lending book.

Pawning

The product contributed significantly to the profitability of the Bank, and represents approximately 15% of the Bank's Total Advances.

Offered across the entire branch network, pawning has evolved from its traditional role as personal financing to be a means of short-term finance especially for bridging working capital needs.

The recent popularity of the product, therefore has served to accelerate its growth in the industry whilst also enhancing the Bank's advances portfolio.

Bank's pawning portfolio grew by 28% during the financial year. Offered as a supplementary product to customers of the Bank, the pawning portfolio is characterised by its quality. The effect of a drop in international gold prices was not felt locally due to the depreciation of the rupee preserving the rupee price of gold.

The Bank's resistance to compromise on the quality of the portfolio is evident in that the Pawning portfolio Non Performing Advance (NPA) ratio is only 0.15%, which is well below the industry NPA levels. Daily assessment of the scale of finance to offset a drop in the global price and to mitigate the contraction of margins is a core component of the assessment of market risk. Varied assessment of gold products, to minimise fraud and the regular training of personnel to identify fraud is a fundamental component of the operational risk assessment process. As a result low capital losses have firmly established pawning as a core in the retail product line.

The Bank's payment card services continued to hold the number one position in merchant acquiring with a steady growth of 36% during the financial year.

During the year pawning services were extended beyond normal banking hours as well as on holidays in many of the customer centres to enhance customer convenience.

Leasing

The industry witnessed a decline of over 50% in the demand for vehicle leasing during the year under review, largely owing to the increase in import duty and related charges imposed in Q1 and Q4 of 2012. As a result demand for vehicles declined precipitously over the course of the year, shrinking the demand for leasing; leasing of vehicles in the consumer segment accounts for over 90% of the industry turnover.

Therefore, the Bank's strategy in 2012 was to place concerted emphasis on the commercial vehicle/ machinery sector. The expansion of the agri, construction and infrastructure development sector, created an opportunity for the Bank to leverage its leasing products. Focused marketing communications and a series of tactical promotions with leading vehicle suppliers facilitated a moderate performance for leasing during the year, strengthening the brand and consolidating the business.

In spite of macro economic challenges, focused efforts were made to maintain the quality of the leasing portfolio through effective monitoring and credit evaluations. This is witnessed in the NPA levels maintained below 3%.

Housing Loans

A decline in the demand for housing loans was witnessed during the financial year, mainly as a result of diminishing household income and the rising costs of construction as an outcome of the depreciation of the LKR throughout 2012.

Also the Bank shifted its emphasis towards promoting more foreign currency advances for housing purposes resulting in a significant growth in advances to NRFC account holders. Advertising in the Middle East and core target markets with a high density of expatriate Sri Lankans has proven to be key to catalyzing demand. Despite challenging market conditions, disbursements during the year exceeded Rs 6 Bn.

The priority for the year, as in previous years, was to maintain portfolio quality with many control measures undertaken to control the NPA levels. Although NPA witnessed an increasing trend across the industry, the Bank managed to reduce the NPA ratio to 5.85%, from 6.14% recorded in 2011.

Personal Loans

The Bank offered a range of personal loan facilities during the year for key customer segments.

Following the introduction of duty concessions and the consequent relaxation of transferability, for import of vehicles to government sector employees, the "Auto loans under Permit Scheme" was revamped to capture the target market of government sector employees.

The Bank's "Dream Drive" loan scheme was modified to suit the requirements of busy professionals with the aim of providing total solutions. The Bank continued to offer a range of customised personal loan solutions for all professionals and executives, meeting their educational, motor vehicle, wedding expenses and all other life style associated needs with very competitive rates along with several payment options such as fixed or variable instalment repayments.

Prudent credit evaluation backed by effective collection efforts enabled the Bank to reduce the NPA ratio to 3.1% from 4.4% in year 2011.

The focus for 2013 will be to strengthen our offering, particularly to capture the potential in the education and health sectors.

Credit Card Services

In 2012, Hatton National Bank launched the HNB VISA Infinite and Signature credit cards with Chip technology. The exclusive launch event showcased the opulent life style and the infinite possibilities these card products would present to the crème de la crème of Sri Lanka's high net worth customers, offering them the choice of Smart Luxury coupled with SMART card protection.

The Bank's payment card services continued to hold the number one position in merchant acquiring with a steady growth of 36% during the financial year. The backend systems continued to be upgraded with a view to enhancing security aspects and to be compliant with the security requirements of MasterCard and Visa as defined by EMV Co specifications for chip based card issuance and acceptance. In addition fraud-monitoring tools were enhanced in line with the Bank's strategy to continually develop security measures.

Management Discussion and Analysis

> Priority Banking services continued to be a focal point in 2012 with both "The Club" and the "Crystal Circle" centres playing a pivotal role in changing the service paradigm for high net-worth customers.

Regular promotions to encourage card usage led to an overall increase in the card usage by 24% from that of the previous financial year whilst the card base grew by 6%.

BancAssurance

With emphasis on Life insurance, Bancassurance solutions have potential to emerge as one of the key ancillary financial products. During the financial year 2012, Bancassurance services were extended to a further 22 customer centres to reach a total of 142 customer centres island wide.

Offered in association with HNB Assurance PLC, the intention is to enhance accessibility to the product by offering Bancassurance across the entirety of the Bank's network enabling the customers to satisfy all their financial needs under one roof.

Priority Banking

Priority Banking services continued to be a focal point in 2012 with both "The Club" and the "Crystal Circle" centres playing a pivotal role in changing the service paradigm for high net-worth customers. The Bank's priority banking centres offer premium services including a customised financial advisory service. The service is centered on partnering with customers to personalise banking services. The Bank witnessed a 20% increase in customer base and 38% increase in transaction value at its priority banking centres during the year under review.

The Bank intends to significantly increase its customer base by leveraging on opportunities available with its corporate banking and middle market customers, expanding its geographical presence and product offering in the medium term.

DEVELOPMENT BANKING

Focus for 2012:

Capacity building - internally and externally

Key highlights:

Disbursements of over Rs 4.5Bn

Focus for 2013:

Enhancing the financial outcome of Development Banking efforts through the formulation of a strategic plan for the medium term while improving the reach of development banking efforts

Development Banking remained a core area of interest for the Bank in 2012. The focus during the reporting period was essentially to build capacity both internally and externally. By building capacity, the Bank looked for the achievement of multiple objectives; the development of the agri-sector to a more sustainable economic platform and enhancing accessibility of finance in rural communities to name a few. For much of the reporting period, the Bank built significant capacities within its internal structure, with concerted focus on enhancements at both the strategic and operational levels. Delivery mechanisms as well as some of the key product developments over the past three years paid dividends in 2012, delivering enhanced efficiencies.

The Bank disbursed over Rs 4.5 Bn in development loans during 2012 despite the constraints posed by challenges such as natural calamities and adverse climatic conditions that affected agriculture and related economic activities across the nation. Additionally, market competition intensified as more financial institutions enlarged their scope of business to penetrate into the microfinance space.

In March 2012, the Bank signed a Memorandum of Understanding with World Bank's AgriFin (Agriculture Finance Support Facility) to benefit from a USD 505,000 grant with equally matched co-financing by Hatton National Bank. The grant facilitates internal and external capacity building in agriculture finance and enables graduating farmers to transform from their traditional role to commercially viable, marketplace-savvy entrepreneurs. Within the programme scope, there are several initiatives lined up to support the Bank's ongoing programmes whilst further enlarging external capacities in the medium term with a view to strengthening agriculture finance through capacity building, peer-to-peer learning, and networking.

The Bank also granted a variety of bulk loans for income generating activities and micro housing during the year, in collaboration with Lanka Financial Services for Underserved Settlement (LFSUS). A loan scheme for Women Entrepreneurs in the Northern and Eastern Provinces was also conceived in collaboration with Standard Chartered Bank, Sri Lanka.

The Banks' Development Banking division also provided technical assistance to ThanekaePhum Cambodia Ltd (TPC), Cambodia in September 2012 to develop a range of savings products. The Development Banking division successfully hosted the first international workshop on 'Innovations in Youth Savings' in April 2012 organised by the Women's World Banking (WWB) with participation from financial institutions in Sub-Saharan Africa, Asia, America, Latin America and the Caribbean regions.

During the financial year, the Bank initiated a project to provide financial literacy to school children, youth and entrepreneurs across Sri Lanka in a more attractive, interactive and efficient manner through the utilisation of an E-learning platform. The project is expected to broad-base reach and impact with accessibility to rural masses and will become operationally effective in the upcoming financial year.

Yauwanabhimana, the Bank's financial inclusion programme to empower youth – conducted in collaboration with corporate partners - reached more than 3300 youth during the year. 24 youth development and awareness programmes were held island-wide during the reporting period, with participants exposed to financial literacy and entrepreneurship development, whilst programmes for migrant workers and their dependents were conducted through workshops and national media. In addition, the Bank co-conducted 6 programmes to empower women community leaders involved in water resources management in rural Sri Lanka by providing new knowledge and advice. In 2012, the Bank also entered into a Memorandum of Understanding with Aitken Spence School of Hospitality to further the potential for knowledge share and capacity building under Yauwanabhimana.

In house capacity building centred around the resourcing and development of carefully selected employees, who were exposed to new developments in agricultural technologies aimed at enhancing their professional competence and at educating them to cope with changing conditions and needs in agricultural production and development.

The Bank in 2012 strove to stimulate change in the nation's development banking sector. The overall objective therefore was not only to build capacities of its own business for future growth but also to enhance the nation's by way of developing the micro sector for commercial viability. The Bank is hopeful that these initiatives will infuse a new lease of life to micro-banking, financial inclusion and entrepreneurship development.

Going forward, the Bank will continue to create linkages for future growth stemming from proactive strategy development and enhanced operations in direct alignment with the nation's developmental strategy.

Management Discussion and Analysis

INTERNATIONAL OPERATIONS

Focus for 2012:

Operate in diversified, unsaturated markets to enhance remittance volume growth and profitability

Key highlights:

Key enabler for 2012 – enhanced remittance partnership and delivery channels

Key disabler for 2012 – continued economic volatility in Europe

Rationalisation of correspondent relationships

Focus for 2013:

1. *Further enhancement of delivery channels for inward remittances*
2. *Enlarge share of business in international guarantees*

Remittances continue on the upward trend

Whilst the global economy grappled with persistent downward pressures, Sri Lanka's remittance inflow increased from USD 4.12 Bn in 2010 to USD 5.14 Bn in 2011 and the forecasted remittance inflow for 2012 is estimated at USD 6.1 Bn. External challenges, predominantly the European economic woes, largely accounted for the deceleration of inward remittances from the region, but were more than offset by remittance volume growth from other regions, particularly the Middle East.

The Bank's concerted efforts during the financial year to secure new remittance partnerships paid dividends with the volume of remittances expanding perceptibly as a result, positively impacting the contribution to the bottom line. The rapid growth of the Bank's network during the past few years, also contributed significantly to this volume growth with enhanced delivery channels fuelling accessibility for remittance receivers. To support the Bank's existing remittance channels, the Bank commissioned its proprietary remittance system – HNB CashXpress – to more remittance partners, further facilitating the remittance process. This initiative greatly supported the delivery of remittances during the year and has been credited as focal to the enhanced pace of remittance growth evidenced during the financial year. CashXpress remains a critical value addition to customers.

Augmented remittance delivery remained a strategic focus during the year, and it is forecasted that continued enhancement of the delivery channels together with establishment of new remittance partnerships paves the way for greater returns in the medium term. As a cumulative effect of these strategies, the Bank achieved a 29% growth in remittances during the reporting period despite acute adversities arising from the European economic crisis.

The Bank's newly launched savings product – Adhishtana – that entered the market in the year 2011 was a key in further enlarging the Bank's market share in the Middle East despite the high levels of saturation that prevail. This product which enables both the sender and the receiver of remittances to open an account, provides access to a range of other financing and insurance services has proved to be an anchor in promoting repeated remittance transactions and a tool for securing loyalty of remitters. In this regard, the Bank opened over 3,600 Adhishtana accounts during the year.

Going forward the focus would be on market growth and penetration.

The Bank's concerted efforts during the financial year to secure new remittance partnerships paid dividends with the volume of remittances expanding perceptibly as a result, positively impacting the contribution to the bottom line.

MoneyGram

MoneyGram Payment System Inc., a leading money service provider teamed up with Hatton National Bank PLC and facilitates remittances to Sri Lanka from 296,000 agents globally across 197 countries and territories and this cordial relationship has been successfully maintained for the past 15 years. In 2008 MoneyGram appointed HNB as MoneyGram's Super Agent in Sri Lanka.

During the year under review, the Bank further strengthened the Sub Agent relationship for MoneyGram in Sri Lanka thereby adding 14 new paying locations reflecting a 15% growth in remittances through MoneyGram. The Bank will continue to evaluate and appoint sub-agents in a bid to enhance the accessibility of the service to even the most remote locations in Sri Lanka.

International Guarantees

Focus in the reporting period, as in previous years, lay predominantly in the facilitation of infrastructure development. Growth in infrastructure development across the nation augured well for the Bank with an increase of over 40% evident in fee based income from Letters of Guarantee. Increased focus on infrastructure development particularly in the areas of water, road, sewerage, healthcare, leisure and power generation across the nation, have been the key drivers of this component of the business in 2012.

TRADE SERVICES

Focus for 2012:

Commissioning of trade units across the country to better facilitate trade finance requirements

Key highlights:

Expansion in total fund and fee income by 34%

Focus for 2013:

Enhance the trade services offer through adoption of latest technology

As the global economy plummeted further into uncertainty, nations such as Sri Lanka grappled with the effects of the global meltdown. Despite the hope of recovery by end 2011, the Euro crisis deepened and global trade declined significantly. Supplementing the downturn were other events in global geo-politics such as the Middle Eastern "Arab Spring" and the growing assent for sanctions against Iran. For Sri Lanka, all of these global issues exerted pressure on defending the growth aspirations of our national economy. Exports from Sri Lanka contracted in the face of a decline in demand for garments as European buyers tightened order quantities. Additionally, Sri Lanka's revenues from tea exports dropped with the nation having to secure alternate orders in the absence of orders from Iran.

On the import front, although oil imports surpassed 2011 numbers, total imports in 2012 declined in comparison with 2011. As a result, private financial institutions recorded declining trade revenues. Increased duties across the board and most notably on motor vehicles added to the decline in imports. Imports of Consumer Goods also declined during the year. Despite a growth in infrastructure and construction, the fact that most are funded by international funding agencies partnering with the state-banking sector shrank the available realm of opportunities for the private banking sector.

In this challenging environment, the Bank's trade services recorded a commendable performance for the year under review. Trade income in 2012 surpassed that of 2011 by 34%; of this, fund income amounted to Rs 2,023 Mn and fee based income to Rs 668 Mn. The Bank attributes this commendable performance to its above industry service standards in trade services.

The Bank's Trade Service operations in 2012 remained in conformity to ISO 9001: 2008 with certification secured from Bureau Veritas (India). The certification which has been in place for the past 8 years, has been a critical foundation upon which the reputation and credibility of the Bank's Trade Services have been built, and remains key to its future success.

In addition, the Bank's team of qualified and experienced professionals who have the expertise and know-how in trade services has placed the Bank in the realm of the best trade services teams in the industry.

The capabilities have been further augmented by a growing base of Certified Documentary Credit Specialists (CDCS).

With a view to enhancing the efficiency of its service offer by increasing its accessibility to a wider audience, the Bank has over the past established a network of trade units in key locations and further enhances the

Management Discussion and Analysis

number after a careful study of the need for a Trade Unit in a particular location. These units interact with a higher density of trade-based customers providing trade solutions that best meet client needs. The model serves not only to be effective in garnering new business but is also a cost-effective solution as the units depend on the existing branch network for customer interaction and service to enhance Trade business, whilst the core functions are directed to the Centralised Trade Processing Centre which acts as the technical resource base.

During the financial year, one more Trade unit was established bringing the total number of Trade units to 27. Going forward, this model will be further explored and extended to achieve a wider reach.

In view of the need to develop Sri Lanka's export potential as a sustainable avenue to bridge the trade deficit in the medium term, the Bank looks to impart technical expertise and know-how to potential exporters and entrepreneurs on an ongoing basis. During the reporting period under review, precedence was also given to customer education in the regions, in an effort to develop SME customers to the required standards to secure international business. As such, focused and well-structured seminars and workshops were conducted in 5 regions across the country in 2012. The Bank was also a Sectoral Partner for Expo 2012, where more than 360 Sri Lankan exhibitors from over 20 different product sectors took part comprising in excess of 60 SME exhibitors.

The Bank views its focus on the SME sector as critical in not only leveraging its trade services position but more importantly in partnering the nation to successfully assimilate the SME sector to the global export supply chain, thereby serving a long term national objective of integrating this sector with promising international markets.

TREASURY OPERATIONS

Focus for 2012:

Preservation of Net Interest Margins through prudent Asset and Liability management

Key highlights:

Raising USD 75Mn from foreign sources
Improvement in NIM to 6.1%

Focus for 2013:

Deepen engagement with customers to further reinforce relationships

In 2012, the global economy continued to remain constrained. The crisis across the Euro zone persisted and despite forecasts in 2011 for a reversal of the free-fall of core economies in the region, their failure to demonstrate convincing growth added pressure on the global economy, as a whole.

The International Monetary Fund (IMF) presented a gloomier picture of the global economy towards the third quarter of the financial year with prospects further deteriorating and risks enhancing. The IMF forecast for global growth in 2012 was revised down to 3.3%for the year. However, as per IMF interpretation, this forecast rests on two crucial policy assumptions - that European policymakers get the euro area crisis under control and that policymakers in the United States do not allow for automatic tax increases and spending cuts to take effect. Failure to act on either issue, the IMF believes, would make growth prospects far worse.

Sri Lanka's economic growth is expected to have slowed down during the financial year to 6.5% with external and internal factors shaping the decline. The stagnation of the global economy placed great pressure on Sri Lanka's economy during the year with exports witnessing a contraction. A drought hampered agriculture output and electricity generation in the first half, while torrential rains caused flooding in the second. The credit ceiling imposed in early 2012 led to a more rapid transition of tightening monetary policy to the markets, moderating inflation and providing a cooling off period for the economy on its path to sustained growth.

Nevertheless, despite a troubled global economy and a less conducive local economy, the Bank's treasury operations performed commendably during the reporting period. Foreign Exchange income rose sharply by 80 % in 2012 as compared to 2011. This is attributable mainly to the volatility of the Sri Lanka Rupee (LKR) precipitating a higher trading income. Despite Sri Lanka's growing trade deficit, the Bank successfully maintained customer transaction flows through an improved product offering, competitive pricing and through the offer of enhanced value based services.

A key challenge in the area of treasury operations during the year was LKR liquidity management against the backdrop of Central Bank of Sri Lanka's (CBSL) cap on credit growth. However, the Bank continued to benefit from its foresight in projecting future policy changes, and was ably prepared through advanced scenario planning, having secured both tier I and tier II capital as well as senior term debt in the local currency during the second half of 2011. During this financial year, the Bank secured senior debt as well as tier II capital from overseas markets to assist in the funding of loan growth. In essence, prudent asset and liability management enabled the Bank to preserve net interest margins.

Going forward, the Bank foresees a recovery in loan growth in 2013 in correlation with improved prospects for economic growth recovery. Liquidity risk management therefore, will remain a priority in the year ahead whilst deeper customer engagement will ensure future sustainability of the Bank's treasury operations in an environment that is defined by policy and economic uncertainty.

> During this financial year, the Bank secured senior debt as well as Tier II capital from overseas markets to assist in the funding of loan growth.

INFORMATION TECHNOLOGY

Focus for 2012:

Value creation through the augmentation and integration of IT systems

Key highlights:

Leveraging on investment made in 2011

Investment on the future value beyond 2012

Focus for 2013:

Using technology to challenge the banking landscape

In 2012, the Bank's technology initiatives were focused fundamentally on deploying supplementary systems around the core banking function to leverage and optimise the core platform through value creation across the product and service continuum. The key drivers were enhancement of functionality, seamless integration of internal systems and with external partners, the development of new product offerings as well as strengthening systems to augment security and compliance.

During the financial year under review, the Bank implemented systems in the areas covering Credit Rating, Evaluation, Basel II, Asset and Liability Management and Margin Trading. In 2012, the Bank further strengthened the control framework associated with security and compliance especially in the Card payment area. The tightening of controls included being compliant with EMV Chip cards and implementation of terminal line encryption, to ensure customer transactions are secure from the point of acquiring to authorisation.

Internal controls were ably supported by technology initiatives during the year with internal monitoring systems – that log and report all database related activities performed through non-routine activities. Further, robust systems have ensured zero vulnerability in security and controls during 2012 with no external or internal threats identified. Improved internal processes, pro-active monitoring mechanisms, and the deployment of external industry resources to undertake cyber security drills have all contributed to the creation of a secure environment that supports safety and compliance across all operational functions.

Management Discussion and Analysis

In the year 2012, required disaster recovery drills were performed with enhancements to system and resources towards achieving the benchmarks keeping in line with the recommended business continuity practices, data safety and regulatory guidelines. Additionally, efforts were made to ensure that the Bank is compliant with all intellectual property laws governing the information technology industry.

In the medium term, the Bank views IT as a core enabler of its future business strategy. In fact, technology initiatives are looked at as a key conduit in enlarging the Banks footprint, with key focus as a means to reach the *Net* generation. This generation consists of young connected adults using electronic means to conduct their daily routine activities ranging from working and social networking to banking. The developments associated with the bank's new payment switch are expected to offer an enhanced product portfolio and leverage on value added services that will attract technology savvy customers.

MARKETING

Focus for 2012:

Gain a comprehensive insight into usage and attitudes of consumers towards the brand HNB and personal financial services on offer

Key highlights:

Total spend on marketing communications in above the line mediums Rs 215 Mn.

Focus for 2013:

Translate the findings of the nation-wide research to sharpen communications and marketing approach

On the marketing front, in 2012, the Bank undertook extensive, nation-wide research to better understand its perceptual position within core targets. A comprehensive usage and attitudinal test was carried out to determine the position of the HNB brand, to better understand customer profiles and to gain insight into usage patterns of personal financial services. The survey included

In 2012, the Bank made a concerted effort to build brand value amongst the high net worth affluent urban category of consumers enabling greater penetration opportunity for private banking and personal financial services within the segment.

respondents from the Northern and Eastern provinces, and is of value to the strategic communications planning process, providing a national outlook and insights. For the Bank, the research is the foundation upon which future brand marketing activities will be built.

As a brand, the Bank maintained its position of leadership during the year under review, and was recognised for the 5th consecutive year as the "Best Retail Bank in Sri Lanka for 2011" by the Asian Banker at the 11th International Excellence in Retail Financial Services Awards Programme. Hatton National Bank remains the only bank in Sri Lanka to win this award for five consecutive years. The Bank in 2012 also became the first internationally rated local bank in Sri Lanka by securing a B1 rating from Moody's, on par with the sovereign rating of B1 of Sri Lanka.

In 2012, the Bank made a concerted effort to build brand value amongst the high net worth affluent urban category of consumers enabling greater penetration opportunity for private banking and personal financial services within the segment. Key strategic sponsorships were pursued with strong brand association for greater linkage and buy in within the segment.

The HNB Pathum Vimana draw was held for the 20th consecutive year in 2012. The promotional tool holds the distinction of being the biggest deposit draw in the financial services and banking industry in Sri Lanka, and incentivises customers to save on a regular basis to build substantial savings accounts. The scheme, which is multi-pronged, provides customers with multiple chances to win. In 2012, Pathum Vimana was launched and marketed via the “winning account” campaign, a multi-pronged Above The Line and social media effort. It was launched with a flag painting activity on National Independence Day by deploying four mobile floats from Devinuwara, Chilaw, Point Pedro and Batticaloa with line drawings of national flags mounted on to each truck which were painted by general public along the way to Colombo.

The Bank’s minor savings scheme was successfully re-launched in 2012 after a number of modulations to the product offer. Marketed by way of two product offerings namely Singithi Lama and Singithi Kirikatiyo, it is a cohesive product that progressively caters to stages across the childhood of a minor from newborn to toddler to child. In 2012, the product was relaunched with the introduction of a scholarship scheme rewarding the year 5 scholorship students with the product being positioned with a new payoff “keep learning, keep saving”. The Bank consciously twinned saving and education as the core values for a students’ future development.

For the Bank’s housing loan product, HNB Shanthi and Personal Loan products, the focus for the year in terms of communication was to maintain a high level of visibility through presence in multiple media platforms. In this light more focused advertising was pursued with online advertising on websites targeting the particular segment along with print, radio and TV mediums.

The Bank conducted a number of cross promotions with leading automotive dealers and importers with a view to promoting the Bank’s leasing product. Agent promotions and brand visibility through activation kept the brand relevant and top of mind for the key targets.

The HNB Pawing brand is one of the best asset based products for the Bank. The objective during the first quarter of the year was essentially to keep the brand presence high. During the remainder of the year, marketing efforts were deployed to enhance and maintain prominent brand visibility across the Bank’s branch network at a point of sale level.

Numerous credit card promotions were held during the year in collaboration with leading partner outlets across the country with the intention of driving usage. The Bank for the first time in Sri Lanka, promoted credit card usage in Jaffna by partnering with the top most merchants in the peninsula. During the year, the Bank also launched cards to match the highest tier of value with the offer of Visa Infinite and Visa Signature. The elaborate launch event –with an Egyptian theme and a New York 5th Avenue theme – matched the brand positioning of smart luxury and the brand offer of ultimate opulence.

The Bank’s network expansion efforts were duly communicated under the theme of “HNB team” giving recognition to the teams at each customer centre whilst also creating an aura of service excellence to the customer. Likewise, Bank maintained the visibility of HNB Crystal Circle continuing to position it as a second tier private banking solution. Communications were focused on creating an aura of privileged and customised banking.

HNB Yauwanabhimana, the Bank’s Youth Empowerment Programme launched in the previous financial year continued to be an area of marketing focus in 2012. Given the need for high brand visibility and continued creation of awareness, the Bank utilised a combination of above the line mainstream media with activation throughout the year which was supported by youth empowerment programmes at ground level in more than 25 geographic locations.

HNB Adhishtana, the Bank’s pioneering remittance product launched in the latter part of 2011 continued to receive significant marketing investment with visibility for the brand maintained in both local and selected overseas media, targeting the Sri Lankan diaspora for inward money remittance. Special tailor made documentaries were also a core component of the media mix to encourage and fashion behavior for continuous saving. During the year, the Bank re-launched its own remittance product HNB CashXpress and was positioned as a fast, safe and dependable money transfer service available across key global markets. Marketing also worked closely with MoneyGram International to further leverage the Bank’s position as a super agent by promoting and sharing advertising platforms. This included opportunities arising from the ICC T20 Championships held in Sri Lanka during the year, with a joint HNB –MoneyGram promotion incentivising and encouraging senders and receivers of remittances during the period.

During 2012 the Bank launched the HNB Money Market Savings Account with a focused campaign targeting corporate, institutional investors and high net worth individuals with short term funds to invest. The product is positioned and targeted at customers who

Management Discussion and Analysis

have developed their own view of interest rate movements and are also experienced enough to actively manage their cash. The Bank also launched the HNB FC Advantage account designed to offer higher returns on foreign currency savings with a competitive variable rate of interest plus flexibility of withdrawals.

In looking to the future, increasing competition and fragmentation of the marketplace will call for greater focus on marketing in the years ahead. Based on insights gleaned from the nation-wide research conducted in 2012, the Bank will look to create brand communications to bridge perceptual and attitudinal gaps. Whilst maintenance of loyalty and consolidation of existing customer bases will remain 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 brand 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 rural and student customers.

In the immediate year ahead, the Bank will seek to leverage its branch network to further interact with customers, utilising these spaces as a medium for communication. Branch based communication targeting the large number of customers accessing the network of branches through the year will allow the Bank to centrally control communication to best meet the needs of each region through a platform of digital screens installed at branch level. Moreover, modulation of intensity and language will assist towards customising communications for each target audience, thereby enhancing the efficacy of communication.

HNBA adopted a strategy of price defence, whereby HNBA maintained economically viable prices.

HNB ASSURANCE PLC

Focus for 2012:

Realise aggressive growth in Life Insurance whilst improving profitability in Non - Life Insurance

Key highlights:

Net income growth of 22%

PAT Growth of 43%

Focus for 2013:

Leverage opportunities to fill market gaps through product innovation whilst optimising distribution channels to enter new target segments

HNB Assurance (HNBA) in the period under review, continued to perform with dexterity and strategic foresight, moving with purposeful momentum to reach its strategic goals for the medium term. As in previous years, HNBA recorded a commendable performance all round, with specific excellence in financial and strategic performance in the Life sector. The year was all the more successful in that in 2012, HNBA fully realised its strategic intent to achieve aggressive growth in Life insurance and improved profitability in Non - Life insurance.

Life was a core contributor to the overall success of HNBA in 2012 with significant growth in the Life portfolio. Notably, HNBA's growth in Life outpaced market growth despite an array of challenges. Growth in new business coupled with a significant improvement in renewals spurred the growth momentum. Of the new business, "myfund", HNBA's retirement fund building product launched in 2011, garnered an impressive growth. The "myfund" product generated a GWP of Rs 318 Mn and was the fastest growing product in HNBA's product portfolio. The growth further resonates HNBA's conviction in the capacity for growth in retirement oriented and endowment products. 2012 for Life though was by no means a challenge free year. In fact, the scenario of high interest rates led to a contraction in housing loans, as a result adversely impacting mortgage reducing policies. However, the strong growth in endowment products served to offset the impact.

The Non - Life Insurance sector, as in the past, continued to be characterised by intense price competition as result of a significant rise in the number of market players. By 2012, the Non - Life Insurance sector comprised approximately 20 players all vying for a component of the market. In this scenario of intense competition and price rivalry, HNBA adopted a strategy of price defence, whereby HNBA maintained economically viable prices. Although, the strategy yielded a deceleration in portfolio growth, it did however, realise the desired outcome of enhancing the profitability of the portfolio. As a result, HNBA's Non - Life portfolio posted a notable improvement in value creation.

During the financial year, steps were taken towards further strengthening HNBA's presence in the retail market. As such, HNBA conceptualised and introduced a series of new products to specifically target individuals and SMEs as well as micro enterprises. Under this strategy, HNBA's home insurance product was re-launched as "myhome" during the year together with "Sesatha", the shop insurance policy that targets small business segments. Additionally, new products in the form of "myhealth" - a health insurance policy and "Motorguard Xtra"- a new motor insurance policy that targets the top end of the market were launched. Cumulatively, all of these initiatives are expected to assist HNBA to further penetrate the retail segment. This remains of strategic interest in that the retail sector holds greater opportunities in the form of market expansion in a profitable manner.

In both Life and Non - Life sectors, HNBA looked to optimise its distribution by leveraging the Bank's comprehensive network of branches, island wide. In 2012, the Bank's branch network contributed in excess of 32% of business, aided by an expansion of the Bancassurance network. During the year, Bancassurance was offered at 142 locations, up from 120 in 2011, covering 57% of the Bank's network.

Product innovation and value generation remain key to the success of HNBA. During 2012, HNBA continued to demonstrate its unique capability to innovate in a manner that is relevant to the consumer and in going forward, this belief in constant meaningful innovation will be a key contributor to the Company's future success. Thus, innovation will play a critical role in designing products to meet market gaps and in the exploration of new ways of product delivery.

2013 is set to be a challenging year. Due to changes in the regulatory sphere, all composite insurance companies will be required to begin the process to split operations between Life and Non-Life. HNBA will need to become more focused and have a sharper business model. There will be an upsurge in the intensity of competition as companies will have to justify their existence and demonstrate growth from every line of business. Nevertheless, HNBA has been in preparation for the regulatory shift, and is confident of its ability to optimise operations whilst safeguarding the interests of all of its stakeholders.

SITHMA DEVELOPMENT (PVT) LTD

Focus for 2012:

Conceptualisation of a new business strategy for the medium term

Key highlights:

Profit of over Rs 272 Mn

Focus for 2013:

Commission construction of a new commercial property

During the course of the financial year, Sithma Development focused primarily on the development of a comprehensive strategic plan for execution over the next three to five years.

Given the growing demand for commercial property in Colombo, Sithma Development explored the available options for the commencement of a commercial property construction project to be launched in the upcoming financial year. Inspired by the continuing demand for commercial space at HNB Towers by prospective tenants and based on market research, Sithma sees great potential in the construction of a state of the art commercial facility in Colombo.

Performance-wise, Sithma continued to maintain the profit momentum and recorded a profit in excess of Rs 272 Mn despite the high interest rate environment. Further, Sithma was successful in disposing all 48 apartments of Spathodea Residencies by October 2012.

Loyal customers for four generations

"I presently have several bank accounts at the HNB City Office - a continuation of the tradition started by my maternal grandfather, Mr Barnes Samaraweera, who also had many accounts opened way back in 1890's at the Mercantile Bank, as it was known then. Our family has been a loyal customer at the Bank since then, as my mother – Mrs Lilian Wickramasuriya also held many accounts at the City Office since 1940's. Today my daughter Chamilka has an account at the HNB City Office as well..."

Dr Gamini Wickramasuriya
Maxillofacial Surgeon

Safe & Sound

Management Discussion and Analysis

EXCHANGE HOUSES

Focus for 2012:

Review of return on investment and divestiture of underperforming affliates

Key highlights:

Realisation of 26% over the investment made in Delma Exchange UAE

Focus for 2013:

Divestment and realization of sale proceeds for Delma Exchange

Majan Exchange LLC (Oman)

Established in 2008, Majan Exchange completed four years of operations in 2012. Despite adversities in global markets, Majan Exchange continued to demonstrate sound growth in business volumes. However, given the operational stresses and resource inputs required to maintain excellence in service, the Bank is currently seeking to secure interest for divestment. The Bank is confident of securing either joint venture partners or outright purchasers for the entity, in the coming financial year. Priority for 2013, therefore, is to pursue and secure the sale of the going concern.

Business snap shot:

Majan Exchange facilitates remittances to Sri Lanka whilst also catering to other corridors such as India, Pakistan, Nepal, Bangladesh, and the Philippines. As an agent for MoneyGram, XpressMoney and EzRemit, Majan Exchange caters to many other corridors. It operates 2 outlets in Oman.

Delma Exchange (UAE)

Despite a significant increase in volumes during the financial year, Delma Exchange continued to be constrained by the rising operational costs that are characteristic to the market context. As in the previous financial year, Delma Exchange posted strong growth in transaction volumes, however, enlargement of operational overheads posed limitations to the viability of achieving break-even during the financial year. While the operational objective for 2012 was to break-even, market restrictions have compelled the need to extend the break-even point to the upcoming financial year.

During the year, backed on the commendable brand strength of Delma Exchange, opportunities arose for the divestment of the Bank's 20% stake in the exchange house. Consequently, at the end of the financial year agreement has been reached and the sale of the Bank's share of investment has been concluded at a premium of 26% over and above every 1 AED invested in this business by the Bank. By early 2013, the Bank expects to realise the sale proceeds consequent to a streamlined handover of the business and the Bank will continue to support the business with staff secondments and making available our domestic distribution capability to mobilise inward remittances to Sri Lanka.

Business Snapshot:

Delma currently operates five outlets in Karama, Al Quoz, Hamdan Street, Musaffah and Abu Dhabi. Established in January 2009, Delma Exchange has been operational just short of four years. Headquartered in the heart of the financial city of Abu Dhabi, United Arab Emirates, Delma Exchange is a remittance house catering to the city's expatriate community. It facilitates remittances to Sri Lanka, India, Pakistan, Nepal, Bangladesh and Philippines and as an agent for Western Union, IME, Trans-fast and Eztop and Global Reach Partners(GRP)

During the year, backed on the commendable brand strength of Delma Exchange, opportunities arose for the divestment of the Bank's 20% stake in the exchange house.

ACUITY PARTNERS (PVT) LIMITED

Focus for 2012:

Maintain viability by consolidating operations

Key highlights:

ASPI 52 week high at 6,074 low at 4,737

Focus for 2013:

Explore acquisition / joint venture

Opportunities to realise the vision to be a leading full serviced investment-banking firm

2012 was essentially a challenging year for those involved in Sri Lanka's capital markets. From the final quarter of 2011, the Colombo Stock Exchange entered a "bearish" phase and despite intermittent signs of recovery and short bull runs, has effectively remained on the downturn or stagnant for much of the financial year. As a result, Acuity Partners – the Bank's full-service investment banking arm – evidenced a year of uncharacteristic performance marked by a contraction in revenue. A continuously static market challenged Acuity and most of the capital market operators throughout the year. As majority of Acuity's performance contribution is equity market centric, Acuity Partners was significantly challenged during the year to realise the projected annual revenue targets.

Moreover, the domino effect arising from a stagnant equity market further aggravated the potential of the business model with corporate finance also taking a toll. It is accepted that in a low performing equity market, corporate finance opportunities will contract due to low investor confidence and thus the decline in demand for corporate finance. However, in the 3rd quarter of the financial year, Acuity Partners witnessed a strong turnaround in the demand for debt instruments. A revival of the capital markets in 2013 will enable Acuity to realise its full value as a one stop Investment Banking firm.

Meanwhile, during the financial year, Acuity Partners explored the introduction of other financial instruments to the Sri Lankan market, with a view to broad-base the investment opportunities for potential investors. Promoted by Guardian Acuity Asset Management Ltd., a joint venture (JV) fund management company formed by Ceylon Guardian Investment Trust PLC of Carson Cumberbatch Group, and Acuity Partners Ltd., two unit trusts branded MoneyMax and MoneyMaker were approved by the Securities and Exchange Commission and launched to the market in February 2012.

Sri Lanka's unit trust industry is considered to have high potential and is viewed as a catalyst for widespread capital market activity. Unit trusts are viewed favourably by risk averse investors as they promise a choice of good, reliable and flexible returns via solid investments.

The launch is into a seemingly crowded market as there are approximately 24 unit trust funds operating in Sri Lanka. However, Acuity partners together with its JV partners perceive potential for the sector, given that the unit trust industry remains largely under marketed. Sri Lanka has a marginal 27,000 unit trust holders – despite being in the market for over two decades - whilst the fund base is Rs 23 Bn, which is less than 1% of the total bank deposit base. As such, Acuity Partners foresees great potential for growth of the sector. As a first step, the Unit trusts were marketed through the Bank's network of branches and actively offered to potential investors across the country.

Guardian Acuity Asset Management also entered into a Joint Venture with Keynote Capital of India to launch a Country fund for investing in Sri Lanka, named the Lanka Opportunities fund. The fund is expected to target the Indian Investors based both in and out of India.

Acuity's associate company Lanka Ventures, too, had a challenging year. Given that over 80% of Lanka Ventures' investments are in energy generation with focused emphasis on hydropower, unfavourable weather conditions – as a result of drought – placed great stress on the Company's ability to align its performance to projected targets. This further aggravated Acuity's overall financial performance during the year.

Despite the challenging year, Acuity Partners is cautiously optimistic of the future. A resurgence of the capital markets in 2013 will enable Acuity to regain its position as a key contributor to Hatton National Bank's Group performance. The launch of the S&P SL20 index by S&P Dow Jones for Sri Lanka is also expected to add to the market confidence in 2013, particularly in attracting net foreign inflows. In the upcoming year, Acuity will pursue acquisition opportunities to further its vision to be a full-service investment banking entity. It will also pursue dynamic strategies to further its market position for MoneyMax and MoneyMaker.

Financial Review

Industry overview

During the financial year under review, significant fluctuations in key economic variables, most notably the exchange and local interest rates, remained the norm. Over the course of the reporting period, the Sri Lankan Rupee (LKR) peaked to 134 against the USD, reflecting a depreciation of over 17% compared to the beginning of the year. Likewise, interest rates maintained an upward momentum throughout the year with the Average Weighted Prime Lending Rate (AWPLR) increasing from 10.8% at the start of 2012 to reach 14.4% by year end. Nevertheless, the Banking sector benefited from these fluctuations, with notable gains from foreign exchange movements and improved interest margins. In early 2012, Central Bank of Sri Lanka (CBSL) issued a directive to restrict overall LKR loan growth to 18% with a leeway to increase the credit growth to 23%, applicable for those banking establishments that support such an increase by securing foreign funding over the course of the year. Consequently, banking sector credit growth contracted from 31.7% in 2011 to 20.9% in 2012 in line with the reduced GDP growth rates.

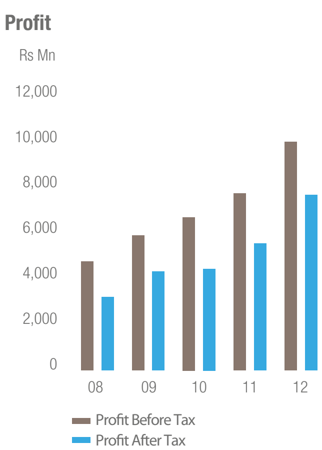
Changes to Financial Reporting Standards

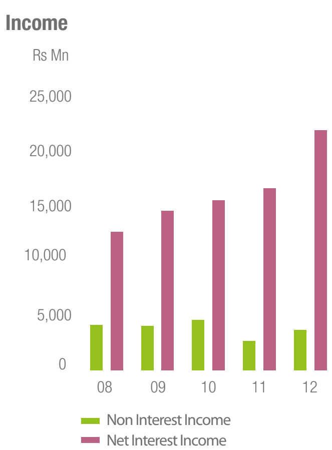
With the new Sri Lanka Accounting Standards (SLFRS / LKAS) issued in line with the International Financial Reporting Standards becoming effective from 1st January 2012, business entities were required to apply these standards retrospectively, with all adjustments to equity up to the transitional date of 1st January 2011, recognised under Statement of Changes in Equity.

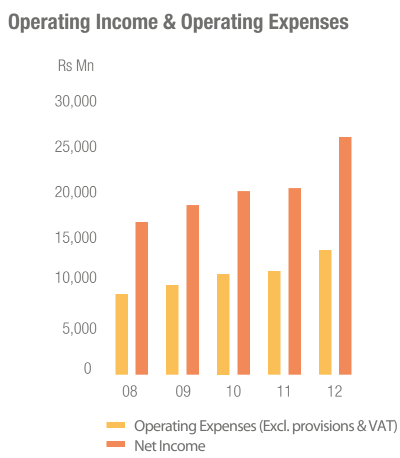
Under this new accounting standards, complete set of financial statements comprises a Statement of Financial Position as at end of the period (previously termed as the Balance Sheet), a Statements of Comprehensive Income, a Statement of Changes in Equity and a Cash Flow Statement for the period and notes, comprising a summary of significant accounting policies and other explanatory information. The Statement of Comprehensive Income consists of a separate Statement of Income which is equivalent to the "Income Statement" under previous volume of standards and a Statement of Other Comprehensive Income (OCI).

As required by these standards, the Bank prepared its opening Statement of Financial Position as at 1st January 2011 based on the assumption that the Bank had applied these standards retrospectively with all the adjustments to equity being recognised directly on the Statement of Changes in Equity.

Accordingly, three Statements of Financial Position as at 1st January 2011, 31st December 2011 and 31st December 2012 have been included with the Bank's 2012 financial statements. Further, Statement of







Comprehensive Income has been prepared for the year ended 31st December 2012 along with the Statement of Comprehensive Income for the year ended 31st December 2011 based on SLFRS / LKAS.

Financial Performance

Income

The Bank's interest income for the reporting period grew by 42.7%, prompted by increase in yields coupled with growth in interest earning assets. Interest cost mirrored this upward movement with a perceptible increase of 53.5%. Higher deposit rates, deposit growth as well as conversion of low cost deposits to fixed deposits at higher rates pushed the interest costs upwards. Nevertheless, the Bank witnessed a growth of 32.0% in net interest income amounting to Rs. 22 Bn during the financial year.

Increase in fee income remained a key strategic priority during the year, as per the Bank's 3 year strategic plan. Efforts in this regard yielded positive results with the Bank increasing its commission income by 37.8% in 2012 against that of the previous financial year. Income from card centre and current accounts contributed towards the growth whilst fee income from trade remained static in the face of diminished foreign trade.

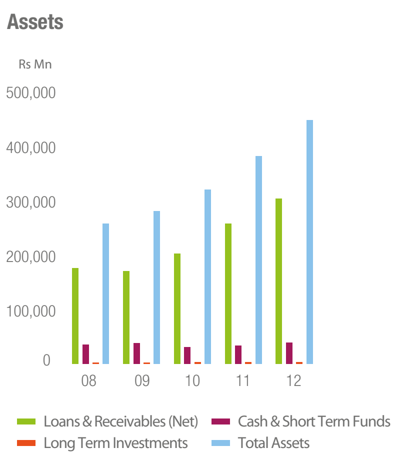
With the change in accounting standards, the cost of interest rate swaps for the conversion of dollars to rupees (for lending), which was accounted for as an interest expense under the previous accounting method, is recorded as a foreign exchange loss under trading income reflecting a corresponding increase in net interest income. As a result of same and the revaluation of swaps and forward exchange contracts, the Bank recorded a book loss of Rs 1.5 Bn in 2012. Further due to bearish sentiments at the Colombo Stock Exchange that prevailed throughout the year, the Bank's total net trading loss increased to Rs 1.6 Bn in 2012.

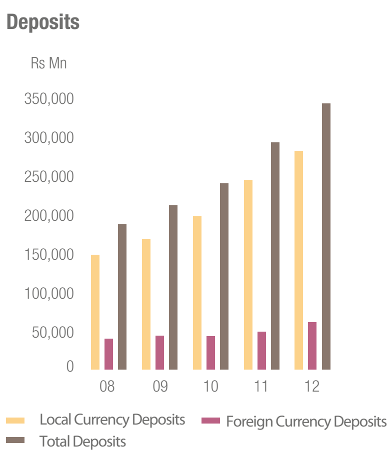
Nevertheless, Other Income of the Bank recorded a growth of 73.9% to Rs 2.0 Bn mainly on account of the increase in foreign exchange gains by an impressive 79.9% to Rs 1.8 Bn in 2012. The growth in forex gains reflected under other income was largely due to the increase in foreign exchange transactions and the volatile exchange rate scenario witnessed during the year. The improvement in exchange gains was recorded, despite the Bank recording a marginal exchange loss culminating from accumulated losses in the Foreign Currency Banking Unit (FCBU) due to rupee depreciation.

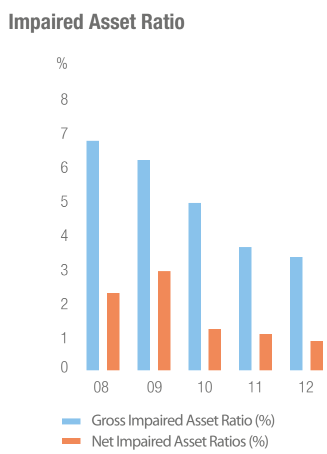
The total operating income of the Bank stood at Rs 26.1 Bn for 2012, which is a significant growth of 27.5% over the previous year.

Operating expenses

During the reporting period, the Bank took giant strides towards productivity improvements. As a result, the cost to income ratio improved by approximately 300 bps to 52.3% despite the renewal of a collective agreement during the year with non - executive staff, consequently prompting the revision of the salaries for this staff segment.







Financial Review

The Bank had to value its liability towards the Employee Share Benefit Trust (ESBT) in order to fall in line with SLFRS 2, Share Based Payments. Accordingly the ESBT liability which stood at Rs 1.8 Bn as at end of December 2010 reduced to Rs 1.1 Bn as at end of December 2011, resulting in a net reversal of approximately Rs 596 Mn to personnel expenses for the year ended 31st December 2011. This liability increased to Rs 1.3 Bn as at end of 2012 requiring the Bank to make an additional provision of Rs 292 Mn as personnel expenses in 2012. In addition, with the implementation of SLFRS 2, the Bank charged Rs 176 Mn to recognise the cost of Employee Share Option (ESOP) scheme for 2012. Although these fair value adjustments on account of ESBT and ESOP reflected an increase of approximately Rs 1 Bn in personnel costs from 2011 to 2012, these did not result in an actual increase in payout.

Other expenses including premises, equipment and establishment costs increased by 12.8% during the year 2012 and despite the stated increases in operating expenses, the higher percentage growth in income compared to expenses was facilitated by new branches that augmented the network during 2010 and 2011. These contributed positively towards the bottom line.

Asset Quality

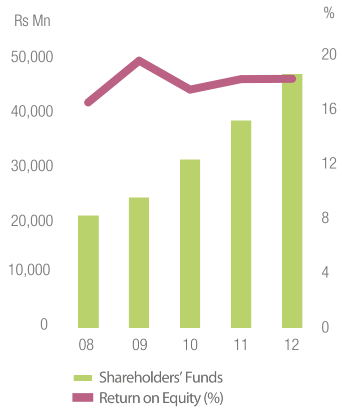
With the rise in interest rates, the Bank witnessed a concurrent increase in impaired loans and advances during the first half of 2012. However, the rigorous recovery and risk management efforts have assisted towards the contraction in impaired loans and advances in December resulting in an improvement in impaired assets (loans and advances) ratio to 3.32% from 3.60% in 2011. Even under the previous accounting standards, the Gross Non Performing Advances ratio of the Bank improved from 3.92% in 2011 to 3.66%.

With the transition from “time based” provisioning method for loans and advances, to “incurred loss” based impairment provisioning method under LKAS 32 and 39 the Bank made a provision of approximately Rs 1Bn against impairment losses for 2012 which included an additional provision of Rs 571 Mn against individually significant unimpaired loans. However in 2011, the Bank made a reversal of Rs 500 Mn due to decrease in provision on account of both individually significant and individually insignificant loans. Accordingly, the net impaired asset ratio of the Bank improved to 0.86% from 1.06% in 2011 while the provision cover remained strong at 74.0% as at end of the reporting period.

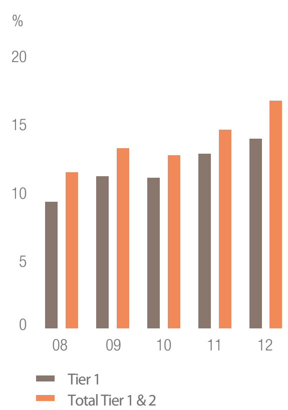
Taxation

Corporate tax charge for the year 2012 increased by 10.3% in comparison to 2011 while the effective tax rate reduced from 25.3% in 2011 to 23.3% in 2012 due to the reversal consequent to settlement of previous year tax liabilities.

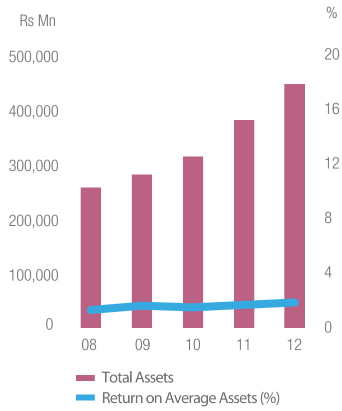
Shareholders’ Funds



Capital Adequacy Ratio



Return on Average Assets



Group Companies

Despite challenging market conditions, HNB Assurance the 60% owned insurance subsidiary posted an outstanding growth of 45% in post-tax profits to reach Rs 351Mn for the year 2012. In the backdrop of sluggish market conditions that persisted in 2012, Acuity Partners (Pvt) Ltd, the investment banking joint venture recorded a modest profit of Rs 96Mn for the year while Sithma Development (Pvt) Ltd the property development subsidiary recorded a post-tax profit of Rs 273 Mn.

During the year, the Bank focused on minimising continuous losses on investments made in the exchange houses, and accordingly the Bank divested its investment in Delma Exchange UAE recognising a net disposal gain of Rs 38Mn against the investment of Rs 83.7 Mn.

Profitability

The Bank's pre-tax profits recorded a strong growth of 19.8% to Rs 10.0 Bn compared to 2011 while Group pre-tax profits also improved by 18.1% to Rs 10.7 Bn.

The net profit after tax for the Bank recorded a growth of 23.0% to stand at Rs 7.7 Bn while the Group net profit after tax recorded a year on year growth of 19.9% to Rs 8.3 Bn for the year ended 31st December 2012.

The Return On Assets (ROA) for the Bank in 2012 improved to 1.86% compared to 1.79% in the previous year, with improved margins, higher non-interest income to net income and reduction in cost to income ratios positively contributing towards same while Return on Equity was maintained at 18.24%.

Statement of Financial Position

The greatest challenge in 2012 was to source adequate funding to support the unprecedented growth in credit witnessed in 2011, which also spilt over to the early part of 2012. As the Central Bank imposed conditional restrictions on the loan growth, obtaining foreign funding (to have the flexibility to increase the asset growth up to 23% if required) was also a key objective at the start of the financial year.

The Bank's asset growth slowed down to 17.3% in 2012, as a result of a slowdown in demand for credit. In totality, net loans and advances grew by 18.0% and other interest earning assets by 15.6%. The domestic currency loan book grew at a faster pace equating to 19.0%. The leasing portfolio witnessed a slowdown in 2012 due to an increase in import duty for vehicles while pawning continued to demonstrate the strong growth momentum witnessed in previous years. Other term loans and overdrafts too witnessed robust growth during the year.

Growth in assets was predominantly funded by deposits, which grew by a healthy 17.2%%, while this was also supplemented by borrowings originating mainly from foreign sources. During the year, the Bank borrowed USD 75 Mn from two reputed international lenders. The first was a USD 50 Mn senior debt from China Development Bank whilst the second was a USD 25 Mn subordinated loan from DEG.

Due to the rising interest rates the growth in deposits was predominantly from fixed deposits while the Bank witnessed a conversion of high cost savings to high yielding fixed deposits. However, the Bank managed to defend its low cost saving base maintaining it to a virtual flat during the year. On the whole, higher growth in fixed deposits resulted in the CASA ratio declining from 45.6% to 38.8% by December 2012.

Shareholders' funds

With the implementation of SLFRS / LKAS the Bank classified its investments which were hitherto classified as Investment portfolio and Dealing portfolio, under four types of financial assets viz financial assets held at fair value through profit or loss, loans and receivables, held to maturity and available for sale.

Consequently, net increase in net assets of the Bank with the implementation of SLFRS / LKAS amounted to approximately Rs 2.5 Bn as at end of December 2012, including the impact from fair valuation of available for sale portfolio, revaluation of land and building, net impact from change in provisioning for impairment and recognition of a liability against the Employee Share Benefit Trust.

Financial Review

Therefore including the above SLFRS / LKAS impact and after making a payment of Rs 1.2 Bn as final cash dividend for the year ended 31st December 2011 as well as an interim dividend of Rs 596 Mn for 2012, total shareholders' funds of the Bank recorded an increase of Rs 8.5 Bn to Rs 46.5 Bn as at 31st December 2012.

Accordingly, the net book value of the Bank improved from Rs 97.75 per share to Rs 116.99 per share while the net book value of the Group improved from Rs 106.99 per share in 2011 to Rs 129.96 per share in 2012.

The Bank proposes a final cash dividend of Rs 7.00 per share in addition to the interim dividend of Rs 1.50 per share declared in December 2012 resulting in a total cash dividend of Rs 8.50 per share for the year amounting to a gross dividend payment of approximately Rs 3.4 Bn.

Capital Adequacy

Capital adequacy position of the Bank further strengthened during the year with tier I capital ratio improving from 12.76% to 13.85% through internal generation of funds while total capital adequacy ratio improved from 14.51% to 16.63% through retained earnings and tier II funding raised through foreign sources.

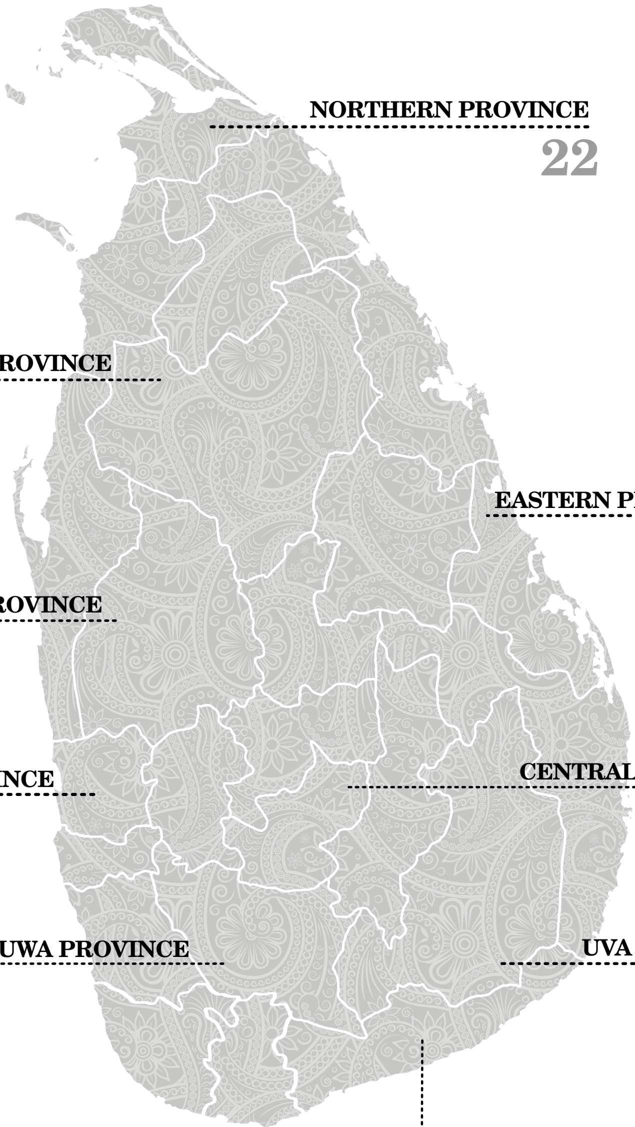
Future outlook

Central Bank of Sri Lanka in its monetary policy road map for 2013 and beyond emphasised its objective of achieving a per capita GDP of USD 4,000 by 2016, which places a significant amount of responsibility on the systemically important banks to provide the funding necessary for propelling economic growth to achieve this objective. While deposits will continue to be the main source of funding, the banks will need to supplement same with non-conventional funding sources. Hence the challenge for the sector in 2013 and beyond would be to maintain margins while supporting the overall growth story in the Country. Therefore we believe our focus on profitable balance sheet growth supplemented by increase in fee income and improved productivity would be the key toward delivering sustainable above average shareholder returns in the foreseeable future.

Note : The figures referred to under this section relating to the Income Statement for 2008, 2009 and 2010 are based on SLAS (previous GAAP) while figures for 2011 and 2012 are based on SLFRS / LKAS.

The balance sheet (Statement of Financial Position) figures for 2008 and 2009 are based on SLAS (previous GAAP) while figures for 2010, 2011 and 2012 are based on SLFRS / LKAS.

Customer Centre Network



HNB Customer Centres to be opened during the 1st quarter of 2013:
Veyangoda, Yakkalamulla, Walasmulla

	as at end of 2011	as at end of 2012
Customer Centres	240	247
HNB Student Banking Centres	164	166
HNB Gami Pubuduwa Banking Centres	119	129
Village Based Units	6	6
Branch Based Units	104	114
Micro Banking Units	9	9
HNB Mobile Banking Service Units	2	2
Overseas Representative Offices:	Chennai – India Karachi – Pakistan	Chennai – India -

Province	Customer Centres	ATMs
Central	25	35
Eastern	26	33
North Central	10	13
North Western	18	25
Northern	22	30
Sabaragamuwa	11	15
Southern	24	30
Uva	11	16
Western	100	213
Total	**247**	**410**

Customer Centre Network

WESTERN PROVINCE	
Airport Office	Maligawatte
Aluthgama	Maradana
Aluthkade	Marandagahamula
Athurugiriya	Mathugama
Avissawella	Minuwangoda
Bambalapitiya	Mirigama
Bandaragama	Mirihana
Beruwela	Moratumulla
Biyagama	Moratuwa
Boralesgamuwa	Mt. Lavinia
Borella	Mutwal
Cinnamon Gardens	Narahenpita
City Office	Nawala
Dehiwela	Nawaloka Hospital
Delgoda	Nawam Mawatha
Dematagoda	Negombo
Divulapitiya	Negombo II
Ekala	Negombo Metro
Gampaha	Nittambuwa
Ganemulla	Nugegoda
Grandpass	Overseas School of Colombo
Green Path	Padukka
Gunasinghepura	Pamunugama
Hanwella	Panadura
Head Office Branch	Panchikawatte
Hendala	Pettah
Homagama	Pettah – 2nd Office
Horana	Peliyagoda
Hulftsdorp	Piliyandala
Ingiriya	Pugoda
IWMI – Pelawatta	Ragama
Ja-ela	Ratmalana
Jampettah Street	Sea Street
Kadawatha	Seeduwa
Kaduwela	Sri Jayawardenapura Hospital
Kalutara	Sri Lankan Airlines Admin Complex
Kandana	
Katunayake	Sri Lanka Ports Authority
Kelaniya	Talangama
Kiribathgoda	Thalawathugoda
Kirindiwela	The Cental Hospital
Kirullapone	Thimbirigasyaya
Kochchikade	Wattala
Kohuwala	Wadduwa
Kolonnawa	Weliweriya
Kollupitiya	Wellawatte
Kotahena	Wellawatte II
Kottawa	Wijerama
Kotte	World Trade Centre
Maharagama	Yakkala
Malabe	

NORTH WESTERN PROVINCE	
Alawwa	Marawila
Anamaduwa	Madampe
Chilaw	Nikaweratiya
Dankotuwa	Norochchole
Galgamuwa	Nawinne - Kurunegala
Giriulla	Puttalam
Hettipola	Udappuwa
Kuliyapitiya	Wennappuwa
Kurunegala	Wariyapola

NORTHERN PROVINCE	
Achchuveli	Mallavi
Chankanai	Mannar
Chavakachcheri	Manipay
Chunnakam	Mullaitivu
Jaffna	Mulliyawalai
Jaffna – 2nd Office	Nanattan
Kaithady	Nelliady
Kilinochchi South	Point Pedro
Kilinochchi North	Thirunelvely
Kodikamam	Vavuniya
Kurumankodu	Velanai

NORTH CENTRAL PROVINCE	
Anuradhapura	Medirigiriya
Anuradhapura II	Nochchiyagama
Aralaganwila	Padaviparakramapura
Kekirawa	Polonnaruwa
Medawachchiya	Thambuttegama

EASTERN PROVINCE	
Akkaraipattu	Mullipothana
Ampara	Muttur
Batticaloa	Ninthavur
Dehiattakandiya	Pottuvil
Eravur	Sammanthurai
Kaluwanchikudy	Serunuwara
Kalmunai	Thandavenveli
Kallady	Trincomalee
Kantalai	Trincomalee – Courts Road
Karaitheevu	Thirukkovil
Kattankudy	Uhana
Kinniya	Uppuveli
Maruthamunai	Valachchenai

CENTRAL PROVINCE	
Akurana	Kundasale
Bogawantalawa	Kurunduwatte
Dambulla	Maskeliya
Digana	Matale
Gampola	Nawalapitiya
Galewela	NuwaraEliya
Galaha	Peradeniya
GeliOya	Pilimathalawa
Ginigathhena	Pussellawa
Hatton	Ragala
Kandy	Rikillagaskada
Kandy City Centre	Thalawakelle
Katugastota	

SABARAGAMUWA PROVINCE	
Balangoda	Mawanella
Embilipitiya	Pelmadulla
Godakawela	Pinnawela
Kahawatte	Ratnapura
Kalawana	Warakapola
Kegalle	

SOUTHERN PROVINCE	
Agunakolapelassa	Karapitya
Akuressa	Kataragama
Ambalangoda	Hambantota
Ambalantota	Koggala
Batapola	Matara
Deniyaya	Middeniya
Dickwella	Pitigala
Devinuwara	Suriyawewa
Elpitiya	Tangalle
Galle	Tissamaharama
Hakmana	Urubokka
Hikkaduwa	Weligama

UVA PROVINCE	
Badulla	Moneragala
Bandarawela	Passara
Bibile	Siyabalanduwa
Buttala	Welimada
Haputale	Wellawaya
Mahiyangana	

Main Correspondents Worldwide

1. Argentina
2. Australia
3. Austria
4. Bahrain
5. Bangladesh
6. Belgium
7. Bermuda
8. Bolivia
9. Botswana
10. Brazil
11. Bulgaria
12. Canada
13. Channel Islands
14. Chile
15. China
16. Colombia
17. Cyprus
18. Czech Republic
19. Denmark
20. Ecuador
21. Egypt
22. Ethiopia
23. Finland
24. France
25. Georgia
26. Germany
27. Ghana
28. Greece
29. Hong Kong
30. Hungary
31. India
32. Indonesia
33. Ireland
34. Isle of Man
35. Israel
36. Italy
37. Japan
38. Jordan
39. Kenya
40. Korea (Republic of)
41. Kuwait
42. Latvia
43. Liechtenstein
44. Luxembourg
45. Macedonia
46. Malaysia
47. Maldive Islands
48. Mauritius
49. Mexico
50. Monaco
51. Morocco
52. Nepal
53. Netherlands
54. New Zealand
55. Norway
56. Oman
57. Pakistan
58. Peru
59. Philippines
60. Poland
61. Portugal
62. Qatar
63. Romania
64. Saudi Arabia
65. Serbia & Montenegro
66. Singapore
67. Slovakia
68. Slovenia
69. South Africa
70. Spain
71. Swaziland
72. Sweden
73. Switzerland
74. Taiwan
75. Thailand
76. Turkey
77. Uganda
78. Ukraine
79. United Arab Emirates
80. United Kingdom
81. United States of America
82. Vietnam
83. Zambia

Safe & Sound

Leading with integrity.

CORPORATE GOVERNANCE

Risk Management

Risk Philosophy

Taking risk is inherent in any bank's strategic business plan and Hatton National Bank (HNB) is no exception. HNB's risk philosophy is that the risk we take should be in line with the Board's risk appetite. It should fit with the Bank's business strategy, assist the decision-making process and enhance management effectiveness.

HNB's risk framework is aimed at strengthening the Bank's ability to identify, measure and manage risk. Formulated under the Integrated Risk Management framework / guidelines of the Central Bank of Sri Lanka, it seeks to maximise shareholder value by aligning risk management with corporate strategy, assessing the impact of emerging risks and developing risk tolerance and risk mitigating strategies which ultimately reflect the Bank's corporate governance and control culture.

The Bank applies the following risk management principles in its day to day business transactions:

- Promotes sustainable long term growth and profitability by embracing prudent risk management and corporate governance practices
- Assists the business in producing stable and consistently high returns for its shareholders
- Ensures its risk management strategy is based on a clear understanding of the various risks, disciplined assessment, measurement and monitoring processes

Governance Structure

HNB sees a strong risk governance structure as the foundation for its successful risk management philosophy. The Bank's risk governance is based on three lines of defence calling for accountability, responsibility, transparency and independent reporting.

Three Lines of Defence

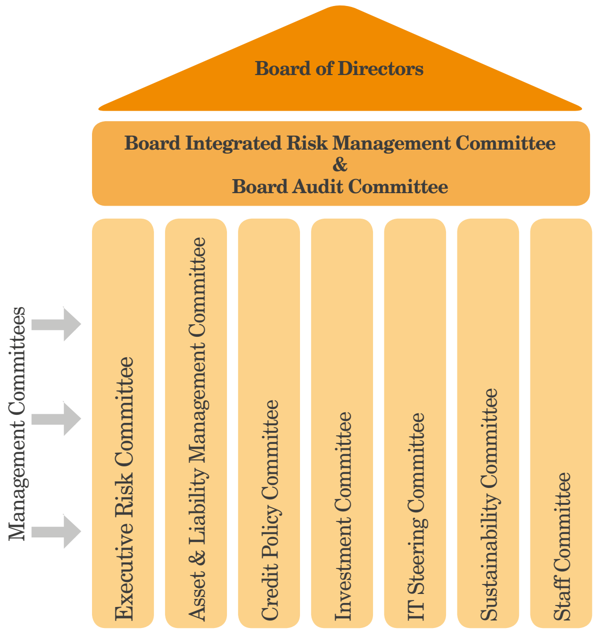
I Business Line Operations	II Risk Management	III Independent Verification
Real time focus • Contributes towards sound risk management practices and standard operating procedures within the risk management framework • Monitors compliance with internal risk management procedures	***Real time review focus*** • Develops and implements the risk management framework, policies, systems, processes and tools • Ensures that the framework encompasses - event identification - risk assessment - risk measurement - risk response - control activities - information & communication - mentoring - reporting • Independent review of the process of exercising credit approval in accordance with delegated authorities	***Compliance*** • Regulatory adherence • Regulatory reporting ***Internal Audit*** Review Focus • Reviews effectiveness of risk management practices and internal control framework • Confirms the level of compliance • Recommends improvements and enforces corrective actions where necessary ***External Audit*** (Reporting to the shareholders) • Issues an opinion on the true and fair view of the financial statements • Reviews the internal controls over financial reporting process

HNB's risk management approach is to combine the specialised knowledge of the business units and risk professionals with the experience of the corporate oversight functions. HNB's Board is however ultimately responsible for risk management and sets the tone at the top for an effective management of risk through its strategic goals and high-level objectives. In discharging its governance responsibility it operates through two key committees the Board Integrated Risk Management Committee (BIRMC) and the Board Audit Committee (BAC).

The BIRMC ensures that risk management strategies, policies and processes are in place to manage events that could impact the Bank's earnings performance, reputation and capital. The approach involves active monitoring of the level of risk exposure against the Bank's risk appetite. Under supervision of the BIRMC, the Bank's Non-Performing Advances (NPA) as a % of Loans and Advances reached a record low in 2012, as the challenging economic environment spurred the Bank to look at ways of restricting the growth of non-performing loans. Strategies were developed to improve penetration to low risk industries and conversely to reduce exposure to high risk industries, to strengthen the watch-listing process and to intensify the Bank's recovery efforts.

The BAC provides its assessment on the effectiveness of internal audit and external disclosure of accounting policies and financial reporting to the Board.

Various Executive Management Committees, each with specialised focus, support the BIRMC and are responsible for the co-ordination of risk matters for each of the business areas.



HNB's Risk Management Division is independent of the business units it monitors and reports directly to the Board Integrated Risk Management Committee (BIRMC) and Chief Executive Officer. Several units within the Risk Division contribute to the management of risk and co-ordinate across all business functions to ensure Risk Management is seamlessly ingrained into HNB's corporate culture.

Risk Management

Risk Appetite

In pursuit of its business and strategic goals, which include the achievement of financial targets, payment of dividends, funding capital growth and maintenance of target capital ratio, the Bank has established a risk appetite framework. Risk appetite is an expression of the amount of risk the Bank is willing to take in order to achieve a target return. It provides us with a basis for controlling our business activities by defining boundaries which align the Bank's business strategy to stakeholder expectations.

The Bank's risk appetite is expressed and monitored in terms of quantitative and qualitative risk measures. Quantitative measures would encompass prudent risk limits, capital adequacy computations and stress testing. Qualitatively HNB expresses risk appetite through its policies, procedures and controls meant to limit risk that may or may not be quantifiable. The Bank's risk appetite framework is duly set and overseen by the Board. Adherence to the Bank's risk appetite is monitored and controlled by the risk management function and key measures tracked and reported regularly to corporate management, the relevant committees and the Board with escalation at each committee level depending on the severity of the breach.

Risk Management in the context of a volatile Financial Landscape

The recent financial crisis which began in 2007 and the consequent events which shook investor confidence worldwide have compelled many economies to revise their growth forecasts with countries carrying unsustainable levels of debt facing several challenges. The most resilient economies during the crisis have been the emerging markets growing at more than twice the rate of developed nations.

Sri Lanka recorded a satisfactory post war economic growth in 2012, although at a lower rate than originally forecast. Whilst the country responded well to the stringent policy measures adopted in early 2012, to curb the rising demand for domestic credit, lack of liquidity in the market and decline in exports due to the Euro crisis and threat of a US fiscal cliff, a prolonged slowdown in the global economy and a tighter domestic monetary policy could dampen the country's growth prospects. Furthermore the volatility of commodity prices particularly the cost of fuel could continue to burden Sri Lanka's state-owned enterprises and strain the country's balance of payments. Going forward some of the areas which will warrant further attention are policies to encourage long term domestic savings, improved investor sentiment which would lead to a higher inflow of foreign direct investment (FDI), promotion of more service based exports, initiatives to curb imports and cutting down on government expenditure.

Prior to the global financial crisis, understanding and managing the risks surrounding business decisions was incorporated in most companies' corporate governance. The crisis and the subsequent world recession have amplified the need for a better management of risk at banks.

While the financial services sector seems to be gradually recovering from the financial crisis, banks today are more vulnerable to short term liquidity issues and as a result more cautious in their lending activities. What is seen today however is a better understanding by banks of the risks inherent in their business models, with many banks having realigned their risk management and governance structure to include a more active role of their boards with improved lines of communication across the organisation down to all business levels.

HNB continues to improve its risk monitoring and management capabilities by focusing more on liquidity, interest rate and operational risk management, raising capital buffers and developing Key Risk Indicators (KRIs) across key businesses. The Bank has further strengthened its stress testing framework which continues to evolve in depth and coverage, the focus being to assess how our portfolios would react if business conditions vary thereby determining the consequent impact on our capital base under various risk scenarios.

Managing Key Risks

Granting loans is the primary activity of HNB and therefore credit risk is its key risk. The Bank's balance sheet comprises of over 2/3rd of assets in the form of loans and advances. The remaining 1/3rd of assets are to a large extent, investments in Sri Lanka Government bonds and treasury bills retained for statutory reserve and liquidity requirements. On the liability side, the Bank has a high retail deposit base built up over the years and therefore reliance on the interbank market is low.

Credit Risk

HNB views credit risk as the risk of a potential loss to the Bank when a borrower or counterparty is either unable or unwilling to meet its financial obligations. The credit risk that we face arises primarily from Corporate Banking, SME and Retail loans and advances and to a lesser degree from debt securities and off-balance sheet products such as guarantees. Given the scale and materiality of the Bank's loan book, managing the credit quality of the lending portfolio is a key focus area with the objective of minimising probable losses and maintaining credit risk exposure within acceptable parameters. The Bank's credit portfolio remains well diversified by customer, business segment and sector.

The Bank has developed policies and processes to measure and monitor credit risk. HNB's Credit Policy is laid down by the Board of Directors and can be described as the rules and parameters within which the Bank's credit officers operate. The Credit Risk Policy plays a central role in managing daily business activities. The policy defines the principles encompassing client selection, due diligence, early alert reporting, tolerable levels of concentration risk and portfolio monitoring in line with the Bank's risk appetite. The approach is to avoid large credit risk on a counterparty or portfolio level by applying stringent underwriting standards combined with sound collateralisation where feasible. The policy is reviewed regularly by the Board of Directors and updated throughout the year to ensure consistency with the Bank's business strategy. A monthly Credit Policy Meeting chaired by the Chief Executive Officer, drives policy decisions and implementation plans.

HNB assesses and manages credit risk by focusing on the following key areas:

Loan Origination and Risk Appraisal	The loan origination process comprises initial screening and credit appraisal. The evaluation focuses on the borrower's ability to meet its obligations in a timely manner. Efforts are made to ensure consistent standards are maintained in credit approval. Collateral and guarantees form an important part of the credit risk mitigation process and internal policy dictates margins in our favour by type of security offered, standards for periodic valuations and assessment of realisable value of collateral. A suite of internal risk rating models (scientifically developed with the assistance of external consultants) is in place for corporate and retail customer segments. The internal risk rating is an important part of the risk assessment of customers and incorporated in the credit decision process. Significant strides have been made in internalising this approach with a view to giving due prominence to lending based on cash flow repayment ability as distinct from collateral based lending.
Loan Approval and Sanction	The Bank has established clear guidelines for loan approvals / renewals by adopting a committee based approval structure, where all approval signatories carry equal responsibility for credit risk. Individual credit facilities beyond a minimum threshold require an independent risk signatory with no revenue targets in respective committees (process ensures over 85% in terms of value of non-cash / gold secured loans are approved in this manner).
Credit Administration and Disbursement	HNB's Corporate Banking loan portfolio is administered through a centralised Credit Administration Division which ensures efficient and effective post sanction customer support including disbursement, settlements, processing renewal notices and advising customers on interest rate amendments. This division independently reports to Risk Management Unit to ensure clear segregation of duties from business origination and disbursements only after stipulated conditions have been met and relevant security documents obtained.
Credit Measurement and Monitoring	To safeguard the Bank against possible credit losses, problem loans need to be identified early. The Credit Risk Management Division measures and tracks the status of the credit portfolio, undertakes impact studies and detects early warning signals pointing to a deterioration in the financial health of a borrower. A credit risk dashboard is prepared monthly to review high level credit portfolio concentration and assess performance against internal limits (board risk appetite) and regulatory requirements. An internally developed Business Intelligence System ('KPI Wizard') is in place to evaluate credit risk indicators at branch, regional, zonal and bank level. Accountability for credit risk performance is vested with individual business units and unhealthy trends addressed at all levels.
Recoveries	Problem credits and Non Performing Advances are managed by the Recoveries and Credit Quality Division. This unit is responsible for all aspects of an overdue facility, follow up of rescheduled facilities, monitoring the value of the applicable collateral and liquidation, scrutiny of legal documents and liaising with the customer until all recovery matters are finalised. This division's activities are seamlessly integrated with Credit Administration and Credit Risk Management to ensure effective follow up. Back Office recovery functions representing Non Performing Advances classification, rescheduling, provisioning and valuation of collateral on delinquent assets was centralized during the year to ensure standardisation and accuracy. The Bank strictly conforms to regulatory requirements in problem loan classification and management.

Risk Management

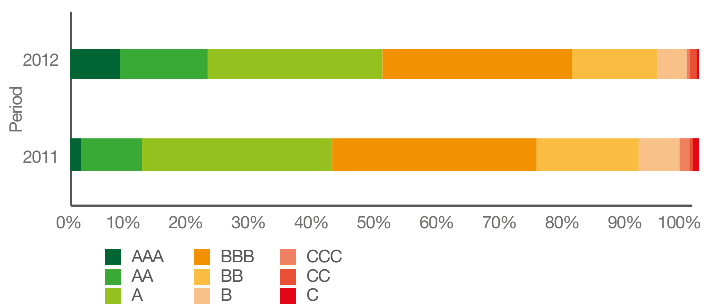
Internal Rating Models

The Bank uses 3 rating models 1) large corporates, 2) middle markets and 3) financial and leasing institutions to rate corporate clients and SMEs, focusing on aspects of operating risks, financial risks and account/facility conduct.

Credit Concentration Risk

Credit concentration risk is the risk of loss to the Bank as a result of excessive build-up of exposure to a single counterparty or counterparty segment, industry, product or geographical location. This concentration typically exists where a number of counterparties are engaged in similar activities and have similar characteristics, which could result in their ability to meet contractual obligations being similarly affected by changes in economic or environmental conditions. The monitoring of credit concentration is an integral part of the credit risk monitoring process. Methodology based on indexing techniques such as the Herfindahl-Hirschman Index (HHI), key ratios analysis, internally developed limit models and stress tests are used to measure and monitor credit concentration in the Bank's loan portfolio.

Credit Risk Console

Risk Category	Risk Rating 2012/2011	Risk Analysis and Mitigating Actions implemented in 2012
Effectiveness of Credit Policy Risk arises where credit policy amendments do not keep pace with changes in the local and global environment	Low/Low	Credit manual reviewed and effectiveness of credit policies assessed in regular meetings based on feedback from the network. Amendments made to credit manual and policies with discretionary lending limits updated regularly. Periodic development / update of credit limits, encompassing portfolio concentration, country limits, credit quality and prudential ratios. Performance against internally defined risk appetite and regulatory directions reviewed monthly in credit risk dashboard. Potential risk exposures arising from changes in the local and global economic environment monitored. For instance the impact of gold price on the Bank's pawning portfolio, review of exposure to tea industry and impact of oil prices on the Bank's large credit exposures. Reports circulated to relevant Business Units, Credit Committees and Board.
Adequacy of Portfolio monitoring Risk arises where systems and controls are not in place to regularly assess the health of the credit portfolio	Low/Low	The credit quality of the corporate banking portfolio has displayed a gradual improvement in 2012 as compared to the previous year with exposures above BBB rating increasing from 70% to 78%. Corporate Banking Portfolio Based On Internal Risk Rating  Assessment of portfolio credit quality is based on internal risk ratings with focus on high risk accounts (BB and below) which are reviewed by risk managers at least quarterly.

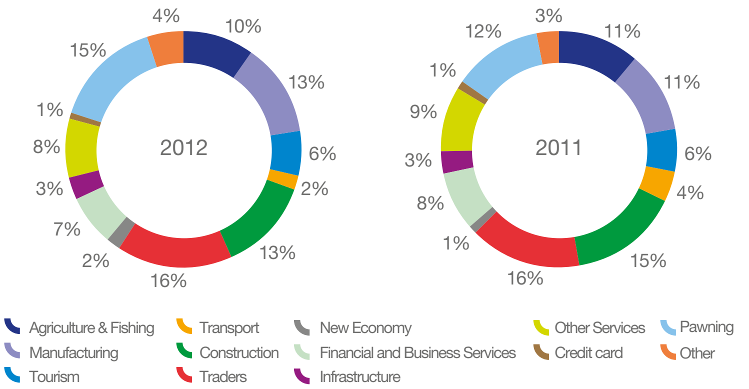
<table>
<tr><th>Risk Category</th><th>Risk Rating 2012/2011</th><th>Risk Analysis and Mitigating Actions implemented in 2012</th></tr>
<tr><td>Credit Concentration Risk

Risk arises where Credit Portfolio is not sufficiently diversified</td><td>Moderate/
Moderate</td><td>

Industry Concentration

Increase in exposure to manufacturing industry. Increased exposure to gold as a result of a growing pawning portfolio.

Industrywise Exposure



Industry risk analysis carried out to review industry risk ratings, portfolio growth and NPA by industry and progress made against medium term industry targets.

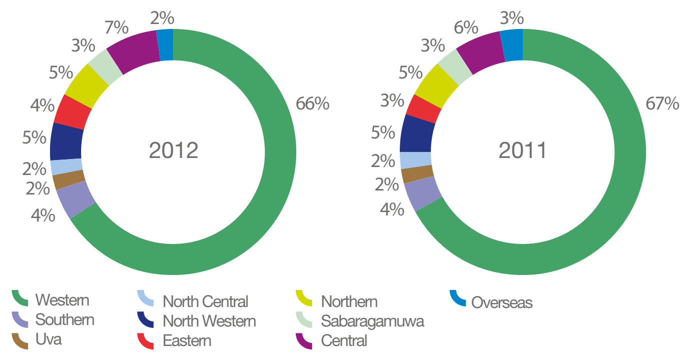
Strategies developed to improve penetration to low risk industries and conversely reduce exposure to high risk industries.

</td></tr>
<tr><td></td><td>High/High</td><td>

Geographical Concentration

Growth of the loan book continued in the Central and Eastern regions, with a high concentration on the Western Province mainly due to project accounts being booked in Head Office although economic benefits accrue to areas of presence across the country.

Geographical Distribution

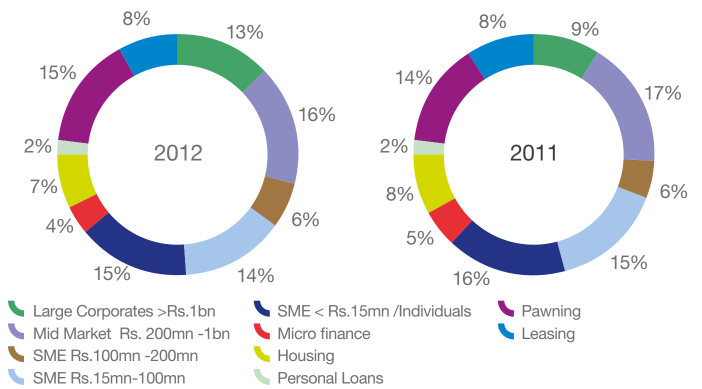


</td></tr>
<tr><td></td><td>Low/Low</td><td>

Exposure by Counterparties

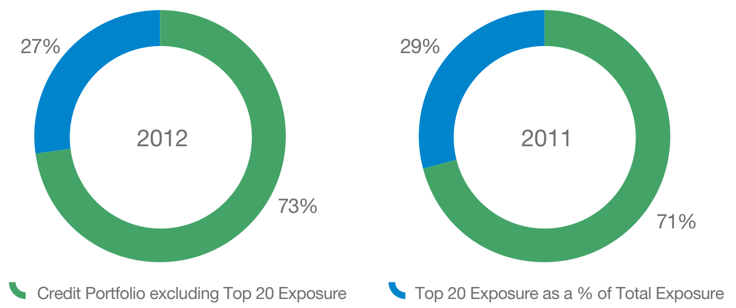
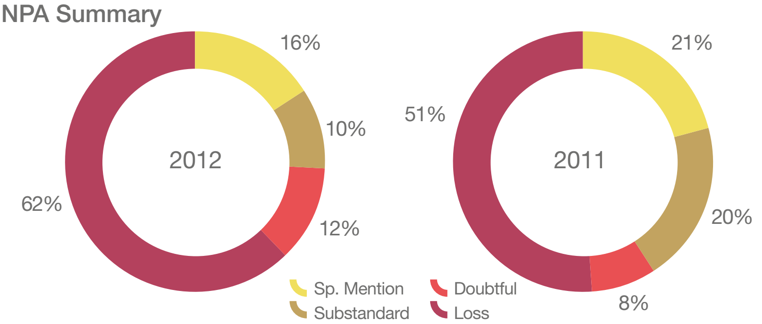
HNB has a well-diversified portfolio of Corporate, SME, Retail and Microfinance segments. Counterparty classifications were changed in accordance with new SME definition issued on 31st Oct 2011 by the Central Bank of Sri Lanka.

Exposure by Counterparties



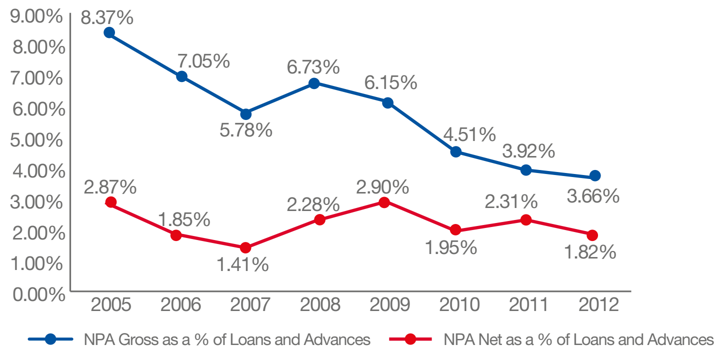
</td></tr>
</table>

Risk Management

Risk Category	**Risk Rating 2012/2011**	**Risk Analysis and Mitigating Actions implemented in 2012**
	Moderate/ Moderate	Top 20 Customer Exposure A decrease in top 20 customer exposure as a % of total customer exposure in 2012 indicates less concentration risk. **Material Exposures**  Risk Review of Top 20 Customers conducted annually and individual account strategies updated.
Adequacy of Recovery Process Risk arises where systems and controls are not in place to monitor recoveries and adequate bad debt provisioning	Low/Low	Non-Performing Advances (NPA) Analysis of NPA by category shows shifts in portfolio composition with an increase in “loss accounts”. **NPA Summary**  The challenging external environment spurred the Bank to look at different ways of restricting the growth of NPA during the year. Strategies were adopted to identify accounts reflecting signs of delinquency and proactive measures were taken to prevent such accounts migrating to the non performing category. Furthermore the watch-listing and recovery processes were strengthened and a prudential provision on all such advances that were over 900 days in arrears was enforced irrespective of the availability of tangible security. Recoveries dashboard tracks delinquency and customers in early stages of NPA by business segment and product. Causes of new additions to NPA reviewed by segment and region.

Risk Category	Risk Rating 2012/2011	Risk Analysis and Mitigating Actions implemented in 2012
		NPA as a % of Loans and Advances at record low level in 2012 (based on previous time based provisioning method). This ratio based on SLFRS provisioning although not represented graphically, shows even lower NPA levels for the past 3 years.

Non - Performing Advances 2005 - 2012



Risk Category	Risk Rating 2012/2011	Risk Analysis and Mitigating Actions implemented in 2012
Risk of potential losses arising from adverse events affecting borrowers.	Low/Low	Stress Testing The Bank has implemented stress tests to measure the resilience of its lending and pawning portfolios to negative NPA movements. 1. Negative shift in NPA categories on credit portfolio

Credit Risk		*Scenario 1*	*Scenario 2*	*Scenario 3*
Magnitude of shock		50%	80%	100%
Negative Shift in NPA Categories	Original CAR	Revised CAR		
Credit Portfolio	16.63%	16.39%	16.24%	16.14%
Composition of NPA categories: Special Mention 16%, Substandard 10%, Doubtful 12% and Loss 62%.				

Minor effect on the Bank's Capital Adequacy Ratio (CAR), due to a well-diversified credit portfolio at geographical, industry and counterparty level.

2. Shift in NPA due to a fall in forced sale value (FSV) of mortgaged collateral

Credit Risk		*Scenario 1*	*Scenario 2*	*Scenario 3*
Magnitude of shock		10%	20%	40%
Negative shift in NPA due to fall in FSV of mortgaged collateral	Original CAR	Revised CAR		
Credit Portfolio	16.63%	16.42%	16.21%	15.79%
Collateral weights from 31.12.2012.				

3. An increase in the level of NPA on credit portfolio
4. A reduction in gold prices and resulting increase in the level of NPA of pawning portfolio due to non-redemption of pawning articles
5. Risk of Top 20 Customers defaulting

Credit Risk		*Scenario 1*	*Scenario 2*	*Scenario 3*
Magnitude of shock		5%	10%	20%
Increase in NPA	Original CAR	Revised CAR		
Credit Portfolio	16.63%	16.43%	16.23%	15.82%
Pawning Portfolio*		16.42%	16.13%	15.42%
Top 20 Customer Scenario**		15.73%	14.81%	12.90%
* Impact of a reduction in gold prices and increase in NPA on pawning portfolio ** Impact of top 20 customers falling into NPA (based on outstandings)				

All scenarios show comfortable Capital Adequacy Ratios (CARs) above the regulatory requirement of 10% and even in the worst case scenario of a 20% NPA shock to the Bank's top 20 customers.

Risk Management

Liquidity Risk and Interest Rate Risk

Liquidity Risk is the risk that the Bank is unable to meet its debt obligations due to a lack of funds or having to meet these obligations at excessive cost. HNB manages liquidity risk in accordance with regulatory guidelines and international best practices. The objective of HNB's liquidity and funding framework is to ensure that funding commitments and deposit withdrawals can be met when due and that market access remains cost effective. A Board approved Liquidity Policy to manage liquidity on a day-to-day basis and a Contingency Funding Plan to deal with crisis situations are in place. Contractual maturity of assets and liabilities, key liquidity ratios and monthly liquidity forecasts are reviewed at ALCO meetings. The main sources of the Bank's funding are capital, core deposits from retail and commercial clients, wholesale deposits and access to borrowed funds from the interbank money market. The Bank also maintains a portfolio of readily marketable securities to further strengthen its liquidity position.

HNB's lending portfolio is financed to a great extent by retail deposits and reliance on wholesale deposits and interbank market is low. Liquidity risk exposure is managed by Treasury with limits and triggers set to ensure that sufficient liquidity surplus and reserves are available to meet daily business requirements and also to deal with a sudden liquidity shock. Treasury reports the Bank's overall liquidity position to Management on a daily basis.

Interest Rate Risk is the risk to which the Bank is exposed to due to uncertain and adverse movements in future interest rates. Interest rate risk is monitored through regular review of net interest yields by product to ensure interest rate margins and spreads are maintained and revisiting asset and liability pricing in line with our expectations on the interest yield curve.

The Bank is exposed to interest rate risk arising from a fixed rate liability book where re-pricing is slower than the majority of loan portfolio on fixed rates (notable exceptions being the entire corporate banking portfolio and some midmarket exposures on floating rates). However, almost the entire deposit base contractually or otherwise can be re-priced within a year, an additional strength, which serves to reduce our vulnerability to interest rate risks. The Bank is committed to improving its liquidity and interest rate risk management infrastructure through its newly implemented Asset & Liability Management System. The system will be used to assess the behavioural and contractual maturity profiles of the Bank's assets and liabilities and the advanced stress testing capabilities will assist the Bank in enhancing its capital management processes.

Liquidity Risk and Interest Rate Risk Console

Risk Category	Risk Rating 2012/2011	Risk Analysis and Mitigating Actions implemented in 2012
Risk arising from inability to raise capital in a liquidity crisis	Moderate/ Moderate	Review of liquidity policy and contingency funding plan to address funding methods in an emergency situation.
Risk arising from inability to meet maturing deposit liabilities as they fall due.	Moderate/ Moderate	Reliance on short term interbank borrowings increased for the first 3 quarters of 2012 in line with market with the LKR Loan to Deposit Ratio (LDR) increasing to around 105%. However deposit growth gained momentum in the 4th quarter of 2012 and the Bank was able to maintain a LDR of 90%. Regular analysis of liquidity carried out to assess funding requirements. Review of Asset and Liability positions by ALCO ensures optimal net interest margins. As part of the market risk dashboard, the Bank monitors a number of liquidity ratios as per the CBSL risk directions which are discussed at the ALCO, Executive and Board Risk committees. Adherence to the statutory liquid asset ratio (SLAR) monitored. The SLAR mandates that 20% of all liabilities excluding shareholder funds should be held in defined liquid assets.
Risk of potential losses which could arise from low liquidity in markets	Low/Low	Stress testing The Bank has implemented stress tests to measure the resilience of its portfolios to low liquidity and unavailability of funding in the market place. High retail deposit base accounts for over 90% of deposits. Funding from overseas already tested and Tier 2 capital increased during the year.

Risk Category	Risk Rating 2012/2011	Risk Analysis and Mitigating Actions implemented in 2012
Risk rising from adverse movements in interest rates	Low/Low	The duration of the bond portfolio monitored regularly to assess sensitivity of bond prices to interest rate changes. The impact of interest rates on portfolios minimal due to the Bank holding treasury bills and bonds with short maturities. The duration of trading and investment portfolios are both less than 1 year.
Risk arising from Maturity Mismatch	Moderate/ Moderate	Contractual maturity mismatch of Assets and Liabilities reviewed and implications identified. Asset and Liability Management (ALM) System implemented in 2012 to enhance the Bank's capital management capabilities.

Operational Risk

Operational Risk is the risk of losses incurred due to inadequate internal processes, systems, human failures and/or external events. The majority of losses that distress companies have operational risk as a main contributor and operational risk management must therefore have its firm place in a company's internal control framework. HNB has a comprehensive operational risk policy in place comprising risk identification and assessment, implementation of controls for improving the management and monitoring process and mitigation tools for operational risks. There has been visible progress on standardizing and quantifying operational risk, this is reflected in the improving preventative culture observed across the business.

Risk identification techniques include highlights of audit reports, discussions with network management, branch visits and operational risk review meetings conducted across branches. A comprehensive loss tracking database is in place containing over 5 years of information, analysed by business function and loss incident matrix. A high level operational risk dashboard is prepared for monthly circulation and monitoring purposes and significant loss incidents (above Rs.500,000) are analysed for root causes and learnings. Insurance continues to be the key risk mitigant for operational risk and adequacy and effectiveness of insurance is independently reviewed by the Operational Risk Unit, at least annually.

Key Risk Indicators

In 2012, HNB identified a number of Key Risk Indicators (KRIs) for the different business units in order to increase transparency of operations and identify possible sources of risk to the Bank. The information derived from these KRIs act as an early warning signal to identify a potential event that may harm our daily business activities and consequently have an impact on the whole Bank. The challenge for operational risk is to identify which ones are most likely to act as effective leading indicators in order for management to take preventive action against these risks materialising. A continuous refinement of these operational risk indicators is planned for 2013.

Operational Risk Console

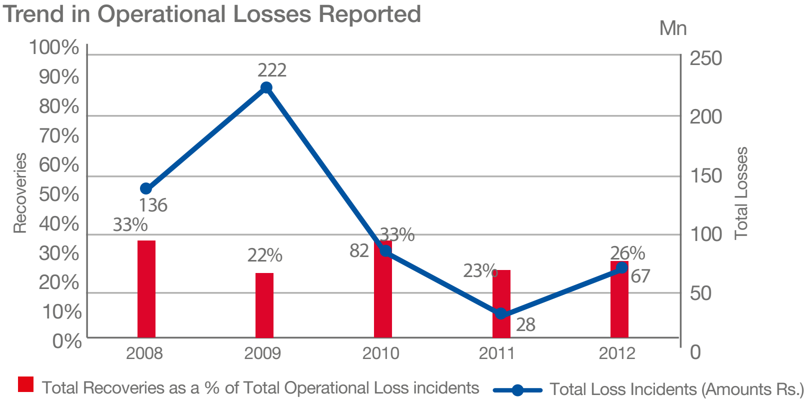
Risk Category	Risk Rating 2012/2011	Risk Analysis and Mitigating Actions implemented in 2012
Effectiveness of Operational Risk Policy	Low/Low	Operational Risk Policies reviewed during the year and updated in line with regulatory developments and internal decisions. Review of insurance adequacy and effectiveness carried out covering insurance premiums by type of policy, claims honoured over time by insurance provider, adherence to recommendations made at last review and effectiveness in terms of insurance coverage and cost.

Risk Management

<table>
<tr><th>Risk Category</th><th>Risk Rating <u>2012</u>/2011</th><th>Risk Analysis and Mitigating Actions implemented in 2012</th></tr>
<tr><td>Risks arising from a poor Control Environment</td><td><u>Low</u>/Low</td><td>
Trend in Operational Losses

A significant improvement in net operational losses indicated over the years. Analysis of last 5 years operational losses indicates a steady decline of losses between 2009 and 2011 with an increase in operational losses recorded for 2012 in comparison to 2011.

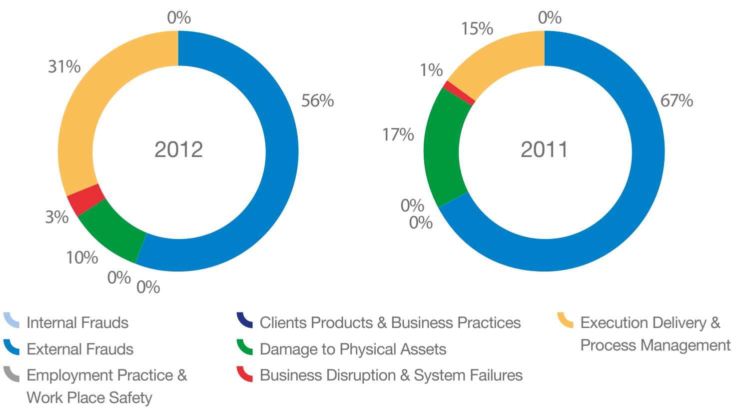
Trend in Operational Losses Reported



The largest contributor to operational losses in both 2012 and 2011 was external frauds (see charts below). Although compared to the other incident types, external frauds have reduced percentage-wise to 56% of total losses this year in comparison to 67% in 2011, losses in monetary terms for external frauds increased in 2012. An analysis of this category showed an increase in fraudulent deeds taken against advances granted.

Increases in operational losses were also recorded in business disruption & system failures and in execution, delivery and process management and damages to physical assets in comparison to 2011.

Operational Losses according to Incident Type

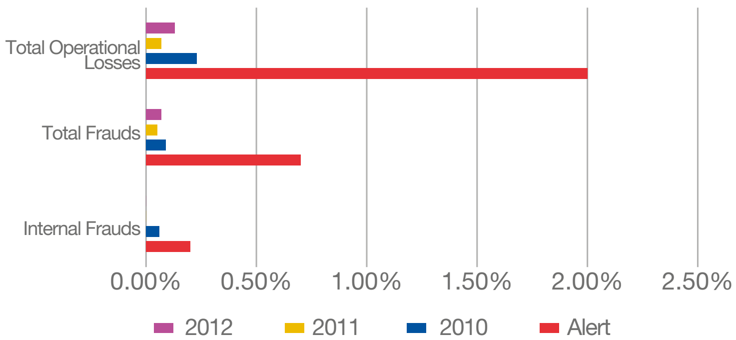


Material losses regularly analyzed by cause and action taken to improve systems and controls to prevent recurrence. For example no. of incidents of forged notes detected, fake or stolen articles pawned.

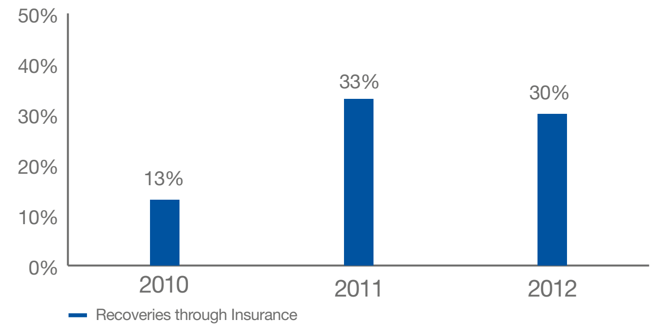
Regular meetings with regional management and support functions to ensure effectiveness of Operational Risk Meetings across the network and adequate follow up of issues identified for implementation.

A comprehensive Operational Loss database in place to track losses by incident type and business line as per BASEL II guidelines.

The Bank was able to recover 26% of losses through insurance or other means in 2012.
</td></tr>
</table>

Risk Category	Risk Rating 2012/2011	Risk Analysis and Mitigating Actions implemented in 2012
Technology Risk Risk arising from system breakdowns and disruptions	Moderate/ Moderate	Periodic review of information security to protect the Bank's data from unauthorised access, modification or deletion and to ensure its confidentiality, integrity and availability. Effectiveness of controls to prevent misuse of internet payment gateway (IPG) assessed. System disruptions reviewed during the year. Observations of KRIs such as number of ATM downtimes (due to lack of cash, age of hardware, power, software or network failures) have enabled us to pinpoint repeated issues at certain ATM machines and improve control processes in these areas. Outsourcing policy and outsourced activities managed centrally by the Compliance Department.
Risk arising from not keeping ahead of latest technology and delivery channels in banking	Moderate/ Moderate	Mobile Banking introduced in 2012 with HNB acting as custodian bank for a leading mobile/ telecommunications operator.
High Impact Unforeseen Events Risk arising due to lack of preparedness to natural disasters and terrorism	Moderate/ Moderate	Risk Assessment and Business Continuity Plans reviewed across the Bank, including IT Disaster Recovery Plan. Significant traction achieved on BCP operations and systems during the year to be in line with regulatory/best practices.
Risk arising from inadequate risk mitigation strategies	Low/Low	Performance against internal alert levels tracked monthly. An internal alert level for total losses set at 2% of annual turnover. Limits of 0.20% for internal frauds and 0.70% for total frauds have been defined. Actual losses experienced remained comfortably within internal alert levels. Operational Risk Versus Tolerance (2010-2012)  Insurance is a key mitigating factor for operational risk and consequently a strong interaction between the risk, insurance and legal departments takes place to ensure adequacy and effectiveness of insurance coverage in key areas. Insurance policies are used to transfer the risk of losses which may occur as a result of events such as frauds, natural disasters and physical loss of securities. A culture where operational risk reviews/challenges effectiveness of insurance in place. Collections show a steady improvement as a result of monitoring insurance claims, settlements, rejections and withdrawals on a regular basis.

Risk Management

Risk Category	Risk Rating 2012/2011	Risk Analysis and Mitigating Actions implemented in 2012
		Recoveries through Insurance as % of Premiums Paid 
People Risk Risk arising from inability to attract and retain skilled staff	Moderate/ Moderate	Talent development, retention of top performers and succession planning for all departments are key focus areas. Increase in the diversification of the Bank's employee base with greater emphasis on recruitment from semi urban and rural sectors as a result of the rapid expansion of the network of customer centres across the country. International and local certification and training programmes for staff.
Risk arising from outsourced security service activities	Low/ Low	KRIs on security service provider such as number of guards on duty, shifts worked monitored and feedback given to service provider. Outsourced ATM machines monitored.
Legal Risk Risk arising from litigation against the bank or faulty legal documentation	Low/ Low	Review of legal charter and monitoring of legal cases and recovery process. An increase in incidences involving forged title deeds was observed in 2012. The Bank has taken preventive control measures to reduce these incidences.

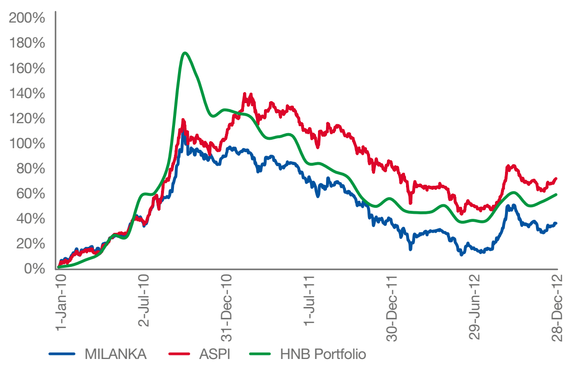
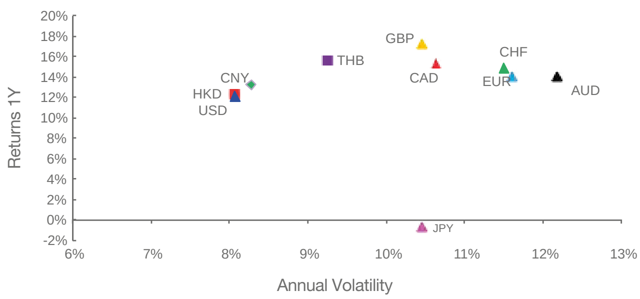
Market Risk

Market Risk quantifies the risks arising from fluctuations in interest rates, foreign exchange positions and prices of commodity and equity investments. HNB's Board approves the market risk appetite and related limits for both the banking book (investments) and the trading book. Treasury Middle Office (TMO) which is part of the independent Risk Management Division reports on market risk and is instrumental in ensuring that the market risk limits are in line with the level of risk acceptable to the Board. TMO keeps track of price movements and other developments in the market that affect the Bank's risk profile and monitors primarily exchange rate, interest rate and equity price risks.

HNB's trading and currency translation risks are minimal in relation to total operations of the Bank. Presently exposure to the Bank's trading book is only 2% of the banking book given the capital market restrictions and minimal opportunities in the market. Market risk on long term investments is managed in accordance with the purpose and strategic benefits of such investments, rather than purely on mark-to-market considerations. Reviews and assessments on the performance of the investments are undertaken regularly by the Bank's Investment Committee.

The Bank has a comprehensive Board approved Treasury Policy in place to reflect regulatory and market developments. The Treasury Middle Office (TMO) under the purview of the Head of Risk Management monitors the asset-liability position with oversight and supervision from the ALCO. The TMO also independently reviews activities of the Treasury Front Office and adherence to regulatory / internal policy guidelines. A Market Risk Dashboard indicates performance against risk appetite for currency, bond and equity positions of the trading portfolio with country, duration and value at risk (VAR) based limits in place.

Market Risk Console

Risk Category	Risk Rating 2012/2011	Risk Analysis and Mitigating Actions implemented in 2012
General appetite for Market Risk based on Treasury activity	Low/Low	Review of Treasury Policy and changes incorporated to reflect regulatory developments and internal decision-making. Capital computation carried out to assess impact of Basel II advanced approach on trading portfolio. The Bank's trading book accounts for just 2% of the banking book and therefore impact on capital is minimal. Foreign exchange exposure limits for individual countries reviewed. Daily treasury report giving all treasury highlights for the day circulated to relevant decision makers.
Market Risk based on customer trades	Moderate/ Low	Implementation of improved controls on customer stock market exposure and adherence to regulatory security margins. Customer positions monitored regularly and specific action plans in place for significant customers in NPA with a view to recover through sale of shares or otherwise.
Equity Risk Risk rising from adverse movements in stock markets	Low/Low	Equity Portfolio HNB's equity portfolio recorded a return of approx. 2% in 2012 which is also reflected in the poor performance of the local stock market indices. Over a 3 year period however the equity portfolio has recorded a positive return of over 54%. Performance of Equity Portfolio and Stock Markets 2010 to 2011  Close monitoring of equity portfolio and benchmark indices by market risk team with recommendations made in Investment Committee and ALCO meetings. The equity portfolio was reduced in January 2012 in line with market developments. Value-at-Risk based measurement for equity portfolio in place.
Foreign Exchange Risk Risk arising from unhedged foreign exchange positions and poor treasury controls	Low/Low	Currency Risk/Return Profile Risk profile of major currencies tracked against LKR. Most currencies outperformed the LKR as a result of the local currency depreciation which took place in 2012. The most volatile currencies (over 11% volatility) during 2012 were the Australian Dollar, Euro and Swiss Franc. The GBP was the best performer against the LKR with a return above 17% and volatility over 10%. Currency Risk / Return Profile - 2012  Low exposure to unhedged positions given internal policy and strengthened supervision by the regulators on minimising open foreign currency positions. Review of market risk dashboard at ALCO. Value at Risk limits to monitor overnight foreign currency positions which is mainly to the USD.

Risk Management

<table>
<tr><th>Risk Category</th><th>Risk Rating 2012/2011</th><th>Risk Analysis and Mitigating Actions implemented in 2012</th></tr>
<tr><td>Commodity Risk arising from adverse movements in global commodity prices</td><td>Moderate/ Moderate</td><td>

Commodity Performance

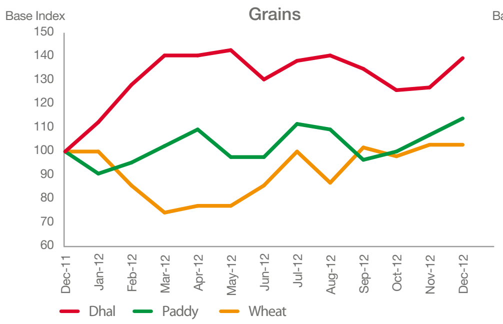
Grains and other Crops

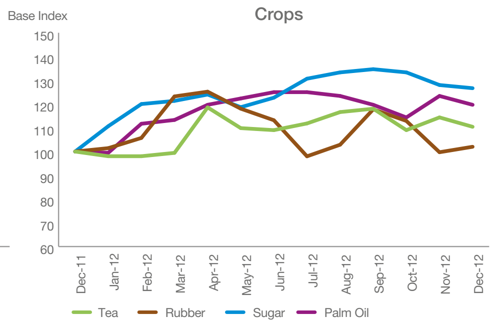
Paddy prices subdued during the first 5 months of 2012 but firmed in the second half of the year influenced to some extent by large government purchases and stock building. Sri Lankan paddy production was at a record high in 2012. Despite surplus production, Sri Lankan exports are limited due to a lack of grades and standards and low demand for indigenous Sri Lankan rice varieties.

Dhal which took a hit in 2011, recovered in 2012 to end slightly below its 2010 price level, while the global demand for wheat in 2012 led to a price increase.

In 2012, tea, sugar, palm oil all recorded positive performances with rubber prices losing gains observed during the year to finish at previous year price levels. Tea prices in Sri Lanka picked up by 8% from their low levels in 2011 due to prevailing drought conditions which helped prop up prices in 2012.

Global uncertainty and weak economic growth may cause a slowdown in demand for agricultural commodities in 2013, with speculative trades likely to continue.



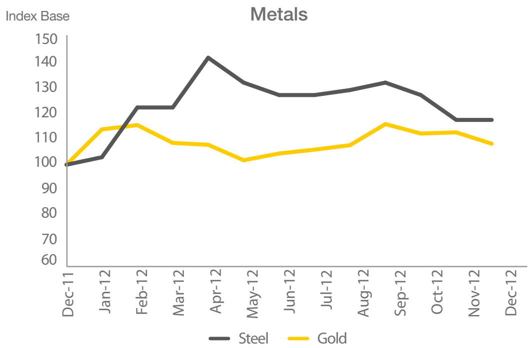


Metals - Steel and Gold

Steel prices reached a peak in April 2012 keeping up their gains as the demand for steel continued to pick up following the steep drop as a result of the 2008 financial crisis.

The steel industry in Sri Lanka plays a significant role in the country's economic growth, particularly in the traditional sectors, such as infrastructure & construction, automobile, transportation and industrial applications. Moreover variant stainless steel is finding innovative applications due to its corrosion resistive property.

Gold prices increased in 2012 by over 8% driven by the escalating Eurozone crisis and global uncertainties. The rupee depreciation further ensured gold prices were 15% higher in SLR. Pawning growth outperformed the rest of the portfolio resulting in pressure on the Bank's internal cap. The driver of gold prices in 2013 will be the development of the global financial crisis.



Quarterly review of commodity price trends for circulation to network to ensure minimal speculative financing. Review of gold prices and stress tests carried out to assess impact on the Bank's pawning portfolio.

</td></tr>
</table>

<table>
<tr><th>Risk Category</th><th>Risk Rating 2012/2011</th><th>Risk Analysis and Mitigating Actions implemented in 2012</th></tr>
<tr><td>Risk of potential losses which could arise from negative market events</td><td>Low/Low</td><td>
Stress testing
Stress tests developed to assess the impact of adverse changes in exchange rates, interest rates and prices of financial instruments such as equities and bonds which could affect the assets of the Bank's trading and investment portfolios as well as its capital base.
<table>
<tr><th>Foreign Currency Risk</th><th>Original CAR</th><th>Scenario 1</th><th>Scenario 2</th><th>Scenario 3</th></tr>
<tr><td>Magnitude of shock</td><td></td><td>5%</td><td>10%</td><td>15%</td></tr>
<tr><td>All foreign currencies</td><td>16.63%</td><td>16.62%</td><td>16.62%</td><td>16.61%</td></tr>
<tr><td>USD/LKR</td><td>16.63%</td><td>16.62%</td><td>16.62%</td><td>16.61%</td></tr>
</table>
95% of the Bank's foreign currency exposure is to the USD and it is hedged to a large extent, hence minimal change to CAR.
<table>
<tr><th>Equity Risk</th><th>Original CAR</th><th>Scenario 1</th><th>Scenario 2</th><th>Scenario 3</th></tr>
<tr><td>Magnitude of shock</td><td></td><td>10%</td><td>20%</td><td>40%</td></tr>
<tr><td>Equity Price</td><td>16.63%</td><td>16.62%</td><td>16.61%</td><td>16.59%</td></tr>
</table>
The Bank holds a very small equity portfolio therefore impact on CAR is minimal even at 40% shock.
<table>
<tr><th>Fixed Income Risk</th><th>Original CAR</th><th>Scenario 1</th><th>Scenario 2</th><th>Scenario 3</th></tr>
<tr><td>Magnitude of shock</td><td></td><td>1%</td><td>2%</td><td>5%</td></tr>
<tr><td>Fixed Income Total Portfolio</td><td>16.63%</td><td>16.41%</td><td>16.19%</td><td>15.53%</td></tr>
<tr><td>Fixed Income Trading Portfolio</td><td>16.63%</td><td>16.63%</td><td>16.63%</td><td>16.63%</td></tr>
</table>
The Bank has invested to a large extent in government treasury bills and bonds with a duration of approx. 9 months, therefore impact on CAR is minimal with the exception of the 5% shock on the total fixed income portfolio which still gives a comfortable CAR of 15.53%.
</td></tr>
</table>

Strategic Risk

Strategic risk can be seen as the impact on a company's earnings or capital, due to poor business policy decisions, improper implementation of business strategies or lack of responsiveness to industry changes. This type of risk is a function of the compatibility of a bank's strategic objectives, business decisions developed to achieve these goals, resources deployed and the quality of implementation.

In pursuing its strategic goals and business objectives, HNB has established clear communication channels at all levels of the organisation, allocated resources for operating systems and delivery networks and increased managerial capacities and capabilities. A formal framework was introduced to assess strategic risks arising from market trends / developments in competition, product, channel, process, human resources and technology. Specific risks are identified, impact on HNB's business plans assessed and mitigating actions reviewed on a quarterly basis.

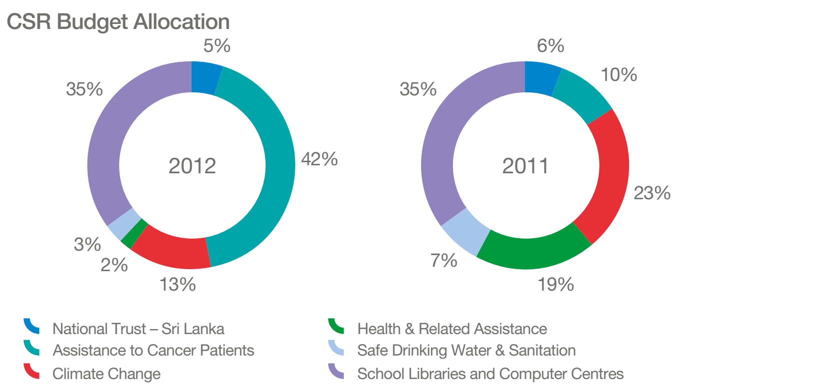
Reputational Risk

Reputational risk results from damage to the Bank's image among stakeholders due to negative publicity regarding the Bank's business practices or management, and whether true or false, it can result in a loss of revenue or decline in shareholder confidence. The reputation of a company can be perceived as an intangible asset similar to goodwill.

HNB considers reputational risk as a consequence of a failure to manage its key risks. The Bank is therefore committed to managing reputational risk by promoting strong corporate governance and risk management practices at all levels of the organisation, by understanding how different aspects of its business activities affect stakeholders' perception of the organisation, through effective communication in the form of timely and accurate financial reports and news bulletins, by maintaining strong media presence, valuable client service and investor relationships and by complying effectively with current laws and regulations.

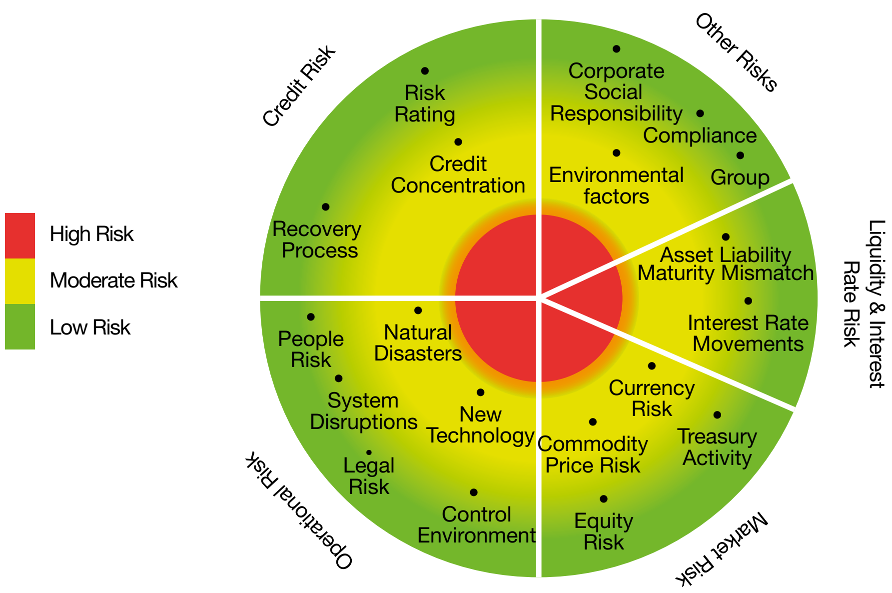
Risk Management

Strategic / Reputational Risk Console

Risk Category	Risk Rating 2012/2011	Risk Analysis and Mitigating Actions implemented in 2012
Strategic Risk arising from geopolitical, economic, social, regulatory and other environmental factors	Moderate/ Moderate	Strategic Risk is reviewed regularly. A strategic risk template was developed for this purpose and is part of the input in the strategic management process. A strategic planning process is conducted annually to develop future strategic direction, take decisions on key business initiatives and allocate resources to business lines. Action plans with timelines and accountability of business units are developed to address each strategic goal/risk area identified.
Reputational Risk arising from poor surveillance of group subsidiaries	Low/Low	Strengthened surveillance on Group entities. Development of template to review the risk management capabilities of the Bank's Subsidiaries undertaken.
Risk to brand /reputation arising from lack of inadequate Corporate Social Responsibility practices	Low/Low	Sustainability Committee oversees implementation of CSR Projects. Key Performance Indicators reviewed to assess progress on CSR initiatives. Corporate Social Responsibility budget allocation increased by more than 20% in 2012 as compared to 2011 

Risk Radar

The following chart highlights the key risks of the Bank.



Compliance Risk

It is HNB's policy to conduct its business in accordance with the Board approved Compliance Policy by complying with the laws and regulations imposed by the regulatory authorities with zero tolerance for failure to identify any breaches and promptly remedy such breaches if any, on the part of the Bank. The compliance policy has been formulated with the broad vision of establishing a fully compliant "corporate governance" and "risk mitigating" culture within the Bank. Accordingly the Bank is continuing its efforts towards establishing and maintaining internal systems and controls with a view to adhering to the highest status of ethical and professional behaviour in the conduct of Bank's business and to be fully compliant with laws, regulations, rules, directions that govern the Bank's business operations.

One of the key initiatives taken by the Compliance Division during the year 2012 was the project to implement an Anti Money Laundering (AML) software. The new Anti-Money Laundering system will assist in the customer due diligence processes, keeping in line with the Financial Transaction Reporting Act No: 6 of 2006. In addition, the Bank commenced capturing Know Your Customer (KYC) data electronically, which is a pre-requisite for successful implementation of the AML software.

Automation of web-based returns submitted to the Central Bank of Sri Lanka is another important initiative taken by the Bank with a view of putting in place a mechanism to further enhance data integrity of such statements. The Phase I of the project was completed in 2012, whilst the internal controls on debit card transactions taking place outside Sri Lanka too were further strengthened. Successful implementation of the Customer Charter was another milestone reached during the year 2012. A Risk Matrix was developed to measure the compliance risk associated with the Bank's business, and proactively mitigate such risks. During the year 2012 as well, the Bank continued its practice of submission of regulatory reports to the Board Integrated Risk Management Committee on matters of concern.

Conformity to new Regulations introduced during 2012

Date issued	Mandatory Regulations/Directions/Determinations	Bank's Present status
01.03.2012 Exchange Control Dept.	Forward sales and purchases of foreign exchange	Compliant
12.03.2012 Director Bank Supervision	Monetary law act order No. 1 of 2012 - Ceiling on Credit Growth of Licensed Banks	Compliant
14.03.2012 Domestic Operations Dept.	Use of REPO standing facility when the Central Bank offers Reverse REPO auction	Compliant
19.03.2012 Bank Supervision Dept.	Threshold age of the senior citizens for transactions with licensed banks	Compliant
29.03.2012 Bank Supervision Dept.	Disclosure in Annual reports	Compliant
05.04.2012 Exchange Control Dept.	Securities Investment Accounts	Compliant
17.04.2012 Bank Supervision Dept.	Interest rates on Credit Cards and Housing Loans	Compliant
15.05.2012 Currency Department	Improving compliance of Commercial Banks in Handling Counterfeit currency notes-Penalty imposed for non-detection of counterfeit currency notes	Noted
24.05.2012 Payment & Settlement	Interest rates on Credit Cards	Compliant
01.06.2012 Exchange Control Dept.	Payment for Foreign Exchange Trading	Compliant.
19.06.2012 Exchange Control Dept.	Loans in Rupees to Sri Lankans employed abroad	Compliant.
11.07.2012 Exchange Control Dept.	NRFC and RFC accounts	Compliant.
11.07.2012 Exchange Control Dept.	Foreign Exchange Earners Account (FEEA)	Compliant.

Risk Management

Date issued	Mandatory Regulations/Directions/Determinations	Bank's Present status
17.07.2012 Bank Supervision Dept.	Special payments/benefits to directors at their retirement	Significantly compliant. (Banks policy on special payments/benefits to the Directors retiring from the Bank's service will be incorporated in the Banks Remuneration Policy Document.)
09.08.2012 Exchange Control Dept.	NRFC and RFC accounts	Compliant.
18.9.2012 Monetary Board	Banking Act Direction no. 1 of 2012 Foreign Exchange Trading Activities of licensed commercial banks in Sri Lanka	Significantly compliant. (With regard to the requirement of disclosure of profits generated through Foreign Exchange Trading, the bank is in liaison with CBSL for certain clarifications.)
02.10.2012 Exchange control Dept.	Daily foreign exchange rates offered to authorised money changers	Compliant
15.10.2012 Bank Supervision Dept.	Definition of liquid assets under section 86 of the Banking act no.30 of 1988, as amended	Compliant
15.10.2012 Bank Supervision Dept.	Submission of statutory returns	Compliant
26.10.2012 Exchange Control Dept.	Definition of liquid assets under section 86 of the Banking act no.30 of 1988, as amended	Compliant
21.11.2012 Currency Div.	Guidelines for detection of counterfeit currency notes (To be fully compliant by 01.04.2013)	Working towards being compliant by the deadline
29.11.2012 Bank Supervision Dept.	Classification of Banking Outlets	Gaps will be progressively narrowed down to achieve total compliance.
29.11.2012 Exchange Control Dept.	Issuance and renewal of Bank Guarantees	Compliant
21.12.2012 Bank Supervision Dept.	Banking Act Direction No.2 of 2012 - Outsourcing of Business Operations of a Licensed Commercial Bank and Licensed Specialised Bank	Compliant
31.12.2012 Exchange Control Dept.	Inward Remittances Distribution Account (IRDA)	Compliant
31.12.2012 Exchange Control Dept.	Non-resident Foreign Currency Accounts (NRFC)	Compliant
31.12.2012 Exchange Control Dept.	Resident Foreign Currency Account (RFC)	Compliant
31.12.2012 Exchange Control Dept.	Foreign Exchange Earners' Account (FEEA)	Compliant

Previous Regulations issued which are being followed up towards necessary compliance	
Guidelines on Mobile phone based payment system – Bank led mobile payment guideline and Custodian based mobile payment services	Dialog has agreed to effectively carryout Customer Due Diligence as per the procedures laid down by the Bank and will commence regulatory reporting by early 2013. The BCP of Dialog needs to be certified by their external auditors.
Banking Act Direction No.7 of 2011 - Integrated Risk Management Framework for Licensed Banks. (To be fully compliant by 05.04.2012)	Compliant
Banking Act Direction No.8 of 2011- Customer Charter for Licensed Banks. (To be fully compliant by 05.04.2012)	Significantly Compliant. (Requirement of dispatching periodic statements on lending products being implemented.)

Best Practices in Risk Management

Since formation of an independent Risk Management Division in 2003, the approach has been to embrace best practices in risk management with the Basel II accord acting as the main catalyst. Following a diagnostic review in 2007, a Basel II roadmap was developed for implementation to elevate the Bank's risk management to meet global best practices and standards.

The year 2012 has been an important milestone for HNB in managing risk. The Bank invested significantly in risk and capital management resources and systems, making clear progress in its Basel II road map. A reflection of some the key risk management initiatives for 2012 and objectives for 2013 are summarised below.

Key Initiatives in 2012

Go-Live of new Loan Origination and Rating System (eSPACE)	A Single Platform for Appraisal and Credit Evaluation (eSPACE) was implemented with the requisite Basel II infrastructure. The project was driven by a cross functional project team and steering committee with the assistance of an external project Manager. Approximately 600 regional, branch and credit managers were trained in usage of the system.
Identification and Measurement of Key Risk Indicators (KRIs) for Operational Risk	The Operational Risk Dashboard was enhanced with KRIs that serve as an early warning signal for potential process and people risk.
Implementation of an Asset and Liability Management (ALM) System	Implementation of an ALM system with a view to developing the necessary infrastructure to manage liquidity and interest rate risks more effectively.
Preparation for Basel Standardized/ Advanced Approaches in Operational Risk	Development of requisite operational risk infrastructure – revenue identification by segment, identifying and monitoring key operational risk indicators.

Priorities for the year ahead

Implementation of an Anti-Money Laundering (AML) System	Implementation of an AML system to better address financial crime and detect patterns of wrongdoing over time across accounts.
Formalization of Internal Capital Adequacy Assessment Process (ICAAP)	Development of the Bank's ICAAP to better address the risks covered under Pillar 2 of the Basel II framework.
Development of requisite Basel II infrastructure in new credit system	Implement Basel II Advanced IRB approaches for credit portfolio covering corporate, SME and retail pooling. Integration of risk based pricing for individual credit facilities.
Development of stress testing capabilities in ALM System	Focus on enhancing liquidity and interest rate risk monitoring capabilities for better management and allocation of capital.

Internal Capital Adequacy Assessment Process (ICAAP)

The recent global financial crisis highlighted the need for banks to strengthen their capital management and risk monitoring capabilities in order to deal more effectively with liquidity issues and complex financial instruments and products available in the market. While many causes for the crisis were identified, what became clear was that the capital of financial institutions was not sufficient to commensurate for the risks they had taken.

The aim of the Internal Capital Adequacy Assessment Process (ICAAP) under Basel II Pillar 2 is therefore to ensure that financial institutions have adequate risk management procedures, processes and sufficient capital to commensurate with their risk profiles, and moreover calls for a greater use of stress-testing by financial institutions to capture and understand the consequences of the current economic environment uncertainties. We believe that this process will add value to our Bank and provide security to our shareholders, capital providers and clients.

HNB has embarked on a journey with a commitment to undertake this analysis on an ongoing basis in order to strengthen its risk management framework and to develop a robust risk and capital management process. The ICAAP describes HNB's risk strategy, capital objectives and methodology used to measure the Bank's capital requirements and provides an insight into the Bank's risk identification, measurement and monitoring processes. A major challenge we face is to accurately identify and assess the significance of the additional risks defined under Pillar 2, to determine what constitutes a relevant risk, the independence of these risks from one another and the pricing of these risks in terms of capital requirements. While there have been developments for analysing and measuring risks quantified under Pillar I of the Basel II accord, the methods and models for assessing risks such as compliance risk, strategic/business risk or reputation risk

Risk Management

are scarce to non-existent. These risks therefore require a comprehensive and prudent examination to include experience, sound common sense, expert judgment and views rather than quantification in figures.

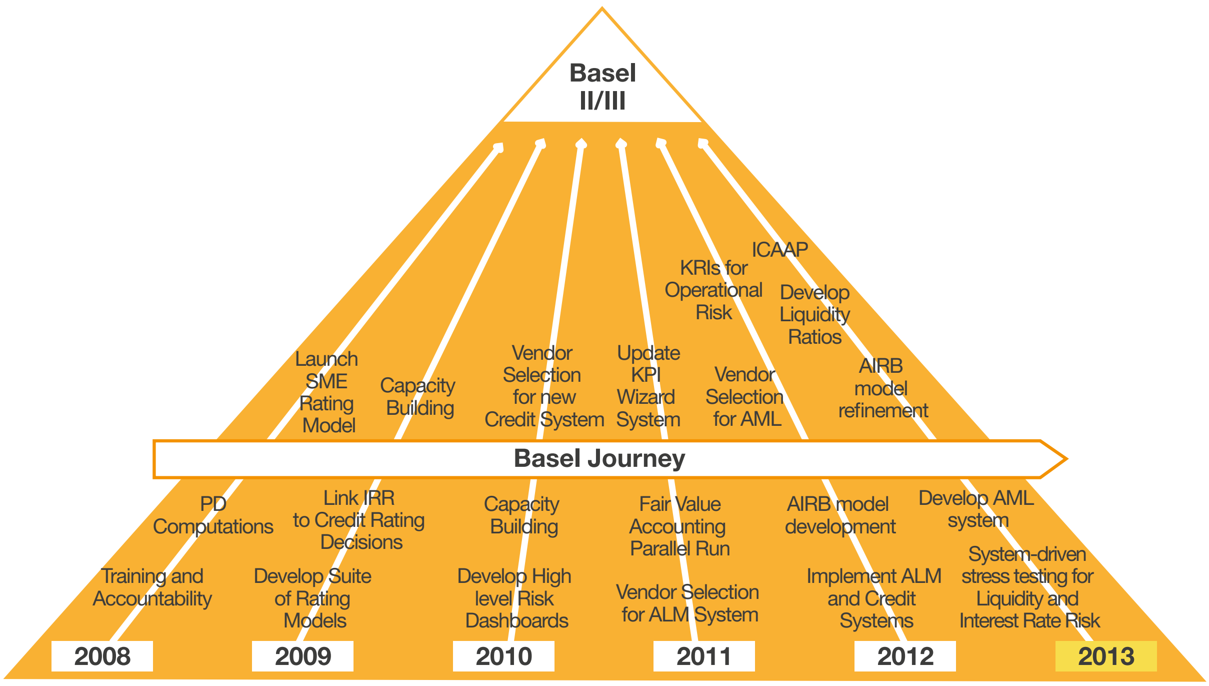
Basel III Liquidity Standards

The Basel III framework for liquidity risk measurement, standards and monitoring issued in December 2010 sets two minimum liquidity measures, the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR).The objective of the LCR is to ensure that financial institutions have sufficient high-quality liquid assets to withstand a stress scenario in short term funding i.e. funding over a 30 day period. Banks are required to maintain a stock of liquid assets to cover cumulative net cash outflows under prescribed scenarios. With the NSFR, the Basel Committee on Banking Supervision (BCBS) hopes to address liquidity mismatches and promote a stronger long term funding profile for banks. This extends the LCR standard to cover a one-year funding horizon. In order to assess its readiness, HNB undertook a trial implementation of the liquidity ratios defined under the Basel III framework and continues to monitor new developments under the Basel III framework.

Way Forward

HNB remains committed in its efforts to strengthen the risk management infrastructure necessary to pursue the growth plans envisaged for the future. As the risk function continues to evolve in the years to come, we believe banks will need to focus on balancing systems, processes, experience and sound business judgement without restricting their ability to identify and manage new forms of risk. We continue to revisit our policy framework and improve our risk dashboards – Credit, Operational, Market and Recovery as a means to communicate our risk appetite and to increase the efficiency of the risk management function across our entire network.

Our Road Map towards Basel II/ Basel III Compliance



KPI: Key Performance Indicator
IRR: Internal Risk Ratings
ICAAP: Internal Capital Adequacy Assessment Process
ALM: Asset & Liability Management
AML: Anti Money Laundering
AIRB: Advanced Internal Rating Based
PD: Probability of Default
SME: Small & Medium Customers
KRI: Key Risk Indicator

For more details on Risk Management please refer to the Financial Risk Management section on pages 234 to 245.

Your Board Room
Governance Report...

Chairperson's Statement

For our Bank, Corporate Governance is a priority, one that has become a way of life. Embedded into every aspect of our business processes. This holistic approach has created a conducive platform that propagates safeness and soundness, validating our move towards the creation of a trust based value proposition. Within this realm, we strive for honesty, transparency, stability and accountability through policies and practices at every level.

Our approach is one that considers the whole picture, to ensure that our strategic goals are aligned and that sound management is achieved through an integrated governance framework. This assists towards focusing on both the value-creating drivers that move the Bank's business forward and those that ensure adequate control. We attribute the successful infusion of conformance and performance measures to a conscious decision to take good governance seriously, recognizing it as an imperative measure as opposed to merely the requirements of formal codes of practice. Conformance and performance measures are not merely viewed as "policing" tools but an avenue for us as a corporate to work better and yield better.

Changes were made in our governance and risk structures in 2012, in a bid to enhance our perspective of risk, regulation and compliance.

Four new Non Executive Directors were invited to join the Board during the year in order to sustain the balance and composition of the Board and the subcommittees.

The report below demonstrates how the Bank has embraced and complied with the Corporate Governance regulations issued under the Banking Act Direction No 11 of 2007 and subsequent amendments thereto for Licensed Commercial Banks in Sri Lanka by the Central Bank of Sri Lanka, and 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 Code).

As required by the above Code, I hereby confirm that, I am not aware of any material violations of any of the provisions of the Code of Business Conduct and Ethics (as embodied in the Charter of the Board of Directors or the Code of Business Conduct and Ethics as the case may be) by any Director or Corporate Management member of Hatton National Bank PLC.

Whilst emphasizing the fact that for Corporate Governance structures to work effectively, active and prudent use of rights by the shareholders is imperative. I hope that this report will assist you to gain a better understanding on how Corporate Governance works at Hatton National Bank PLC.

Ranee Jayamaha
Chairperson

Colombo, Sri Lanka
21st February 2013

Corporate Governance Initiatives During 2012 at a Glance

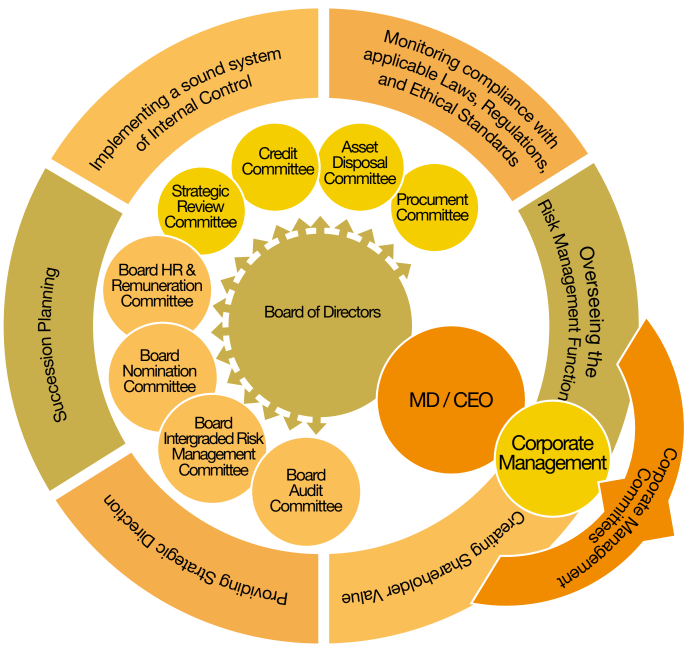
January	• Changes were made to the Corporate Management structure and reporting lines as part of the Bank's overall strategy on succession planning. • Supporting the Credit Approval process by scheduling regular monthly Board Credit Committee meetings. • Re composition of Board Sub committees to include newly appointed Directors and optimise contribution.
February	• Board Approval of the Terms of Reference of the Nomination and HR & Remuneration Committees.
May	• Further re composition of Board Sub - committees.
August	• As a best practice, a formal policy document for the engagement of the External Auditor to provide non audit services (which was recommended by the Board Audit Committee), was approved by the Board. • The Board of Directors resolved to adopt a new set of Articles which will be in line with the Companies Act No 7 of 2007.
November	• The Bank conducted an induction programme for the newly appointed Directors and in that process further indulged in an exercise to elucidate the members of the Board on the strategic direction and key areas of operations of the Bank. • Board approval was obtained for the Credit Committee Charter.
December	• Board approval was obtained for the policy on Share Trading by Bank's employees and Board members. • Presented the proposed "whistle blowing" policy for the Bank, to the Board sub committee on HR and Remuneration for consideration.

Your Board Room
Governance Report...

Corporate Governance Framework

Good Corporate Governance practices are not just a matter for the Board but are at the heart of everything that we do within the Bank.

The Bank operates within an integrated Governance framework formulated after taking into consideration the Corporate Governance regulation issued by the Central Bank and other Corporate Governance best practices , which is outlined in the diagram below and set out in the report that follows;



Corporate Governance

Corporate Governance is the system by which a Company is directed, controlled and managed. At Hatton National Bank, the Corporate Governance Framework guides our Bank and drives towards progress by way of developing and implementing appropriate corporate strategies. The approach to governance is predicated on the belief that there is a link between high-quality governance and the creation of long-term stakeholder value. In pursuing the Corporate Objectives, we have committed to the highest level of governance and strive to foster a culture that values and rewards exemplary ethical standards, personal and corporate integrity and mutual respect.

The Board of Directors, led by the Chairperson, is responsible for the governance of the Bank, and developing effective Governance Framework to meet challenges, both in the short and long term. The Board is committed to reviewing and improving our systems to provide transparency and accountability, and initiate transformational changes whenever necessary to ensure best practices are maintained and enhanced according to the principles of good Corporate Governance.

We continually review our systems and procedures to provide transparency and accountability, and update our Corporate Governance policies to keep in line with the stipulated guidelines.

HNB has incorporated in its Governance Framework the guidelines prescribed in the Banking Act Direction No 11 of 2007 (as amended) on Corporate Governance for Licensed Commercial Banks in Sri Lanka and 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 (the Code) .

The extent of compliance by HNB for the year ended 31st December 2012 with the above rules, directive principles and best practices are given in the following sections:

The Compliance with CSE listing rules on Corporate Governance, has not been disclosed as Listed Banks are exempted from complying with the said rules from the year 2010 onwards. This is because such requirement has been adequately covered in the Banking Act Direction No 11 of 2007 (as amended) on Corporate Governance for Licensed Commercial Banks in Sri Lanka.

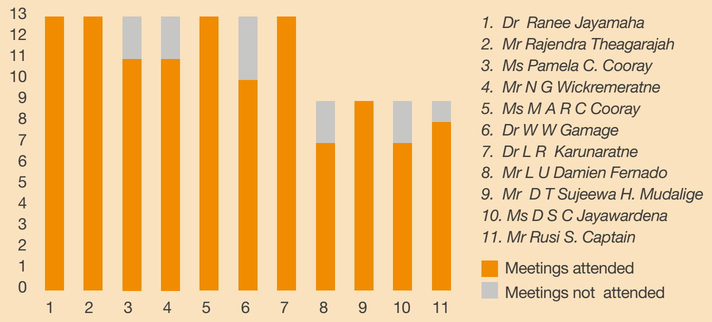
SECTION ONE

CODE OF BEST PRACTICE ON CORPORATE GOVERNANCE ISSUED BY THE SECURITIES AND EXCHANGE COMMISSION OF SRI LANKA (SEC) AND THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA (ICASL)

Statement of Compliance

The disclosures below reflect HNB's level of conformance with the above Code which comprises of six (6) fundamental principles. These are namely:
A. Directors
B. Directors' Remuneration
C. Relations with Shareholders
D. Accountability and Audit
E. Institutional Investors and
F. Other Investors

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

Corporate Governance Principles	SEC & ICASL Code Reference	Adoption Status	HNB's Extent of Compliance in 2012
A. DIRECTORS			
A.1. The Board			
The Bank should be headed by a Board, which should direct, lead and control the Bank			
All Directors with the exception of the MD / CEO serve the Bank in a Non Executive capacity. The Board consists of professionals in the fields of Banking, Accounting, Management, Law, Economics, Engineering, Marketing and Business. All Directors possess the skills and experience and knowledge complemented with a high sense of integrity and independent judgment. The Board gives leadership in setting the strategic direction and establishing a sound control framework for the successful functioning of the Bank. The Board's composition reflects sound balance of independence and anchors shareholder commitment.			
1. Board Meetings	A.1.1	Adopted	The Board usually meets on monthly intervals, but meets more frequently whenever it is necessary. The Board met thirteen (13) times during the year. Scheduled Board and Committee meetings were arranged well in advance, and all Directors were expected to attend each Board meeting. Any instance of non-attendance at Board meetings were generally related to prior business, personal commitments or illness. The attendance at Board meetings held in 2012 is set out on page 113. Attendance at Board meetings during 2012  *Note: Mr L U Damien Fernando, Mr D T Sujeewa H. Mudalige, Ms D S C Jayawardena and Rusi S. Captain were appointed to the Board w.e.f. 02nd April 2012.*

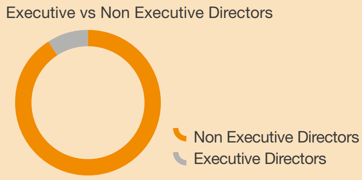
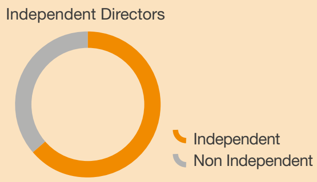
Your Board Room Governance Report...

Corporate Governance Principles	SEC & ICASL Code Reference	Adoption Status	HNB's Extent of Compliance in 2012
2. Board Responsibilities	A.1.2	Adopted	The Board Charter sets out the responsibility of the Board The Board is responsible to the shareholders for creating and delivering long term sustainable shareholder value through the oversight of business. The Board has provided strategic direction to the development of short, medium and long term strategy which is aimed at promoting the long term success of the Bank. The business strategy is reviewed at least on a quarterly basis by the Board with updates at each Board meeting on execution of the agreed strategy by the management. The Board has put in place a Corporate Management team led by the MD / CEO with the required skills, experience and knowledge necessary to implement the business strategy of the Bank. The names and the qualifications of the Corporate Management team are provided on pages 24 to 27. The Board has also implemented a structured approach towards succession planning of the Corporate Management team during the past couple of years. During the early part of 2012, changes were made to the Corporate Management structure and reporting lines as part of Banks' strategy on succession planning. The Board recognizes it's responsibility for the Bank's system of internal control and for reviewing its effectiveness on a continuous basis. These systems manage the risk of the Bank's business and ensure that the financial information on which business decisions are made and published is reliable. It also ensures that the Bank's assets are safeguarded against unauthorised use or disposition. The Board is satisfied with the integrity of financial information and the robustness of the financial controls and systems of risk management of the Bank.
3. Compliance with laws and access to independent professional advice	A.1.3	Adopted	The Board collectively as well the Directors individually, recognize their duty to comply with laws of the country which are applicable to the Bank. The Board of Directors ensures that procedures and processes are in place to ensure that the Bank complies with all applicable laws and regulations. A procedure has been put in place for Directors to seek independent professional advice, in furtherance of their duties, at the Bank's expense. This will be coordinated through the Board Secretary, as and when it is requested.
4. Board Secretary	A.1.4	Adopted	All Directors have access to the Board Secretary, who is an Attorney-at-Law by profession. Her services were available to all Directors, particularly the Non Executive Directors who needed additional support to ensure they receive timely and accurate information to fulfil their duties. Further, she had provided the Board with support and advice relating to corporate governance matters, Board procedures and applicable rules and regulations during the year.
5. Independent judgment	A. 1.5	Adopted	Non Executive Directors are responsible for bringing independent and objective judgment, and scrutinizing the recommendations/ proposals made by the Corporate Management led by the MD / CEO, on issues of strategy, performance, resources utilisation and business conduct. The Board promotes an environment whereby challenging contribution from the Non Executive Directors is welcomed and encouraged, combined with full support for and empowerment of the MD / CEO in implementing decisions.

Corporate Governance Principles	SEC & ICASL Code Reference	Adoption Status	HNB's Extent of Compliance in 2012
6. Dedication of adequate time and effort by the Board and Board Committees	A.1.6	Adopted	The Chairperson and members of the Board have dedicated adequate time for the fulfilment of their duties as Directors of the Bank. In addition to attending Board meetings, they have attended Sub-committee meetings and also have contributed to decision making via circular resolution where necessary. The Board Sub-committees include: - Audit Committee - Board Integrated Risk Management Committee - Human Resources & Remuneration Committee - Nomination Committee - Credit Committee - Procurement Committee - Asset Disposal Committee - Strategic Review Committee
7. Training for new Directors	A.1.7	Adopted	The Board of Directors recognises the need for continuous training and expansion of knowledge and undertakes such professional development as they consider necessary in assisting them to carry out their duties as Directors. During the year, presentations were made to the Board / Board Sub - committees by the Corporate Management of HNB from time to time on industry specific matters and regulatory updates. The new Directors have attended a number of meetings with the Corporate Management team to familiarise themselves with the Bank's strategy, risk appetite, operations and internal controls. The Directors have attended the "Directors' symposium" conducted by CBSL during the year. The Bank conducted an induction programme for the newly appointed Directors on the strategic direction and key areas of operations of the Bank in November 2012.
A.2. Chairperson and Chief Executive Officer			
There should be a clear division of responsibilities between the Chairperson and Chief Executive to ensure a balance of power and authority, in such a way that any individual has no unfettered powers of decisions. The roles of the Chairperson and Chief Executive Officer are segregated at HNB. The Chairperson's main responsibility is to lead, direct and manage 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.			
8. Division of responsibilities of the Chairperson and MD / CEO	A.2.1	Adopted	The roles of the Chairperson and Chief Executive are separate. The role of the Chief Executive is to manage the day-to-day running of the Bank. The Board has delegated this responsibility to the Chief Executive and he then leads the Corporate Management team in making and executing operational decisions. The Chief Executive is also responsible for recommending strategy to the Board.
A.3. Chairperson's Role			
The Chairperson should lead and manage the Board, ensuring that it discharges its legal and regulatory responsibilities effectively and fully and preserves order and facilitates the effective discharge of the Board function. The profile of the Chairperson is given on page 22.			
9. Role of the Chairperson	A.3.1	Adopted	The Chairperson is responsible for leadership of the Board and ensuring effectiveness in all aspects of its role. The Chairperson of HNB is a Non Executive Director, elected by the Board. The Chairperson's role encompasses: - Ensuring that the new Board members are given appropriate induction, covering terms of appointment, duties and responsibilities. - Leading the Board and managing the business of the Board while taking full account of the issues and concerns of the Board. - Approving the agenda for each meeting prepared by the Board Secretary. - Ensuring that the Board members receive accurate, timely and clear information, in particular about the Bank's performance to enable the Board to take sound decisions, monitor efficiently and provide advice to promote success of the Bank.

Your Board Room Governance Report...

Corporate Governance Principles	SEC & ICASL Code Reference	Adoption Status	HNB's Extent of Compliance in 2012
			- Ensuring regular meetings, the minutes of which are accurately recorded and where appropriate include the individual and collective views of the Directors. - Facilitates and encourages discussions amongst all Directors where decisions are needed on matters of risk and strategy. - Encouraging effective participation of all Directors in the decision making process to optimise contribution. - Representing the views of the Board to the public. - Initiates the process for self assessment of the Board from its members and uses the meaningful feedback to further improve the effectiveness of the Board.
A.4. Financial Acumen			
The Board should ensure the availability within it of those with sufficient financial acumen and knowledge to offer guidance on matters of finance. The Board is equipped with members having sufficient financial acumen and knowledge.			
10. Availability of sufficient financial acumen and knowledge	A.4	Adopted	The Chairperson has more than 40 years of experience as a banking sector policy maker / regulator (at the Central Bank of Sri Lanka), during which she has acquired hands on experience of implementing monetary policy and financial systems stability initiatives at national level. The MD / CEO is a Fellow member of the Institute of Chartered Accountants of Sri Lanka and the Chartered Institute of Management Accountants – UK. He functions as the Vice Chairman of the Chartered Institute of Management Accountants (U.K) Governing Board- Sri Lanka and also serves as a member of the Sri Lanka Accounting & Auditing Standards Monitoring Board. Mr D T Sujeewa H. Mudalige is a fellow member of the Institute of Chartered Accountants of Sri Lanka, the Chartered Institute of Management Accountants – UK and the Chartered Institute of Securities and Investments -UK. He is the immediate past president of the Institute of Chartered Accountants of Sri Lanka and currently serves as the Vice President of the Confederation of Asia and Pacific Accountants. Mr Mudalige is also a member of the Sri Lanka Accounting & Auditing Standards Monitoring Board. Mr L U Damien Fernando is also a Fellow member of the Chartered Institute of Management Accountants - UK. The other Directors with the business acumen gained from leading large private and public enterprises coupled with their academic background also possess financial acumen and knowledge. The details of their qualifications and experience have been set out on pages 18 to 23.

Corporate Governance Principles	SEC & ICASL Code Reference	Adoption Status	HNB's Extent of Compliance in 2012
A.5. Board Balance			
There should be balance of Executive and Non Executive Directors so that no individual or small group of individuals can dominate the Board's decision-taking. All Directors are Non Executive Directors except for the MD / CEO. Each of them bring to the Board, wide experience and the ability to exercise independence and judgment when taking informed decisions.			
11. Presence of Non Executive Directors	A.5.1	Adopted	All Directors are Non Executive Directors except for the MD / CEO. Executive Vs Non Executive Directors The requirement as per the Code has been complied with throughout 2012.
			
12. Independent Directors	A.5.2	Adopted	Seven (7) Non Executive Directors are independent as defined by the Code.  The requirement as per the Code has been complied with throughout 2012.
13. Criteria to evaluate Independence of Non Executive Directors	A.5.3	Adopted	Please refer Section A.5.5 below. The Board considers Non Executive Director's independence on an annual basis, as part of each Director's performance evaluation. The Board reviewed the independence of each Non Executive Director in 2012 and concluded that each of them continues to demonstrate these essential behaviours.
14. Signed declaration of independence by the Non Executive Directors	A.5.4	Adopted	All Non Executive Directors of the Bank have made written submissions as to their independence against the specified criteria set out by the Bank, which is in line with the requirements of Schedule H of the Code.
15. Determination of independence of the Directors by the Board	A.5.5	Adopted	The Board has determined that the submission of declaration/s by the Non Executive Directors, as to their independence, as fair representation and will continue to evaluate their submission annually. Circumstances have not arisen for the determination of independence by the Board, beyond the criteria set out in the Code. The following Directors are deemed to be Independent Directors; Ms Pamela C. Cooray Mr N G Wickremeratne Ms M A R C Cooray Dr W W Gamage Dr L R Karunaratne Mr L U Damien Fernando Mr D T Sujeewa H. Mudalige
16. Senior independent Director	A.5.6	N/A	Although the requirement to appoint a Senior Independent Director does not arise under this Code, the Bank designated Ms Pamela C. Cooray as the Senior Independent Director in 2010, to meet the requirement under Rule 3(5) (ii) of the CBSL Direction on Corporate Governance.

Your Board Room Governance Report...

Corporate Governance Principles	SEC & ICASL Code Reference	Adoption Status	HNB's Extent of Compliance in 2012
17. Confidential discussion with the Senior Independent Director	A.5.7	N/A	Please refer above comment.
18. Meeting of Non Executive Directors	A.5.8	Adopted	Chairperson meets with the Non Executive Directors without the presence of MD / CEO, on a need basis. The Board has met two (02) times without the presence of the CEO during 2012.
19. Recording of concerns in Board Minutes	A.5.9	N/A	There were no concerns raised by the Directors during the year, which needed to be recorded in the Board meeting minutes.
A.6. Supply of Information			
Management should 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 to the Board to make informed and accurate decisions.			
20. Information to the Board by the Management	A.6.1	Adopted	The Board was provided with timely and appropriate information by the management by way of Board papers and proposals. The Board sought additional information as and when necessary. Members of the Corporate and Senior Management team made presentations to Directors on important issues relating to strategy, risk management, recoveries endeavours and audit. The Chairperson ensured that all Directors were briefed on issues arising at Board meetings. The Directors have free and open contact with the Corporate and Senior Management of the Bank.
21. Adequate time for effective Board meetings	A.6.2	Adopted	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 respective meetings.
A.7. Appointments to the Board			
A formal and transparent procedure should be followed for the appointment of new Directors to the Board.			
The Nomination Committee assesses the suitability of the prospective nominees to the Board and recommends persons found to be "fit and proper" for consideration of the entire Board. Upon completion of this process, names are referred to the Director of the Bank Supervision Department of the Central Bank of Sri Lanka for approval as a "fit and proper" person, prior to the appointment. The following Non Executive Directors were appointed to the Board during the year: Mr L U Damien Fernando Mr D T Sujeewa H. Mudalige Ms D S C Jayawardena Mr Rusi S. Captain The profiles of the above Directors are given on pages 22 and 23.			
22. Nomination Committee	A.7.1	Adopted	The Nomination Committee made recommendations to the Board on all new appointments. The Terms of Reference for the members of the Nomination Committee are similar to the one set out in Schedule A to the Code. The Terms of Reference of the Committee was formally approved by the Board in 2012. The following Directors served on the Nomination Committee during 2012. MD / CEO attends these meetings by invitation. Dr W W Gamage Dr Ranee Jayamaha Ms M A R C Cooray (appointed w.e.f. 1st January 2012) Dr L R Karunaratne (appointed w.e.f. 1st January 2012) Dr W W Gamage serves as the Chairman of the above Committee.

Corporate Governance Principles	SEC & ICASL Code Reference	Adoption Status	HNB's Extent of Compliance in 2012
23. Assessment of Board Composition by the Nomination Committee	A.7.2	Adopted	The Nomination Committee carries out continuous review of the structure, size and composition (including the skills, knowledge, experience and independence required of Directors) of the Board to address and challenge adequately key risks and decisions that confront, or may confront, the Board and makes recommendations to the Board with regard to any changes. New appointments were made in 2012 to strengthen the Board composition and to respond to the challenges and take advantage of the opportunities in the Banking sector. Currently, more than 60% of Board members are Independent Non Executive Directors.
24. Disclosure of details of new Directors to shareholders	A.7.3	Adopted	Details of new Directors are disclosed to the shareholders at the time of their appointment by way of public announcements as well as in the Annual Report. Prior approval for appointment of new Directors is obtained from the Director of Bank Supervision of CBSL and notification is sent to 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 changes in their professional responsibilities and business associations to the Nomination Committee, which will examine the facts and circumstances and make recommendations to the Board.
A.8. Re - election			
All Directors should submit themselves for re-election at regular intervals and at least once in every three years, and all Non Executive Directors should be appointed for a specific term and subject to re-election.			
25. Appointment of Non Executive Directors	A.8.1	Adopted	Articles of Association of the Bank require each Director other than the MD / CEO and any nominee Director, to retire by rotation once in every three years and they are 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. Dr Ranee Jayamaha, Dr W W Gamage and Dr L R Karunaratne will retire by rotation at the AGM under the Articles of Association of the Bank. Dr Ranee Jayamaha, Dr W W Gamage and Dr L R Karunaratne have offered themselves for re-election, with the unanimous support of the Board. Mr L U Damien Fernando and Ms D S C Jayawardena were appointed during the year to fill in casual vacancies which arose in 2011 due to resignation of Mr R K Obeyesekere and Mr D H S Jayawardena (ceased to be a Director). All Directors appointed to fill casual vacancies during the year will be subject to election by shareholders at the 2013 Annual General Meeting. The following Directors also joined the Board during 2012: Mr D T Sujeewa H. Mudalige Mr Rusi S. Captain
26. Election of Directors by the shareholders	A.8.2	Adopted	Please refer to comments above.
A.9. Appraisal of Board Performance			
The Board should periodically appraise its own performance against the pre set targets in order to ensure that the Board responsibilities are satisfactorily discharged.			
27. Appraisal of Board performance	A.9.1	Adopted	Each member of the Board carried out a self assessment of his / her own effectiveness as an individual as well as effectiveness of the Board as a team for the year 2012. The outcome of the assessment were tabled at a meeting of the Board in January 2013. The Sub committees, except for the Audit Committee, carries out a self assessment process annually, in accordance with the pre-set criteria, to ensure they function effectively and efficiently with the objective of facilitating continuous improvement individually and collectively in the performance of the Board. The Audit Committee evaluation was conducted by the Non Executive Chairperson, with individual assessments from the members of the Audit Committee, MD/CEO, Deputy CEO, CFO, Head of Internal Audit and the External Auditor, in accordance with international best practices.

Your Board Room Governance Report...

Corporate Governance Principles	SEC & ICASL Code Reference	Adoption Status	HNB's Extent of Compliance in 2012
28. Annual self evaluation of the Board and its Committees	A.9.2	Adopted	Refer to comments given for Section A.9.1
29. Disclosure of the method of Appraisal of Board and Board Sub Committee performance	A.9.3	Adopted	Refer to comments given for Section A.9.1
A.10. Disclosure of Information in respect of Directors			
Details in respect of each Director should be disclosed in the Annual Report for the benefit of the shareholders.			
30. Details in respect of Directors	A.10.1	Adopted	Details of the Directors are given on pages 18 to 23. Directors' attendance at the Board and Board Sub Committee meetings are given on page 113.
A.11. Appraisal of the CEO			
The Board of Director should at least annually assess the performance of the Chief Executive Officer.			
31. Targets for MD / CEO	A.11.1	Adopted	MD / CEO's performance objectives are aligned with business sustainability of the Bank. The performance targets for the MD / CEO are set at the commencement of every year by the full Board which are in line with the short, medium and long term objectives of the Bank.
32. Evaluation of the performance of the MD / CEO	A.11.2	Adopted	There is an ongoing process to evaluate the performance of MD / CEO against the financial and non financial targets set as described above, which is followed by a formal annual review by the Board at the end of each financial year.
B. DIRECTORS' REMUNERATION			
B.1. Remuneration Procedures			
The Bank should have a formal and transparent procedure for developing policy on executive remuneration and fixing the remuneration packages of individual Directors. No Director should be involved in deciding his / her remuneration in order to avoid the self review threat.			
33. HR & Remuneration Committee	B.1.1	Adopted	The HR & Remuneration Committee is responsible for assisting the Board with regard to the remuneration policy for the Executive Director and the Corporate Management. The Committee determines and agrees with the Board, the broad policy framework for the remuneration of the MD / CEO. The MD / CEO participates at meetings when deciding the remuneration of the Corporate Management in order to recruit, retain and motivate the Corporate Management team.
34. Composition of the HR & Remuneration Committee	B.1.2 B.1.3	Adopted Adopted	The following Non Executive Directors served on the HR & Remuneration Committee during 2012. Ms Pamela C. Cooray Dr Ranee Jayamaha Mr N G Wickremeratne Dr W W Gamage Ms M A R C Cooray (appointed w.e.f. 1st January 2012 for the period upto 01st May 2012) Ms Pamela C. Cooray serves as the Chairperson of the above Committee. The Terms of Reference of the Committee was formally approved by the Board in February 2012.

Corporate Governance Principles	SEC & ICASL Code Reference	Adoption Status	HNB's Extent of Compliance in 2012
35. Remuneration of the Non Executive Directors	B.1.4	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 being a member of a Committee. They do not receive any performance related / incentive payments.
36. Consultation of the Chairperson and access to professional advice	B.1.5	Adopted	Input of the Chairperson is obtained by her involvement as a member of the said Sub - committee. External professional advice is sought by the HR & Remuneration Committee, on a need basis through the Board Secretary.
B.2. Level and make up of Remuneration			
The level of remuneration of both Executive and Non Executive Directors should be sufficient to attract and retain the Directors needed to run the Bank successfully. A Proportion of Executive Directors remuneration should be structured to link rewards to the corporate and individual performance.			
37. Level and make up of the remuneration of MD / CEO	B.2.1	Adopted	The Board is mindful of the fact that the remuneration of Executive and the Non Executive Directors should reflect the market expectations and is sufficient enough to attract and retain the quality of Directors needed to run the Bank. The remuneration package of the MD / CEO is structured to link rewards to corporate and individual performance. The Bank's remuneration framework for the CEO is designed to create and enhance value for all HNB's stakeholders and to ensure there is strong alignment between the short term and long term interest of the Bank.
38. Comparison of remuneration with other companies	B.2.2	Adopted	The HR & 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 entailed in his job.
39. Comparison of remuneration with other companies in the Group	B.2.3	N/A	The size and scale of the Bank is not comparable with any other Group companies.
40. Performance related payment to MD / CEO	B.2.4	Adopted	Please refer to Section B.2.1 on page 97.
41. Executive share options	B.2.5	Adopted	Share options have been offered to the Executive Director as part of the scheme offered to Senior and Corporate Management which was approved by the shareholders of the Bank. The details of which are given in note No 52 (b) (i) of the Financial Statements on page 296.
42. Deciding the Executive Directors remuneration	B.2.6	Adopted	In deciding the remuneration of the MD / CEO the Bank takes note of the provisions set out in Schedule D.
43. Early termination of Directors	B.2.7	N/A	Not applicable to the Board except for the MD / CEO who is an employee of the Bank and his terms of employment is governed by the contract of service.
44. Early termination not included in the initial contract	B.2.8	N/A	Refer to comments above.
45. Remuneration of the Non Executive Directors	B.2.9	Adopted	Non Executive Directors receive a nominal fee in line with the market practices. Non Executive Directors do not participate in the current share option plans of the Bank and / or other performance related incentive schemes.
B.3. Disclosure of Remuneration			
The Bank should disclose the remuneration policy and the details of remuneration of the Board as a whole.			
46. Disclosure of remuneration	B.3.1	Adopted	Please refer to Section B.1.2 on page 96 for the details on the composition of the HR & Remunerations Committee. The Committee's report setting out the policy of the Committee is given on pages 198 and 199. The remuneration paid to the Board of Directors is disclosed in aggregate in note No 15 to the Financial Statements on page 248.

Your Board Room Governance Report...

Corporate Governance Principles	SEC & ICASL Code Reference	Adoption Status	HNB's Extent of Compliance in 2012
C. RELATIONS WITH SHAREHOLDERS			
C.1. Constructive use of the Annual General Meeting and Conduct of General Meetings			
The Board should use the Annual General Meetings to communicate with shareholders and encourage their active participation.			
47. Use of proxy votes	C.1.1	Adopted	The Bank has a mechanism to record all proxy votes and proxy votes lodged for each resolution prior to the General meeting.
48. Separate resolution for all separate issues	C.1.2	Adopted	The Board, remains mindful of being accountable to the shareholders and the need for transparency at all levels, striving to maintain it's value framework in all shareholder dealings and communications. HNB proposes a separate resolution for each item of business, giving shareholders the opportunity to vote on each such issue, separately.
49. Availability of all Board Sub Committee Chairmen at the AGM	C.1.3	Adopted	The Board, which includes the Chairpersons of the Audit, HR & Remuneration, and Board Integrated Risk Management Committees, was present at the AGM to answer any questions. The Chairman of the Nominations Committee was not present at the 2011 AGM held in March 2012 due to a prior personal commitment, however all other members of the Nomination was present at the AGM, to answer any questions raised by the shareholders in relation to the Nomination Committee.
50. Adequate notice of the AGM	C. 1.4	Adopted	The primary modes of communication between HNB and the shareholders are the Annual Report and AGM. Information is provided to the shareholders prior to the AGM to give them an opportunity to exercise the prerogative to raise any issues relating to the business of HNB, either verbally or in writing prior to the AGM. 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 15 working days prior to the date of the AGM.
51. Procedures of voting at General Meetings	C.1.5	Adopted	Voting procedures at General Meetings are circulated to the shareholders.
C.2. Major transactions			
Directors should disclose to shareholders all proposed material transactions which would materially alter the net asset position of the Bank, if entered into.			
52. Major transactions	C.2.1	Adopted	During 2012 there were no major transactions as defined by Section 185 of the Companies Act No 07 of 2007 which materially affected HNB's net asset base. Transactions, if any, which materially affect the net assets base of HNB, will be disclosed in the quarterly / annual financial statements.
D. ACCOUNTABILITY AND AUDIT			
D.1. Financial Reporting			
The Board should present a balanced and understandable assessment of the company's financial position, performance and prospects.			
53. Statutory and Regulatory reporting	D.1.1	Adopted	HNB has reported a true and fair view of its financial position and performance for the year ended 31st December 2012 and at the end of each quarter of 2012.

Corporate Governance Principles	SEC & ICASL Code Reference	Adoption Status	HNB's Extent of Compliance in 2012
			In the preparation of quarterly and annual financial statements, HNB had complied with the requirements of the Companies Act No 07 of 2007, the Banking Act No 30 of 1988 and amendments thereto, and are prepared and presented in conformity with Sri Lanka Accounting Standards. HNB has complied with the reporting requirements prescribed by the regulatory authorities such as the Central Bank of Sri Lanka, the Colombo Stock Exchange and the Securities and Exchange Commission.
54. Directors' report in the Annual Report	D.1.2	Adopted	The "Annual Report of the Board of Directors on the Affairs of the Company" which is given on pages 186 to 194 covers all areas of this Section.
55. Statement of Directors' and Auditor's responsibility for the Financial Statements	D.1.3	Adopted	The statement of "Directors' Responsibility for Financial Reporting" is given on page 204. Auditor's reporting responsibility is given in their report on the Financial Statements on page 205.
56. Management Discussions and Analysis	D.1.4	Adopted	The Management Discussion and Analysis is given on pages 30 to 55.
57. Declaration by the Board that the business as a going Concern	D.1.5	Adopted	This is given in the "Annual Report of the Board of Directors on the Affairs of the Company" on pages 186 to 194.
58. 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.
D.2. Internal Control			
The Board should have a sound system of internal controls to safeguard shareholders' investments and the Bank's assets.			
59. Annual evaluation of the internal controls system	D.2.1	Adopted	The Board is responsible for establishing a sound framework of internal controls and monitoring its effectiveness on a continuous basis. Through such an effective framework, HNB manages business risks and ensures that the financial information on which business decisions are made and published is reliable, and also ensures that the Bank's assets are safeguarded against unauthorised use or disposition. The Internal Audit Division of the Bank carries out regular reviews on the internal control system including internal control over financial reporting. The Audit Committee monitors, reviews and evaluates the effectiveness of internal control system including the internal controls over financial reporting. In the year 2012, the Board of Directors was satisfied with the effectiveness of the system of internal controls of the Bank. The report by the Board of Directors on the Internal Control over Financial Reporting is given on pages 114 and 115. The External Auditors of the Bank have independently reviewed the report of the Directors referred to above and have issued a report which is given on page 116.
60. Need for internal audit function	D.2.2	N/A	The Bank's internal audit function is managed by capacity which has been developed in house.

Your Board Room Governance Report...

Corporate Governance Principles	SEC & ICASL Code Reference	Adoption Status	HNB's Extent of Compliance in 2012
D.3. Audit Committee			
The Board should have a formal and transparent arrangements in selecting and applying the accounting policies, financial reporting and internal control principles and maintaining an appropriate relationship with the Bank's External Auditor.			
61. Composition of the Audit Committee	D.3.1	Adopted	The following Directors served on the Audit Committee during 2012. Mr D T Sujeewa H. Mudalige (appointed w.e.f. 01st May 2012) Mr N G Wickremeratne Ms Pamela C. Cooray Ms M A R C Cooray Mr N G Wickremeratne was the Chairman of the Audit Committee up to 01st May 2012. Mr D T Sujeewa H. Mudalige was appointed as the chairman of the committee w.e.f. 01st May 2012 in order to comply with Governance Regulations. The Committee had co-opted Mr H M A Jayasinghe, Partner - Messrs Ernst & Young Sri Lanka, as a consultant up to 20th June 2012 The said Committee met ten (10) times during the year. The Board Secretary functions as the Secretary to the Audit Committee. The Chairperson, CEO, Deputy CEO, SDGM - Strategy & Compliance, DGM - Risk & Credit Quality, Head of Internal Audit, CFO and External Auditor attend meetings on invitation.
62. Review of Objectivity of the External Auditor	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 sets out the policy for the engagement of the External Auditor to provide non-audit services, taking into account : (a) 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". (b) The External Auditor's skills and experience for providing the particular non-audit service. (c) The Nature of non-audit services, the related fee levels individually and in aggregate relative to the audit firm. A formal policy document for the engagement of the external auditor to provide non audit services was approved by the Board in August 2012. The Audit Committee has the primary responsibility for making recommendations on the appointment, re-appointment or removal of the External Auditor in-line with professional standards and regulatory requirements.
63. Terms of reference of the Audit Committee	D.3.3	Adopted	The Audit Committee is guided by the Committee Charter which sets out authority and responsibility of the said Committee. The Charter was last reviewed in 2010. The Board also considered the Code of Best Practice on Audit Committees of the ICASL in defining the terms of reference for the Audit Committee. Duties of the committee encompasses: - Assisting the Board in the preparation and presentation of Financial Statements - Bank's compliance with applicable regulations

Corporate Governance Principles	SEC & ICASL Code Reference	Adoption Status	HNB's Extent of Compliance in 2012
			- Assess the processes to ensure internal controls are adequate, specially in relation to financial reporting - Assess the Bank's ability to continue as a going concern 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 Audit Committee is authorized to obtain external professional advice and to invite outsiders with relevant experience to attend if necessary. The Committee also has full access to information in order to investigate into matters relating to any matter within its terms of reference.
64. Disclosures of the Audit Committee	D.3.4	Adopted	The names of the members of the Audit Committee are given in the Audit Committee Report on pages 201 and 202. The Committee ensures that the rotation of External Audit Engagement Partner, once in every 5 years, is met. The External Auditor, has provided an Independence confirmation in compliance with the "Guidelines for Appointment of Auditors of Listed Companies" issued by SEC. In order to safeguard the objectivity and independence of the External Auditor, the Audit Committee reviewed the nature and scope taking account of the regulations guidelines stated in Section D.3.2 on page 100.
D.4. Code of Business Conduct and Ethics			
The Bank should develop a Code of Business Conduct and Ethics for Directors and members of the Senior Management team.			
65. Code of Business Conduct and Ethics	D.4.1	Adopted	The Bank has developed a Code of Business Conduct and Ethics for all employees, which addresses conflict of interest, corporate opportunities, confidentiality of information, fair dealing, protecting and proper use of the Bank's assets, compliance with applicable laws and regulations and encouraging the reporting of any illegal or unethical behaviour etc. The code of business conduct and ethics for Directors is embodied in the Board Charter. The Board is not aware of any material violations of any of the provisions of the Code of business conduct and ethics by any Director or Corporate Management member of the Bank.
66. Affirmation by the Chairperson that there is no violation of the code of conduct & ethics	D.4.2	Adopted	Please refer to Chairperson's statement on page 87 for details.
D.5. Corporate Governance Disclosures			
The Bank should disclose the extent of adoption of best practice in Corporate Governance.			
67. Disclosure of Corporate Governance	D.5.1	Adopted	This requirement is met through the presentation of this report.

Your Board Room Governance Report...

Corporate Governance Principles	SEC & ICASL Code Reference	Adoption Status	HNB's Extent of Compliance in 2012
E. INSTITUTIONAL INVESTORS			
E.1. Shareholders voting			
Institutional shareholders are required to make considered use of their votes and encouraged to ensure their voting intentions are translated into practice.			
68. Institutional shareholders	E.1.1	Adopted	Annual General Meeting is used to have an effective dialogue with the shareholders on matters which are relevant and concern to the general membership. The Investor Relations team headed by the MD / CEO has regular discussions with key institutional shareholders to share highlights of the Bank's performance and also with the view to obtaining constructive feedback. The feedback obtained from institutional shareholders are communicated to the entire Board by the MD / CEO.
E.2. Evaluation of Corporate Governance initiatives			
Institutional investors are encouraged to give due weight to all relevant factors in Board structure and composition.			
F. OTHER INVESTORS			
F.1. Investing / Divesting decision			
69. Individual Shareholders	F.1	Adopted	Individual shareholders are encouraged to carry out adequate analysis or seek independent advice on their investing, holding or divesting decisions.
F.2. Shareholder Voting			
70. Individual shareholders voting	F.2	Adopted	Individual shareholders are encouraged to participate at Annual General Meetings and exercise their voting rights.

SECTION TWO

Statement of Compliance

Central Bank of Sri Lanka issued the Direction on Corporate Governance (Banking Act Direction No 11 of 2007 and subsequent amendments thereto), in order to improve and sustain the Corporate Governance processes and practices of the Licensed Commercial Banks in Sri Lanka. The disclosures below reflect HNB's level of conformance to the above Direction which comprises of eight (8) fundamental principles, namely:

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

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

Corporate Governance Principles	CBSL Rule Reference	Compliance Status	Level of Compliance in 2012
3 (1) The Responsibilities of the Board			
1. Strengthening the safety and soundness of the Bank	Rule 3 (1) (i)	Compliant	The Board Charter sets out the responsibility of the Board. The Board is responsible for formulating strategy, ensuring the adequacy of the risk management processes, review of the internal control system and defining the responsibility of the Corporate Management. Please refer Section A.1.2 of the SEC & ICASL Code table on page 90 for further details. The Board has strengthened the safety and soundness of the Bank through the implementation of the following : **(a) Strategic Objectives and Corporate Values** The Bank's strategic objectives and corporate values which are derived from our vision and mission statement have been communicated to all staff members throughout the Bank. Further, as explained in Section D.4.1. of the SEC & ICASL Code table on page 101, the Bank has developed a Code of Business Conduct and Ethics for all employees, which is in line with our strategic objectives and corporate values. This Code was communicated to all staff members throughout the Bank. **(b) Overall Business Strategy** The Board has provided direction in the development of short, medium and long term strategy of the Bank with the objective of promoting sustainability and profitable growth of the Bank. The strategic plan covering the period 2012-14 was approved in 2011. The business strategy is reviewed usually on a quarterly basis by the Board with updates at Board meetings on execution of the agreed strategy. The Board approves and monitors the annual budget which is derived from Bank's strategic plan. Further, the overall risk management policy, procedures and mechanisms with time bound implementation milestones was approved and monitored by the Board Integrated Risk Management Committee on a regular basis.

Your Board Room
Governance Report...

Corporate Governance Principles	CBSL Rule Reference	Compliance Status	Level of Compliance in 2012
			(c) Risk Management The Board takes responsibility for the overall risk framework of the Bank. The Board Integrated Risk Management Committee ensures that the risks taken in Credit, Operational, Market, Strategic and other areas are within the approved risk appetite set out by the Board. **(d) Communication with Stakeholders** The Board is responsible for ensuring timely and effective communication with shareholders and other stakeholders. The Bank substantially implemented the provisions of Banking Act Direction No 8 of 2011 "Customer Charter of Licensed Banks" which became effective in 2012. This Charter sets key standards of fair banking practices envisaged by customers when they undertake transactions with the Bank and provides guidelines to adopt a "Code of Conduct" on customer protection. The Charter also includes a set of customer obligations towards the Bank in the interest of stable relationship. Please refer Section E.1.1 of the SEC & ICASL Code table on page 102 for further details. **(e) Bank's Internal Control System and Management Information System** Please refer Section D.2.1 of the SEC & ICASL Code table on page 99. **(f) Key Management Personnel (KMP)** According to Sri Lanka Financial Reporting Standard (LKAS 24) "Related Party Disclosures", Key Management Personnel are those having authority and responsibility for planning, directing and controlling the activities of the entity. The Bank considered the members of its Corporate Management Team, Chief Accountant and Chief Manager-Operations as KMP as per LKAS 24 with effect from 01st January 2012 since they have the authority and responsibility for planning, directing and controlling the activities of the Bank. Accordingly, the Directors of the Bank (including executive and non-executive Directors), members of the corporate management, Chief Accountant, Chief Manager- Operations and their immediate family members have been classified as KMP of the Bank as at 31st December 2012. 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. **(g)** Authority and Responsibility of Key Management Personnel Duties and responsibilities of the Board of Directors are included in the Board Charter. The Duties and responsibilities of Bank's Corporate Management is formally documented through the Corporate Management Charter and their respective job descriptions.

Corporate Governance Principles	CBSL Rule Reference	Compliance Status	Level of Compliance in 2012
			(h) Oversight of the affairs of the Bank by Key Management Personnel The Board of Directors formulates policies and exercises oversight of the affairs of the Bank through the MD / CEO. **(i) Board's own Governance Practices** The effectiveness of the Board's own governance practices, including the process for selection, nomination and election of Directors (which is explained in detail in Section A.7.1 and A.7.2 of the SEC & ICASL Code table on pages 94 and 95 respectively) and the process for management of conflict of interest (which is explained in detail under Rule 3 (1) (xii)) are reviewed by Board on a periodic basis. Further, the review of the effectiveness of the Board's own Governance practices are embodied in the Board and Sub Committee self-assessment process which is explained in detail under Rule 3 (1) (xvii) and Section A.9.1 of the SEC and ICASL Code table on page 95. **(j) Succession Plan for Corporate Management Personnel** Please refer Section A.1.2 of the SEC & ICASL Code table on page 90 for details on succession planning for Corporate Management Personnel. **(k) Regular Meetings with Corporate Management Personnel** As explained in Section A.6.1 of the SEC & ICASL Code table on page 94, the Directors have free and open contact with the Corporate and Senior management of the Bank. Further Non Executive Directors have the option to attend important management meetings at the invitation of MD / CEO. **(l) Regulatory Environment** Please refer Section A.1.3 of the SEC & ICASL Code table on page 90 for details. **(m) Review of Objectivity of the External Auditor** Please refer Section D.3.2 of the SEC & ICASL Code table on page 100. A formal policy document for the engagement of the external auditor to provide non audit services was approved by the Board in August 2012.
2. Chairperson and CEO	Rule 3 (1) (ii)	Compliant	The Board has appointed the Chairperson and the Chief Executive. The roles of the Chairperson and the Chief Executive are separate. Please refer Section A.2 and A.3 of the SEC & ICASL Code table on page 91 for details.
3. Board Meetings	Rule 3 (1) (iii)	Compliant	Please refer Section A.1.1 of the SEC & ICASL Code table on page 89.
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 where relevant in the agenda for regular meetings.
5. Notice of Meetings	Rule 3 (1) (v)	Compliant	Directors are given adequate time and usually at least 7 days of notice is given for regular Board meetings. For all other meetings a reasonable notice period is given.
6. Non attendance of Directors	Rule 3 (1) (vi)	Compliant	All Directors have attended at least two thirds (2/3) of the meetings held during 2012. Further no Director has been absent from three consecutive regular Board meetings during 2012.
7. Board Secretary	Rule 3 (1) (vii) Rule 3 (1) (viii)	Compliant	Please refer Section A.1.4 of the SEC & ICASL Code table on page 90 for details.

Your Board Room
Governance Report...

Corporate Governance Principles	CBSL Rule Reference	Compliance Status	Level of Compliance in 2012
8. Minutes of the Meetings	Rule 3 (1) (ix) Rule 3 (1) (x)	Compliant	Minutes of the Board meetings are maintained in sufficient detail by the Board Secretary, and is open for inspection by any Director.
9. Independent professional advice	Rule 3 (1) (xi)	Compliant	Please refer Section A.1.3 of the SEC & ICASL Code table on page 90.
10. Conflicts of Interest	Rule 3 (1) (xii)	Compliant	The Board is conscious of its obligations to ensure that Directors avoid conflicts of interest (both real and apparent) between their duty to HNB and their other interests. The Board has taken steps to ensure that conflicts and potential conflicts of interest of Directors are disclosed to the Board. Any Director with a material personal interest in a matter being considered by the Board, declares his / her interest and unless the Board resolves otherwise, he / she does not participate in discussions or vote on that specific matter.
11. Formal schedule of matters	Rule 3(1) (xiii)	Compliant	The Board reserves for itself a formal schedule of matters on which it takes the ultimate decision.
12. Situation of Insolvency	Rule 3(1) (xiv)	N/A	This situation has not arisen during the year.
13. Capital adequacy	Rule 3 (1) (xv)	Compliant	The Bank has been fully compliant with the capital adequacy requirements of the Monetary Board during 2012.
14. Corporate Governance Report	Rule 3 (1) (xvi)	Compliant	This requirement is met through the presentation of this report.
15. Annual self assessment by the Directors	Rule 3 (1) (xvii)	Compliant	Individual Directors carried out an annual self-assessment of their own performance and the effectiveness of the Board as a whole. The summary findings together with areas for future improvement has been tabled at the Board meeting for discussion and endorsement by the full Board. Each director carries out an assessment of "fitness and propriety" to serve as a Director of the Bank. These declarations are tabled at the Board meeting prior to onward transmission to the Director Bank Supervision of the Central Bank of Sri Lanka. Please refer Section A.9.1 of the SEC & ICASL Code table on page 95 for details of the evaluation of the Board and the Sub-committees.
3 (2) The Board's Composition			
16. Number of Directors	Rule 3 (2) (i)	Compliant	At the beginning of the year the Board comprised of seven (7) Directors and the number was increased to eleven (11) from April 2012.
17. Period of service of a Director	Rule 3 (2) (ii)	Compliant	The total period of service of all Non Executive Directors does not exceed nine (9) years.
18. Appointment of an employee as a Director	Rule 3 (2) (iii)	Compliant	Mr Rajendra Theagarajah (MD / CEO) is the only employee appointed to the Board as at date, as such the number of Executive Directors does not exceed one third (1/3) of the number of Directors of the Board.
19. Independent Non Executive Director	Rule 3 (2) (iv)	Compliant	The Board includes seven (7) Independent Non Executive Directors as per the definition of this Direction, which is more than one third (1/3) of the Board. The Board considers Non Executive Directors' independence on an annual basis, based on the self declaration and as part of each Director's self assessment.

Corporate Governance Principles	CBSL Rule Reference	Compliance Status	Level of Compliance in 2012
20. Alternative Director	Rule 3 (2) (v)	N/A	This situation has not arisen.
21. Credibility, skills and experience of Non Executive Directors	Rule 3 (2) (vi)	Compliant	Please refer pages 18 to 23 for the profiles of the Non Executive Directors.
22. Presence of Non Executive Directors in Board Meetings	Rule 3 (2) (vii)	Compliant	At all Board meetings convened during the year, more than one half (1/2) of the Directors present were Non Executive Directors.
23. Details of Directors	Rule 3 (2) (viii)	Compliant	Please refer page 113 for the details of the Directors and their categories.
24. Appointment of new Directors	Rule 3 (2) (ix)	Compliant	Please refer Section A.7 of the SEC & ICASL Code table on page 94 for details.
25. Appointment to fill a casual vacancy	Rule 3 (2) (x)	Compliant	Mr L U Damien Fernando and Ms D S C Jayawardena were appointed during the year to fill in casual vacancies which arose due to resignation of Mr R K Obeyesekere and Mr D H S Jayawardena (ceased to be a Director). All Directors appointed to fill casual vacancies during the year will be subject to election by shareholders at the 2012 Annual General Meeting.
26. Resignation / removal of a Director	Rule 3 (2) (xi)	Compliant	This situation has not arisen during the year.
27. Appointments to other Banks	Rule 3 (2) (xii)	Compliant	None of the Directors are either employees or Directors of other Banks.
3 (3) Criteria to assess the fitness and propriety of Directors.			
28. Directors over 70 Years of age	Rule 3 (3) (i)	Compliant	All Directors are below the age of Seventy (70) years as at 31st December 2012.
29. Holding of office in more than 20 companies	Rule 3 (3) (ii)	Compliant	No Director holds office as a Director in more than 20 companies (not more than 10 companies are classified as "Specified Business Entities" in terms of Sri Lanka Accounting and Auditing Standards Act No 15 of 1995).
3 (4) The Management function delegated by the Board			
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. The Financial authority manual and the credit delegation authority are reviewed annually by the Board as part of its delegation of authority to the Management through the MD / CEO.
31. Extent of Delegation	Rule 3 (4) (ii)	Compliant	Please refer comments above.
32. Evaluation of the delegated process	Rule 3 (4) (iii)	Compliant	Please refer comments on rule 3(4)(i) above.
3(5) The Chairperson and Chief Executive Officer			
33. Division of Responsibilities of the Chairperson and MD / CEO	Rule 3 (5) (i)	Compliant	The roles of the Chairperson and Chief Executive Officer are separate. Please refer Section A.2 and A.3 of the SEC & ICASL Code table on page 91 for details.

Your Board Room Governance Report...

Corporate Governance Principles	CBSL Rule Reference	Compliance Status	Level of Compliance in 2012
34. Chairperson preferably be an Independent Director and if not designate a Senior Director	Rule 3 (5) (ii)	Compliant	Dr Ranee Jayamaha is considered non independent as she holds office as the Chairperson of two (2) subsidiary companies. However, her non independent status was countered by the existence of a Senior Director designated by the Board. The Bank will develop a formal terms of reference for the Senior Director during 2013.
35. Relationship between Chairperson and CEO and other Directors	Rule 3 (5) (iii)	Compliant	There are no material relationship between the Chairperson / CEO and / or other members of the Board which will impair their respective roles.
36. Role of the Chairperson and CEO	Rule 3 (5)(iv) to Rule 3 (5)(xi)	Compliant	Please refer Section A.2 and A.3 of the SEC & ICASL Code table on page 91 for detailed information.
3(6) Board appointed Committees			
37. Board appointed four Sub - committees	Rule 3 (6) (i)	Compliant	There are eight (8) Board appointed Sub-committees including the four (4) Committees prescribed by the CBSL Direction. Please refer section A.1.6 of the SEC & ICASL Code table on page 91 above for the names of the Board Sub-committees.
38. Audit Committee			
38.01 Chairman of the Audit Committee	Rule 3 (6) (ii) (a)	Compliant from 01st May 2012	Up to 01st May 2012, the Audit Committee had been Chaired by an Independent Non Executive Director who did not possess any formal qualification and experience in accountancy or audit. With the approval of CBSL. The Committee co-opted Mr H M A Jayasinghe, Partner - Messrs Ernst & Young Sri Lanka, as a consultant up to 20th June 2012. Mr D T Sujeewa H. Mudalige (Independent Non Executive Director) was appointed as the Chairman of the Audit Committee w.e.f. 01st May 2012 in order to comply with Governance Regulations. Mr Mudalige is a fellow member of the Institute of Chartered Accountants of Sri Lanka, the Chartered Institute of Management Accountants – UK and the Chartered Institute of Securities and Investments -UK. He is the immediate past president of the Institute of Chartered Accountants of Sri Lanka and currently serves as the Vice President of the Confederation of Asia and Pacific Accountants.
38.02 Composition of the Audit Committee	Rule 3 (6) (ii) (b)	Compliant	All members of the Audit Committee are Independent Non Executive Directors.
38.03 External Auditors	Rule 3 (6) (ii) (c), (d) and (e)	Compliant	Please refer Section D.3.2 and D.3.4 of the SEC & ICASL Code table on pages 100 and 101 respectively.
38.04 Nature and Scope of External Audit	Rule 3 (6) (ii) (f)	Compliant	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.
38.05 Review of Financial Information of the Bank	Rule 3 (6) (ii) (g)	Compliant	The Audit Committee has reviewed the Bank's Annual Report and quarterly Financial Statements before the submission to the Board for approval.

Corporate Governance Principles	CBSL Rule Reference	Compliance Status	Level of Compliance in 2012
38.06 Meeting with External Auditors	Rule 3 (6) (ii) (h) and (l)	Compliant	The Committee met the External Auditor two (02) times without the presence of the Executive Director and Corporate Management.
38.07 External Auditor's Management Letter	Rule 3 (6) (ii) (i)	Compliant	During the year, the Audit Committee reviewed the year end Management Letter for 2011, and Interim Management letter for 2012, and the responses thereto with the External Auditor and the Corporate Management team.
38.08 Internal Audit	Rule 3 (6) (ii) (j) and (k)	Compliant	During the year, the Audit Committee reviewed the independence, objectivity and performance of the internal audit function. The findings of the internal audits completed during the year and the internal audit department's evaluation of the Bank's internal controls were reviewed by the Committee. The Audit Committee also reviewed the adequacy of coverage of the internal audit plan and approved the same. It also assessed the Department's resource requirements including succession planning. The Committee reviewed the performance appraisal of the Head of Internal Audit and the senior staff members of the internal audit department.
38.09 Terms of Reference	Rule 3 (6) (ii) (m)	Compliant	Please refer Section D.3.3. of the SEC & ICASL Code table on page 100 for details.
38.10 Meetings	Rule 3 (6) (ii) (n) and (o)	Compliant	The Committee met ten (10) times for 2012. The attendance at Audit Committee meetings held in 2012 is set out on page 113.
38.11 Secretary	Rule 3 (6) (ii) (p)	Compliant	The company secretary also act as secretary to the Audit Committee.
38.12 Process by which employees raise concerns in confidence	Rule 3 (6) (ii) (q)	Partially Compliant	A formal whistle blowing policy has been formulated and tabled at the HR and Remuneration Committee meeting in December 2012. The policy had been approved by the Board in January 2013. The policy will be communicated to staff members and be implemented during 2013. The Audit Committee reviews issues relating to breach of ethics if any and the arrangements by which the staff of the Bank may in confidence raise concerns about possible improprieties. The Committee also ensured that the procedures for the independent investigations of such matters are appropriate and are in place. The Board Charter which was formally approved by the Board in December 2011, addresses the Boards responsibility to encourage any communication regarding non compliances and unethical behaviour within the Bank.
39. Human resources / Remuneration Committee	Rule 3 (6) (iii)	Compliant	Please refer Section B.1.1 and A.1.1 of the SEC & ICASL Code table on pages 96 and 89 respectively for details. The Human Resources & Remuneration Committee is chaired by an Independent Non-Executive Director and has three other Non-Executive Directors as its members, two of whom are also Independent. The Committee met three times during the year. The Committee reviews all significant human resource policies and initiatives, salary structures, promotions and terms and conditions relating to staff at senior management level with information and recommendations from the MD/CEO and DGM (HR & Administration). The remuneration packages, annual increments and bonuses of the MD/CEO, DCEO, members of the Corporate Management and senior management staff are deliberated upon and recommended to the Board of Directors for ratification.

Your Board Room Governance Report...

Corporate Governance Principles	CBSL Rule Reference	Compliance Status	Level of Compliance in 2012
			During the year under review, Terms of Reference for the Committee, the Employee Share Trading Policy and the Whistle-Blowing Policy were formalized and presented to the Board for ratification.
40. Nomination Committee	Rule 3 (6) (iv)	Compliant	Please refer Section A.7.1 and A.7.2 of the SEC & ICASL Code table on page 94 and 95 respectively for details for the composition of the Committee. The Nominations Committee is chaired by an Independent Non Executive Director. The Committee considers and recommends the re-election of the Directors to the Board. The Committee also set criteria of the succession of the CEO. The Terms of Reference of the Committee was formally approved by the Board in February 2012.
41. Integrated Risk Management Committee	Rule 3 (6) (v)	Compliant	The following personnel served on the Board Integrated Risk Management Committee during 2012. Ms M A R C Cooray - Independent Non Executive Director Dr Ranee Jayamaha - Non Executive Director Mr Rajendra Theagarajah - Managing Director / CEO Dr W W Gamage - Independent Non Executive Director (resigned w.e.f. 01st May 2012) Dr L R Karunaratne - Independent Non Executive Director Mr A J Alles - Deputy CEO (appointed w.e.f. 9th December 2012) Mr J D N Kekulawala - Senior DGM - Strategy & Compliance (resigned w.e.f. 08th December 2012) Mr J R P M Paiva – DGM - Strategy & Compliance (appointed w.e.f. 09th December 2012) Mr D P N Rodrigo - DGM - Risk and Credit Quality Mr D A de Vas Gunasekara - CFO Ms S Gnanapragasam - A G M- Treasury & Markets (appointed w.e.f. 09th December 2012) Ms M A R C Cooray serves as the Chairperson of the above Committee. The Committee met six (6) times for 2012. The Sub - committee had kept the Board informed of their risk assessment of the Bank continuously during the year. The Committee assesses, reviews and takes action to mitigate the effects of the specific identified risks in credit, market, liquidity, strategic and operational areas. The Committee also oversees the compliance function. The designated Compliance officer also reports to the Committee. The Committee also reviewed the adequacy and effectiveness of the Credit Committee and the Asset and Liability Committee for 2012. During the year, the Committee also reviewed the Bank's Business Continuity Plan and Disaster Recovery Plan.

Corporate Governance Principles	CBSL Rule Reference	Compliance Status	Level of Compliance in 2012
3(7) Related Party Transactions			
42. Avoiding conflicts of interest in related party transaction and favourable treatment	Rule 3 (7) (i) Rule 3 (7) (ii) Rule 3 (7) (iii)	Compliant	Steps have been taken by the Board to avoid any conflicts of interest, that may arise, in transacting with related parties as per the definition of this Direction and Sri Lanka Accounting Standard - 24 (LKAS 24) on "Related Party Transactions". Further, the Board ensures that 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. In order to further strengthen the Bank's accountability and transparency with regard to transactions with related parties the Bank has extended the classification of "Key Management Personnel" to Corporate Management Officers of the Bank as well from 2012 onwards. The net accommodation granted to each category of related parties as a percentage of the Bank's regulatory capital is given under Rule 3 (8) (ii) (e).
43. Accommodation 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. All accommodations to Directors and / or their close relatives are secured by security which is prescribed by the Monetary Board.
44. Appointment of Director subsequent to approval of facilities to him / her	Rule 3 (7) (v)	Compliant	During the year, four (4) new Directors were appointed to the Board. Of these, three (3) did not have any facilities or accommodation with HNB at the time of appointment. The fourth Director has been informed in writing by the management of the requirements under the Banking Act for providing approved security to secure such accommodation. As at balance sheet date, accommodations extended to the said Director were within the exemption period of one year specified by CBSL.
45. Accommodation to employees	Rule 3 (7) (vi) Rule 3 (7) (vii)	Compliant	Accommodation has not been given to employees on a favourable basis other than the general schemes applicable to all employees of the Bank.
3(8) Disclosures			
46. Financial reporting, statutory and regulatory reporting	Rule 3 (8) (i)	Compliant	The Financial Statements for the year ended 31st December 2012, are in conformity with all rules and regulatory requirements and for the quarters then ended have been published in the newspapers in all three languages.
47. Minimum disclosure in the Annual Report	Rule 3 (8) (ii)	Compliant	(a) Compliance with applicable accounting standards and regulatory requirements has been reported under the "Directors' Responsibility for Financial Reporting" on page 204 , the "CEO's and CFO's Responsibility Statement" on page 203 and note No 2.1 (Statement of Compliance) to the Financial Statements on page 214. (b) Directors' report on the effectiveness of the internal control system over financial reporting is given under the "Statement of Internal Control" on pages 114 and 115. (c) The Assurance Report issued by the External Auditor on the Internal Control over Financial Reporting based on the auditing framework issued by ICASL for this engagement is given on page 116. The recommendations made by the Auditors where relevant, will be dealt with, in 2013.

Your Board Room
Governance Report...

Corporate Governance Principles	CBSL Rule Reference	Compliance Status	Level of Compliance in 2012
			(d) Details of the Directors are given on pages 18 to 23. Directors' transactions with the Bank have been disclosed in note No 52 to the Financial Statements on pages 295 to 305. The remuneration paid to the Board of Directors is disclosed in aggregate in note No. 15 to the Financial Statements on page 248. (e) The net accommodation granted to each category of related parties is given below as a percentage of the Bank's regulatory capital. **Category of Related Party Transactions** — (Amount in Rs Mn) / % - Key Management Personnel: 417.15 / 0.92 - Subsidiaries: 1,755.58 / 3.88 - Associate: 97.31 / 0.22 - Joint Venture: 150.00 / 0.33 - Other Related Parties: 3,344.30 / 7.39 (f) The aggregate amount of remuneration paid to Key Management Personnel and the transaction with Key Management Personnel have been disclosed in note No 52 (b) to the Financial Statements on pages 295 to 298. (g) The Bank has obtained a Factual Findings Report from the Auditors on annual Corporate Governance Report, based on the auditing framework issued by ICASL for this engagement. The recommendations made by the Auditors where relevant will be dealt with, in 2013. (h) There were no material non compliance to prudential requirements, regulations, laws and internal controls affecting the Bank. (i) There were no supervisory concerns on lapses in the Bank's risk management system or non compliance with this Direction that have been pointed out by the Director of the Bank Supervision Department of the CBSL and requiring disclosure to the public.
48. Transitional and other general provisions	Rule 3 (9)	Compliant	The Bank has complied with the transitional and other general provisions.

Report from External Auditors

The external auditors have performed procedures set out in Sri Lanka Related Services Practice Statement 4750 issued by the Institute of Chartered Accountants of Sri Lanka (SLRSPS 4750), to meet the compliance requirement of the Corporate Governance directive. Their findings presented in their report dated 21st February 2013 addressed to the Board are consistent with the matters disclosed above and did not identify any inconsistencies to those reported above by the Board.

J R P M Paiva
DGM - Strategy & Compliance

Ranee Jayamaha
Chairperson

Colombo, Sri Lanka
21st February 2013

Board and the Committee Attendance

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

Names	Directorship Status	Board	Audit Committee	Nomination Committee	HR & Remuneration Committee	Board Integrated Risk Management Committee	Strategic Review Committee	Credit Committee
Total No. Meetings		**13**	**10**	**3**	**3**	**6**	**4**	**6**
Dr Ranee Jayamaha	Non Executive Chairperson	13/13	10[a]	3/3	3/3	6/6	4/4	5/6
Mr Rajendra Theagarajah	Managing Director / CEO	13/13	10[a]	3[a]	2[a]	5/6	4[a]	6/6
Ms Pamela C. Cooray	Senior/Independent Non Executive Director	11/13	9/10		3/3	1[a]	2[a]	3/4
Mr N G Wickremeratne	Independent Non Executive Director	11/13	9/10		3/3	1a	3/4	5/6
Ms M A R C Cooray	Independent Non Executive Director	13/13	10/10	2/3	2/2 1[a]	6/6	4/4	6/6
Dr W W Gamage	Independent Non Executive Director	10/13		3/3	2/3	0/1		3/4
Dr L R Karunaratne	Independent Non Executive Director	13/13		3/3		4/6	4/4	6/6
Mr L U Damien Fernando (appointed w.e.f. 02nd April 2012)	Independent Non Executive Director	7/9						
Mr D T Sujeewa H. Mudalige (appointed w.e.f. 02nd April 2012)	Independent Non Executive Director	9/9	8/8			4[a]	1[a]	2[a]
Ms D S C Jayawardena (appointed w.e.f. 02nd April 2012)	Non Executive Director	7/9	5[a]			2[a]	1[a]	1[a]
Mr Rusi S. Captain (appointed w.e.f. 02nd April 2012)	Non Executive Director	8/9					1[a]	

The papers relating to Credit 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	Procurement
Total No of papers approved in 2012	**287**	**17**
Dr Ranee Jayamaha	277	17
Mr Rajendra Theagarajah	212	16
Ms Pamela C. Cooray	150	15
Mr N G Wickremeratne	108	8
Ms M A R C Cooray	175	2
Dr W W Gamage	123	
Dr L R Karunaratne	150	1
Mr L U Damien Fernando	7	
Mr D T Sujeewa H. Mudalige	11	
Ms D S C Jayawardena	6	9
Mr Rusi S. Captain	11	

Key

[a] meetings attended by invitation

Chairman / Chairperson of the Board / respective sub- committee as at 31.12.2012

Statement of Internal Control

RESPONSIBILITY

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

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

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

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

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

KEY INTERNAL CONTROL PROCESSES

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

- The Board Sub Committees are established to assist the Board in ensuring:
  - the effectiveness of the Bank's daily operations.
  - that the Bank's operations are in accordance with the corporate objectives and strategies.
  - that the operations of the Bank are in line with the annual budget as well as the policies and business directions that have been approved by the Board.
- The Internal Audit division of the Bank checks for compliance with policies and procedures and the effectiveness of the internal control systems and highlights significant findings in respect of any non-compliance. Audits are carried out on majority of units and branches, the frequency of which is determined by the level of risk assessed by the Internal Audit, to provide an independent and objective report on operational and management activities of these units and branches. The annual audit plan is reviewed and approved by the Audit Committee and the findings of the audits are submitted to the Audit Committee for review at their periodic meetings.
- The Audit Committee of the Bank reviews internal control issues identified by the Internal Audit Division, the external auditors, regulatory authorities and management; and evaluates the adequacy and effectiveness of the risk management and internal control systems. They also review the internal audit function with particular emphasis on the scope of audits and quality of the same. The minutes of the Audit Committee meetings are tabled for the information of the Board on a periodic basis. Further details of the activities undertaken by the Audit Committee of the Bank are set out in the Audit Committee Report on pages 201 to 202.

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

In assessing the internal control system, the relevant officers of the Bank collated all procedures and controls that are connected with significant accounts and disclosures of the financial statements of the Bank. These in turn were observed and checked by the Internal Audit division for suitability of design and effectiveness on an on-going basis. As the current year was the first year of adoption of new Sri Lanka Accounting Standards comprising LKAS and SLFRS, the Bank implemented a system to capture all adjustments separately from the accounting systems and made the adjustments as required by the transitional provisions. However, an automated financial reporting process that is required to comply with new requirements of recognition, measurement, classification and disclosures is being introduced to integrate these requirements to existing accounting processes.

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

The comments made by the external auditors in connection with the internal control system in previous years were reviewed during the year and appropriate steps have been taken to rectify them. The recommendations made by the external auditors in 2012 in connection with the internal control system will be dealt with in the future.

CONFIRMATION

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

REVIEW OF THE STATEMENT BY EXTERNAL AUDITORS

The external auditors, Messrs KPMG, have reviewed the above Directors Statement on Internal Control for the year ended 31st December 2012 and reported to the Board that nothing has come to their attention that causes them to believe that the statement is inconsistent with their understanding of the process adopted by the Board in the review of the design and effectiveness of the internal control system of the Bank. Their Report on the Statement of Internal Control is given on page 116 of this Annual Report.

By order of the Board

Sujeewa Mudalige
Chairman - Audit Committee

Rajendra Theagarajah
Managing Director /
Chief Executive Officer

Ranee Jayamaha
Chairperson

Colombo, Sri Lanka
21st February 2013

Independent Assurance Report

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

Tel : +94 - 11 542 6426
Fax : +94 - 11 244 5872
+94 - 11 244 6058
+94 - 11 254 1249
+94 - 11 230 7345
Internet : www.lk.kpmg.com

To the Board of Directors of Hatton National Bank PLC

We were engaged by the Board of Directors of Hatton National Bank PLC ("Bank") to provide assurance on the Directors' Statement on Internal Control ("Statement") included in the annual report for the year ended 31st December 2012.

Management's responsibility for the Statement on Internal Control

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

Scope of the engagement in compliance with SLSAE 3050

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

Summary of work performed

Our engagement has been conducted to assess whether the Statement is both supported by the documentation prepared by or for directors and appropriately reflects the process the directors have adopted in reviewing the system of internal control for the Bank.

To achieve this objective, appropriate evidence has been obtained by performing the following procedures:

(a) Enquired the directors to obtain an understanding of the process defined by the Board of Directors for their review of the design and effectiveness of internal control and compared their understanding to the Statement made by the directors in the annual report.

(b) Reviewed the documentation prepared by the directors to support their Statement made.

(c) Related the Statement made by the directors to our knowledge of the Bank obtained during the audit of the financial statements.

(d) Reviewed the minutes of the meetings of the Board of Directors and of relevant Board Committees.

(e) Attended meetings of the audit committee at which the annual report, including the Statement on Internal Control is considered and approved for submission to the Board of Directors.

(f) Considered whether the Director's Statement on Internal Control covers the year under review and that adequate processes are in place to identify any significant matters arising.

(g) Obtained written representations from directors on matters material to the Statement on Internal Control where other sufficient appropriate audit evidence cannot reasonably be expected to exist.

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

Our conclusion

Based on the procedures performed, nothing has come to our attention that causes us to believe that the Statement included in the annual report on pages 114 and 115 is inconsistent with our understanding of the process the Board of Directors have adopted in the review of the design and effectiveness of internal control system over the financial reporting of the Bank.

KPMG

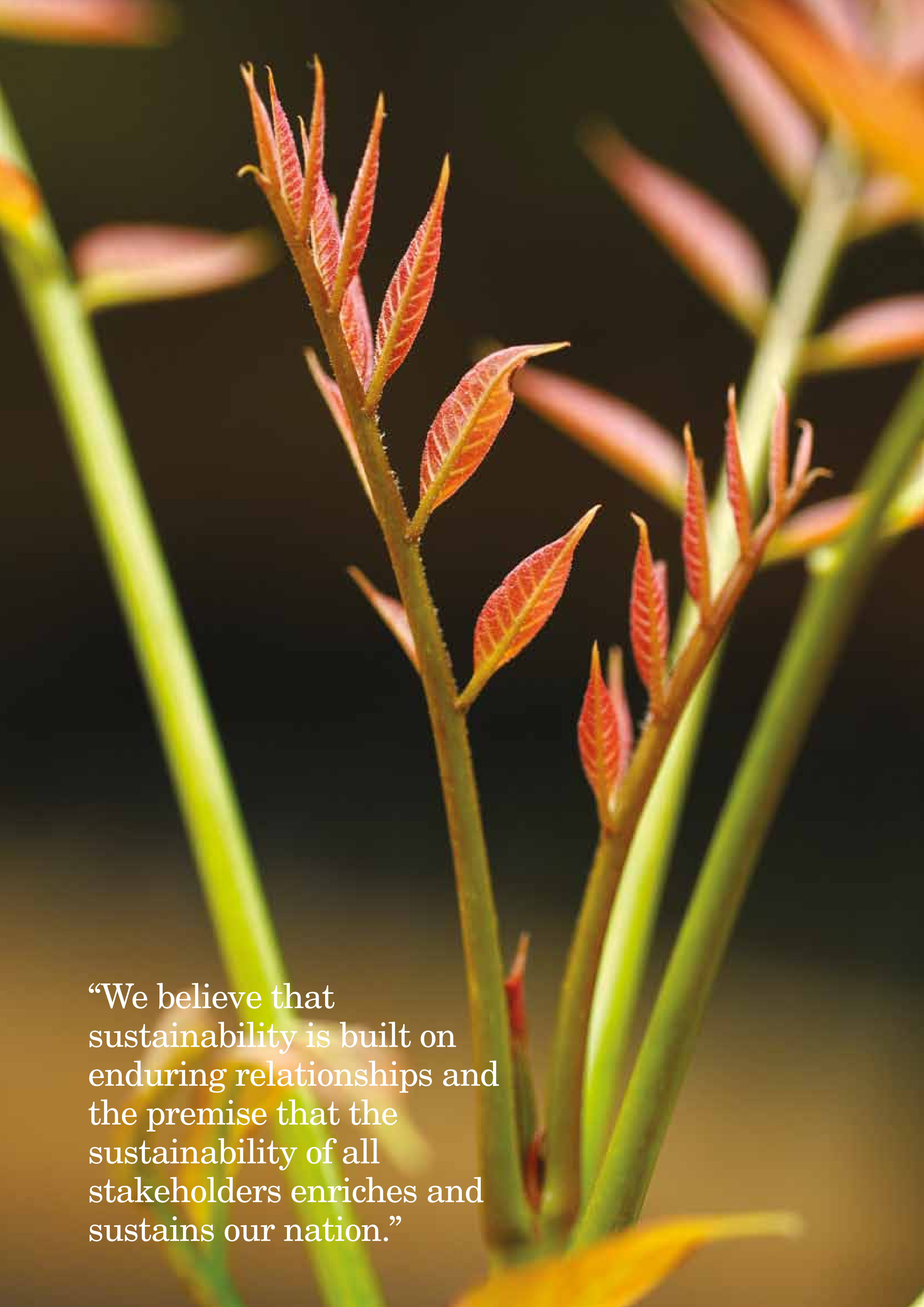
Chartered Accountants

Colombo, Sri Lanka
21st February 2013

Safe & Sound

Going the distance.

SUSTAINABILITY REPORT



"We believe that sustainability is built on enduring relationships and the premise that the sustainability of all stakeholders enriches and sustains our nation."

Sound
Strategy

The Bank's strategy for the future defines how we do business. Within this broad direction, a set of priorities shapes our business agenda and defines our short and medium term operations. These strategic priorities are reviewed annually and redefined every year based on the indications of the micro and macro environments. They are managed to ensure the long term sustainability of the business. Growth, risk, return and productivity are assessed as fundamentals in determining not only our move towards strategic priorities but also how the Bank impacts all key stakeholders thereby ensuring that alignment between business objectives and sustainability objectives co-exist.

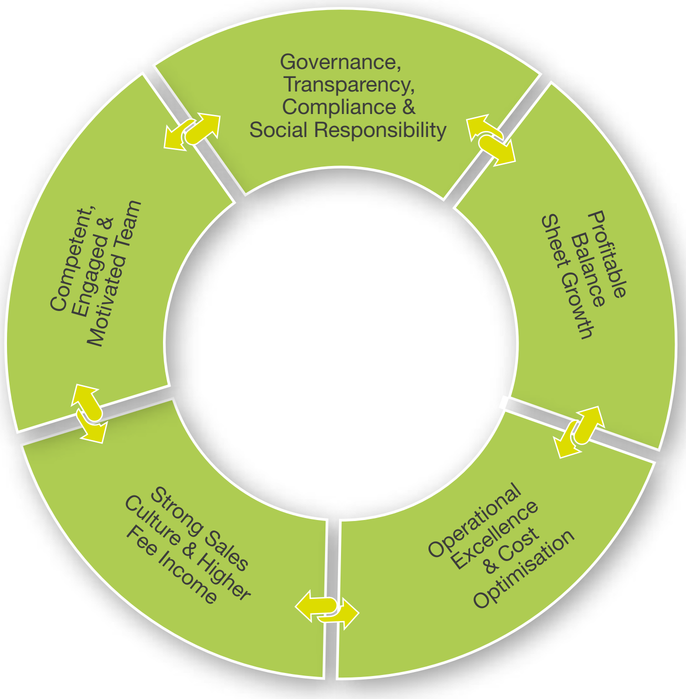
The Bank recognises core growth areas in the future based on forecasts of demographic and economic changes. The constant review of strategies to cater to this evolving market place gives the Bank adequate foresight to mould its operations for the medium term.

The Bank seeks to reorient the business to higher growth/higher return sectors and segments through the evolution of its business model through targeted investment in higher growth sectors and segments. Its core focus will lie in determining the future banking needs of key sectors; namely youth, senior citizens, high networth individuals, SME and micro entrepreneurs. In deeply entrenching its relationships, the Bank places customers at the centre of its strategic and operational focus, and will look to meet their total financial needs throughout their lives. As in the past, the Bank will continue to drive a 'deposits first' culture and further the concept and connectivity between wealth and banking. Accessibility will be a key focus, and the Bank will drive digital innovation to better meet the demands of future technology-enabled customers. Research and development into new product needs, delivery mechanisms and tools to empower both the customer and employee base will enable the Bank to innovate.

Simplification of how we do business is key to the Bank's future sustainability. The Bank is cognizant of the need to invest in technology to re-engineer the business, simplify its products and processes and drive continuous improvement, focusing on both revenue and cost productivity. Process mapping to enhance productivity will yield a leaner and more optimal structure. The Bank will continue to attract and support more customers online, thus transferring to a click and mortar business. In pursuing a better cost to income ratio, the Bank will explore opportunities to establish smaller, more flexible and agile customer centres.

The Bank will continue to focus on the one-team approach. It will build the HNB Team culture to ensure that it is able to continue its creation of a customer centric, high performance workforce. The HNB team will be constantly strengthened through skills development to better support customers' needs. They will be empowered to innovate and to be responsive to change.

Core Strategic Priorities



Sound Strategy

Core Strategic Drivers:

Focus on balance sheet growth

The Bank seeks to maximise the utlisation of funding and capital and to ensure the strength and security of the business by improving capital and funding positions whilst sustaining the mobilisation of low cost funding. The Bank has implemented initiatives such as diversifying funding sources and building on deposits, to further strengthen its capital, funding and liquidity positions. In the medium term, the Bank will continue to strengthen both tier 1 and tier 2 funding ratios. The Group will continue to focus on deposits as a key source of balance sheet strength. The Bank places emphasis on balance sheet strength and this strategic priority supports the Bank's Basel II transition strategy.

Focus on governance, transparency, compliance & social responsibility

The Bank continues to strengthen its risk management framework. The integration of Environmental, Social and Governance risk principles assist towards assessing a broader set of operational risks. 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 are responsible and accountable for the management of the affairs of the Bank, its conduct of business, maintenance of prudent risk management and its overall soundness. 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.

The Bank adheres to governance standards complying with regulatory requirements and maintains the highest levels of transparency through business philosophy and responsible reporting, whilst addressing the broader responsibility towards society with regard to financial inclusion, financial literacy and responsible lending.

Focus on operational excellence & cost optimisation

Complexity and cost management is a core priority for the Bank. With a cost to income ratio of 52%, the Bank recognises the need to maintain a disciplined approach to cost management. The Bank has adopted measures to improve its cost to income ratio through the simplification of processes, tight expense management and instituting a culture of continuous improvement and productivity. Quality circles and productivity enhancements, cost management through achievement of operational efficiencies - resource efficiency projects to further reduce waste, water, electricity and paper use -, reduce, re-use, recycle efforts and acceptance of the Green Policy have contributed positively to our business performance.

The Bank continues to improve key areas of customer service, streamline systems and processes, ensure efficient cost management and upgrade technology in line with its business strategy.

Enhance our reason for being whilst striving towards a stronger sales culture & higher fee income

As a financial institution that was established over 124 years ago, the Bank has a genuine commitment towards its customers and employees and is focused on playing a broader role in society. Our fair banking practices have been founded on the principles of depositor responsibility, access to financial services, financial literacy and responsible lending.

For future sustainability, the Bank will build momentum in personal banking through a differentiation strategy whilst improving rates of cross-selling across the distribution network. An enhanced focus on growing the non funded fee income portfolio is key for this strategic drive.

Build a competent, engaged & motivated team

Our people are the core of our Bank. They define who we are as an institution and therefore our people remain pivotal to our future strategy. We will continue to invest in the HNB Team for skill development, leadership, and in promoting diversity. We look for ways and means to encourage initiative and build new thinking across all levels, and we strive towards being an unbiased, transparent and empathetic employer at all times.

Complementing Priorities:

Focus on our strong national franchise

The Bank's business strategy has and will continue to pivot on the end achievement of national priorities. As a national brand, the Bank strives to address national agenda and meet national objectives through the effective implementation of its own business strategy. Thus, it fully appreciates that to achieve the greatest long-term benefit, the Bank must consistently streamline its own unique approach and business case for sustainability. This is demonstrated in the way the Bank has aligned its business goals in tandem with national goals and in turn with sustainability development.

Focus on customer relationships & fair banking

Individual relationships with our customers form the core of our business. By embedding our 'fair banking' philosophy, we have created lasting relationships and provided better products and advice to our customers. In a challenging economic environment we have continued to show strong commitment to our customers, driven by a long-term, holistic view of customer relationships. The business case for sustainable banking is strongest when a bank can focus on a business line where it can take advantage of scale, become a first mover, or find a niche market. Hatton National Bank has demonstrated its ability to focus on key business lines that have been fully explored through the infusion of innovation across time.

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

Focus on innovation for tomorrow's customer

The needs of customers are changing rapidly, encouraging the Bank to build new capabilities to serve them better over the long-term. This involves becoming more efficient in our ability to integrate advances in technology into banking. The Bank is currently making investments into the development of digital channels and payment systems. These investments will improve customer experience and functionality and assist towards enhancing accessibility. The Bank's IT strategy is focused fundamentally on supporting the core banking function. Information Technology is leveraged to optimise core banking through value creation across the product and service continuum. Enhanced functionality, seamless integration of networks and links both internally and with external partners, the development of new delivery channels such as mobile kiosks, enhancement of tools for business intelligence as well as system implementations to augment the security and compliance functions remain key factors in how the Bank addresses the needs of tomorrow's customer.

Focus on Green banking

Over the past five years, in line with the environmental agenda, the Bank has taken advantage of new market opportunities, acting as the leading provider of project finance to renewable energy projects across Sri Lanka. Sustainable energy finance has increased the Bank's visibility and market differentiation in a highly competitive domestic market. The Bank has actively sought to endorse sustainable energy finance in propagating an awakening amongst Sri Lankan commercial enterprises to propel sustainable energy projects. As a niche market player, the Bank foresees future growth potential from a business strategy perspective, whilst fostering a sound solution to the growing energy needs of the nation. The Green Pledge is also practiced as a core principle at the Bank, and Hatton National Bank remains the only Bank in Sri Lanka to operate two green branch buildings with one more under construction to be opened in 2013.

Responsible sourcing is a fundamental base in the Bank's overall approach to supporting enterprise. As an essential component of the overall business function, suppliers are regarded as inclusive partners. The Bank's strategic sourcing strategy promotes sustainable procurement by taking into consideration environmental, ethical and social factors when making sourcing decisions.

Integrating Sustainability

The Bank's corporate vision "to be the acknowledged leader and chosen partner in providing financial solutions through inspired people" forms the foundation of our sustainability vision. As a Bank, we were formed over a century ago to serve beyond mere realm of commercial enterprise by partnering for social wealth creation and community empowerment. To date, our performance is measured beyond monetary value and we continue to champion and support the sustainable development of lives and the national economy. We believe that sustainability is built on enduring relationships and the premise that the sustainability of all stakeholders enriches and sustains our nation.

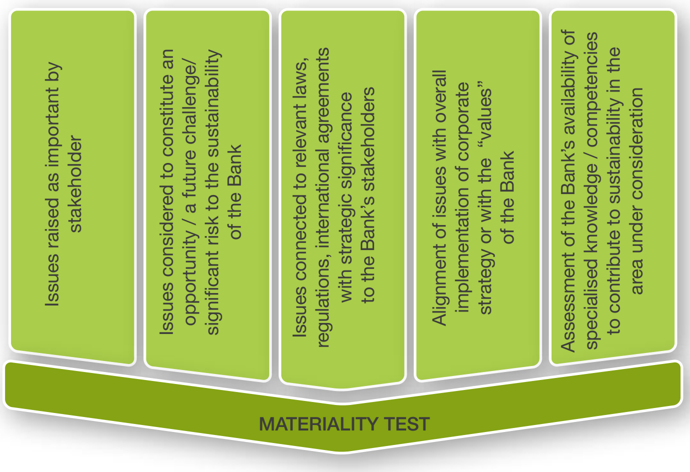
Hatton National Bank has worked strategically towards environmental and social responsibility for over a century, and today sustainability is an integral part of the business strategy. Engagement in stakeholder dialogue and corporate social responsibility is extremely important to the Bank.

Sustainable development is an ongoing and continuous area of concern in strategic discussions, and is given full consideration when objectives, goals, and targets are set 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 envisioning, whilst also integrated into all parts of the operational plan.

The Bank adopts an organic strategy review process that evolves based on the emerging sustainability needs of our stakeholders. In this light, we constantly strive to define our approach to sustainability and are responsive to the fact that the materiality of sustainability issues and our response to them will evolve over time. As such, we:

- Monitor issues and spot trends that may affect future business
- Engage with stakeholders and build relationships to create an inclusive business in a bid to find more sustainable solutions
- Embed a long-term strategic sustainability culture throughout the Bank
- Translate and integrate our sustainability approach across all business processes to obtain sustainable competitive advantages in the marketplace

Thus, the materiality assessment process assists the prioritisation of the issues based on their potential impact on our business and their significance to our stakeholders. In turn, this process moulds future strategy development.



This year, key issues that were rated as the most material in respect to both importance to stakeholders and potential impact to business were:

- Customer service
- Product range and access
- Business expansion / growth
- Recruitment and retention of the best talent
- Improved internal processes and development of the core banking system
- Compliance with regulatory requirements
- Financial inclusion and community empowerment
- Environmental citizenship
- Human rights
- Diversity and inclusion
- Ethics and governance

2012 - MEMBERSHIP COMMITMENTS

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

Short & Medium Term Sustainability Commitments

Entrench environmental concern

Implementation of Environmental Management System with an Integrated Sustainability Policy that supports the Bank's operations.

Increase the Green building concept and further neutralise the Bank's carbon footprint.

Sharpen the environmental evaluation in the credit approval process.

Entrench community outreach

Develop existing strategic CSR initiatives to harness a greater impact.

Entrench a drive for value creation

Develop the business model to deliver greater value to investors, customers and all stakeholders.

Entrench risk & security

Implementation of a diverse range of sophisticated technological tools for risk management and security of data and processes.

Entrench talent

Enhance talent and innovation through the latest HR development tools, foster creativity and an inspired workplace.

Entrench customer excellence

Implement continuous assessment of customer service levels, audits to determine lapses and institute new processes to facilitate locations and platforms for ease of banking.

Deliver mechanisms to create a platform for customer education.

Entrench suppliers with a sustainability focus

Implement the supplier procurement evaluation process fully, to ensure the sustainability principles are integrated into supplier operations.

Sustainability as a Precautionary Approach

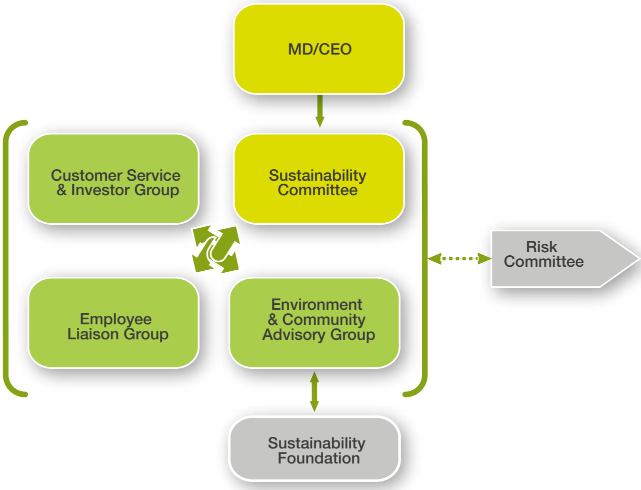
We believe sustainability management is an important precautionary approach to economic, social and environmental risk management. We are committed to serve all strata of society and through careful customer segmentation provide financial access and services across the continuum of socio-demographic groups. Sustainability is at the very core of the Bank's corporate strategy. By integrating social responsibility into core business processes and stakeholder management, the Bank recognises its ability to achieve the ultimate goal of creating both social and corporate value.

Sustainability Precepts

Policies & Frameworks For Sustainable Business

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

Sustainability Stewardship & Structure



Led by the Managing Director / CEO, the Sustainability Committee comprises of key functional heads including DGM Strategy & Compliance, DGM Corporate & Wholesale Banking, DGM Retail Banking, DGM Development Banking, Chief Financial Officer (CFO) and Risk Committee. It is endowed with the tasks of:

- Overseeing progress across the four strategic CSR pillars
- Acting as the think tank in developing the sustainability agenda
- Ensuring conformance to all sustainability guidelines
- Proactively evaluating decisions that impact on the reputation, ethics, and values of the Bank
- Identifying and managing areas of non-compliance within the sustainability principles
- Setting standards for policies and procedures in meeting sustainability principles

The Bank's Risk Committee oversees the Bank's Sustainability strategy and implementation.

The Bank's Sustainability Foundation was founded in 2009 and acts to further propel social responsibility agenda and strategy. The Foundation independently drives the CSR strategy and acts as the base for social/ community initiatives irrespective of adverse external environments. The Foundation formulates policy and strategy with implementation delegated to the Bank's employees. The Foundation's Trustees comprise of 2 members of the Board of Directors and 7 members of the Bank's Management team. The presence of 2 Board Directors facilitates representation of shareholder interest.

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

Risk & Governance
for Sustainable Business

The Corporate Governance and Risk frameworks play a key role in supporting the operations of the business and provide clear guidance on how authority is exercised within the Bank. Corporate governance is a fundamental part of our culture and business practices – providing a framework for effective decision making in all areas of the Bank's operations through the following practices:

1. Strategic and operational planning
2. Risk management and compliance
3. Financial management and external reporting
4. Succession planning and risk-based culture
5. Promotion of awareness of a risk-based culture and the achievement of a balance between risk and reward for risks accepted.

The Board's role is cognizant of the need to provide entrepreneurial leadership to the Bank within the framework of prudent and effective controls that enable risks to be managed. One of the primary roles of the Board, therefore is to advise the Bank's management in the development of a strategy that aligns with the mission of the organisation and with the short and long-term vision of stakeholders. The Board provides important leadership in the strategic planning process and in the continuing dialogue of monitoring strategic objectives, by asking the right questions whilst facilitating the required resources.

Risk exists in all aspects of our business, and the environment in which we operate. The Bank's collective risk management capability and competency supports successful implementation of our strategic priorities. It also enables the development of a sustainable and resilient business that is appropriately responsive to its changing environment.

Risk is identified and managed as part of a Bank-wide Risk Management Framework that starts with the Board approved Strategy, Risk Appetite, Capital, Funding and Operational Plans. Risk Appetite is translated and cascaded to our businesses qualitatively (through our risk postures, policies, standards and operating procedures) and quantitatively (through our risk limits, settings and decisioning authorities).

Every one of our employees are responsible for managing risk as part of their duties driven by an operating model which differentiates accountabilities using a 'three lines of defence' approach that sees the Management (owners of risk) at the first line, Risk and Compliance unit in the second line who provides insight, oversight and appetite, whilst the third line comprises of internal audit, who provide independent assurance of Risk.

2012 - AWARDS & RECOGNITIONS

- "Bank of the Year – 2012" in Sri Lanka, awarded by the prestigious UK based "The Banker Magazine"
- Winner for the "Best Retail Bank in Sri Lanka - 2011" presented by "The Asian Banker" at the Asian Banker Excellence in Retail Financial Services Awards 2012
- Business Today Top Twenty Five 2011 – 2012: 6th place
- The Institute of Chartered Accountants of Sri Lanka - Annual Report Awards 2012:
  - Joint Gold Award for the Best Presentation in Corporate Governance
  - The Silver Award for the Best Presented Annual Report in Banking Sector
  - The Bronze Award for the Best Presented Annual Report in Corporate Social Responsibility (CSR)
- Asia's Best Employer Awards for "Excellence in Training"
- Association of Human Resources Professionals - HRM Awards 2012 - Silver Award
- National Energy Efficiency Awards – Silver Award for the most energy efficient building in the medium scale commercial sector building category
- Mr Rajendra Theagarajah MD/CEO was conferred with the award for "Outstanding Contribution to the Banking Industry" in recognition of the valuable services rendered to the Banking industry by the Council of Association, at the 24th Anniversary Convention of the Association of Professional Bankers Sri Lanka
- The first internationally rated local bank in Sri Lanka by securing a B1 rating from Moody's on par with the sovereign rating of B1 of Sri Lanka
- Taiki Akimoto 5S Awards - Sector Awards for Banking for 2011 in the Medium and Small categories by HNB Pettah & HNB Nawalapitiya with Merit Awards for HNB Grandpass & Panchikawatte Customer Centres

2012 - Sustainability
Impacts, Risks & Opportunities Identified

Economic Impact

- Through our products and services the Bank fosters and stimulates risk taking and entrepreneurship - two fundamental ingredients of sustainable growth and progression
- Inculcation of the savings habit - attractive savings schemes with a host of special prizes, savings products in a wide range of target markets from new born infants to senior citizens
- Promoting entrepreneurship and creating self employment opportunities from micro finance and leasing products
- Technical assistance and marketing opportunities for micro entrepreneurs and farmers through tie ups with large corporate organisations and deployment of qualified agricultural field officers
- Actively supporting the growth of SMEs through a host of loan and lease products
- Meeting the needs of the corporate sector

Social Impact

- Poverty alleviation through risk taking and entrepreneurship - micro finance, micro insurance and other advance products
- Initiatives of the HNB Sustainability Foundation - a separate Trust to carry out community development programmes and to ensure the continuity of these projects
- Promotion of Education and IT literacy through the School Libraries & Computer Centre programme
- Active member of the Sri Lanka Business Coalition for HIV/AIDS and a proponent of HIV/AIDS awareness at the workplace
- Creation of a Trust Fund to provide financial assistance to cancer patients and their families and continued assistance to the Counselling Centre at the National Cancer Institute to fulfill the need for trauma counselling associated with cancer for patients and their families

Environmental Impact

- Incorporating environmental policies into lending, customer and supplier assessment and commitment to finance renewable and clean technology projects
- Implementation of the “Green Pledge” and 3R concept towards reducing our carbon footprint whereby all employees have taken a pledge to support this cause
- Energy efficient buildings and construction of “Green Buildings”
- Tree planting initiatives in a bid to reverse our impact as measured against the amount of paper consumed
- Significant investment over a period of time in reclaiming the Bundala National Park from invasive species that threaten the bio diversity of the area

Economic Risks/Opportunities

The economic impact is seen as both an opportunity as well as a challenge. There are opportunities for more business growth in terms of increased deposits and lending. It is a challenge due to the difficulty in reaching out to different segments especially those who are inhibited by their lack of education and poverty to reach out to the benefits offered through a structured savings programme or self-employment scheme. A further challenge is to ensure repayment of facilities. For this purpose the Bank has implemented rigorous screening processes on lending to minimise risk of willful default

Social Risks/Opportunities

Social impact is a clear opportunity for the Bank to become involved in the community. Over 50% of the population is still not part of the financial system in Sri Lanka. Through our schemes we try to reach out to such segments of people to create awareness and promote inclusion.

Environmental Risks/Opportunities

Although the nature of our business is such that we are not directly influenced by environmental considerations in our day-to-day activities or through the scope of our business, the fact that we interact with millions on a daily basis enables us to act as a conduit in changing societal behaviour and perceptions. Our role therefore is to be a good environmental citizen and a role model for the Sri Lankan public. As such we take it upon ourselves to lead from the front in creating awareness about environmental considerations and incorporate it in our daily activities as far as possible. Further by implementing a supplier screening system and rigorous loan covenants, we are able to influence our business suppliers and customers to adopt eco friendly practices.

Responsive Business Processes

- Implementation of Know Your Customer and Anti Money Laundering policies.
- Rigorous monitoring and follow up on advances
- Promote responsible lending practices
- Risk and compliance
- Promotion of e-banking
- Implementation of an Environmental Management System (EMS)
- Move towards a paperless office in pursuing eco friendly practices
- Assessment criteria to measure emissions
- Establish Green buildings to promote energy conservation
- Cascade the learnings from the Green Building to all the customer centres and target the reduction in the consumption of electricity and water by 10%
- Screening of supplier's processes for purchases exceeding Rs 1.0 Mn
- Give precedence through Business policy to perpetuate human rights, negation of child labour at customer and supplier businesses, equal opportunities at the workplace, diversity and female empowerment, service equality to all, facilitate the differently-abled

Reporting Sustainability

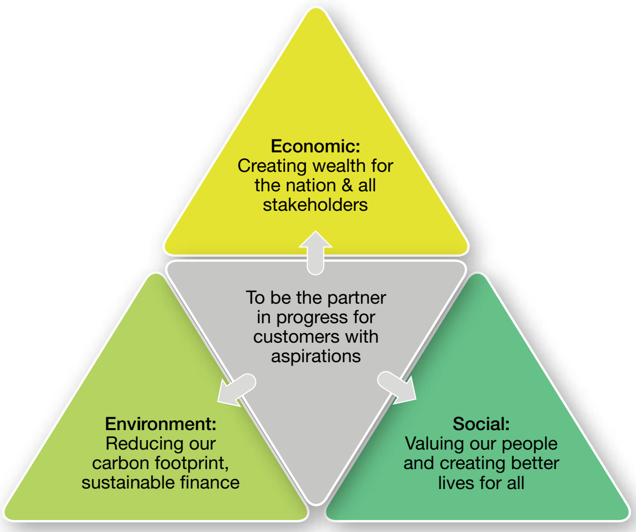
Sustainability reporting is not a new concept for Hatton National Bank. In fact, we have been reporting our commitment to go beyond our financial performance for many years. But aside from reporting our sustainability efforts, we have been engaged in sustainable business for over a century. As far back as 1888, as a fledgling financial institution we embarked on a journey to function beyond pure commercial interest. Our Bank was born from the need to serve a community living within the valleys of Hatton's mountainside, thus embedding an innate consciousness for sustainability. We have now grown to be one of Sri Lanka's largest financial institutions and yet this heritage keeps Hatton National Bank true to its origins.

The Bank recognises its potential to promote the principles of sustainability from environmental protection, social justice, sustainable development, employee responsibility, and customer partnership to investor relations. We know how sustainability works because it is at the very core of our operations be it from lending, insurance, financial literacy or investment activities to the greening of internal operations.

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

The Bank's sustainability efforts are aligned to the United Nations Millennium Development Goals for economic empowerment, poverty alleviation, education, human rights, labour, health and sanitation and are thus inherently aligned to the national agenda. The integration of the sustainability strategy into four CSR pillars is expanded under Sustainability Stewardship & Structure on page 126.

2012- Sustainability Reporting Focus



"Sustainability remained a core priority during the year, and as in the past we focused on integrating sustainability into the business function. In fact, I can confidently say that the Bank in pursuing business continuity also simultaneously ensures the sustainability of people, environment and the national economy."

Rajendra Theagarajah
Managing Director / CEO

** Refer CEO's Review pages 16-17*

Defining the Report Content

This year, as in the past five years, we report our sustainability strategy and initiatives against the Global Reporting Initiative Reporting Framework (GRI). As in the previous financial year, we continue to report against the requirements of GRI Application Level A+, and this report has undergone a GRI Application Level Check (refer page 171).

Issue of Materiality - The Bank is cognizant of the criticality of materiality in reporting. This Sustainability Report therefore, focuses on indicators that reflect the Bank's significant economic, environmental and social impacts or that would influence the assessment and decisions of its stakeholders (refer pages 122-123).

Stakeholder Inclusiveness & Engagement - Sustainability Reporting affords the Bank a means to communicate and engage with its stakeholders. Given the disparate nature (and interests) of various stakeholders, the Bank is compelled to strategically define its' key stakeholder audience to ensure materiality in engagement and reporting (refer pages 132 -135).

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

Defining the Report Quality

Balance, Accuracy and Clarity - This Report endeavours to present an unbiased presentation of the Bank's performance by reporting on the positive and negative aspects of the Bank's performance to enable a reasonable assessment of overall performance.

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

Defining Report Boundary - This Report covers only the sustainable performance of the Bank and has not been extended to cover its subsidiaries.

Standard Disclosures in the Report

Strategy and Profile - In this section we provide a high level strategic view of the Bank's relationship to sustainability in order to provide context for understanding the Bank's performance such as its strategy, profile and governance (refer pages 119-127).

Management Approach & Performance Indicators - The Performance Indicators are organised by economic, environmental and social categories as set out in the GRI Table.

Independent Assurance

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

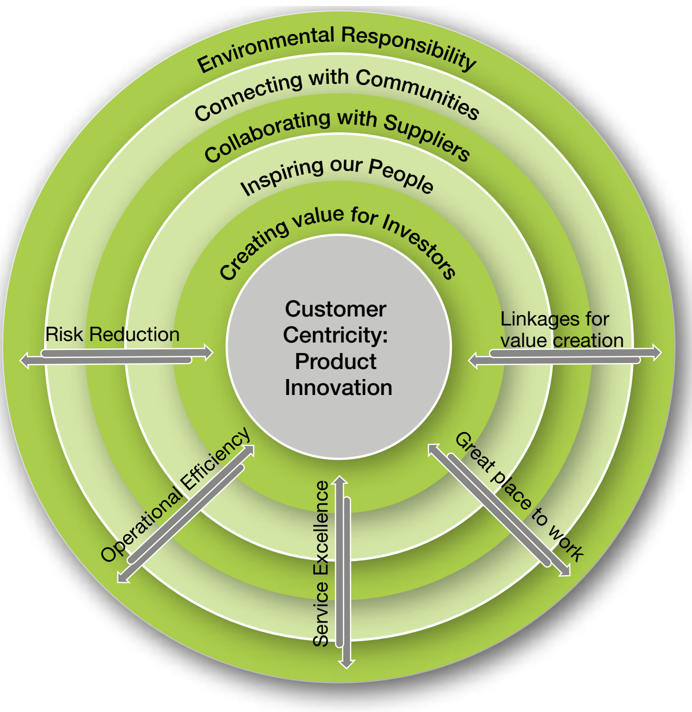
M/s KPMG Sri Lanka have provided an Independent Assurance Report on Hatton National Banks' Sustainability Report. The Auditors review engagement was carried out in accordance with the Sri Lanka Standard on Assurance Engagements (SLSAE 3000).

Stakeholder Feedback

The Bank recognises the critical role of stakeholder feedback in further enhancing its sustainability reporting frameworks. To facilitate better engagement and formal feedback, an Investor/Stakeholder Feedback Form is attached to this Report.

Engaging
for Inclusivity

Connecting with our many and varied stakeholders is a vital aspect of our operations. Maintaining an open and constructive dialogue with our stakeholders helps us understand expectations, and contributes to risk management, learning and innovation. It also helps us to identify emerging issues and opportunities for creating new products and services and improving our performance. We believe that stakeholder engagement is a strategic activity that is core to creating a sustainable business. We interact with a diverse range of stakeholders but given the criticality of only certain stakeholders to direct business function we choose to have a robust and consistent engagement process with our investors, customers, employees, suppliers, and the community, all of whom we recognise as key to our operations. The environment remains a core stakeholder given that its sustainability over-rides commercial interest and is the basis for the viability of life.



Stakeholder Engagement Process

Investors	
Sustainable Business Objectives	• To meet the confidence of the investors and maintain a balance between profits and the ability to sustain a long term, stable stream of earnings • To maintain internal processes and policies as tools to combat financial crime and poor quality lending
Engagement Objective	• Create sustainable wealth for shareholders, whilst setting benchmarks for the industry and contributing towards the achievement of national macro economic objectives
Method of Engagement & Frequency	• Annual General Meeting (Annually) • Investor Feedback Form (Annually) • Investor Relations Team (All year) • Corporate website (All year) • Email access to management team (All year) • Quarterly Reports (Quarterly)
Key topics/ concerns/issues	• Better interaction • Increasing financial returns
Our Response	• Presentations at offshore locations, web casts • Improved website • Regular email feedback of performance to investors who request same • Implement best management practices to improve returns

Customers	
Sustainable Business Objectives	To safeguard the interests of depositors through responsible banking • To be a responsible lender by judging whether a customer's aspiration to borrow is affordable and meets the Bank's assessment of risk and pricing • To always serve customers with passion and dedication • To make finance more accessible especially to those who lack access to finance as a result of socio-economic, demographic and geographic limitations • To promote financial literacy proactively for capacity development
Engagement Objective	• Ensure that service excellence remains a fundamental in the delivery of superlative products and services
Method of Engagement & Frequency	• Customer get-togethers (As required) • Meetings (As required) • Daily interactions at customer centres • Religious activities (All major religious events—minimum of 2 a year)
Key topics/ concerns/issues	• Ease of access • More banking facilities as available in a fully fledged customer centres at extension offices • Assistance to Senior Citizens •Consideration of differently abled customers • Increased range of services for SME customers
Our Response	• Customer centres spread throughout the country • Systematic upgrading of extension offices to customers centres to provide better service • A special senior citizen scheme with higher interest rates, free medical insurance • Separate access, specially designed restrooms, low level counters being systematically introduced

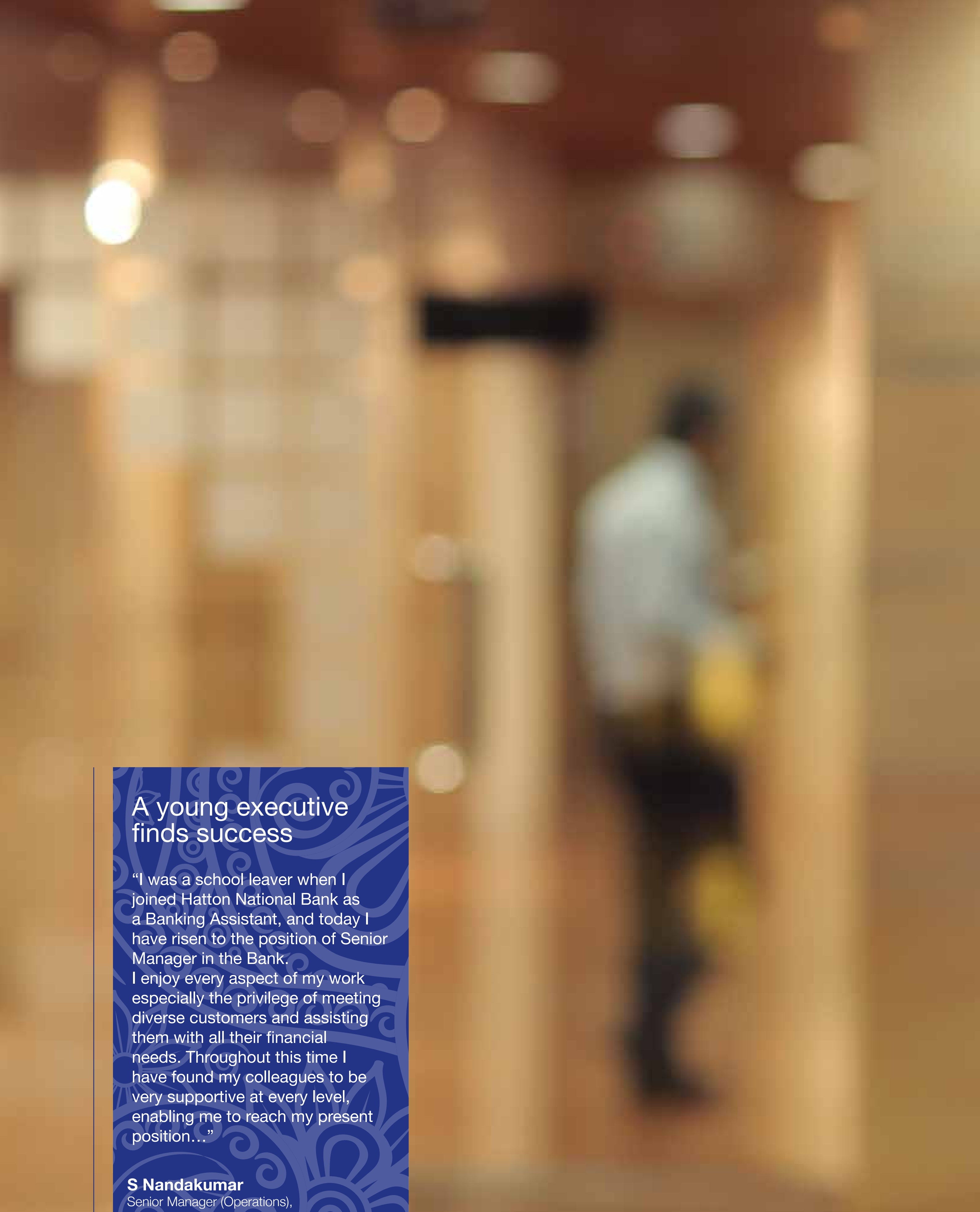
Engaging for Inclusivity

Employees	
Sustainable Business Objectives	• To foster a diverse talent pool that delivers superior and efficient performance whilst ensuring that such efficiency is not achieved at the expense of work-life balance or corporate values.
Engagement Objective	• Create two-way relationships that inculcate team spirit within the Hatna Family concept whilst consciously enhancing the tangible and intangible worth of employees
Method of Engagement & Frequency	• Open door policy for communication throughout the organisation (Daily) • Meetings (minimum of 1 a month) • Branch managers conference (Annual) • Regional level conferences (Quarterly) • Round Table discussions (Monthly) • Cross functional committees (minimum of 1 a month) • Circulars (weekly) • Emails (daily / weekly) • Video conferencing / Townhall meetings (minimum of 1 month) • Performance Reviews (annually) • In-house Magazine (once in 4 months) • Intranet (daily) • E Learning System (daily) • Online Discussion Forums (daily) • Surveys (as required) • Grievance handling procedure (daily) • Online systems for HR & Training (daily) • Measurement & management of Key Performance Indicators (Monthly) • Spark system – the Bank's inspiring innovation online system for communicating innovative ideas (daily)
Key topics/ concerns/issues	• Access to the Bank's e Learning system at home • Improving the time lag of application to recruitment and placement • Making the staff suggestion scheme more user friendly and transparent •Increase in allowances for trainees
Our Response	• The system was modified to allow access through the internet on a 24x7 basis from any location at the user's convenience • Introduction of online recruitment• Implementation of a homegrown online system for communicating ideas • Increased allowances for trainees

Suppliers	
Sustainable Business Objectives	• To balance cost considerations with sustainable procurement practices
Engagement Objective	• Focus on long lasting partnerships on qualitative platforms
Method of Engagement & Frequency	• Supplier surveys for ongoing relationship management (Bi-annually) • Feedback evaluations (Annually) • Registration of Suppliers (Annually) • Procurement committees (Monthly) • Committees to address supplier appeals and grievances (Monthly) • Green audit (Annually)
Key topics/ concerns/issues	• System for handling appeals and other grievances • Support micro and SME suppliers • Support and guidance to become sustainable businesses
Our Response	• Appointment of 2 committees to address supplier issues • Over 60% of the Bank's suppliers are SME and micro level suppliers • Workshops on sustainable business practices and guidance on implementation

Community	
Sustainable Business Objectives	• To engage with the community at every level • To act as a catalyst for positive change through action in healthcare, education and entrepreneurship
Engagement Objective	• Create sustainable communities through Education, Entrepreneurial Assistance and Health
Method of Engagement & Frequency	• Sponsorships (Need basis) • Employee involvement in local community projects (Need basis) • Continuous dialogue through network of customer centres (Daily)
Key topics/ concerns/issues	• Needs that emerged through constant dialogue with the community through our customer centre network
Our Response	• Introducing the Gami Pubuduwa micro finance scheme as a method of assisting young entrepreneurs after the youth insurrection in 1988/89 • Setting up a separate Trust to carry out community development programmes – the HNB Sustainability Foundation - to ensure continuity of the Bank's community projects • Establishment of school libraries • Establishment of computer centres in schools • Establishment of a counselling centre at the National Cancer Institute • Providing financial assistance to cancer patients • Investment in rural / off the beaten path areas

Environment	
Sustainable Business Objectives	• To promote environmental conservation at the work place, integrating environmentally friendly practices into daily operations whilst also giving due consideration to responsible lending practices.
Engagement Objective	• Ensure a sustainable planet through conservation and preservation of the environment by introducing best practices
Method of Engagement & Frequency	• Efficiency Meetings (monthly) • Consultancy Audits (Adhoc)
Key topics/ concerns/issues	• Climate change
Our Response	• Green building and eco friendly practices • Funding to rid the Bundala National Park of invasive species • Tree planting initiatives • E-waste programmes



A young executive finds success

"I was a school leaver when I joined Hatton National Bank as a Banking Assistant, and today I have risen to the position of Senior Manager in the Bank.
I enjoy every aspect of my work especially the privilege of meeting diverse customers and assisting them with all their financial needs. Throughout this time I have found my colleagues to be very supportive at every level, enabling me to reach my present position..."

S Nandakumar
Senior Manager (Operations),
Head Office Branch

Safe & Sound

Economic Wealth Creation

We firmly believe that the sustainable economic and social development of Sri Lanka is dependant on the contribution of Corporate Sri Lanka as partners in national progress. We have and continue to demonstrate our support to the national economy through our unique approach to social inclusion, through which we have actively drawn thousands from less privileged financial circumstances to be contributors to the national economy. In the light of post conflict Sri Lanka where the re-integration of the northern and eastern provinces with the rest of the economy have opened approximately 2/3rd of the nation's maritime and coastal resources, 1/3rd of untapped fertile land for productive use and enabled approximately 15% of the country's population to fully participate in rejuvenated economic activity, we are confident that our model for financial and social inclusion will have far and wide-reaching possibilities.

In 2012 we expanded our strategy for inclusive wealth creation. By meeting our own corporate strategies we ensured that we created wealth for the nation and her people, our investors, customers, suppliers and our employees.

Safe & Sound: Our management approach to economic wealth creation

Our premise for economic wealth creation is founded on the belief that we need to provide equal and uniform access to finance and banking services. We therefore work to improve access to our services and to improve financial literacy in society. We have a long tradition of supporting financial literacy and we continue to build on this as a key pillar for future wealth creation, both for ourselves as a Bank as well as for wider social and economic development.

Our goal is to serve as broad a range of customers as possible, serving their different financial needs whenever and wherever they desire. We make our financial services accessible to all, regardless of economic standing, ethnic origin, disability or other factors. This includes both tools and technologies that facilitate access to banking services.

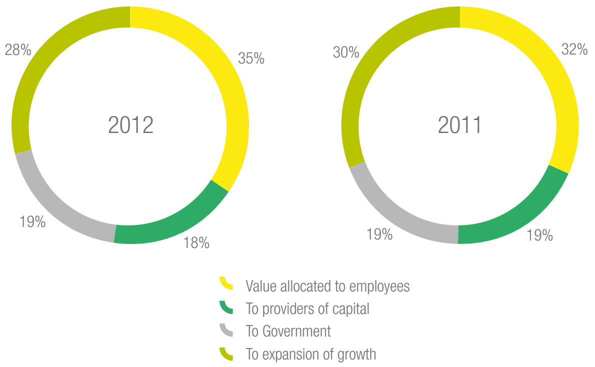
We use our products and services as well as our network and our core competencies to provide greater access to financial services. This creates a competitive advantage for the Bank and stimulates demand for our financial services.

Management Approach Actioned –

- Gami Pubuduwa: draws the "non bankable" to the formal economy
- HNB Student Managers programme: instills the savings habit and financial management
- Adhishtana: empowers women and youth through financial inclusion
- Yauwanabhimana: empowers youth through skills development

2012 – Economic value addition

Analysis of Value Addition



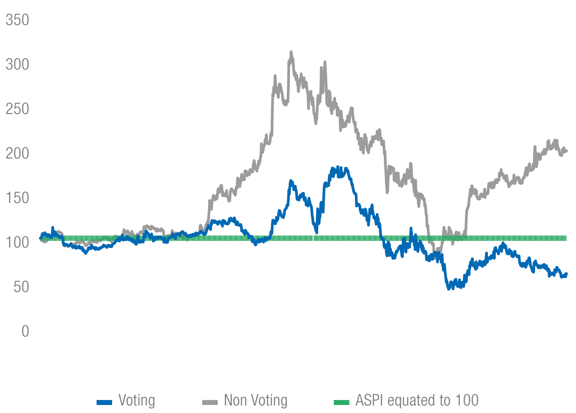
2012 – Investor value creation

The Bank has been striving to create and enhance shareholder value by focusing on growth in sustainable earnings and recording above average returns on equity.

Despite short term fluctuations in share price the Bank has succeeded in providing attractive returns to its shareholders over the long run.

Over the past 5 years the Bank has recorded a CAGR of 22% pa in earnings per share. This robust growth in earnings has enabled the Bank to distribute healthy dividends to its shareholders with Rs 8.50 per share declared as dividends in 2012 resulting in a dividend yield of 5.7% for voting shares and 7.6% for non-voting shares.

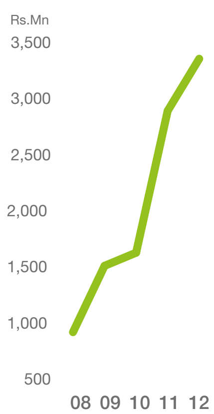
HNB Share Price Performance against ASPI



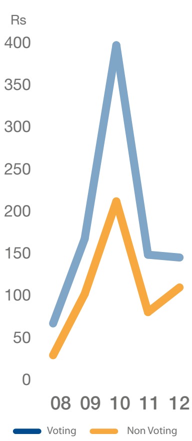
	2008	2009	2010	2011	2012
Earnings per Share (Adjusted) (Rs) *	8.7	11.8	12.1	16.5	19.3
Dividend Yield (%) - Voting	5.7	3.8	1.8	5.0	5.7
Dividend Yield (%) - Non Voting	12.5	6.2	3.3	9.0	7.6
Assets Growth (YOY) (%)	10.2	9.2	12.0	19.0	17.3
Holding Period Return - Voting (%)	(39.8)	153.4	139.0	(42.7)	3.4
Holding Period Return - Non Voting (%)	(32.4)	247.7	111.6	(39.6)	45.4
Operating Cost - Efficiency Ratio (%)	52.6	52.7	54.9	55.3	52.3
Share Price - Voting (Rs)	69.8	170.3	399.9	151.3	148.0
Share Price - Non Voting (Rs)	32.0	104.8	214.6	83.2	112.5
Gross Dividends (Rs Mn)	942.1	1,533.2	1,649.5	2,914.5	3,378.0

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

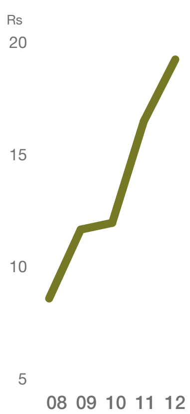
Gross Dividends



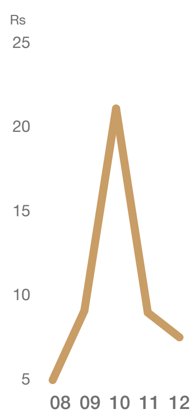
Share Price



Earnings Per Share



Price Earning Ratio



Economic Wealth Creation

2012 – Customer value creation

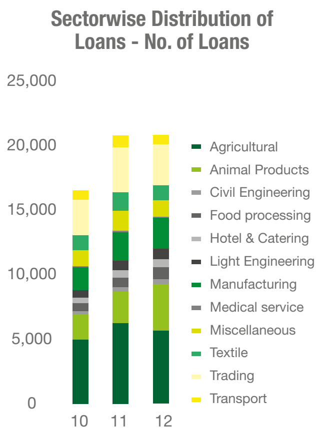
The Bank's commitment remains to servicing all segments and strata of socio-economic and geographic groups, as it has done from its inception. The SME and Micro customer base remains critical to the Bank from a strategic perspective, and unlike peer banks, this increasing critical economic component is not a new area of focus for Hatton National Bank. Under the national development agenda, SME and Micro segments have been identified as the seeds to national growth in the medium term. For over four decades, we have pioneered the introduction of financial services to persons considered otherwise as "non-bankable" and the HNB Gami Pubuduwa (Village Re-awakening) micro finance programme emphasises harnessing the skills of rural entrepreneurs towards achievement of self reliance. The entrepreneurial poor remain a critical customer base for the Bank with financial inclusion for these segments an area of strategic priority from the perspective of the development of commercial enterprise.

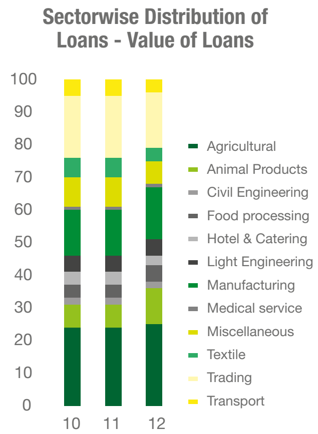
We recognise that one of our most critical roles is to support the growth of the economy, effectively fostering wealth creation and facilitating capacity development in key economic sectors and segments.

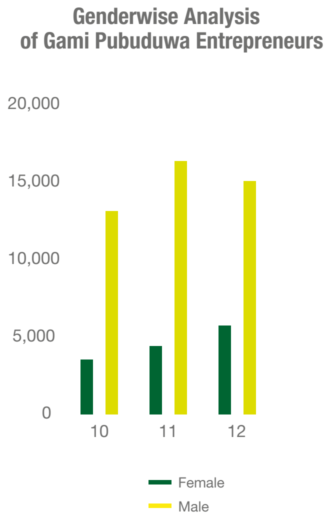
From the Bank's point of view, empowering the entrepreneurial poor is cyclical in nature. As the micro entrepreneur enters the SME threshold, the Bank undertakes to further assist them across to the next level of the business cycle through the introduction of new financial services, thus enhancing their access to finance in line with their 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.

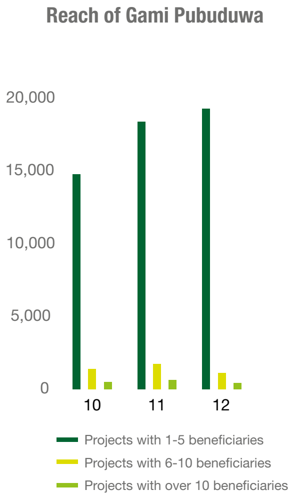
Our financial literacy and knowledge sharing programmes for Small and Medium Enterprises (SMEs) and Small and Medium Industries (SMI) has fostered commercial vivacity over the years, and helped graduate these industries and enterprises to more complex and sophisticated commercial entities. The Bank's financial literacy programme has followed a planned approach over the last three years, and we have effectively collaborated with other corporates and Chambers of Commerce to establish linkages and share know-how, to facilitate SMEs and SMIs to build their capacities and follow a realistic roadmap for sustainable business. The Bank's Microfinance and Development Banking strategy continues to provide access to finance for under-served communities.

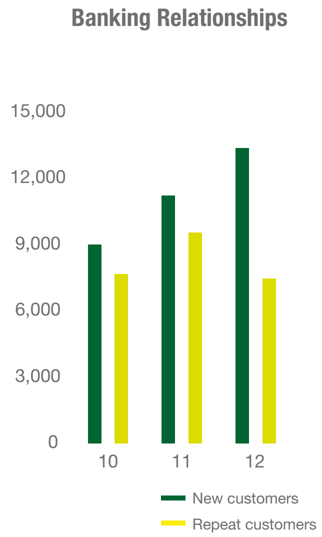
Gami Pubuduwa Review











Economic Wealth Creation

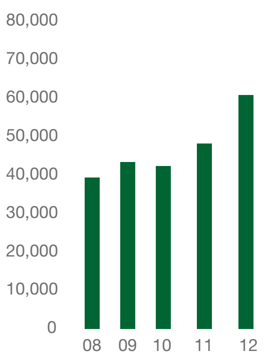
The Bank's value proposition ranges across the enterprise chain. It identifies that apart from a lack of financial literacy, the second most debilitating deterrent to business success amongst SME's is, in fact, access to markets. The Bank has actively sought to assist SME's to overcome this weakness.

Awareness Programmes for SME Customers	
Location	**No. of Participants**
Buttala	26
Trincomalee	27
Batticaloa	30

Services to migrant workers

Assistance to the migrant workers who are Sri Lanka's highest forex income earner remains a core pillar of our business strategy. But the Bank does not limit itself to merely facilitating inward remittances. Instead, over the years, we have been increasing our focus on inculcating the savings habit, promoting RFC savings whilst offering and cross-selling a range of domestic currency financial instruments and services such as agricultural loans. Thus, capacity building through savings and recycling and capture of capital has enabled the Bank to effectively sustain the livelihoods of its client base whilst also meeting national objectives towards the augmentation of foreign exchange reserves.

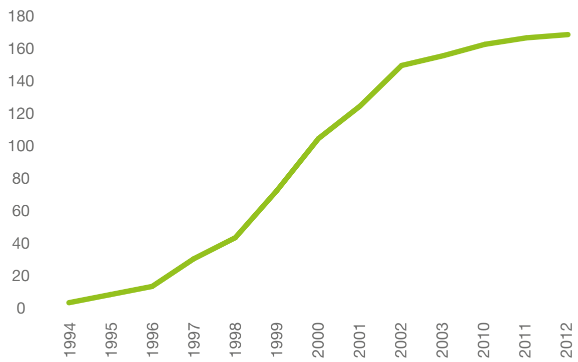
Foreign Currency Deposits



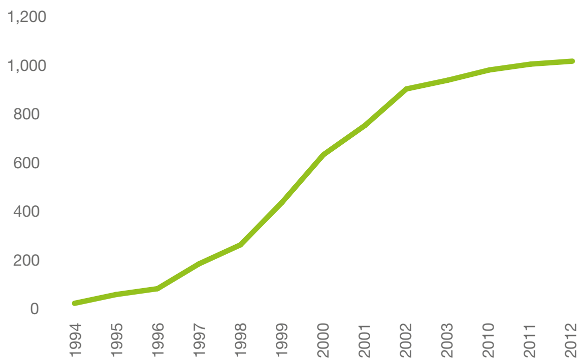
Student Bankers

Most importantly, we have been leading a move to inculcate the savings habit amongst children, the future of our nation. Through the HNB Student Managers Programme, which was established in 1994, the Bank has been engaging and empowering youth. Over the years, with the consent of the Ministry of Education and the Central Bank of Sri Lanka, the Bank has progressively approached schools, assisting them in infrastructure development and capacity building. To complement the national curriculum the Bank established Student Savings Units within the premises of these schools and has effectively inculcated the savings habit amongst today's youth whilst also imparting the basics of financial education, responsibility and accountability.

No of Student Savings Units

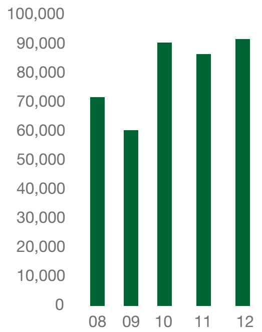


No of Student Managers

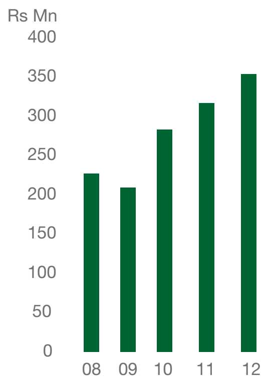


SSU Performance Review

No. of Student Savings Accounts



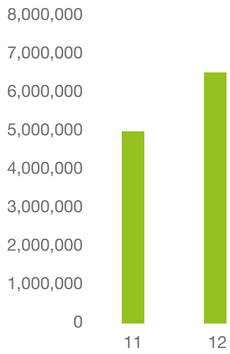
Cumulative value of Student Savings



2012 - Employee wealth creation

Value allocated to Employees

Average percentage by which salarieswere incremented



Number of recruitments made permanent

No. of recruitments to the permanent cadre	
Year	**No. of Employees**
2010	138
2011	133
2012	205

Number of employees promoted

Internal promotions to a higher grade	
Year	**No. of Employees**
2010	161
2011	271
2012	188

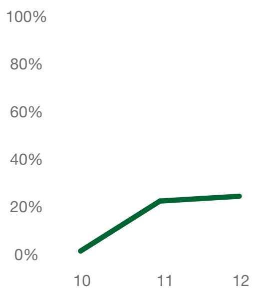
Economic Wealth Creation

2012 – Supplier value creation

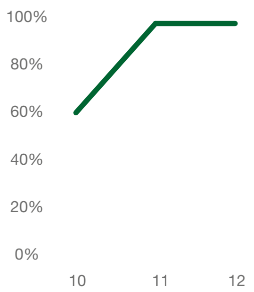
Suppliers and their actions impinge on our sustainability and we believe that it is our prerogative to define the boundaries for their sustainable behaviour. Our strategic sourcing strategy promotes sustainable procurement by taking into consideration environmental, ethical and social factors when making sourcing decisions. We view supplier relations as an opportunity to promote and catalyse greater economic activity especially in the area of micro-enterprise.

Of the Bank's supplier portfolio, 97.5% is classified as SME/Micro suppliers where the classification is defined as vendors with an annual turnover of less than Rs 600 Mn. The value of procurement from SME/Micro suppliers is estimated at 23% of total procurements.

Procurement from SME / Micro Enterprises



SME / Micro Enterprises as a % of Total Suppliers



Equitable wealth creation and providing equal opportunities to suppliers through a transparent procurement process ranks high on our priorities. Our procurement policy facilitates the procurement of goods and services at fair prices, accommodates credit for suppliers that require financial assistance, and comprises of a review process for supplier complaints. Stringent review process for suspension of supplier services enhances transparency as does the tender process. Suppliers are imposed late delivery penalties and required to adhere to the Bank's Green procurement policy.

Accommodative Processes for SME / Micro Enterprises
Processing of invoices within 1 week
Tenders invited for amounts as low as Rs 25,000/-
Credit accommodation

COMPONENTS OF THE PROCUREMENT PROCESS

- Pre-evaluation of suppliers' business processes.
- Pre-evaluation of suppliers stand on human rights, labour, health & safety and ethics.
- Tender process ensures transparency of expectations.
- Selection process beyond the financial benefits to sustainability criteria.
- Micro/SME suppliers assisted through accommodative processes.
- Inspection of suppliers premises and business practices on an ongoing basis.
- Supplier appeal scheme and whistle-blow mechanism.
- Credit accommodation for suppliers.
- Late delivery penalties and fair review prior to suspension.
- Green policy engagement with suppliers that have a turnover in excess of Rs 1.0 Mn.
- Panel of auctioneers appointed for the disposal of environmentally friendly fixed assets.
- All environmentally hazardous fixed assets disposed of under the Bank's Green Policy.
- Procurement of goods and services at fair prices.

People
Progress

Employees

Striving for employee excellence is at the very core of our strategic priorities. From a professional standpoint, we endeavour in every conceivable manner to create a conducive environment for professional development particularly by way of grooming financial management and banking experts. Through people investment we lay the foundation for a workplace that challenges, stimulates creativity and pushes our teams to innovate.

Our work ethic is shaped by values such as equality, meritocracy and a participatory interactive approach. We encourage teamwork, entrepreneurial spirit and individual pursuance of excellence. Our management approach to people development promotes innovation, creativity and has fostered a culture of continuous learning.

The leadership stance we enjoy, the accolades we have won and the winning passion we have displayed through the years is testament to our multi-disciplined professional team, whose work ethic is beyond reproach and whose proactive togetherness has fuelled a multi-dimensional culture of excellence in everything we do.

Safe & Sound: Our management approach to employee excellence

We strive to be a sound workplace that attracts and retains the right people and provide scope for individual development by making our people feel valued, included and engaged. Our Hatna family concept is the core of our efforts towards creating a team that is the best in the banking and financial services sector, not only professionally but as all round performers. The many Human Resource Development systems and policies in place, our value system and culture fosters a workplace where work-life balance is maintained, diversity upheld and ethical conduct is a priority.

An engaging, sound and healthy work environment encourages high quality performance as well as high employee satisfaction and loyalty. This is in the interest of both customers and shareholders. To maintain our position as the Partner in Progress and a relationship based bank we believe we must attract, develop and retain the best people so that we can provide the best service and experience to our customers

Our goal is to offer our employees and potential employees the very best work environment with equal opportunities to develop their individual careers, regardless of gender, ethnicity, age, or religion. Our responsibility is to drive career development, a performance based culture and to create a workplace with surety of job satisfaction, security and a perceptible career path for achievers.

Management Approach Actioned –

- Mentoring programme
- Employee Relationship Manager
- Employee grievance handling process
- Sound relationships with unions
- Sports Club and Welfare Associations
- Learning culture: e-learning brings 24x7 learning to employees
- Professional Learning & Development centre

People Progress

Our Employee Intents

Employee Progress Highlights 2012

- Asia's Best Employer Awards for "Excellence in Training"
- Silver Award winner at the HRM Awards organised by HRP, Sri Lanka
- Collective Agreement for Junior Executives renewed
- Reward for employees in the clerical and allied grades revised
- Embedded a base for a strong "sales" culture
- Increased emphasis on management development programmes, English language and communication skills development, competency training
- Prescribed "whistle blowing" policy

Culture of Learning

The Bank actively strives towards the creation of a culture of learning, one that is built on a firm foundation of knowledge, skills and attitude. In 2012 we have continued to invest heavily into capacity building and development of our people and have enhanced the orientation towards continuous learning and development by rebranding the Training function as "Learning & Development".

By sharing knowledge across the talent pool irrespective of job function, proactively and on an on-going 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 has allowed the Bank to achieve sustained and sustainable business.

The Bank's employee development programmes are focused on instilling the pursuit of excellence amongst employees and future employees. It does not believe in merely developing an individual in his or her current capacity or job function but focuses on developing an individual who is inspired, motivated and professional and has the depth and capacity to impact not only on value creation for the Bank but also for the industry, and the nation at large.

The Bank was recognised for its commitment to Learning at the Asia's Best Employer Awards for "Excellence in Training". Hosted by Universum Employer Branding Institute a world leader in Employer Branding; the award was conferred by World HRD Congress, Employer Branding Institute, India and Stars of Industry Group with CMO Asia as a strategic partner and endorsed by Asian Confederation of Business.

The Bank was also recognised at the HRM Awards of the Association of Human Resource Professionals (HRP) in Sri Lanka, with a Silver award. The HRM Awards commends the nation's best HR practices while assessing, recognising and felicitating the best HRM systems and processes in Sri Lankan organisations.

Safe And Sound Workplace

Over the years, our focus has been to essentially create a safe and sound workplace where our employees have the freedom to grow, have the surety of job safety, are welcomed in a place that embraces diversity and equality and consciously enjoy their careers in an environment that is ethical and just. We want our people to enjoy a good balance between work and private life and we therefore provide a number of work-life balance and welfare opportunities.

Our employees are expected to take considerable responsibility for their own work, individual development and career. Performance is continuously followed up through structured dialogues between managers and employees which focus on evaluating past performance and planning achievable goals for the future. An important part of the dialogue is to highlight the connection between the individuals' objectives and performance and the Bank's objectives, strategy and vision. By doing so, we are able to create a platform that fosters succession planning and creates leaders through a definitive leadership management process.

Employee Training - 2012

Employee Category	Foreign Training No. of Programmes	Average No. of hours	
		Local training	In-house
Corporate Management	38	8	-
Senior Management	7	6	-
Management Officers	24	8	-
Executives	15	8	21
Non Executives	-	22	40

Employees covered by Collective Agreements

Year	No	%
2010	3,267	75%
2011	3,259	71%
2012	3,358	71%

Permanent vs Contract Staff

Employment Type	No	%
Permanent	4,644	99.3%
Contract	35	0.7%
Total	**4,679**	**100.0%**

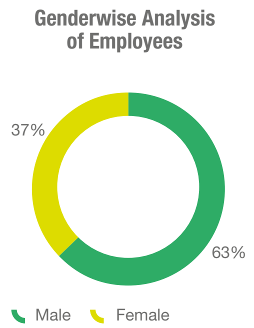
People Progress

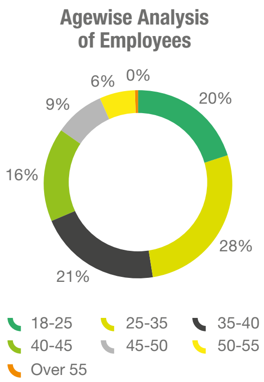
Staff Strength, Gender Analysis

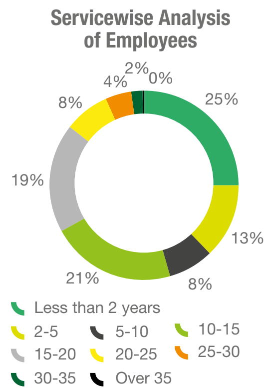
Category	2010			2011			2012		
	Male	Female	Total	Male	Female	Total	Male	Female	Total
Corporate Management	19	7	26	19	6	25	15	5	20
Senior Management	25	5	30	29	7	36	30	7	37
Managers & Executives	459	128	587	470	131	601	495	141	636
Officers	687	324	1,011	756	343	1,099	784	356	1,140
Banking Assistants	1,036	690	1,726	903	655	1,558	898	666	1,564
Trainees	155	92	247	372	190	562	403	210	613
Secretaries, Stenographers, Typists	9	367	376	9	358	367	9	343	352
Support Staff	314	-	314	297	-	297	282	-	282
Contract Staff	30	5	35	29	10	39	22	13	35
Total	**2,734**	**1,618**	**4,352**	**2,884**	**1,700**	**4,584**	**2,938**	**1,741**	**4,679**

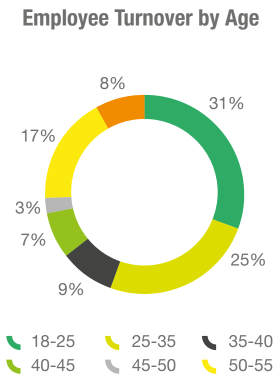
Staff distribution by Region

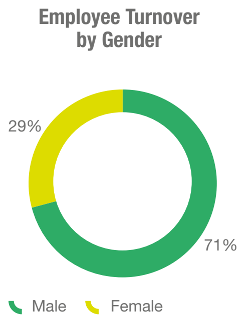
Province	2010		2011		2012	
	No	%	No	%	No	%
Central Province	305	7.0%	316	6.9%	331	7.1%
Eastern Province	171	3.9%	222	4.8%	230	4.9%
North Central Province	133	3.1%	129	2.8%	142	3.0%
North Western Province	217	5.0%	266	5.8%	219	4.7%
Northern Province	155	3.6%	170	3.7%	216	4.6%
Sabaragamuwa Province	143	3.3%	135	2.9%	149	3.2%
Southern Province	233	5.4%	208	4.5%	267	5.7%
Uva Province	117	2.7%	122	2.7%	125	2.7%
Western Province	2,863	65.8%	2,997	65.4%	2,987	63.8%
Foreign	15	0.3%	19	0.4%	13	0.3%
Total	**4,352**	**100.0%**	**4,584**	**100.0%**	**4,679**	**100.0%**

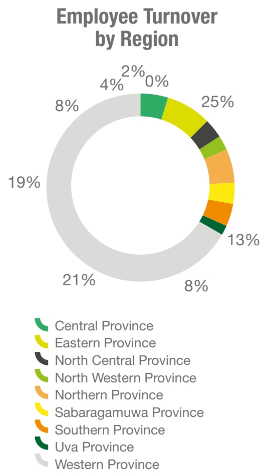

Genderwise Analysis of Employees
37%
63%
Male
Female

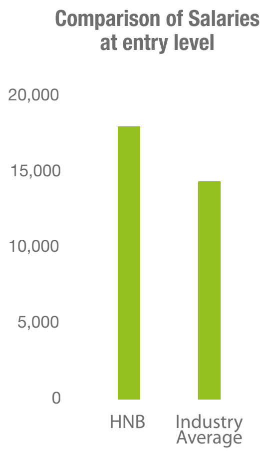

Agewise Analysis of Employees
6%
0%
9%
20%
16%
28%
21%
18-25
25-35
35-40
40-45
45-50
50-55
Over 55


Servicewise Analysis of Employees
2%
4%
0%
8%
25%
19%
13%
21%
8%
Less than 2 years
2-5
5-10
10-15
15-20
20-25
25-30
30-35
Over 35


Employee Turnover by Age
8%
31%
17%
3%
7%
25%
9%
18-25
25-35
35-40
40-45
45-50
50-55


Employee Turnover by Gender
29%
71%
Male
Female


Employee Turnover by Region
2%
4%
0%
8%
25%
19%
13%
21%
8%
Central Province
Eastern Province
North Central Province
North Western Province
Northern Province
Sabaragamuwa Province
Southern Province
Uva Province
Western Province


Comparison of Salaries at entry level
20,000
15,000
10,000
5,000
0
HNB
Industry Average

People Progress

Sports Achievements - 2012

Badminton
- Mercantile Novices Championship Tournament – March 2012 - Men's Veteran - Winners
- Mercantile Double Championship Tournament – May 2012 - Grand Slam – Winners
- Mercantile Open Badminton Championship Tournament – September 2012 - Overall Champions
- Mercantile Team Championship Tournament – November 2012 - Runners up

Cricket
- Mercantile Open Six-a-side Tournament (Over 40) – March 2012 - Winners
- Mercantile 'G' Division Tournament – August 2012 - Winners
- Mercantile 'A' Division Tournament – December 2012 - Runners up

Basketball (Women)
- Mercantile Knockout Tournament – July 2012 - Winners
- Mercantile League Tournament – August 2012 - Winners

Basketball (Men)
- Mercantile Knockout Tournament – June 2012 - Winners

Hockey
- Mercantile League Tournament – August to October 2012 - Runners up
- Mercantile Knockout Tournament – May to October 2012 - Runners up

Netball
- Open Club Tournament – February 2012 - Winners – (Open, Mix & Men's)
- Open Club Tournament – July 2012 - Runners up (Masters & Men's)

Soccer
- Mercantile 'A' Division League Tournament - March 2012 - Runners up
- Mercantile 'A' Division Knockout Tournament - December 2012 - Runners up

Athletics
- Mercantile Athletic Meet – November 2012 - 17 Athletes achieved honours by winning 8 Gold, 8 Silver and 8 Bronze Medals.

National Players – 2012

Badminton
- Mr. Dinuka Karunaratne
- Ms. Nadeesha Gayanthi

Cricket
- Mr. Sajeewa Weerakoon

Basketball (Men)
- Mr. R R S Fernando

Basketball (Women)
- Ms. Anjali Ekanayake
- Ms. Kumarine Silva
- Ms. Shenika Herman was appointed as the Asst. National Coach – Basketball (Women).

Netball
- Ms. Gayathri Lankatilleke
- Ms. Shashika Samarasinghe

Product Responsibility

Our Bank provides financial services and manages financial risks and transactions, and helps both individuals and corporates realise their ambitions. We strive to build and maintain strong relationships with our customers.

Our core focus in product responsibility is to aim for simplicity and transparency, and to always deliver products and services that build trust. We strive always to understand and meet our customers' needs and to meet those needs in the best ways possible through products and services that go beyond face value to build wealth and value in many ways.

Safe & Sound: Our management approach for customer responsibility

Minimising risks and safeguarding the interests of our customers' money is one of our core responsibilities. Similarly, we strive to ensure that customers have a full understanding of the long-term and short-term impacts of the products and services they seek. Credit affordability is a driving factor in how we provide finance to our customers and often we tailor-make solutions to best meet their sustainable needs. We also believe in long-term relationships, and trust based partnerships, so we graduate customers along the development continuum, assisting them to achieve their vision and objectives in life. This enables us to be on top of customer expectations and to minimise customer complaints and dissonance.

Management Approach Actioned –

- Responsible lending practices where human rights are upheld, malpractices minimised and that entry into or catering of industries in malpractice are avoided
- Products and services governed by customer charter
- Whistle-blower policy for corruption and malpractice
- Ethical and responsible advertising code
- Product committees oversee fair product, pricing, positioning
- Network and e-platforms facilitate accessibility
- Cohesive customer engagement process to build strong relationships
- Continuous customer service evaluation system
- Formalised customer complaint system
- Independent compliance function for AML, KYC under the Compliance Policy
- Code of Conduct and Code of Ethics enhance focus on Anti-Corruption Practices, Compliance and Transparency.
- Data security and fraud management strategy implemented
- IT support for Risk Management

People Progress

Our Customer Intents

Customer Service Highlights 2012

- The Banker Magazine - "Bank of the Year"
- Excellence in Retail Financial Services Awards 2012 - "Best Retail Bank in Sri Lanka"
- Business Today Top 25
- 7 new customer centres & 1 electronic banking unit
- Dedicated Islamic banking unit
- 4 new products, 1 new service & 3 revised products
- Customer charter and communication systems
- Launch of customer complaint management system
- Communication skills development, competency training
- Prescribed "whistle blowing" policy
- 241 financial literacy and capacity development programmes for 15,968 micro entrepreneurs

Your Partner In Progress

Serving the interests of customers is the fundamental that propels the Hatton National Bank. In 2012 the Bank focused on 6 areas to serve customer interests

- New product development
- Access to banking services
- Protecting customer interests
- Listening and engaging with our customers
- Financial Literacy to build lives
- Embracing the next generation

Product and Service Development

Market needs assessment and customer feedback formed the impetus that drove new product development for the Bank. The Product Development Committee effected changes to existing products and designed new products to match customer expectations and the changing socio-economic context.

Each new product is fully tested and evaluated for suitability and undergoes a rigorous assessment for compliance in addition to being often put for compliance testing and verification to regulators such as the Central Bank of Sri Lanka.

The Bank's customer charter is the foundation for sustainable banking. Our product fact sheet for each product/service provides a comprehensive overview of the costs, additional charges and any implications of the product. The Bank undertakes education on new products giving customers a holistic understanding of the product and supplements these with consistent product communication such as video walls at branches to bring greater transparency.

2012 - New / Revised Products & Services

Product/Service	Brand	Description and Target Customer Groups
Money Market Savings Account	HNB Money Market Savings Account	Corporate customers and high networth individuals who have developed their own view of interest rate fluctuations and experienced enough to manage their cash. Interest rates would be based on weekly money market rates.
Foreign Currency Savings Account	HNB FC Advantage	Corporate customers and high net worth individuals. Competitive variable interest rate connected to LIBOR plus flexibility of withdrawals.
Senior Citizens Account	HNB Senior Citizens Account	Product was modified by the requirement for joint account holders being scaled down facilitating more senior citizen couples to open accounts with a lesser minimum deposit requirement.
Children's Savings and Teen Savings	HNB Singithi and HNB Teen	Product was modified by making the gifts schemes aligned with the market requirements to award the students taking the Year-5 Scholarship Examination and HNB Teen Account Holders to be rewarded for educational excellence.
Electronic Banking Unit at Orion City	HNB Electronic Banking Unit	Electronic mediums of banking on site introduced
Islamic Banking	HNB Al Najah	To serve Islamic Banking clients with a special banking unit
Electronic Data Interchange	EDI	A system to facilitate real time electronic fund transmission from business to business.
Privilege credit cards	HNB VISA Infinite & Signature Credit Cards	Credit Cards for high net worth customers with convenience, special benefits and savings. The credit cards are also CHIP enabled thus providing the best level of security for card information.

Access To Banking Services

The Bank is committed to serve all strata of society through effective product segmentation and provides financial access and services across the continuum of socio-demographic groups.

2012 - Multi-Point Distribution Network

	2010	2011	2012
Premier Grade Branches	5	5	5
Super Grade Branches	9	9	10
A - Grade Branches	27	28	27
B - Grade Branches	40	41	42
C & D - Grade Branches	73	105	119
Extension Offices	51	52	44
No of Branches with Dedicated Micro Banking Officers	117	119	129
Dedicated Micro Banking Units	1	9	9
Crystal Circles – Personalised Banking Services	-	3	3
Priority Banking Services	1	1	1
On-site ATMS	294	335	339
Off-site ATMs	56	65	71
Total ATM penetration points including strategic collaborations	350	400	672
Student Banking Units	159	164	166
Mobile Banking Units	2	2	2
No of e-Banking customers	29,214	43,139	69,795
No of SMS Banking customers	4,095	5,807	14,349

People Progress

Protecting Customer Interests

Our relationships with our customers depend upon trust. To retain this trust we must set our customers' interests first while ensuring that all our customers are treated fairly according to the highest standards of service, transparency and responsible banking practices. We conduct our business in an ethical way, guided by our core values of mutual respect, continuity, professionalism and commitment.

The Bank is extremely conscious of the need to safeguard the interests of its depositors. Through many measures of governance and risk management, the Bank has earned a reputation as a stable financial institution. The deposit product line is vast and extends across the lifecycle continuum with products available for newborns to senior citizens.

Deposit products offer a variety of value-additions and are tailored to suit the needs of the target markets. The Bank's extensive customer centre network ensures easy access to depositors' monies and the many safety and security measures adopted by the Bank in addition to risk management and compliance efforts adds to the physical security of the deposits.

Ensuring that our customers can afford to manage their credit is a key component of responsible lending. This is why our credit decisions always are based on the customer's individual situation and repayment abilities. Our approach entails fair and ethical marketing, and we consciously avoid products that may pose risk of debt over-exposure to our customers whilst ensuring that our depositors stay safe.

Fraud prevention has been a priority for the Bank in recent years, including the launch of a new fraud prevention strategy. We are strengthening our focus on proactive measures, by reviewing fraud issues earlier in the business processes. Our core fraud combating units are Security, Compliance, Internal Audit, Information Security, Human Resources and Risk Control. They work together to strengthen fraud prevention management. This includes assisting business and support functions in building and maintaining "fraud proof" banking processes.

Security & Safety Initiatives:

Following are a few of the initiatives undertaken by the Bank to augment security and safety of the Bank's operations and its customers and other stakeholders:

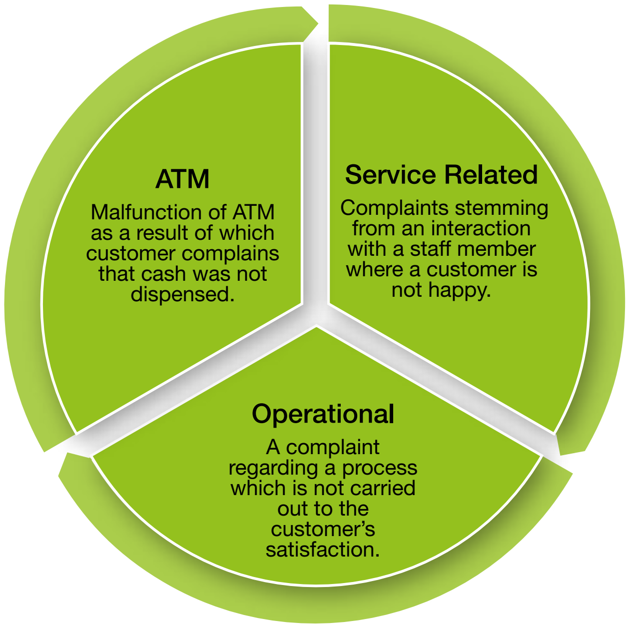
Initiative	Description	End Objective
AML Risk profiling of all customers	Action taken towards implementing on-line collation of data to better profile customers based on risk	To meet regulatory requirements
Obtaining KYC data from customers	An ongoing process to enhance the Bank's database on customers	To carry out Customer Due Diligence more effectively
Stress Testing	Stress Testing enables the Bank to determine how its portfolios will react if business conditions become more challenging	Enhance the risk picture and possible outcomes of a deteriorating external environment.
Implementation of Risk Management Systems	To enhance and automate the Bank's risk monitoring processes	Better and more effective management of risk
Business Intelligence & Analytics tool	Enables the business performance to be with greater depth and drill down capabilities	Enhances the top-level perspective of the business and shortcomings
Data security enhancements	Adoption of better encryption methodologies for credit cards	Enhance security of transactions
Multifactor authentication	Adoption of multi-layer authentication for online banking	Enhances security of data and transaction
3D security implementation	Payment gateway security enhancement	Ensures transaction points are secure

Listening & Engaging Our Customers

Hatton National Bank actively engages in a robust and consistent process of customer engagement. The objectives of the Bank's customer engagement process are two-fold. Primarily it aims to raise issues, concerns and suggestions from customers for the betterment of the service process so that continuous service development can be achieved. Secondly, it engages customers with the intention of educating and empowering them, with the Bank acting as the catalyst for livelihood and capacity development.

During the year the Bank upgraded its customer complaint procedures and a customer complaint database system has been created. The Complaints Management System ensures continuity in the resolution process and provides a birds-eye view of the complaints to top management.

Areas of frequent complaints



	2010	2011	2012
No. of Customer Centres	205	240	247
No. of Direct Complaints	86	289	510*
No. of complaints to the Financial Ombudsman	16	11	12

***excluding complaints received at the CMU*

People Progress

Knowledge Share For Customer Progress

We are a strong advocate for improving the financial literacy of our customers and the general public. We have developed a variety of programmes and initiatives to help customers better understand financial matters and improve their money management skills. Our commitment to building capacity on basic business skills, financial capabilities and providing access to business networks is apparent from the many initiatives that we direct to a spectrum of sectors and customers.

Project	Description	Investment & Impact in 2012
Student Banking: Financial Literacy to the Youth	The Student Banking Programme was established in 1994 to involve rural youth, provide them access to resources and to allow them to interact with the rest of the nation. The Bank established Student Savings Units within school premises with a view to not only inculcate the savings habit but also to impart financial education, responsibility and accountability to Student Bankers.	Investment – Rs 3.8 Mn No. of Student Savings Units – 166 No. of Student Managers participated at Student Managers Outward Bound Training – 835
Financial Literacy to rural, micro entrepreneurs & Youth Empowerment Programmes	The “Divi Saviya” Programme has been in existence for over twenty years and strives to create financial inclusion for rural micro entrepreneurs. It has now been merged with the “Yauwanabhimana” programme , and has to date facilitated over 100,000 young micro entrepreneurs and compounded accessibility to financial services.	Investment – Rs 2.4 Mn No. of Programmes – 241 No. of Participants - 15,968
Financial Management Education	Programmes aimed at creating a greater understanding of financial management amongst Small and Medium Enterprises. Seminars and workshops on Marketing Management and Improving Business Skills for Entrepreneurs were organised by the Bank with the financial assistance of the SMEDeF credit line and conducted by International Finance Corporation authorised trainers.	Investment – Rs 0.3 Mn No. of Programmes – 3 No. of Participants - 83

Social Responsibility

We recognise that a thriving society is critical to our future success as a bank. In addition to the role that our business plays in the communities where we operate, we support local communities. It is important for us to help mitigate social imbalances, to support innovations and entrepreneurship and to promote a sound and healthy lifestyle.

Safe & Sound: Our management approach for social responsibility

Social responsibility has been woven into the very fabric of our Bank from its inception. In fact, over a century ago, Hatton National Bank was established to serve the people of a tiny community in the hillside hamlet of Hatton. Those origins remain the foundation of our desire to create opportunities, to catalyse change and to bring social inclusiveness for many thousands of rural communities.

Management Approach Actioned –

- Clear community investment strategy
- Sustainability Committee and Sustainability Foundation overlooks CSR
- Employee volunteerism encouraged
- Education as an extension of the Bank's focus on financial literacy
- Healthcare, Water & Sanitation
- Entrepreneurship as a tool for social empowerment

Community Responsibility Strategy

Healthcare

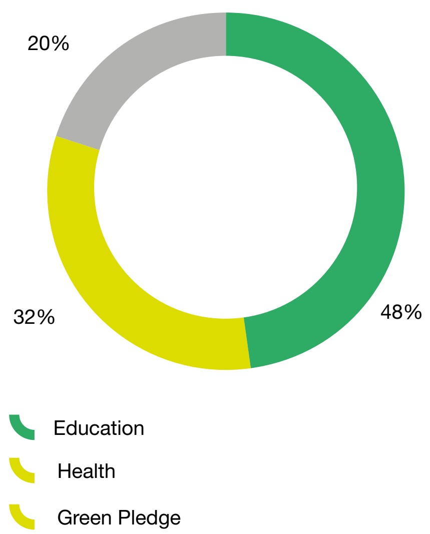
United Nations Millennium Development Goal Target 7 "providing safe drinking water and sanitation facilities" and create a safe and supportive environment for healing

Education

United Nations Millennium Development Goal Target 2 "Achieve Universal primary Education"

Entrepreneurship

National Vision for an empowered rural community



People Progress

Cancer Counselling Centres – Maharagama & Jaffna

Inaugurated in 2007, the Cancer Counselling Centre was the first and only facility of its nature in Sri Lanka. Established in association with Maharagama National Cancer Hospital with support from Arbeiter Samariter Bund (ASB) Germany, the counselling centre caters to both the patients as well as their families in overcoming the psychological trauma associated with the diagnosis of cancer.

The Bank also supported to set up a similar unit at the Teaching Hospital in Jaffna in 2011.

Investment Commitment

Year	Rs Mn
2007	7.0
2008	5.0
2009	1.0
2010	5.0
2011	2.25
2012	1.5

Financial assistance to cancer patients

The Bank assists patients and their families overcome the financial burden of daily expenses especially in cases where the sole breadwinner is afflicted.

Investment Commitment

Year	Rs Mn
2010	0.76
2011	0.705
2012	0.23

Renovations to the National Cancer Institute, Maharagama

The Bank continued to maintain the Male Surgical Ward at the National Cancer Institute, Maharagama and assisted towards the renovation of the ward.

Investment Commitment

Year	Rs Mn
2009	0.25
2010	1.20
2011	1.0
2012	1.0

HIV/AIDS Awareness

	Description of Activity
2009	Commemoration of World AIDS Day by all employees & Training of HIV Champions - 20
2010	Commemoration of World AIDS Day by all employees & Training of HIV Champions – new recruits under 25
2011	Commemoration of World AIDS Day by all employees & Training of HIV Champions – new recruits under 25
2012	Training of HIV Champions – 5, Branch wise Awareness Programmes in the Greater Colombo Region, Northwestern Region and Southern Region & Awareness Programmes for HNB Student Managers - 35

The National Trust – Sri Lanka

The Bank continued its support to the National Trust for Cultural and Natural Heritage as its Principal Patron with the view of protecting and preserving the cultural heritage of the country.

Investment Commitment

Year	Rs Mn
2010	0.75
2011	1.5
2012	1.5

Nena Pubuduwa

An ambitious project aimed at enhancing the educational resources of students in rural communities specifically those whose resources are low due to lack of infrastructure at school- level. At its inception the project aimed to provide a 100 libraries to schools lacking in facilities and financial resources. The project has progressively enhanced the literacy skills of over 50,000 children across Sri Lanka with 200 libraries in place. The Bank has also been setting up computer centres in a bid to enlarge the scope of the project to include computer literacy.

Province wise distribution of libraries

Province	No. of Libraries 2010	No. of Libraries 2011	No. of Libraries 2012
Investment Commitment	Rs 6.025 Mn	Rs 4.36 Mn	Rs 4.0 Mn
Central	31	33	33
Eastern	12	15	15
North Central	14	16	18
North Western	9	9	11
Northern	8	11	16
Sabragamuwa	14	14	15
Southern	22	24	26
Uva	15	15	18
Western	43	48	48
Total	168	185	200

Province wise distribution of computer centres

Province	No. of Computer Centres 2010	No. of Computer Centres 2011	No. of Computer Centres 2012
Investment Commitment	Rs 3.0 Mn	Rs 4.37 Mn	Rs 3.3 Mn
Central	3	4	5
Eastern	-	-	3
North Central	2	2	2
North Western	-	-	--
Northern	-	-	--
Sabragamuwa	3	4	4
Southern	2	2	2
Uva	1	2	3
Western	-	1	1
Total	11	15	20

People Progress

Skills Development for Youth

The Bank also set the wheels in motion to offer young people throughout the island the opportunity to improve both themselves and their skills through a programme aimed at youth empowerment named "Yauwanabhimana". Yauwanabhimana aims to provide young people between the ages of 18 to 30 years with the resources, skills and tools they need to become more 'employable' in the corporate sector or to successfully manage self-employment.

Youth Empowerment Programmes

Year	Investment (Rs)	No. of programmes	No. of participants
2011	151,560/-	1	130
2012	2,294,327/-	21	2,339

Entreprenuer Development & Financial Literacy Programmes

Programme Type	No. of programmes	No. of participants
YEP	21	2,339
Financial Education	113	6,857
Entrepreneur Development	103	6,527
General Awareness - Entrepreneurs	4	245
General Awareness - Youth	3	1,000
	244	16,968

Environmental
Citizenship

To address the many environmental challenges that the world faces, new ways of thinking, innovations and not least, financial assistance is needed. We believe that our Environmental Citizenship plays a critical role in how we catalyse change and behaviours. Our Green policy and Green Pledge lies at the heart of our approach to environmental stewardship. We believe that by developing competitive financial solutions that promote sustainability goals we can change the role of finance in perpetuating a greener future.

The Bank also strives to enlarge the scope of its environmental citizenship to encompass customers and suppliers as well as the public at large. On the commercial side, the Bank has been actively supportive of sustainable energy finance and has continued to increase its visibility and exposure to the sector.

Safe & Sound: Our management approach for environmental citizenship

We are actively supportive of sustainable energy finance and continue to increase our exposure to the sector (Refer page 163). Our credit assessment process employs a systematic assessment of environmental risk as a key criteria of the credit approval process. We work hard to reduce our own impact on the environment and have laid considerable emphasis on the achievement and the measurement of this impact. The Bank's Green Pledge serves as the fundamental base for impact reduction and is the catalyst for behavioural change both within and outside of the organisation.

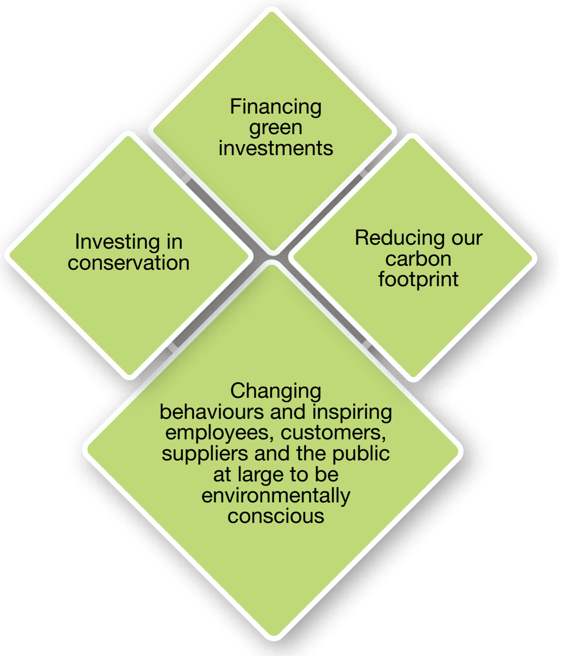
We support focal environmental preservation initiatives that have far reaching sustainability consequences in the future preservation of the country's natural assets and actively seeks to support projects that will support biodiversity enrichment.

Management Approach Actioned –

- Scorecards and rating systems to assess credit risks
- Covenants placed in offer letters and agreements regularly monitored and inspected
- Environmental Management System (EMS) under implementation
- Measurement of environmental sustainability criteria against key performance indicators
- Initiatives to enhance the environmental credibility by minimising carbon footprint.
- 2 Green Buildings commissioned at Nittambuwa and Kalmunai; another under design and construction at Jaffna
- Natural asset restoration in key wilderness projects

Environmental Citizenship

Our Green Tenets



Highlights 2012

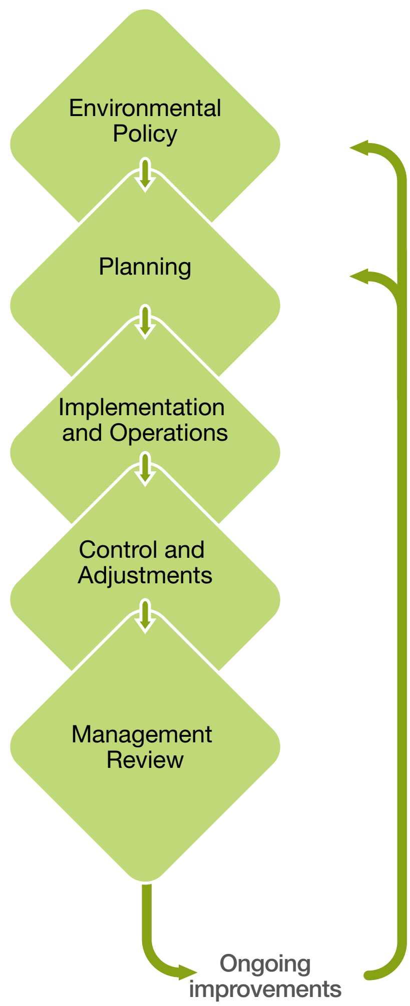
- Financing of renewable energy projects - Rs 1,480.6 Mn
- Sri Lanka National Energy Efficiency Award for the second consecutive year for "Green Branch"
- Construction of 2 Green Buildings in Kalmunai and Jaffna
- Significant reduction in energy & water consumption
- More than 20,000 trees planted
- Rs 3.3 Mn invested into the Bundala National Park & the Udawalawe National Park
- An e-waste disposal policy
- 3,025 kgs e-waste collected

Engaging for sustainable business practice

The Bank endeavours to achieve a balance of social and environmental considerations in business and is aware of the role of and the need for stakeholder inclusiveness as a core driver of sustainable business practice. It also considers the behaviours of all of its stakeholders in championing change towards sustainability awareness and empathy. Changing behaviours is deemed critical to the long-term effectiveness of the Bank's sustainability strategy. Towards this end, the Bank continues to progressively initiate programmes that instill the values of environmental and social responsibility.

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

In order to manage the Bank's environmental impact systematically and efficiently, the Bank decided in 2012



to implement an Environmental Management System (EMS). The system will ensure that the Bank continually improves its environmental behaviour and regularly reports on environmental conditions internally as well as externally.

The EMS will be based on the Bank's green policy and will set forth procedures, responsibilities and controls for individual areas. Management will review the system on an ongoing basis and see that adjustments are implemented, for example as the result of new statutory provisions.

Green Finance

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

We are committed to financing clean technology, energy efficiency and renewable energy transactions. In 2012, the Bank provided Rs 1,480.6 Mn in dedicated financing of renewable energy projects.

Project	Funding in 2012		
	No of Projects	Capacity	Advances Rs Mn
Hydro power projects	4	7.0 MW	375.1
Wind power projects	2	12.8 MW	1,105.5

Environmental risk assessment process for credit evaluation of environment sensitive projects

Environmental Citizenship

Green Pledge In Practice

During the year the Bank broadened its scope on the implementation of the "Green Pledge". Key focus areas included

- Tree planting
- Waste management
- Resource efficiency

Tree Planting Initiatives

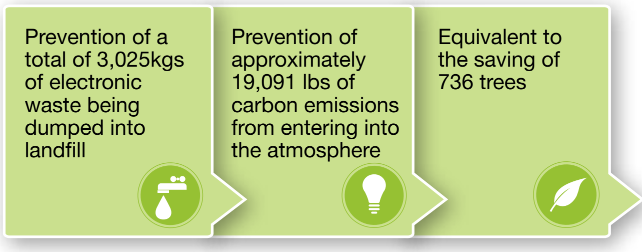
Programme Type	2010	2011	2012
No. of trees planted to commemorate World Environment Day	1,550	18,300	20,000
Green barrier at Udawalawa National Park	-	-	3,700

Waste Management

(a) E-waste collection campaign

Considering the harm caused to the environment by the careless disposal of electronic waste, the Bank carried out an island-wide e-waste collection campaign for a period of one week in October 2012. Customers, employees and the general public were requested to drop off any old or unwanted computers, phones, CDs and similar electronic items at any of the Bank's 244 customer centres during this period. The electronic waste was handed over to "Think Green", a registered e-waste recycling company for proper disposal.

HNB E-waste campaign results



(b) Waste Management Systems

Programme Type	2010	2011	2012
Disposal of sanitary waste	-	230 customer centres	247 customer centres and Head Office
Anaerobic waste waster treatment systems	5 customer centres	5 customer centres	6 customer centres
Waste Disposal System	Head Office	Head Office	Head Office and 247 customer centres

Resource Efficiency

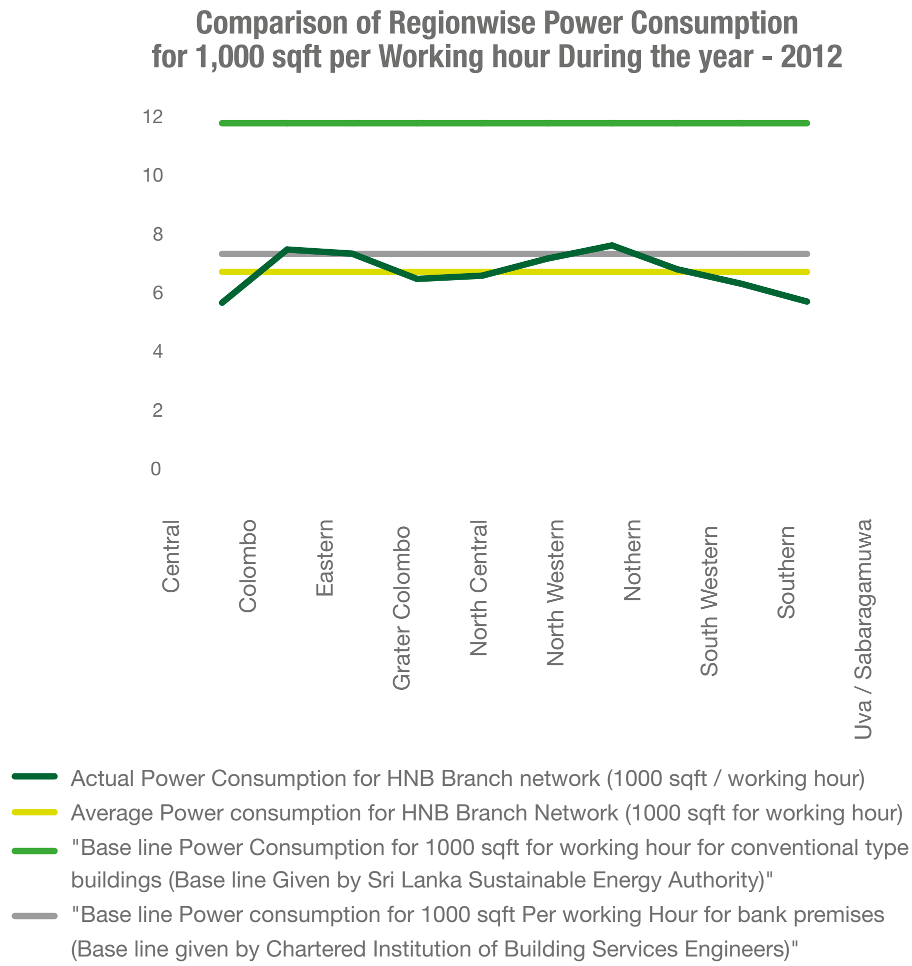
(a) Water Efficiency

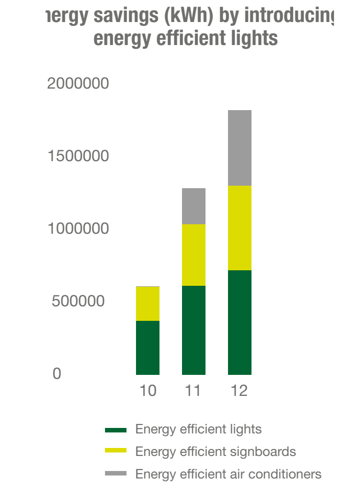
Programme Type	2010	2011	2012
Rainwater Harvesting	1. customer centre	2. customer centres	5 customer centres
Anaerobic waste waster treatment systems	5 customer centres	5 customer centres	6 customer centres

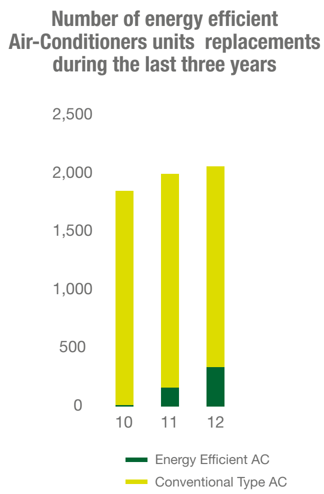
(b) Resource Management

Measures taken to reduce resource usage in future	Extent to which the measures have reduced environmental damage during the year	Total direct and indirect greenhouse gas emissions by weight	Energy Consumption
- Introduction of energy efficient lights - Introduction of energy efficient signages - Introduction of energy efficient inverter type air conditioners - Introduction of 30 kVA generators instead of 45 kVA by reducing electrical power requirement of customer centres - Maximise natural lightings - Continuous awareness programmes to reduce energy consumption in customer centres - Maintain correct temperature settings for air conditioners installed in the entire customer centre network to reduce electricity consumption - Maintain correct indoor air quality - Continue the "Best Green Branch" competition	- Total savings = 12,355,000 kWh (in accordance with the baseline given by Sri Lanka Sustainable Energy Authority) - Introduced energy efficient lights for 14 customer centres, Savings : 108,660 kWh / Rs 2,281,860/- - Introduce energy efficient signages, Savings : 157,280 kWh / Rs 3,302,880/- - Introduce 175 energy efficient inverter type air conditioners, Savings : 272,000 kWh / Rs 5,712,000/- - Fuel savings by introducing 12 numbers of 30 kVA Generators, Savings : 9,600L / Rs 1,152,000/-	- Direct green greenhouse gas emissions from Diesel Generators and Head Office Travel: 1,755.74 metric tons of Co_2 (Assume 1L of Diesel =2.572 x10^{-3} metric tons of Co_2 – ref: www.carbonfootprint.com) - Indirect green greenhouse gas emissions from Electricity consumption: 8,931.56 metric tons of Co_2 (Assume 1kWh = 4.278 x 10^{-4} metric tons of Co_2 - ref: www.carbonfootprint.com)	- Direct energy consumption by primary energy source – Total Diesel usage for (a) Generators 634,338L (b) Head Office Travel – 48,300L - Indirect energy consumption by primary energy source - Annual Electricity consumption 20,877,900 kWh

Environmental Citizenship







(c) Engagement Programmes For Efficiency Management

- Implementing waste management system for HNB customer centres with the collaboration of Central Environmental Authority
- Introducing eco friendly gas generation system at HNB Gampola
- Training programme on introducing solar power air conditioning systems to HNB
- Programme to integrate solar power and the national grid in normal working environment with required demand
- Training in environmental friendly material usage for the Bank's interior, conducted by Dura International
- Training in Green Rating Systems of commercial buildings, conducted by the Green Building Council of Sri Lanka with 3 managers being awarded Associate Professional status
- Training in modern technological air conditioning systems in Malaysia

Green Buildings

In 2012, the Bank invested significantly in construction of buildings which are designed on the principles of green construction, especially those targeting energy savings and improved energy efficiency.

Our own green buildings demonstrated productivity in enhancing energy efficiencies. To perpetuate the drive for operational sustainability, the Bank invested a further Rs 87.2Mn for the construction of a green branch in Kalmunai and in the Jaffna peninsula under the guidelines of the Green Building Society of the United States and the Green Building Council of Sri Lanka.

Our green branch in Nittambuwa was recognised for its environmental leadership at the National Energy Efficiency Awards 2011, having secured a Silver award for the most energy efficient building in the medium scale commercial sector-building category.
HNB Towers, one of Sri Lanka's most energy efficient buildings, met energy savings targets in 2012. An energy audit was conducted during the year to determine areas that required improvement.

Green Procurement Policy

The Bank adopts a green procurement policy 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 the planet.

3R Policy

The Bank also adopts a 3R policy – Recycle, Reuse, Reduce - towards all tangible resources including furniture, paper and paint amongst others.

Recycle

- Paper Recycling: 152,319 Kg of paper equivalent to 2,589 trees, 4,840,698 litres of water, 609,276 kWh of electricity, 267,320 litres of oil, 457 cubic Meter of land fill, Reduced Green House Gas Emission by 152,319 Kg of Carbon Equivalent.

Re-use

- Reconditioning and re-use of office furniture, prolonging lifetime and thereby reducing the waste generated through routine replacement.

Reduce

- Paper consumption (most relevant material used by the Bank)

	2010	2011	2012
Total weight of office paper purchased (A4, B5, Legal, Computer Paper, Letterheads) tonnes	148	142	146
No. of customer centres	205	240	247
Total office paper purchased per customer centre (kg)	720	590	592

Natural Asset Conservation

Project	Description	Investment to date (Rs Mn)	Impact to date
Bundala National Park – 2007 to date	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.	10.3	Cleared over 40 hectares.
Udawalawe National Park - 2012	Creating an 18Km green boundary between the two outer fences of the Park for approximately 120 hectares. This Green belt would comprise of over 12,000 trees and prevent elephants from accessing the motorway.	1.3	3,700 saplings of endemic trees planted
Nation wide tree planting – 2010 to date	Tree planting campaigns led by employees, customers, school children to protect our environment. The significance of this campaign would be that each sapling planted would have an owner who has pledged to nourish and protect it until it grows into a mature tree.	4.0	42,000 trees planted

A small industry success story

"I always wanted to be a successful businessman and provide for my family. I got my first break when HNB gave me a small loan of Rs 25,000 although I was only 19 years old and was unemployed at that time. I used this to launch my first plant nursery and today the business is worth over Rs 6 million.
I now have several other enterprises including a fruit stall and even road development contractor services, all of which I have funded with a series of loans from Hatton Nation Bank. I am very grateful for the assistance they have given me right through...."

W R M Nishan Indika Gunatilake
Plant Nursery and Fruit Stall Owner,
Service Contractor

Independent Assurance Report

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

Tel : +94 - 11 542 6426
Fax : +94 - 11 244 5872
+94 - 11 244 6058
+94 - 11 254 1249
+94 - 11 230 7345
Internet : www.lk.kpmg.com

Independent Assurance Report to Hatton National Bank PLC On the Sustainability Report for the year ended 31 December 2012

Introduction

We were engaged by the Board of Directors of Hatton National PLC ("Bank") to provide assurance on the following elements of the Sustainability Report for the year ended December 31, 2012 of Hatton National Bank PLC ("the Report") for the year ended 31st December 2012.

- Reasonable assurance on the data on financial performance, as reported on page 139 of the Report 2012;
- Limited assurance on Performance Indicators and other information presented in the Report.

Managements' responsibility and the criteria applied

Management is responsible for the preparation and presentation of the Report in accordance with the GRI Sustainability Reporting Guidelines as described in 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 stakeholders 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 SLSAE 3000

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

This Standard requires that we comply with applicable ethical requirements, including independence requirements, and plan and perform the engagement to obtain limited assurance about whether the Report is free from material misstatement.

Summary of work performed

Financial data

A reasonable assurance engagement on financial performance involves verification that they were properly derived from the audited financial statements of the Bank for the year ended 31 December 2012.

Performance Indicators and the other information

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

- Inquiries of management to gain an understanding of the Bank's processes for determining the material issues for the Bank's key stakeholder groups.
- Interviews with senior management and relevant staff at group level and selected business unit level concerning sustainability strategy and policies for material issues, and the implementation of these across the business.
- Interviews with relevant staff at corporate and business unit level responsible for providing the information in the Report.
- Inquiries about the design and implementation of the systems and methods used to collect and process the information reported, including the aggregation of data into information as presented in the Report.
- Comparing the information presented in the Report to corresponding information in the relevant underlying sources to determine whether all the relevant information contained in such underlying sources has been included in the Report.
- Reading the information presented in the Report to determine whether it is in line with our overall knowledge of, and experience with, the sustainability performance of the Bank

Our conclusion

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

- The data on financial performance, as reported on page 139 of the Report 2012 are properly derived from the financial statements of the Bank for the year ended 31 December 2012.
- Nothing has come to our attention that causes us to believe that the Performance Indicators and other information presented in the Report are not fairly presented, in all material respects, in accordance with the GRI Sustainability Reporting Guidelines.

KPMG

CHARTERED ACCOUNTANTS

Colombo, Sri Lanka

21st February 2013

GRI
Statement

Global Reporting Initiative™

Statement
GRI Application Level Check

GRI hereby states that **Hatton National Bank PLC** has presented its report "Sustainabilty Report - Safe & Sound" (2013) to GRI's Report Services which have concluded that the report fulfills the requirement of Application Level A+.

GRI Application Levels communicate the extent to which the content of the G3 Guidelines has been used in the submitted sustainability reporting. The Check confirms that the required set and number of disclosures for that Application Level have been addressed in the reporting and that the GRI Content Index demonstrates a valid representation of the required disclosures, as described in the GRI G3 Guidelines. For methodology, see www.globalreporting.org/SiteCollectionDocuments/ALC-Methodology.pdf

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

Amsterdam, 18 February 2013

A+
GRI REPORT
GRI CHECKED

Nelmara Arbex
Deputy Chief Executive
Global Reporting Initiative

The "+" has been added to this Application Level because Hatton National Bank PLC has submitted (part of) this report for external assurance. GRI accepts the reporter's own criteria for choosing the relevant assurance

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

***Disclaimer:** Where the relevant sustainability reporting includes external links, including to audio visual material, this statement only concerns material submitted to GRI at the time of the Check on 8 February 2013. GRI explicitly excludes the statement being applied to any later changes to such material.*

GRI
Indicators

Profile Disclosure	Description	Reported	Direct Answer / HNB Annual Report Page Reference	Explanation / Notes
STANDARD DISCLOSURES PART I: Profile Disclosures				
1. Strategy and Analysis				
1.1	Statement from the most senior decision-maker of the organisation.	●	6-11; 12-17	
1.2	Description of key impacts, risks, and opportunities.	●	6-11; 12-17; 68-83; 122-123; 128-129	
2. Organisational Profile				
2.1	Name of the organisation.	●	Hatton National Bank PLC (HNB)	
2.2	Primary brands, products, and/or services.	●	33-50	
2.3	Operational structure of the organisation, including main divisions, operating companies, subsidiaries, and joint ventures.	●	33-55; 61-64	
2.4	Location of organisation's headquarters.	●	No. 479, T B Jayah Mawatha (Darley Road), P O Box 837, Colombo 10, Sri Lanka	
2.5	Number of countries where the organisation operates, and names of countries with either major operations or that are specifically relevant to the sustainability issues covered in the report.	●	The Company primarily operates in Sri Lanka. The operating locations within Sri Lanka are given on pages 61-63. The business dealings between the Bank and its business partners are given on pages 50-51, 54-55	
2.6	Nature of ownership and legal form.	●	Public Limited Company registered under the Companies Act No 7 of 2007, Sri Lanka	
2.7	Markets served (including geographic breakdown, sectors served, and types of customers/beneficiaries).	●	1-24; 61-64; 71	
2.8	Scale of the reporting organisation.	●	Number of employees 4679; Income statement - Page 206; 10 year summary - Page 331-332; 20 largest shareholders 338-339	
2.9	Significant changes during the reporting period regarding size, structure, or ownership.	●	No significant changes happened during the year	
2.10	Awards received in the reporting period.	●	127	
3. Report Parameters				
3.1	Reporting period (e.g., fiscal/calendar year) for information provided.	●	1 January 2012 to 31 December 2012	
3.2	Date of most recent previous report (if any).	●	31-Dec-2011	
3.3	Reporting cycle (annual, biennial, etc.)		Annual	
3.4	Contact point for questions regarding the report or its contents.	●	Deputy General Manager - Strategy & Compliance	
3.5	Process for defining report content.	●	130-131	
3.6	Boundary of the report (e.g., countries, divisions, subsidiaries, leased facilities, joint ventures, suppliers). See GRI Boundary Protocol for further guidance.	●	131	
3.7	State any specific limitations on the scope or boundary of the report (see completeness principle for explanation of scope).	●	131	
3.8	Basis for reporting on joint ventures, subsidiaries, leased facilities, outsourced operations, and other entities that can significantly affect comparability from period to period and/or between organisations.	●	131	
3.9	Data measurement techniques and the bases of calculations, including assumptions and techniques underlying estimations applied to the compilation of the Indicators and other information in the report. Explain any decisions not to apply, or to substantially diverge from, the GRI Indicator Protocols.	●	131	

● Fully reported ◐ Partially reported ○ Not reported

Profile Disclosure	Description	Reported	Direct Answer / HNB Annual Report Page Reference	Explanation / Notes
3.10	Explanation of the effect of any re-statements of information provided in earlier reports, and the reasons for such re-statement (e.g.,mergers/ acquisitions, change of base years/periods, nature of business, measurement methods).	●	No such requirements arose during the year	
3.11	Significant changes from previous reporting periods in the scope, boundary, or measurement methods applied in the report.	●	No significant changes from the previous reporting year	
3.12	Table identifying the location of the Standard Disclosures in the report.	●	This GRI Table	
3.13	Policy and current practice with regard to seeking external assurance for the report.	●	131	
4. Governance, Commitments, and Engagement				
4.1	Governance structure of the organisation, including committees under the highest governance body responsible for specific tasks, such as setting strategy or organisational oversight.	●	88; 126	
4.2	Indicate whether the Chair of the highest governance body is also an executive officer.	●	Dr Ranee Jayamaha is Chairperson and non-executive director of HNB's Board of Directors. Mr Rajendra Theagarajah is Managing Director and Chief Executive Officer.	
4.3	For organisations that have a unitary board structure, state the number of members of the highest governance body that are independent and/or non-executive members.	●	89; 93	
4.4	Mechanisms for shareholders and employees to provide recommendations or direction to the highest governance body.	●	131	
4.5	Linkage between compensation for members of the highest governance body, senior managers, and executives (including departure arrangements), and the organisation's performance (including social and environmental performance).	●	96-97	
4.6	Processes in place for the highest governance body to ensure conflicts of interest are avoided.	●	106	
4.7	Process for determining the qualifications and expertise of the members of the highest governance body for guiding the organisation's strategy on economic, environmental, and social topics.	●	92; 106-108	
4.8	Internally developed statements of mission or values, codes of conduct, and principles relevant to economic, environmental, and social performance and the status of their implementation.	●	4	
4.9	Procedures of the highest governance body for overseeing the organisation's identification and management of economic, environmental, and social performance, including relevant risks and opportunities, and adherence or compliance with internationally agreed standards, codes of conduct, and principles.	●	101-112	
4.10	Processes for evaluating the highest governance body's own performance, particularly with respect to economic, environmental, and social performance.	●	95-96	
4.11	Explanation of whether and how the precautionary approach or principle is addressed by the organisation.	●	124	
4.12	Externally developed economic, environmental, and social charters, principles, or other initiatives to which the organisation subscribes or endorses.	●	131	

GRI Indicators

Profile Disclosure	Description	Reported	Direct Answer / HNB Annual Report Page Reference	Explanation / Notes
4.13	Memberships in associations (such as industry associations) and/or national/international advocacy organisations in which the organisation: * Has positions in governance bodies; * Participates in projects or committees; * Provides substantive funding beyond routine membership dues; or * Views membership as strategic.	●	123	
4.14	List of stakeholder groups engaged by the organisation.	●	132-135	
4.15	Basis for identification and selection of stakeholders with whom to engage.	●	132-135	
4.16	Approaches to stakeholder engagement, including frequency of engagement by type and by stakeholder group.	●	132-135	
4.17	Key topics and concerns that have been raised through stakeholder engagement, and how the organisation has responded to those key topics and concerns, including through its reporting.	●	132-135	
STANDARD DISCLOSURES PART II: Disclosures on Management Approach (DMAs)				
DMA PS	**Disclosure on Management Approach PS**			
Aspects	Product Portfolio	●	33-50	
FS1	Policies with specific environmental and social components applied to business lines.	●	161-163	
FS2	Procedures for assessing and screening environmental and social risks in business lines.	●	161-163	
FS3	Processes for monitoring clients' implementation of and compliance with environmental and social requirements included in agreements or transactions.	●	69; 82; 161-163	
FS4	Process(es) for improving staff competency to implement the environmental and social policies and procedures as applied to business lines.	●	161-163	
FS5	Interactions with clients/investees/business partners regarding environmental and social risks and opportunities.	●	133-135; 156;161-163;	
Aspects	Audits	●	100-101; 108-109	
	Active Ownership	●	33-51;54-55	
DMA EC	**Disclosure on Management Approach EC**			
Aspects	Economic Performance	●	31-46; 138-144	
	Market presence	●	31-46	
	Indirect economic impacts	●	31-46; 138-144	
DMA EN	**Disclosure on Management Approach EN**			
Aspects	Materials	●	Zero impact operations and resource efficiency are inherent objectives of our sustainability strategy	
	Energy	●	Energy Minimum impact operations and resource efficiency are inherent objectives of our sustainability strategy	
	Water	●	Water Minimum impact operations and resource efficiency are inherent objectives of our sustainability strategy	
	Biodiversity	●	The Bank addresses environmental impacts in its lending policies	

● Fully reported ◐ Partially reported ○ Not reported

Profile Disclosure	Description	Reported	Direct Answer / HNB Annual Report Page Reference	Explanation / Notes
Aspects	Emissions, effluents and waste	●	The Bank strives to minimise its carbon footprint and adopts a strategy of resource reduction/optimisation. However, it is presently not material to our type of operations to further breakdown our emissions and waste indicators	
	Products and services	●	The Bank's product and service portfolio is continuously screened for environmental impact under the green banking policies	
	Compliance	●	General stance towards compliance covers this aspect fully and therefore detailed reporting is not considered material	
	Transport	●	Our objectives towards reducing our carbon footprint includes business related travel and transport	
	Overall	●	Minimum impact and efficient use of energy and resources are inherent objectives of our sustainability strategy	
DMA LA	**Disclosure on Management Approach LA**			
Aspects	Employment	●	145-147	
	Labor/management relations	●	145-147	
	Occupational health and safety	●	145-147	
	Training and education	●	145-147	
	Diversity and equal opportunity	●	145-150	
DMA HR	**Disclosure on Management Approach HR**			
Aspects	Investment and procurement practices	●	119; 138; 144	
	Non-discrimination	●	119; 145-147	
	Freedom of association and collective bargaining	●	145-147	
	Child labor	●	145-147	
	Forced and compulsory labor	●	145-147	
	Security practices	●	145-147; 154	
	Indigenous rights	●	119	
DMA SO	**Disclosure on Management Approach SO**			
Aspects	Community	●	119-135;157-160	
	Corruption	●	119-135	
	Public policy	●	119-135	
	Anti-competitive behavior	●	119-135	
	Compliance	●	119-135	
DMA PR	**Disclosure on Management Approach PR**			
Aspects	Customer health and safety	●	119-135; 151-156	
	Product and service labelling	●	119-135; 151-156	
FS15	Policies for the fair design and sale of financial products and services.	●	119-135; 151-156	
	Marketing communications	●	119-135; 151-156	
	Customer privacy	●	119-135; 151-156	
	Compliance	●	119-135; 151-156	
STANDARD DISCLOSURES PART III: Performance Indicators				
Product and Service Impact				
Product portfolio				
FS6	Percentage of the portfolio for business lines by specific region, size (e.g. micro/SME/large) and by sector.	●	71	
FS7	Monetary value of products and services designed to deliver a specific social benefit for each business line broken down by purpose.	●	33-47	
FS8	Monetary value of products and services designed to deliver a specific environmental benefit for each business line broken down by purpose.	●	33-47	

GRI Indicators

Profile Disclosure	Description	Reported	Direct Answer / HNB Annual Report Page Reference	Explanation / Notes
Audit				
FS9	Coverage and frequency of audits to assess implementation of environmental and social policies and risk assessment procedures.	●	108-110	
Active ownership				
FS10	Percentage and number of companies held in the institution's portfolio with which the reporting organisation has interacted on environmental or social issues.	●	294-305	
FS11	Percentage of assets subject to positive and negative environmental or social screening.	●	71-72; 161-163	
FS12	Voting policy(ies) applied to environmental or social issues for shares over which the reporting organisation holds the right to vote shares or advises on voting.	○	Not applicable	HNB only exercises significant voting rights on its subsidiaries and associates. There have not been instances where HNB had to vote on environmental and social issues upto date. Whilst currently the Bank does not have a specific voting policy applied to environmental or social issues for shares it is intended that this aspect would be addressed during the implementation of the proposed EMS by 2015.
Economic				
Economic performance				
EC1	Direct economic value generated and distributed, including revenues, operating costs, employee compensation, donations and other community investments, retained earnings, and payments to capital providers and governments.	●	139; 330	
EC2	Financial implications and other risks and opportunities for the organisation's activities due to climate change.	●	6-11; 12-17; 82; 122-123	
EC3	Coverage of the organisation's defined benefit plan obligations.	●	289-293	
EC4	Significant financial assistance received from government.	○	Not applicable	The Bank does not receive significant financial assistance
Market presence				
EC5	Range of ratios of standard entry level wage compared to local minimum wage at significant locations of operation.	●	As defined in the Collective Agreements. Page 149	

● Fully reported ◐ Partially reported ○ Not reported

Profile Disclosure	Description	Reported	Direct Answer / HNB Annual Report Page Reference	Explanation / Notes
EC6	Policy, practices, and proportion of spending on locally-based suppliers at significant locations of operation.	◐	Not material	At HNB 'locally based suppliers' is defined as manufacturers using locally available material in their production process. The Bank only deals with suppliers who have registered their services with HNB. Prior to approving the registration of the supplier an inspection is carried out by the Bank to ascertain the supplier's business, social and environmental practices. Selection of suppliers for a particular procurement decision would be based on number of factors including price, quality and ability to supply a large order in an ethical manner.
EC7	Procedures for local hiring and proportion of senior management hired from the local community at significant locations of operation.	●	All hiring is done locally at significant locations of operation	
Indirect economic impacts				
EC8	Development and impact of infrastructure investments and services provided primarily for public benefit through commercial, in-kind, or pro bono engagement.	●	157-160	
EC9	Understanding and describing significant indirect economic impacts, including the extent of impacts.	●	HNB is the largest private commercial bank in the country with an extensive branch network spanning the entire country. HNB works on the premise "Parters in progress" and focuses on sustainable business through the supply chain. The Bank works to ensure that our customers have access to fair and affordable banking. HNB is one of the leading private banks in micro finance and project finance. With over 4,679 employees the Bank invest heavily in the development of staff.	
Environmental				
Materials				
EN1	Materials used by weight or volume.	●	167	
EN2	Percentage of materials used that are recycled input materials.	○	Not material	Our business processes are not material intensive.
Energy				
EN3	Direct energy consumption by primary energy source.	●	165-166	
EN4	Indirect energy consumption by primary source.	●	165-166	
EN5	Energy saved due to conservation and efficiency improvements.	●	165-166	

GRI Indicators

Profile Disclosure	Description	Reported	Direct Answer / HNB Annual Report Page Reference	Explanation / Notes
EN6	Initiatives to provide energy-efficient or renewable energy based products and services, and reductions in energy requirements as a result of these initiatives.	●	161-167	
EN7	Initiatives to reduce indirect energy consumption and reductions achieved.	●	161-167	
Water				
EN8	Total water withdrawal by source.	○	Not material	Our core business processes do not utilise water.
EN9	Water sources significantly affected by withdrawal of water.	○	Not material	Our core business processes do not utilise water.
EN10	Percentage and total volume of water recycled and reused.	●	165	
Biodiversity				
EN11	Location and size of land owned, leased, managed in, or adjacent to, protected areas and areas of high biodiversity value outside protected areas.	○	Not applicable	Our operations are centred on urban, semi urban and rural areas that have a significant population density. Not a material issue and not applicable to type of operations.
EN12	Description of significant impacts of activities, products, and services on biodiversity in protected areas and areas of high biodiversity value outside protected areas.	○	Not applicable	Not applicable to our business as our operations have no direct impact on bio diversity rich habitats. However the Bank addressess environmental impacts in its lending policies - given on pages 162-163
EN13	Habitats protected or restored.	●	167	
EN14	Strategies, current actions, and future plans for managing impacts on biodiversity.	○	Not applicable	Our operations are centred on urban, semi urban and rural areas that have a significant population density. Not a material issue and not applicable to type of operations.

● Fully reported ◐ Partially reported ○ Not reported

Profile Disclosure	Description	Reported	Direct Answer / HNB Annual Report Page Reference	Explanation / Notes
EN15	Number of IUCN Red List species and national conservation list species with habitats in areas affected by operations, by level of extinction risk.	○	Not applicable	Our operations are centred on urban, semi urban and rural areas that have a significant population density. Not a material issue and not applicable to type of operations.
Emissions, effluents and waste				
EN16	Total direct and indirect greenhouse gas emissions by weight.	○	Not material	Not relevant or applicable to type of operations
EN17	Other relevant indirect greenhouse gas emissions by weight.	○	Not material	Not relevant or applicable to type of operations
EN18	Initiatives to reduce greenhouse gas emissions and reductions achieved.	○	Not material	Not relevant or applicable to type of operations
EN19	Emissions of ozone-depleting substances by weight.	○	Not applicable	Not relevant or applicable to type of operations
EN20	NOx, SOx, and other significant air emissions by type and weight.	○	Not applicable	Not relevant or applicable to type of operations
EN21	Total water discharge by quality and destination.	○	Not material	Not material to our industry or operations
EN22	Total weight of waste by type and disposal method.	○	Not material	The cost of implementing additional data breakdowns do not outweigh the benefits, since such breakdowns are not deemed material, neither business wise nor volume wise
EN23	Total number and volume of significant spills.	○	Not applicable	Not relevant or applicable to type of operations
EN24	Weight of transported, imported, exported, or treated waste deemed hazardous under the terms of the Basel Convention Annex I, II, III, and VIII, and percentage of transported waste shipped internationally.	○	Not applicable	Not relevant or applicable to type of operations
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.	○	Not applicable	Not relevant or applicable to type of operations
Products and services				
EN26	Initiatives to mitigate environmental impacts of products and services, and extent of impact mitigation.	●	Being a commercial bank our products and services do not typically impact directly on the environment. There may however be an indirect impact through the activities of customers to whom we lend. HNB has strived to address this issue by lending guidelines and conditions. Further information on environmental credit risk assessment is given on pages 162-163	
EN27	Percentage of products sold and their packaging materials that are reclaimed by category.	○	Not material	Not relevant or applicable to the type of products & services in our industry

GRI Indicators

Profile Disclosure	Description	Reported	Direct Answer / HNB Annual Report Page Reference	Explanation / Notes
Compliance				
EN28	Monetary value of significant fines and total number of non-monetary sanctions for non-compliance with environmental laws and regulations.	●	During the year under review so far as we are aware HNB did not incur any significant fines, penalties or non-monetary sanctions for non-compliance with any environmental laws and regulations	
Transport				
EN29	Significant environmental impacts of transporting products and other goods and materials used for the organisation's operations, and transporting members of the workforce.	●	During the year under review, the total mileage relating to official business travel and transport at Head Office stands at 930,310 km	
Overall				
EN30	Total environmental protection expenditures and investments by type.	●	164-167	
Social: Labor Practices and Decent Work				
Employment				
LA1	Total workforce by employment type, employment contract, and region.	●	147-148	
LA2	Total number and rate of employee turnover by age group, gender, and region.	●	149	
LA3	Benefits provided to full-time employees that are not provided to temporary or part-time employees, by major operations.	●	As defined in the Collective Agreements. Permanent employees are eligible to a range of benefits including loans at subsidised rates, medical reimbursements, other allowances	
Labor/management relations				
LA4	Percentage of employees covered by collective bargaining agreements.	●	147	
LA5	Minimum notice period(s) regarding significant operational changes, including whether it is specified in collective agreements.	●	The Bank endeavours to give a minimum of 1 month notice regarding significant operational changes. It is not defined in collective agreements except for notice regarding resignations	
Occupational health and safety				
LA6	Percentage of total workforce represented in formal joint management-worker health and safety committees that help monitor and advise on occupational health and safety programs.	●	As defined in the Collective Agreements	
LA7	Rates of injury, occupational diseases, lost days, and absenteeism, and number of work-related fatalities by region.	○	Not applicable	Not relevant or applicable to type of operations
LA8	Education, training, counseling, prevention, and risk-control programs in place to assist workforce members, their families, or community members regarding serious diseases.	●	158	
LA9	Health and safety topics covered in formal agreements with trade unions.	●	Medical leave, medical insurance, annual health check up and reimbursement of medical expenses including hospitalisation as benefits while Unions commit to abide by the Bank's Health and Safety Policies at all times	
Training and education				
LA10	Average hours of training per year per employee by employee category.	●	147	
LA11	Programs for skills management and lifelong learning that support the continued employability of employees and assist them in managing career endings.	●	146-147	
LA12	Percentage of employees receiving regular performance and career development reviews.	●	100%	

● Fully reported ◐ Partially reported ○ Not reported

Profile Disclosure	Description	Reported	Direct Answer / HNB Annual Report Page Reference	Explanation / Notes
Diversity and equal opportunity				
LA13	Composition of governance bodies and breakdown of employees per category according to gender, age group, minority group membership, and other indicators of diversity.	●	147-149	
LA14	Ratio of basic salary of men to women by employee category.	●	HNB is an equal opportunity employer. The Bank's salary scales do not discriminate in terms of gender. Annual pay increments are based on collective agreements and / or performance	
Social: Human Rights				
Investment and procurement practices				
HR1	Percentage and total number of significant investment agreements that include human rights clauses or that have undergone human rights screening.	●	All credit audits comprise of HR screening as a part of the overall business screening. If brought to the Bank's attention, it influences to change the HR position in creditors' business environment or terminates where change is not foreseeable.	
HR2	Percentage of significant suppliers and contractors that have undergone screening on human rights and actions taken.	●	100%	
HR3	Total hours of employee training on policies and procedures concerning aspects of human rights that are relevant to operations, including the percentage of employees trained.	●	Policies and procedures concerning aspects of human rights are covered in Induction training. Total number of training hours for 2012 - 4,243; 88%	
Non-discrimination				
HR4	Total number of incidents of discrimination and actions taken.	●	None reported during the year under review	
Freedom of association and collective bargaining				
HR5	Operations identified in which the right to exercise freedom of association and collective bargaining may be at significant risk, and actions taken to support these rights.	●	Collective Agreements are adhered to	
Child labor				
HR6	Operations identified as having significant risk for incidents of child labor, and measures taken to contribute to the elimination of child labor.	●	HNB employs only adult workforce	
Forced and compulsory labor				
HR7	Operations identified as having significant risk for incidents of forced or compulsory labor, and measures to contribute to the elimination of forced or compulsory labor.	●	HNB does not have operations at risk of forced or compulsory labour	
Security practices				
HR8	Percentage of security personnel trained in the organisation's policies or procedures concerning aspects of human rights that are relevant to operations.	●	Security Coordinators are employed to monitor the security functions which are outsourced	
Indigenous rights				
HR9	Total number of incidents of violations involving rights of indigenous people and actions taken.	●	Our operations are centred on urban, semi urban and rural areas that have a significant population density. As far as we are aware no incidents of violations involving rights of indigenous people were reported during the year under review	
Social: Society				
Community				
SO1	Nature, scope, and effectiveness of any programs and practices that assess and manage the impacts of operations on communities, including entering, operating, and exiting.	●	157-160	
FS13	Access points in low-populated or economically disadvantaged areas by type.	●	61-63	
FS14	Initiatives to improve access to financial services for disadvantaged people.	●	140-143; 153; 156; 160	

GRI Indicators

Profile Disclosure	Description	Reported	Direct Answer / HNB Annual Report Page Reference	Explanation / Notes
Corruption				
SO2	Percentage and total number of business units analyzed for risks related to corruption.	●	100%. HNB has extensive risk management policies and processes in place to reduce the risk of corruption. All employees are trained on a Code of Coduct and a Compliance and Integrity programme.	
SO3	Percentage of employees trained in organisation's anti-corruption policies and procedures.	●	100%. All employees are inducted on the Code of Ethics and Code of Conduct	
SO4	Actions taken in response to incidents of corruption.	●	None reported during the year under review	
Public policy				
SO5	Public policy positions and participation in public policy development and lobbying.	●	The policy is to not donate to or sponsor political activities	
SO6	Total value of financial and in-kind contributions to political parties, politicians, and related institutions by country.	●	The policy is to not donate to or sponsor political activities	
Anti-competitive behavior				
SO7	Total number of legal actions for anti-competitive behavior, anti-trust, and monopoly practices and their outcomes.	●	None reported during the year under review	
Compliance				
SO8	Monetary value of significant fines and total number of non-monetary sanctions for non-compliance with laws and regulations.	●	None reported during the year under review	
Social: Product Responsibility				
Customer health and safety				
PR1	Life cycle stages in which health and safety impacts of products and services are assessed for improvement, and percentage of significant products and services categories subject to such procedures.	●	Given the nature of our business, product assessment and redesign is not dependent on health and safety aspects. Further information on product & service development is given on pages 151-153	
PR2	Total number of incidents of non-compliance with regulations and voluntary codes concerning health and safety impacts of products and services during their life cycle, by type of outcomes.	●	None reported during the year under review	
Product and service labelling				
PR3	Type of product and service information required by procedures, and percentage of significant products and services subject to such information requirements.	●	All credit based products are accompanied by contractual agreements which outline the nature of the product, their terms of credit and repayment conditions. All deposit based products are accompanied with information on deposit type, terms of deposit and withdrawal conditions. Our website too includes information about the various products amd services	
PR4	Total number of incidents of non-compliance with regulations and voluntary codes concerning product and service information and labeling, by type of outcomes.	●	All complaints from customers are addressed through the Bank's complaints resolution process. If a customer is not satisfied by the outcome of the internal complaints resolution process, the customer can refer the matter to the Financial Ombudsman. During the year under review there were no such events reported in relation to non-compliance with regulations and voluntary codes concerning product and service information and labeling	
PR5	Practices related to customer satisfaction, including results of surveys measuring customer satisfaction.	●	133; 155	

● Fully reported ◐ Partially reported ○ Not reported

Profile Disclosure	Description	Reported	Direct Answer / HNB Annual Report Page Reference	Explanation / Notes
FS16	Initiatives to enhance financial literacy by type of beneficiary.	●	156; 160	
Marketing communications				
PR6	Programs for adherence to laws, standards, and voluntary codes related to marketing communications, including advertising, promotion, and sponsorship.	●	HNB complies with laws and regulations relating to the disclosure of information about the products and services we provide	
PR7	Total number of incidents of non-compliance with regulations and voluntary codes concerning marketing communications, including advertising, promotion, and sponsorship by type of outcomes.	●	All complaints from customers are addressed through the Bank's complaints resolution process. If a customer is not satisfied by the outcome of the internal complaints resolution process, the customer can refer the matter to the Financial Ombudsman. During the year under review there were no such events reported in relation to non-compliance with regulations and voluntary codes concerning marketing communications	
Customer privacy				
PR8	Total number of substantiated complaints regarding breaches of customer privacy and losses of customer data.	●	At HNB any occurrence involving inappropriate disclosure that may cause the privacy of our customers to be impacted is taken into serious consideration and we focus on identification and investigation of all such events. During the year under review there were no such events reported	
Compliance				
PR9	Monetary value of significant fines for non-compliance with laws and regulations concerning the provision and use of products and services.	●	No significant fine was levied against the Bank for the current reporting period	

Financial Calendar – 2012

43rd Annual General Meeting held on	30th March 2012
Rs 6.00 per share Final Dividend for 2011 paid on	10th April 2012
(Cash Dividend Rs 3.00 per share and Scrip Dividend Rs 3.00 per share)	
Rs 1.50 per share Interim Dividend for 2012 paid on	20th December 2012
Audited Financial Statements signed on	21st February 2013
44th Annual General Meeting to be held on	28th March 2013
Rs 7.00 per share Final Dividend for 2012 payable in	*April 2013

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	14th May 2012
2nd Quarter Interim Results released on	6th August 2012
3rd Quarter Interim Results released on	9th November 2012

Proposed Financial Calendar – 2013

Interim Dividend for 2013 to be payable in **	December 2013
45th Annual General Meeting to be held in	March 2014
Final Dividend for 2013 to be payable in ***	April 2014

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 2013
2nd Quarter Interim Results to be released in	August 2013
3rd Quarter Interim Results to be released in	November 2013

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

Safe & Sound

Surging forward.

FINANCIAL INFORMATION

SUPPLEMENTARY INFORMATION

Annual Report of the Board of Directors on the Affairs of the Company

1. General

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 2012, together with the audited Financial Statements of the Bank, Consolidated Financial Statements of the Group for that year and the Auditors' Report on those Financial Statements, conforming to the requirements of the Companies Act No 7 of 2007, and the Banking Act No 30 of 1988. The Financial Statements were reviewed and approved by the Board of Directors on 21st February 2013.

This Report includes the information as required by the Companies Act No 7 of 2007, Banking Act Direction No 11 of 2007 on Corporate Governance for licensed commercial banks and subsequent amendments thereto, Listing Rules of the Colombo Stock Exchange and is also guided by the recommended best practices on Corporate Governance.

Hatton National Bank PLC (the Bank) is a licensed commercial bank registered under the Banking Act No 30 of 1988 and was incorporated as a public limited liability company in Sri Lanka on 5th March 1970 under the Companies Ordinance No 51 of 1938. The Bank was re-registered as required under the provisions of the Companies Act No 7 of 2007, on 27th September 2007.

The ordinary shares (both voting and non-voting) and the majority of the unsecured subordinated redeemable debentures of the Bank are listed on the main board of the Colombo Stock Exchange in Sri Lanka.

The Bank has been assigned a National Long Term Rating of AA-(lka) by Fitch Ratings Lanka Ltd. During the year under review, the Bank has been assigned a foreign currency issuer rating of B1 by Moody's which is on par with the sovereign rating of B1 of Sri Lanka. This is the first ever international rating obtained by a Sri Lankan Bank.

The registered office as well as the Head Office of the Bank is at No 479, T B Jayah Mawatha, P O Box 837, Colombo 10, Sri Lanka.

2. Principal Activities

The principal activities of the Bank and the Group during the year were general banking, development banking, offshore banking, mortgage financing, lease financing, corporate banking, dealing in government securities and listed equities, pawn broking, credit card facilities, Islamic banking, custodian banking for mobile banking, stock broking, providing life and general insurance services, other financial services and property development. The Bank opened its Islamic banking unit "Al Najah" on 27th February 2012. There were no significant changes in the nature of the principal activities of the Bank and the Group during the financial year under review other than the aforesaid Islamic banking services and custodian banking for mobile banking.

3. Changes to the Group Structure

During the year the Bank wrote off its investment (Rs 10.06 Mn) in Commercial Interlink Services (on account of Delma Exchange Canada), 100% owned Subsidiary Company, against the provision brought forward.

The Bank sold its 20% stake in Delma Exchange UAE – a simple limited partnership incorporated and registered in Abu Dhabi. 50% of the sale proceeds have already been received by the Bank and the balance amount is to be received on deferred terms as per the Sale and Purchase Agreement entered into with the buyer.

The Employee Share Benefit Trust (ESBT) was introduced as a Special Purpose Entity (SPE) in 2005 with the approval of the Shareholders to offer shares to executive employees of the Bank.

The Bank has consolidated the ESBT as a subsidiary in the consolidated financial statements of the Group with effect from 2012.

4. Review of Operations

A review of the operations of the Bank during the financial year 2012 and results of its operations are contained in the Chairperson's Message (pages 6 to 11), the Chief Executive Officer's Review (pages 12 to 17) and the Management Discussion & Analysis (pages 30 to 64). These reports form an integral part of the Annual Report of the Board of Directors.

5. Future Developments

An overview of the future developments of the Bank is given in the Chairperson's Message (pages 6 to 11), the Chief Executive Officer's Review (pages 12 to 17) and the Management Discussion & Analysis (pages 30 to 64).

6. Financial Statements

Sri Lanka converged fully with International Financial Reporting Standards (IFRSs) with effect from 1st January 2012. Accordingly The Institute of Chartered Accountants of Sri Lanka has issued a new volume of Sri Lanka Accounting Standards which became applicable for financial periods beginning on or after 1st January 2012. These Sri Lanka Accounting Standards comprises of Accounting Standards prefixed both SLFRS (corresponding to IFRS) and LKAS (corresponding to IAS). Application of Sri Lanka Accounting Standards prefixed SLFRS and LKAS for the first time shall be deemed to be an adoption of SLFRS's.

The Financial Statements of the Bank and the Group have been prepared in accordance with these Sri Lanka Accounting Standards

(SLFRSs) 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.

As required by these standards the Bank prepared its opening Statement of Financial Position (previously termed as the Balance Sheet) as at 1st January 2011 with the assumption that the Bank had applied these standards retrospectively with all the adjustments to equity being recognized directly on the statement of changes in equity.

Accordingly, three Statements of Financial Position as at 1st January 2011, 31st December 2011 and 31st December 2012 have been included with the Bank's 2012 financial statements. Further, the Statement of Comprehensive Income has been prepared for the year ended 31st December 2012 along with the Statement of Comprehensive Income for the year ended 31st December 2011 based on SLFRS.

The Financial Statements of the Bank and the Group for the year ended 31st December 2012 duly signed by the Chief Financial Officer, two of the Directors of the Bank and the Board Secretary are given on pages 206 to 323 which form an integral part of the Annual Report of the Board of Directors.

7. Directors' Responsibility for Financial Reporting

The Directors are responsible for the preparation of the Financial Statements of the Bank to present a true and fair view of its state of 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 204 and forms an integral part of the Annual Report of the Board of Directors.

8. Auditors' Report

Bank's Auditors, Messrs KPMG, 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 2012 and their report on those Financial Statements is given on page 205 of this Annual Report.

9. Significant Accounting Policies

The significant accounting policies adopted in the preparation of the Financial Statements are given on pages 214 to 245.

10. 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.

11. Income

The Income of the Group for 2012 was Rs 55,160,069,000/- (2011: Rs 40,122,582,000/-) while the Bank's income was Rs 51,558,900,000/- (2011: Rs 37,066,301,000/-). An analysis of the income is given in Note 8 to the Financial Statements.

12. Financial Results and Appropriations

The Bank has recorded a profit before tax and profit after tax growth of 19.8% and 23% respectively in 2012. The Group's profit before tax and profit after tax for the year too recorded a growth of 18.1% and 19.9% respectively over 2011.

The Bank's Total Comprehensive Income for the year is Rs 10,115,400,000/- (2011: Rs 2,968,942,000/-) while the Group has recorded a Total Comprehensive Income of Rs 11,631,209,000/- for the year (2011: Rs 3,603,211,000/-).

	2012 Rs 000	2011 Rs 000
The Group Profit for the year ended 31st December 2012 after payment of all operating expenses and provision for depreciation and contingencies	10,692,594	9,056,464
Less : Taxation	(2,421,431)	(2,156,077)
Group net profit after taxation	8,271,163	6,900,387
Other Comprehensive income net of Income Tax		
Gains and losses arising from translating the financial statements of foreign operations	13,843	4,292
Gains and losses on re-measuring available-for-sale financial assets		
Net change in fair value on available-for-sale financial assets	305,986	(3,341,133)
Transfer to life policy holder reserve fund	(21,335)	6,149
Net amount transferred to profit or loss (available-for-sale financial assets)	76,765	(5,745)
Actuarial gains and losses on defined benefit plans	587,494	34,870
Changes in revaluation surplus	2,397,293	4,391
Total Group comprehensive income for the year	11,631,209	3,603,211
Minority interest	(170,621)	(81,613)
	11,460,588	3,521,598

Annual Report of the Board of Directors on the Affairs of the Company

	2012 Rs 000	2011 Rs 000
Other comprehensive income net of tax relating to:		
Capital reserve	(2,397,293)	(4,391)
Available for sale reserve	(359,690)	3,339,576
Exchange equalization reserve	(5,142)	(2,989)
	8,698,463	6,853,794
Unappropriated profit brought forward from previous year	3,504,132	2,120,000
Balance available before Appropriation / adjustments	12,202,595	8,973,794
Write off of subsidiary	(3,665)	-
Disposal of associate	52,052	-
Deemed disposal gain	76,873	-
	12,327,855	8,973,794
Appropriations		
Transfer to General Reserve	(2,400,000)	(2,400,000)
Transfer to Reserve Fund	(430,000)	(290,000)
Transfer to Investment Fund Account	(1,322,225)	(978,337)
Transfer of Revaluation Reserve on disposal of PPE	5,689	19,374
Dividends		
Interim dividend paid (Cash) 2010 Final	-	(559,955)
Final dividend paid (Cash) 2011 Interim	-	(1,260,744)
Interim dividend paid (Cash) 2011 Final	(1,120,823)	-
Final dividend paid (Scrip) 2011 Final	(1,166,032)	-
Final dividend paid (Cash) 2012 Interim	(572,619)	-
Balance carried forward as at 31st December	5,321,845	3,504,132

13. Reserves

The Group Reserves consist of:

	31.12.2012 Rs 000	31.12.2011 Rs 000	01.01.2011 Rs 000
Capital Reserve	8,795,153	6,403,549	6,418,532
Statutory Reserve Fund	2,230,000	1,800,000	1,510,000
Investment Fund Account	2,300,562	978,337	-
Available for Sale Reserve	2,724,492	2,364,802	5,704,378
Exchange Equalisation Reserve	8,544	5,733	2,744
Life Policy Holder Reserve Fund	(1,191)	(22,526)	31,050
Treasury Shares	(310,938)	(310,938)	(147,224)
ESOP Reserve	176,515	-	-
Revenue Reserve	23,121,845	18,904,132	15,120,000
	39,044,982	30,123,089	28,639,480

The movement in these reserves is shown in the Statement of Changes in Equity on pages 210 and 211 of the Annual Report.

As per the Central Bank's Guidelines on the Operations of the Investment Fund Account, the Directors propose to transfer Rs 1,322,225,000/- (2011: Rs 978,337,000/-) to the Investment Fund Account.

Further, the Directors propose to transfer Rs 430,000,000/- (2011: Rs 290,000,000/-) to the Statutory Reserve Fund, and Rs 2,400,000,000/- (2011: Rs 2,400,000,000/-) to the General Reserve Account.

14. Corporate Donations

During the year the Bank made donations amounting to Rs 32,579,000/- (2011: Rs 53,945,000/-) in terms of the resolution passed at the last Annual General Meeting. Donations made by the Group during the year amounted to Rs 32,879,000/- (2011: Rs 54,370,000/-).The donations made by the Bank to Government approved charities from the above sum amounted to Rs 2,000,000/- (2011: Rs 28,500,000/-).

15. Taxation

The income tax rate applicable on the Bank's domestic operations and FCBU on-shore & off-shore banking operations is 28% (2011: 28%).

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 Services VAT at 12% (2011: 12%).

16. 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.

17. Dividends on Ordinary Shares

An interim dividend of Rs 1.50 per share (2011: Rs 1.50) was paid on 20th December 2012 to the holders of the ordinary shares (both voting and non-voting) for the financial year 2012. 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 61% of the interim dividend paid for 2012 is subject to income tax.

The Directors recommend that final cash dividend of Rs 7.00 per share (2011: Rs 6.00 per share which consisted of Rs 3.00 per share in cash and Rs 3.00 per share in the form of a scrip dividend) on both voting and non-voting shares of the Bank, be paid for the financial year ended 31st December 2012.

The Board of Directors was satisfied that the Bank would meet the solvency test immediately after the interim dividend was paid on 20th December 2012 and the final dividend proposed which will be paid in April 2013 in terms of the provisions of the Companies Act No 7 of 2007 and listing rules of the Colombo Stock Exchange. The Board provided the Statements of Solvency to the Auditors and obtained Certificates of Solvency from the Auditors in respect of each dividend payment conforming to the statutory provision.

18. 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 1,059,463,000/- and Rs 1,134,293,000/- respectively (2011 Bank: Rs 1,356,099,000/- and Group: Rs 1,415,488,000/-). Details are given in Notes 34, 35 and 36 to the Financial Statements. The capital expenditure approved and contracted for, after the year end is given in Note 51 (a) to the Financial Statements.

19. Property, Plant and Equipment (PPE)

Details of property, plant and equipment are given in Note 35 to the Financial Statements.

20. Net Book Value of Freehold Properties

The net book values of freehold properties owned by the Bank and the Group as at 31st December 2012 are included in the accounts at Rs 6,843,071,000/- and Rs 13,444,282,000/- respectively (2011 Bank: Rs 5,189,255,000/- and Group: Rs 10,908,036,000/-).

A panel of Chartered Valuers / Licensed Surveyors carried out a revaluation of the Bank's freehold properties in 2012. The details of freehold properties owned by the Bank are given in Note 35 (a) to the Financial Statements.

21. Outstanding Litigation

In the opinion of the Directors and the Bank's Lawyers, pending litigation against the Bank disclosed in Note 51 (e) of the Financial Statements will not have a material impact on the financial position of the Bank or its future operations.

22. Events after the Reporting Date

No circumstances have arisen since the Statement of Financial Position date which would require adjustments to, or Disclosure in, the accounts, except those disclosed in Note 55 to the Financial Statements.

23. Stated Capital, Debentures and Subordinated Loans

The stated capital of the Bank as at 31st December 2012 was Rs 12,579,479,000/-, consisting of 397,246,449 ordinary shares, 317,650,102 (voting) and 79,596,347 (non-voting).
2011: Rs 11,451,451,000/- consisting of 388,596,843 ordinary shares, 311,406,247 - voting and 77,190,596 - non-voting.

The shareholders at the Annual General Meeting held on 30th March 2012 approved to issue 7,890,528 ordinary shares, 5,682,148 (voting) and 2,208,380 (non-voting), as scrip dividend for the financial year ended 31st December 2011. Total value of new shares issued on 30th March 2012 amounted to Rs 1,049,429,000/- (voting Rs 840,958,000/- and non-voting Rs 208,471,000/-).

The Bank issued 759,078 ordinary shares during the year, 561,707 shares (voting) at a consideration of Rs 64,975,000/- and 197,371 shares (non-voting) at a consideration of Rs 13,624,000/- under the approved Employee Share Option Plan (ESOP). Therefore the Stated Capital increase of the Bank due to employees exercising their options under ESOP amounted to Rs 78,599,000/- (2011: Rs 66,102,000/-). The total increase in the stated capital during the year is Rs 1,128,028,000/- (2011: Rs 6,132,901,000/-).

The Bank had issued Unsecured, Subordinated, Redeemable Debentures to the value of Rs 4,585,568,000/- as at 31st December 2012. (2011: Rs 5,023,216,000/-). The details of debentures redeemed during the year 2012 and those outstanding as at 31st December 2012 are given in Note 44 to the Financial Statements.

The Bank raised USD 25 Mn (Rs 3,212,500,000/=) through an eight (8) year subordinated loan which forms part of Tier II capital. The above funds raised from the German Development Finance Institution (DEG) has been utilised to finance the growth in small and medium enterprises which is one of the most important sectors supporting the post conflict growth in Sri Lanka. This loan is eligible for the Tier II capital of the Bank.

24. Share Information

Information relating to earnings, dividend, net assets and market price per share is given in the Financial Highlights on the inner front cover of the Annual Report. Information on share trading is given on page 335 of the Annual Report.

25. Shareholdings

As at 31st December 2012 there were 4,389 and 11,360 registered voting and non-voting shareholders respectively (2011: voting 4,430 & non-voting 11,828). Information on the distribution of shareholding and the respective percentages is indicated on pages 334 and 335 of the Annual Report. The twenty largest voting and non-voting

Annual Report of the Board of Directors on the Affairs of the Company

shareholders of the Bank as at 31st December 2012, together with an analysis are given on pages 338 and 339 of the Annual Report.

26. Equitable Treatment to Shareholders

The Bank has at all times ensured that all shareholders (both voting and non-voting) are treated equitably except for the right to vote.

27. The Board of Directors

The Board of Directors of the Bank consists of eleven (2011: nine) Directors with wide financial and commercial knowledge and experience. The following Directors held office as at the Statement of Financial Position date and their brief profiles appear on pages 18 to 23 of the Annual Report.

Name of the Director	Status
Dr Ranee Jayamaha - Chairperson	NED
Mr Rajendra Theagarajah (Managing Director / CEO)	ED
Ms Pamela C. Cooray - Senior Director	IND / NED
Mr N G Wickremeratne	IND / NED
Ms M A R C Cooray	IND / NED
Dr W W Gamage	IND / NED
Dr L R Karunaratne	IND / NED
Mr L U Damien Fernando (appointed w.e.f. 2nd April 2012)	IND / NED
Mr D T Sujeewa H Mudalige (appointed w.e.f. 2nd April 2012)	IND / NED
Ms D S C Jayawardena (appointed w.e.f. 2nd April 2012)	NED
Mr Rusi S Captain (appointed w.e.f. 2nd April 2012)	NED

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

28. Resignation of Directors

There were no resignations during the year.

29. Appointment of Directors

Mr L U Damien Fernando and Ms D S C Jayawardena were appointed to the Board in terms of Article 93 of Articles of Association as Non-Executive Directors with effect from 2nd April 2012 to fill two casual vacancies. Mr D T Sujeewa H Mudalige and Mr Rusi S Captain were appointed to the Board as Non-Executive Directors with effect from 2nd April 2012 by the Board also in terms of Article 93 of Articles of Association, as additional Directors.

30. Retirement and re-election / re-appointment of Directors

Mr L U Damien Fernando, Mr D T Sujeewa H Mudalige, Ms D S C Jayawardena and Mr Rusi S Captain 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.

Dr Ranee Jayamaha, Dr W W Gamage and Dr L Rohan Karunaratne retire by rotation at the AGM and offer themselves for re-election under Article 87 of the Articles of Association of the Bank.

31. Board Sub-Committees

The Board while assuming the overall responsibility and accountability for the management oversight of the Bank has also appointed Board Sub-Committees to ensure oversight and control over certain affairs of the Bank, conforming to the Banking Act Direction No 11 of 2007 issued by the Monetary Board of the Central Bank of Sri Lanka, on “Corporate Governance for Licensed Commercial Banks of Sri Lanka”. Accordingly, the following mandatory Sub-Committees have been constituted by the Board:

Audit Committee - Comprises -
- Mr Sujeewa Mudalige (Chairman - appointed w.e.f. 1st May 2012)*
- Mr N G Wickremeratne (Chairman upto 1st May 2012)
- Ms Pamela C. Cooray (Senior Director)
- Ms M A R C Cooray
- Mr H M A Jayasinghe (Consultant – resigned w.e.f. 20th June 2012)

* (Note: Mr N G Wickremeratne was the Chairman of this committee till 1st May 2012 and Mr Sujeewa Mudalige was appointed as the Chairman w.e.f. 1st May 2012 in order to comply with Corporate Governance Regulations).

The Report of the Audit Committee is given on page 201 to 202 and forms part of the Annual Report of the Board.

Nomination Committee - Comprises -
- Dr W W Gamage (Chairman)
- Dr Ranee Jayamaha
- Ms M A R C Cooray (appointed w.e.f. 1st January 2012)
- Dr L R Karunaratne (appointed w.e.f. 1st January 2012)

The Report of the Nomination Committee is given on page 199 and forms part of the Annual Report of the Board of Directors.

Human Resources & Remuneration Committee	- Comprises -	• Ms Pamela C. Cooray (Chairperson) • Dr Ranee Jayamaha • Mr N G Wickremeratne • Dr W W Gamage • Ms M A R C Cooray (appointed w.e.f. 1st January 2012 for the period upto 1st May 2012)

The Report of the Human Resources & Remuneration Committee is given on page 198 and forms part of the Annual Report of the Board.

The Board Integrated Risk Management Committee	- Comprises -	• Ms M A R C Cooray (Chairperson) • Dr Ranee Jayamaha • Dr W W Gamage (resigned w.e.f. 1st May 2012) • Dr L R Karunaratne • Mr Rajendra Theagarajah (MD/CEO) • Mr A J Alles (Deputy CEO – appointed with effect from 9th December 2012) • Mr J D N Kekulawala (Senior DGM - Strategy & Compliance– retired w.e.f. 8th December 2012) • Mr J R P M Paiva (DGM – Strategy & Compliance appointed w.e.f 9th December 2012) • Mr D P N Rodrigo (DGM - Risk & Credit Quality) • Mr D A de Vas Gunasekara (CFO) • Ms S Gnanapragasam (AGM – Treasury & Markets - appointed w.e.f. 9th December 2012)

The Report of the Integrated Risk Management Committee is given on page 200 and forms part of the Annual Report of the Board.

Mr Rajendra Theagarajah, Mr A J Alles, Mr J D N Kekulawala, Mr J R P M Paiva, Mr D P N Rodrigo, Mr D A de Vas Gunasekara and Ms S Gnanapragasam represented the Management on the Committee.

Apart from the mandatory board sub-committees, the Board has appointed four other non-mandatory sub-committees namely the Board Credit Committee, Strategic Review Committee, Procurement Committee and Committee for Disposal of Assets/Investments Properties to effective discharge of its duties.

32. Directors' Meetings

The details of the Directors' meetings which comprise Board meetings, Audit Committee meetings, Nomination Committee meetings, Human Resource & Remuneration Committee meetings and Board Integrated Risk Management Committee meetings and the attendance of Directors at these meetings are given on page 113 of the Annual Report. Furthermore, the Directors contributed towards policy advocacy and direction by participating in the deliberations of the Board appointed sub-committees on Strategic Review, Credit, Asset Disposal and Procurement.

33. Directors' Interests Register

The Bank maintains Directors' Interests Register conforming to the provisions of the Companies Act No 7 of 2007. The Directors of the Bank have disclosed their interests in other companies to the Board and those interests are recorded in the Interests Register conforming to the provisions of the Companies Act. The particulars of those entries are set out on pages 195 to 197 of the Annual Report and form an integral part of the Annual Report of the Board of Directors.

34. Directors' Interests in the Ordinary Shares (Voting and Non-Voting)

The shareholdings of Directors were as follows:

	As at 31st December 2012 No of Shares	As at 31st December 2011 No of Shares
Dr Ranee Jayamaha	101	100
Mr Rajendra Theagarajah	36,788	36,001
Ms Pamela C. Cooray	78,473	76,886
Mr N G Wickremeratne	8,451	8,300
Ms M A R C Cooray	5,312	5,165
Dr W W Gamage	101	-

Annual Report of the Board of Directors on the Affairs of the Company

	As at 31st December 2012 No of Shares	As at 31st December 2011 No of Shares
Dr L R Karunaratne	1,018	1,000
Mr L U Damien Fernando (appointed w.e.f. 2nd April 2012)	2,667	-
Mr D T Sujeewa H Mudalige (appointed w.e.f. 2nd April 2012)	-	-
Ms D S C Jayawardena (appointed w.e.f. 2nd April 2012)	500	-
Mr Rusi S Captain (appointed w.e.f. 2nd April 2012)	6,007	-

There has been no change in their interests in shares between 31st December 2012 and 21st February 2013, being the date of this Report. There are no arrangements enabling the Non-Executive Directors of the Bank to acquire shares of the Bank other than via the market.

35. Directors' Interest in Debentures

There were no debentures registered in the name of any Director as at the beginning and at the end of the year.

36. Related Party Transactions

The Directors have also disclosed transactions if any, that could be classified as related party transactions in terms of LKAS 24 "Related Party Disclosures" which is adopted in the preparation of the Financial Statements. Those transactions disclosed by the Directors are given in Note 52 to the Financial Statements forming part of the Annual Report of the Board of Directors.

37. Directors' Remuneration

Details of Directors' emoluments and other benefits paid in respect of the Group and the Bank during the financial year ended 31st December 2012 are given in Note 52 (b) to the Financial Statements.

38. 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.

39. Employee Share Benefit Trust (ESBT)

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

The scheme was formulated to pass certain benefits (dividends, bonus shares etc.) on the ordinary shares (non-voting) of the Bank to the staff without transferring the ownership. For this purpose, the Bank created a Trust and the Trustees were entrusted to acquire ordinary shares (non-voting) of the Bank in the secondary market or otherwise and to allocate the shares to the staff on a basis determined by the Board.

The Trustees were granted an overdraft facility 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 overdraft outstanding, interest and statutory payments are recovered prior to transferring the benefits. From inception up to 31st December 2012, 262 staff members have received benefits from this scheme.

The overdraft outstanding as at 31st December 2012 was Rs 292,259,000/- (2011: Rs 308,196,000/-). The amount released to the employees who left the services of the Bank during 2012 was Rs 92,326,000/- (2011: Rs 90,879,000/-).

SLFRS 2, Share Based Payments, requires the Bank to fair value the share appreciation rights offered to employees of the Bank under ESBT. The Bank has created a liability against such share appreciation rights which amounted to Rs 1.3 Bn (2011 : 1.1 Bn).

40. Employee Share Option Plan

In the year 2008 with the approval of the shareholders, the Bank formulated an Employee Share Option Plan for the staff in the Management grades, recognising and rewarding them for their contribution. The Scheme was aimed at further motivating the Management staff. This gives an option to the Management staff to acquire ownership in the ordinary shares (both voting and non-voting) of the Bank, provided the Bank has met certain set profit goals. It is operative for 5 years and the Management staff has the option to purchase ordinary shares (voting and non-voting) of the Bank each year up to a limit of 1.25% of the shares issued up to a maximum of 5% of the shares issued.

Based on the performance achieved for the year 2007, first option to purchase shares, has been offered to 175 Management Officers. The option to purchase shares is exercisable up to 1st October 2013. As at 31st December 2012, 154 Management Officers have exercised the option (some fully, some partially) and purchased shares.

Based on the performance achieved for the year 2009, second option to purchase shares has been offered to 182 Management Officers. The option to purchase shares is exercisable up to 1st April 2015. As at 31st December 2012, 49 Management Officers have exercised the option (some fully, some partially) and purchased shares.

Based on the performance achieved for the year 2011, third option to purchase shares has been offered to 196 Management Officers. The option to purchase shares is exercisable up to 29th March 2017. As at 31st December 2012, 9 Management Officers have exercised the option (some fully, some partially) and purchased shares.

SLFRS 2, Share Based Payments, requires the Bank to fair value the employee share options granted during the year. The total fair value of these options amounting to Rs 176.5 Mn has been charged to the Statement of Comprehensive Income for the year ended 31st December 2012 crediting a special reserve called "ESOP Reserve"

The details of the options offered to the employees as at 31st December 2012 are as follows:

	2008 Allocation		2010 Allocation		2012 Allocation	
	Voting	Non voting	Voting	Non voting	Voting	Non voting
No of options brought forward	82,713	15,331	3,427,335	839,696	-	-
No of options exercised before scrip issue	-	-	(561,638)	(175,201)	-	-
No of options immediately before the scrip issue	82,713	15,331	2,865,697	664,495	-	-
No of additional options due to the scrip issue	1,509	438	59,462	22,647	-	-
No of options immediately after the scrip issue	84,222	15,769	2,925,159	687,142	-	-
No of options granted in 2012	-	-	-	-	3,861,708	957,155
No of options exercised after scrip issue	-	-	(47,189)	(12,119)	(69,372)	(61,137)
No of options expired during the year	-	-	-	-	-	-
No of options remaining	84,222	15,769	2,877,970	675,023	3,792,336	896,018
Allotment price (Rs)	77.33	35.07	111.43	65.67	145.79	81.43
Funding granted to employees	None	None	None	None	None	None

41. Environmental Protection

To the best of knowledge of the Board, the Bank has complied with the relevant environmental laws and regulations. The Bank has not engaged in any activity that is harmful or hazardous to the environment.

42. Risk and Internal Control

The Board considers that strong internal controls are integral to the sound management of the Bank and it is committed to maintain strict financial, operational and risk management controls over all its activities.

The Directors are ultimately responsible for the Bank's system of internal control and for reviewing its effectiveness. Such a system is designed to manage, rather than eliminate, the risk of failure to achieve business objectives and can provide only reasonable and not absolute assurance against material misstatement or loss. There is an ongoing process for identifying, recording, evaluating and managing the risks that are faced by the Bank, and the Directors have reviewed this process, through the Audit Committee.

The Board of Directors is satisfied with the effectiveness of the system of internal control for the year under review and up to the date of approval of the Annual Report and Financial Statements.

43. Directors' Statement on Internal Control

The Board has issued a report on the internal control mechanism of the Bank as per Section 3 (8) (ii) (b) of Banking Act Direction No 11 of 2007 on Corporate Governance. The Board has confirmed that the financial reporting system has been designed to provide reasonable assurance regarding the reliability of the financial reporting, and that the preparation of financial statements for external purposes has been done in accordance with relevant accounting principles and regulatory requirements. The above report, which forms an integral part of the Annual Report of the Board of Directors, is given on page 114 to 115.

The Board has obtained an assurance report from the External Auditors on Directors' Statement on Internal Control which is given on page 116 of the Annual Report.

Annual Report of the Board of Directors on the Affairs of the Company

44. Corporate Governance

In the management of the Bank, the Directors have placed emphasis on 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 Corporate Governance is given on pages 87 to 113.

45. 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. Head of Compliance Department tables a report on compliance at the quarterly meetings of the Board Audit Committee.

46. Auditors

The Bank's Auditors during the period under review were Messrs 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 7,678,000/- (2011: Rs 7,476,000/-) and Rs 11,055,000/- (2011: Rs 10,562,000/-) respectively. Further Rs 8,592,000/- (2011: Rs 7,934,000/-) and Rs 11,057,000/- (2011: Rs 9,411,000/-) 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, and as far as the Directors are aware, the Auditors do not have any relationship with or interest with the Bank that in our judgment, may reasonably be thought to have a bearing on their independence within the meaning of the Code of Professional Conduct and Ethics issued by the Institute of Chartered Accountants of Sri Lanka, applicable on the date of this Report.

The retiring Auditors, Messrs KPMG, 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

47. Notice of Meeting

The 44th Annual General Meeting of the Bank is convened on Thursday the 28th March 2013, 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 44th Annual General Meeting is enclosed.

For and on behalf of the Board of Directors.

Rajendra Theagarajah
Managing Director /
Chief Executive Officer

Ranee Jayamaha
Chairperson

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

Colombo, Sri Lanka
21st February 2013

Directors' Interest in Contracts with the Bank

Related party transactions as required by LKAS 24 "Related Party Disclosures", are detailed in Note 52 to the financial statements. In addition, the Bank carries out transactions in the ordinary course of its business at commercial rates with entities in which a Director/other KMP of the Bank is the Chairman or a Director of such entities, the details of which are given below.

1. Lending Transactions with the Bank

Company	Name of the Director/ Relationship	Nature of Transaction	Aggregate Amount of Accommodation				
			as at 31st December 2012		as at 31st December 2011		
			Limit (Rs Mn)	Outstanding (Rs Mn)	Limit (Rs Mn)	Outstanding (Rs Mn)	Security
Ambewela Livestock Company Ltd	Ms D S C Jayawardena (Director)	Overdraft	50.00	4.08	50.00	11.82	Quoted company shares
		Letters of Credit	10.00	-	10.00	-	Corporate guarantee
		Total	**60.00**	**4.08**	**60.00**	**11.82**	
Ambewela Products (Pvt) Ltd	Ms D S C Jayawardena (Director)	Overdraft	100.00	14.32	10.00	8.60	Quoted company shares
		Letters of Credit	50.00	56.90	50.00	0.17	Corporate guarantee
		Total	**150.00**	**71.22**	**60.00**	**8.77**	
Lanka Dairies (Pvt) Ltd	Ms D S C Jayawardena (Director)	Overdraft	200.00	46.09	200.00	4.22	Quoted company shares
		Letters of Credit	100.00	53.75	100.00	13.41	Corporate guarantee
		Letters of Guarantee	25.00	-	25.00	-	
		Total	**325.00**	**99.84**	**325.00**	**17.63**	
Lanka Milk Foods (CWE) PLC	Ms D S C Jayawardena (Director)	Overdraft	300.00	81.78	300.00	11.15	Quoted company shares
		Letters of Credit	600.00	-	600.00	-	
		Letters of Guarantee i	(70.00)	-	(70.00)	-	
		Letters of Guarantee ii	30.00	64.65	30.00	81.65	
		Total	**930.00**	**146.43**	**930.00**	**92.80**	
Pattipola Livestock Company Ltd	Ms D S C Jayawardena (Director)	Overdraft	50.00	0.18	50.00	6.45	Quoted company shares
		Letters of Credit	10.00	3.84	10.00	-	Corporate guarantee
		Total	**60.00**	**4.02**	**60.00**	**6.45**	
Finlays Colombo PLC	Mr N G Wickremeratne (Director)	Revolving Short Term Loan	75.00	-	75.00	-	-
		Export Bill Discounting	(50.00)	-	(50.00)	-	
		Total	**75.00**	**-**	**75.00**	**-**	
Finlays Cold Storage (Pvt) Ltd	Subsidiary of Finlays Colombo PLC	Leases	4.68	4.68	6.23	6.23	Vehicles leased
		Total	**4.68**	**4.68**	**6.23**	**6.23**	
Ceylon Guardian Investment Trust PLC	Ms M A R C Cooray (Director)	Overdraft / Revolving Short Term Loan	*300.00	-	*300.00	-	*Inter changeable limit
		Total	**300.00**	**-**	**300.00**	**-**	
Ceylon Investment PLC	Ms M A R C Cooray (Director)	Overdraft / Revolving Short Term Loan	*(300.00)	-	*(300.00)	-	*Inter changeable limit
		Total	**-**	**-**	**-**	**-**	
Mobitel (Pvt) Ltd	Dr W W Gamage (Director)	Term Loan	352.08	352.08	528.13	528.13	Corporate guarantee
		Overdraft	500.00	-	500.00	-	
		Total	**852.08**	**352.08**	**1,028.13**	**528.13**	

Directors' Interest in Contracts with the Bank

1. Lending Transactions with the Bank (Contd.)

Company	Name of the Director/ Relationship	Nature of Transaction	Aggregate Amount of Accommodation as at 31st December 2012 Limit (Rs Mn)	as at 31st December 2012 Outstanding (Rs Mn)	as at 31st December 2011 Limit (Rs Mn)	as at 31st December 2011 Outstanding (Rs Mn)	Security
Carsons Cumberbatch PLC	Mr Rajendra Theagarajah (Director)	Overdraft / Revolving Short Term Loan	600.00	79.33	-	-	-
		Total	**600.00**	**79.33**	**-**	**-**	
CBL Retailers (Pvt) Ltd	Subsidiary of Carsons Cumberbatch PLC	Overdraft	50.00	47.20	-	-	-
		Total	**50.00**	**47.20**	**-**	**-**	
Ceylon Beverage Holdings PLC	Subsidiary of Carsons Cumberbatch PLC	Overdraft	350.00	350.00	-	-	-
		Temporary Overdraft	50.00	42.09	-	-	
		Term Loan	52.50	52.50	-	-	
		Total	**452.50**	**444.59**	**-**	**-**	
Lion Brewery (Ceylon) PLC	Subsidiary of Carsons Cumberbatch PLC	Letters of Credit	50.00	-	-	-	PD Cheques
		Import Loan	(50.00)	-	-	-	Indemnity
		Overdraft	115.00	75.57	-	-	
		Letters of Guarantee	10.00	11.16	-	-	
		Import Loan	1,000.00	-	-	-	
		Temporary Overdraft	(1,000.00)	1,000.00	-	-	
		Total	**1,175.00**	**1,086.73**	**-**	**-**	

2. Other Business Transactions with the Bank

Company	Name of Director / Relationship	Nature of Transaction	Amount (Rs Mn) 2012	2011
Asian Bankers Association	Mr Rajendra Theagarajah (Chairman)	Subscription and other charges	0.35	-
Ceylon Chamber of Commerce	Mr Rajendra Theagarajah (Exco Member)	Participation/subscription and other charges	0.12	0.27
		Merchant commission	0.01	0.01
Chartered Institute of Management Accountants	Mr Rajendra Theagarajah (Vice Chairman)	Sponsorships and other payments	0.31	0.04
Colombo Stock Exchange	Mr Rajendra Theagarajah (Director)	Professional fees	0.01	-
Equity Hotels Ltd	Subsidiary of Carsons Cumberbatch PLC in which Mr Rajendra Theagarajah is a Director	Merchant Commission	0.27	-
Institute of Bankers of Sri Lanka	Mr Rajendra Theagarajah (Council Member)	Fees and subscription	0.14	-
Lanka Clear (Pvt) Ltd	Mr Rajendra Theagarajah (Director)	Clearing and other charges	41.99	40.63
Lanka Financial Services Bureau Ltd	Mr Rajendra Theagarajah (Director)	Subscription and other charges	0.77	3.17

2. Other Business Transactions with the Bank (Contd.)

Company	Name of Director / Relationship	Nature of Transaction	Amount (Rs Mn) 2012	2011
Pegasus Hotels of Ceylon PLC	Subsidiary of Carsons Cumberbatch PLC in which Mr Rajendra Theagarajah is a Director	Merchant Commission	0.05	-
Sri Lanka Institute of Directors	Mr Rajendra Theagarajah (Council Member)	Subscription and other charges	0.15	-
Ceylon Guardian Investment Trust PLC	Ms M A R C Cooray (Director)	Repurchase agreements	42.11	-
		Interest on repurchase agreements	0.31	13.66
Ceylon Investments PLC	Ms M A R C Cooray (Director)	Repurchase agreements	34.28	-
		Interest on repurchase agreements	0.83	10.93
Mobitel (Pvt) Ltd	Dr W W Gamage (Director)	Interest on repurchase agreements	1.79	2.33
		Merchant commission	2.05	0.23
		Other charges	0.03	-
The National Trust Sri Lanka	Mr N G Wickremeratne (Trustee)	Sponsorships provided	1.50	1.50

The above entities also held customer deposits with the Bank totalling to Rs 547.384 Mn as at 31st December 2012.

New Directors appointed during the year had no interest in the Bank's contracts before their appointment to the Board. Therefore transactions with other entities in which such Director is the Chairman or a Director have been reported from the date of appointment to the Bank's Board. Further where an existing Director of the Bank has been appointed as a Director/Chairman of another entity, transactions with such entities have been captured from the date of appointment as a Director/Chairman. Accordingly comparative figures for 2011 have not been disclosed for such entities.

* Other KMP included members of Corporate Management, Chief Accountant and Chief Manager Operations.

The Human Resources & Remuneration Committee Report

Composition of the Committee

The Human Resources & Remuneration Committee ("the Committee") appointed by and responsible to the Board of Directors comprises four Non-Executive Directors of whom three including the Chairperson are also Independent Directors. One member is Non-Independent. The following Directors serve on the HR & Remuneration Committee:

Ms Pamela C. Cooray - Chairperson (IND/NED)

Dr Ranee Jayamaha (NED)

Mr N G Wickremeratne (IND/NED)

Dr W W Gamage (IND/NED)

Ms M A R C Cooray (IND/NED)
Appointed w.e.f. 1st January 2012 for the period upto 1st May 2012

(IND = Independent Director, NED = Non-Executive Director)

Brief profiles of the Directors are given on pages 18 to 23 of the Annual Report

The Managing Director/Chief Executive Officer (MD/CEO) who is responsible for the overall management of the Bank, attends meetings and participates in the deliberations by invitation, together with the Deputy Chief Executive Officer (DCEO). The MD/CEO took part in all deliberations except when his own interest, performance and compensation were discussed.

The Board Secretary functions as the Secretary to the Committee.

Policy

The Bank's remuneration policy aims to attract, motivate and retain management in a 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 remuneration package is sufficiently competitive to attract the best available talent to the Bank.

The Bank's remuneration of the MD/CEO, DCEO 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 management.

Scope

The Committee is vested with power to examine, evaluate and recommend to the Board of Directors any matter that may affect the human resources management of the Bank within its Terms of Reference (TOR) and any other matters as may be referred to it by the Board.

The Committee reviews all significant Human Resource policies and initiatives, salary structures and terms and conditions relating to staff at senior management level. In this process, necessary information and recommendations are obtained from the MD/CEO and the DGM (Human Resources and Administration). The Committee deliberates upon and recommends to the Board of Directors the remuneration packages, annual increments and bonuses of the MD/CEO, DCEO and Members of the Corporate Management and senior management staff.

The organisational structure is also reviewed annually and adjustments made according to the focus of the Strategic Plan. An ongoing priority is to ensure proper succession for key posts. In doing so, the aspirations for career progression of Management are taken into account.

Recruitments and promotions of staff at management level are also considered and approved based on proposals submitted by the MD/CEO and DGM (Human Resources and Administration) following a formal process of evaluation and thereafter recommended to the Board for ratification. When necessary, interviews are held to assess the core competencies of applicants for key posts.

Reports of meetings of the Committee with its recommendations are referred to the Board for discussion, and ratified or otherwise acted upon by the Board of Directors.

During the year under review, Terms of Reference for this Committee together with certain other HR policies were formalized and ratified by the Board on presentation.

Meetings

The Committee met three times during 2012. Other Board Members may attend meetings on invitation.

Attendance at the meetings is given on page 113 of the Annual Report.

Fees

All Non-Executive Directors receive a monthly fee for participation in the deliberations of the Board including attendance at meetings. They may also receive fees for attendance at sub-committee meetings and/or meetings of subsidiary boards. They do not receive any performance or incentive payments.

Professional Advice

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

Committee Evaluation

The Committee completed the evaluation process with self-assessment in 2012, which was conducted by the Chairperson and Committee Members and was deemed to be satisfactory.

Pamela C. Cooray
Chairperson
Human Resources & Remuneration Committee

Colombo, Sri Lanka
21st February 2013

Nomination Committee Report

Composition of the Nomination Committee

The Nomination Committee ("the Committee") comprises of four Non-Executive Directors appointed by the Board of Directors of the Bank. The following Directors serve/served on the Nomination Committee:

Dr W W Gamage (IND/NED) Chairman

Dr Ranee Jayamaha (NED)

Ms M A R C Cooray (IND/NED) appointed w.e.f. 1st January 2012

Dr L R Karunaratne (IND/NED) appointed w.e.f. 1st January 2012

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

Brief profiles of the members of the Committee are given on pages 18 to 23 of the Annual Report.

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

The Terms of Reference (TOR) and the Primary Responsibilities of the Nomination Committee

The scope of the Nomination Committee includes the following:

i. To implement a procedure to select/appoint new Directors/CEO and the Key Management Personnel;

ii. To consider and recommend (or not recommend) the re-election of the current Directors, taking into account the performance and contribution made by the Director/s concerned towards the overall discharge of the Board's responsibilities;

iii. To set the criteria such as qualifications, experience and key attributes required for eligibility to be considered for appointment or promotion to the post of Managing Director/CEO and the Key Management positions;

iv. To ensure that Directors, Managing Director/CEO and the Key Management Personnel are fit and proper persons to hold office as required by the Banking Act and such other applicable laws, regulations and directions;

v. To consider and recommend from time to time the requirements of additional/new expertise and the succession arrangements for retiring Directors and Key Management Personnel;

vi. To provide advice and recommendations to the Board or the Chairman (as the case may be) on any such appointment;

vii. To regularly review the structure, size, composition and competencies (including the skills, knowledge and experience) of the Board and make recommendations to the Board with regard to any changes;

The TOR of the Nomination Committee which was adopted by the Board of Directors in 2012 was revived by the members at its meeting held on 15th January 2013.

Nomination Committee Meetings

The Nomination Committee met three times during the year under review to consider and recommend the appointment of four additional Non-Executive Directors including one Independent Director to the Board and to assess the fitness and propriety of each of the Directors holding office in terms of the provisions of the Banking Act and the Directions of the Monetary Board relating to Corporate Governance. Attendance by the Committee members at the meeting is given in the table on page 113 of the Annual Report. The Chief Executive Officer also attended all meetings by invitation.

Re-election / Re-appointment of Directors at the 44th Annual General Meeting

Since 3 members of the Committee namely Dr Ranee Jayamaha, Dr W W Gamage and Dr L R Karunaratne should be re-elected / re-appointed at the 44th Annual General Meeting to be held on 28th March 2013, the Committee decided to recommend that this matter be discussed at and approved by the full Board. Accordingly, the Board at its meeting held on 15th January 2013 decided that Dr Ranee Jayamaha, Dr W W Gamage and Dr L R Karunaratne be re-elected / re-appointed at the next Annual General meeting.

Committee Evaluation

The Committee completed the evaluation process with self-assessment in 2012, which was conducted by the Chairman and Committee Members and was deemed to be satisfactory.

W W Gamage
Chairman
Nomination Committee

Colombo, Sri Lanka
21st February 2013

The Board Integrated Risk Management Committee

The Board Integrated Risk Management Committee (BIRMC) comprises of eleven members of which four members are Non-Executive Directors.

Ms M A R C Cooray - Chairperson (IND/NED)

Dr Ranee Jayamaha (NED)

Dr W W Gamage (IND/NED)
Resigned w.e.f. 1st May 2012

Dr L R Karunaratne (IND/NED)

Mr Rajendra Theagarajah (Managing Director/CEO)

Mr A J Alles (DCEO)
Appointed w.e.f. 9th December 2012

Mr J D N Kekulawala (Senior DGM - Strategy & Compliance)
Resigned w.e.f. 8th December 2012

Mr J R P M Paiva (DGM - Strategy & Compliance)
Appointed w.e.f. 9th December 2012

Mr D P N Rodrigo (DGM - Risk & Credit Quality)

Mr D A de Vas Gunasekara (CFO)

Ms S Gnanapragasam (AGM - Treasury & Markets)
Appointed w.e.f. 9th December 2012

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

Brief profiles of the Directors representing the Committee are given on pages 18 to 23 of the Annual Report.

The Primary Responsibilities of the Committee

The terms of reference set out by the Board of Directors, includes the following to:

1. Ensure that the Bank has a comprehensive risk management framework, appropriate compliance policies and systems in place.
2. Assess all risk types, including but not limited to: credit, market, liquidity, operational and strategic/reputational risks to the Bank through appropriate risk indicators and management information.
3. 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. Monitor and assess the effectiveness of the Bank's Risk Management System and the robustness of the risk management function.
5. Periodically assess performance against internally defined risk appetite.
6. Review the Bank's compliance report on money laundering and action taken in relation to report
7. Review issues raised by Internal Audit that impact upon the Risk Management framework
8. Review progress on Basel II Roadmap implementation

Meetings

Six meetings were held and at least one in each quarter. Attendance at the meeting is given in table on page 113 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. The Chairman of the Committee also briefs the Board of Directors on the main findings of the Committee at each Board meeting.

Professional Advice

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

Appreciation

The Committee wishes to convey its gratitude to Director Dr W W Gamage and retiring Senior DGM – Strategy & Compliance, Mr J D N Kekulawala for their valuable contribution to the Committee over the years.

Compliance

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

Committee Evaluation

The Committee completed the evaluation process with self-assessment in 2012, and was deemed to be satisfactory.

M A R C Cooray
Chairperson
Integrated Risk Management Committee

Colombo, Sri Lanka
21st February 2013

Audit Committee Report

Composition of the Committee

The Audit Committee ("the Committee"), appointed by and responsible to the Board of Directors comprises of four Non Executive & Independent Directors. . Mr N G Wickremeratne who was the Chairman of the Committee stepped down from that position w.e.f. 1st May 2012, making way for Mr Sujeewa Mudalige, Chartered Accountant, to become the Chairman from that day. Mr N G Wickremeratne continues to serve on the Committee as a member. Mr H M A Jayasinghe (FCA, FCMA) served as a Consultant to the Audit Committee up to 20th June 2012. The following members serve / served on the Audit Committee:

Mr Sujeewa Mudalige (IND/NED)
Appointed w.e.f. 1st May 2012. Chairman of the Committee w.e.f. 1st May 2012

Mr N G Wickremeratne (IND/NED)
Chairman up to 1st May 2012

Ms Pamela C. Cooray (IND/NED)

Ms M A R C Cooray (IND/NED)

Mr H M A Jayasinghe - Consultant
Resigned w.e.f. 20th June 2012

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

Brief profiles of the members are given on pages 18 to 23 of the Annual Report.

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

Audit Committee Meetings

The Audit Committee met ten times during the year. Attendance by the Committee members at each of these meetings is given in the table on page 113 of the Annual Report. The Managing Director / Chief Executive Officer, Deputy CEO, Senior DGM Strategy & Compliance, DGM Risk and Credit Quality, Chief Financial Officer and Head of Internal Audit also attended these meetings by invitation. On the invitation of the Committee, the Engagement Partner of the Bank's External Auditors, Messrs KPMG attended four Committee meetings during the year. The Audit Committee continued to closely monitor the implementation of new Sri Lanka Accounting Standards (SLFRSs & LKASs) which became effective from 1st January 2012. The Committee also guided the Management with the selection of the new Accounting Policies which is required under the aforesaid new Accounting Standards.

Financial Reporting

The Committee, as part of its responsibility to oversee the Bank's financial reporting process on behalf of the Board of Directors, has reviewed and discussed with the Management, the annual and the quarterly Financial Statements prior to their release. The review included the extent of compliance with the Sri Lanka Accounting Standards, the Companies Act No 7 of 2007, the Banking Act No 30 of 1988 and amendments thereto. 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.

Risks and Internal 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 and / or operational failures. Additionally, the Committee also assessed the effectiveness of the Bank's internal control over financial reporting as of 31st December 2012, as required by the Banking Act Direction No 11 of 2007, Corporate Governance for Licensed Commercial Banks in Sri Lanka, Subsection 3(8)(ii) (b), based on the "Guidance for Directors of Banks on the Directors' Statement on Internal Control" issued by the Institute of Chartered Accountants of Sri Lanka. The result of the assessment is given on pages 114 and 115, "Directors' Statement on Internal Control" in the Annual Report.

The External Auditors have issued an Assurance Report on Directors' Statement on Internal Controls. The report is given on page 116 of the Annual Report.

The Committee has reviewed the processes for identification, recording, evaluation and management of all significant risks throughout the Bank and other Group entities.

Corporate Governance Report

As required by the Banking Act Direction No 11 of 2007, Corporate Governance for Licensed Commercial Banks in Sri Lanka, Annual Corporate Governance Report for 2012 is provided on pages 87 to 113. The external auditors have performed procedures set out in Sri Lanka Related Services Practice Statement 4750 issued by the Institute of Chartered Accountants of Sri Lanka (SLRSPS 4750), to meet the compliance requirement of the Corporate Governance directive. Their findings presented in their report dated 21st February 2013 addressed to the Board are consistent with the matters disclosed above and did not identify any inconsistencies to those reported by the Board on pages 87 to 113.

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 four times during the year to discuss their audit approach and procedures, including matters relating to the scope of the audit and Auditor's independence. Messrs KPMG rotated the Lead Audit Partner this year as the Audit Partner is required to be rotated every five years, in order to ensure the independence of the Auditor and to comply with the requirements of the Banking Act Direction No 11 of 2007, Corporate Governance for Licensed Commercial Banks in Sri Lanka.

The Committee reviewed the audited Financial Statements with the External Auditor who is responsible for expressing an opinion on its conformity with the Sri Lanka Accounting Standards.

Audit Committee Report

The Committee reviewed the Interim Management Letters issued by the External Auditor together with the management responses thereto.

The Committee met the External Auditors twice during the year without the presence of MD / CEO and the Corporate Management to ensure that there was no limitation of scope in relation to the Audit and to allow for full disclosure of any incidents which could have had a negative impact on the effectiveness of the external audit, and concluded that there was no cause for concern.

The 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 prohibited under:

1. The guidelines issued by the Central Bank of Sri Lanka, for External Auditors, relating to their statutory duties in terms of Section 39 of Banking Act No 30 of 1988 and amendments thereto.

2. The Guidelines for Listed Companies on Audit and Audit Committees issued by the Securities and Exchange Commission of Sri Lanka.

The Letter of Representation issued to the External Auditor by the Board and Letter of Independence Confirmation issued by the External Auditor were tabled at the Audit Committee Meeting.

The Audit Committee has recommended to the Board of Directors that Messrs KPMG, Chartered Accountants, be re-appointed for the financial year ending 31st December 2013 subject to the approval of shareholders at the next Annual General Meeting.

Internal Audit

During the year, the Audit Committee reviewed the independence, objectivity & performance of the internal audit function, the findings of the internal audits completed and their evaluation of the Bank's internal control including internal control systems. The Audit Committee also reviewed the adequacy of coverage of the internal audit plan and approved the same. It also assessed the Internal Audit Department's resource requirements including succession planning.

Regulatory Compliance

The Committee reviewed the procedures established by Management for compliance with the requirements of regulatory authorities. Senior Deputy General Manager – Strategy & Compliance who has oversight of the Compliance function, submitted quarterly reports to the Audit Committee on the extent to which the Bank was in compliance with the regulatory requirements.

The Committee also reviewed the Statutory Examination Report issued by the Central Bank of Sri Lanka together with the management responses thereto during the year.

Professional Advice

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

Appreciation

I wish to record with appreciation the immense contribution of Mr H M A Jayasinghe whose knowledge and insights were invaluable in the deliberations of the Committee.

Committee Evaluation

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

Sujeewa Mudalige
Chairman
Audit Committee

Colombo, Sri Lanka
21st February 2013

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

The Financial Statements of Hatton National Bank PLC (the Bank) and the Consolidated Financial Statements of the Bank and its Subsidiaries as at 31st December 2012 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 the Listing Rules of the Colombo Stock Exchange. The Accounting Policies used in the preparation of the Financial Statements are appropriate and are consistently applied by the Group. There are no departures from the prescribed Accounting Standards in their adoption. Comparative information has been reclassified wherever necessary to comply with the current presentation.

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

The Board of Directors and the Management of the Bank accept responsibility for the integrity and objectivity of these Financial Statements. The estimates and judgments relating to the Financial Statements were made on a prudent and reasonable basis; in order that the Financial Statements reflect in a true and fair manner, the form and substance of transactions and that the Bank's state of affairs is reasonably presented. To ensure this, the Bank has taken proper and sufficient care in installing a system of internal control and accounting records, for safeguarding assets and for preventing and detecting frauds as well as other irregularities, which is reviewed, evaluated and updated on an on going basis. Our Internal Auditor has conducted periodic audits to provide reasonable assurance that the established policies and procedures of the Bank were consistently followed. However, there are inherent limitations that should be recognised in weighing the assurances provided by any system of internal controls and accounting. Further your Board assessed the effectiveness of the Bank's internal controls over financial reporting during the year ended 31st December 2012, as required by the Banking Act Direction No 11 of 2007, result of which is given on page 114 to 115 in the Annual Report, the "Directors Statement on Internal Control". External Auditors' Assurance Report on the "Directors Statement on Internal Control" is given on page 116 of the Annual Report.

The Financial Statements of the Group were audited by Messrs KPMG, Chartered Accountants, the independent External Auditors. Their report is given on page 205 of the Annual Report.

The Audit Committee of the Bank meets periodically with the Internal Audit team and the independent External Auditor to review their audit plans, assess the manner in which these auditors are performing their responsibilities and to discuss their reports on internal controls and financial reporting issues. To ensure complete independence, the External Auditor and the Internal Auditor have full and free access to the members of the Audit Committee to discuss any matter of substance.

The Audit Committee approves the audit and non audit services provided by External Auditor, Messrs 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 Note 51 (e) to the Financial Statements in this Annual Report.

Rajendra Theagarajah
Managing Director / Chief Executive Officer

Ajantha de Vas Gunasekara
Chief Financial Officer

Colombo, Sri Lanka
21st February 2013

Directors' Responsibility for Financial Reporting

The responsibility of the Directors in relation to the Financial Statements of the Bank and its Subsidiaries prepared in accordance with the provisions of the Companies Act No 7 of 2007 is set out in the following statement. The responsibilities of the External Auditor in relation to the Financial Statements are set out in the Report of the Auditors given on page 205 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 Statement of Financial Position as at 31st December 2012, and the Statement of Comprehensive Income, Statement of Changes in Equity and Statement of Cash Flows for the year then ended and notes thereto.

The Financial Statements of the Bank and its Subsidiaries give a true and fair view of:

1. the state of affairs of the Bank and its Subsidiaries as at 31st December 2012; and
2. the profit or loss of the Bank and its Subsidiaries for the financial year then ended.

In preparing these Financial Statements, the Directors are required to ensure that:

1. the appropriate accounting policies have been selected and applied in a consistent manner and material departures, if any, have been disclosed and explained;
2. judgments and estimates have been made which are reasonable and prudent; and
3. all applicable Accounting Standards, as relevant, have been complied with.

The Directors are also required to ensure that the Bank and its Subsidiaries have adequate resources to continue in operation to justify applying the going concern basis in preparing these Financial Statements.

Further, the Directors have a responsibility to ensure that the Companies within the Group maintain sufficient accounting records to disclose, with reasonable accuracy the financial position of the Bank and its Subsidiaries.

Financial Statements prepared and presented in this Report are consistent with the underlying books of account and are in conformity with the requirements of Sri Lanka Accounting Standards, Companies Act No 7 of 2007, Sri Lanka Accounting and Auditing Standard Act No 15 of 1995, Banking Act No 30 of 1988 and amendments thereto.

The Directors have also instituted effective and comprehensive systems of Internal Control for identifying, recording, evaluating and managing the significant risks faced by the Bank throughout the year and it is being under regular review of the Board of Directors. This comprises internal reviews, Internal Audit and the whole system of financial and other controls required to carry on the business of banking in an orderly manner, safeguard its assets, prevent and detect frauds and other irregularities and secure as far as practicable the accuracy and reliability of the records. The results of such reviews carried out during the year ended 31st December 2012 are given on pages 114 to 115 of the Annual Report, "Directors Statement on Internal Control". External Auditors' Assurance Report on the "Directors Statement on Internal Control" is given on page 116 of the Annual Report.

Directors are required to prepare the Financial Statements and to provide the Bank's External Auditor, Messrs KPMG, 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 7.00 per share for this year to be paid in April 2013.

The Directors to the best of their knowledge and belief, are satisfied that all statutory payments in relation to all relevant regulatory and statutory authorities which were due and payable by the Bank and its Subsidiaries as at the Statement of Financial Position date have been paid or where relevant provided for.

The Directors are of the view that they have discharged their responsibilities as set out in this statement.

By order of the Board

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

Colombo, Sri Lanka
21st February 2013

Independent Auditors' Report

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

Tel : +94 - 11 542 6426
Fax : +94 - 11 244 5872
+94 - 11 244 6058
+94 - 11 254 1249
+94 - 11 230 7345
Internet : www.lk.kpmg.com

TO THE SHAREHOLDERS OF HATTON NATIONAL BANK PLC

Report on the Financial Statements

We have audited the accompanying financial statements of Hatton National Bank PLC ("the Company") and the consolidated financial statements of the Company and its subsidiaries ("the Group"), which comprise the statements of financial position as at December 31, 2012, the statements of comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information set out on pages 206 to 323 of the annual report.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Sri Lanka Accounting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Scope of Audit and Basis of Opinion

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Sri Lanka Auditing Standards. Those standards require that we plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting policies used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

We have obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purposes of our audit. We therefore believe that our audit provides a reasonable basis for our opinion.

Opinion - Company

In our opinion, so far as appears from our examination, the Company maintained proper accounting records for the year ended December 31, 2012 and the financial statements give a true and fair view of the financial position of the Company as at December 31, 2012, and of its financial performance and its cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

Opinion - Group

In our opinion, the consolidated financial statements give a true and fair view of the financial position of the Company and its subsidiaries dealt with thereby as at December 31, 2012, and of its financial performance and its cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

Report on Other Legal and Regulatory Requirements

These financial statements also comply with the requirements of Sections 153(2) to 153(7) of the Companies Act No. 07 of 2007 and present the information required by the Banking Act, No 30 of 1988.

KPMG

CHARTERED ACCOUNTANTS

21st February 2013
Colombo, Sri Lanka.

Consolidated Statement of Comprehensive Income

For the year ended 31st December	Note	BANK 2012 Rs 000	BANK 2011 Rs 000	GROUP 2012 Rs 000	GROUP 2011 Rs 000
Income	8	51,558,900	37,066,301	55,160,069	40,122,582
Interest income		47,346,498	33,175,928	47,939,508	33,546,871
Less: Interest expenses		25,368,432	16,530,253	25,495,541	16,626,472
Net interest income	9	21,978,066	16,645,675	22,443,967	16,920,399
Fee and commission income		3,740,497	2,710,552	3,833,378	2,987,433
Less: Fee and commission expenses		53,407	34,521	64,032	56,292
Net fee and commission income	10	3,687,090	2,676,031	3,769,346	2,931,141
Net interest, fee and commission income		25,665,156	19,321,706	26,213,313	19,851,540
Net loss from trading	11	(1,632,528)	(347,078)	(1,624,049)	(426,335)
Net gain from financial investments	12	142,479	398,936	114,412	390,630
Other operating income	13	1,961,954	1,127,963	4,896,820	3,623,983
Total Operating income		26,137,061	20,501,527	29,600,496	23,439,818
Less: Impairment charge/(reversal) for loans and other losses	14	1,162,231	(445,373)	1,162,231	(501,494)
Net operating income		24,974,830	20,946,900	28,438,265	23,941,312
Less:					
OPERATING EXPENSES	15				
Personnel expenses	16	6,520,648	4,987,287	7,103,764	5,525,978
Premises, equipment and establishment expenses		3,575,606	3,277,004	3,481,168	2,956,320
Other overhead expenses		3,584,997	3,070,598	5,929,498	5,162,678
		13,681,251	11,334,889	16,514,430	13,644,976
Operating profit before value added tax (VAT)		11,293,579	9,612,011	11,923,835	10,296,336
Less: Value added tax (VAT) on financial services		1,247,873	1,224,143	1,247,873	1,224,143
Operating profit after value added tax (VAT)		10,045,706	8,387,868	10,675,962	9,072,193
Share of profit/(loss) of Associates (net of income tax)	17	-	-	16,632	(15,729)
PROFIT BEFORE INCOME TAX		10,045,706	8,387,868	10,692,594	9,056,464
Less: Income tax expense	18	2,342,335	2,123,203	2,421,431	2,156,077
PROFIT FOR THE YEAR		7,703,371	6,264,665	8,271,163	6,900,387
Profit attributable to:					
Equity holders of the Bank		7,703,371	6,264,665	8,110,969	6,818,923
Non-controlling interests		-	-	160,194	81,464
PROFIT FOR THE YEAR		7,703,371	6,264,665	8,271,163	6,900,387
OTHER COMPREHENSIVE INCOME, NET OF INCOME TAX					
Gains and losses arising from translating the financial statements of foreign operations		-	-	13,843	4,292
Gains and losses on re-measuring available-for-sale financial assets					
Net change in fair value on available-for-sale financial assets		284,016	(3,334,984)	305,986	(3,341,133)
Transfer to life policy holder reserve fund		-	-	(21,335)	6,149
Net amount transferred to profit or loss (available-for-sale financial assets)		75,402	-	76,765	(5,745)
Actuarial gains and losses on defined benefit plans		587,494	34,870	587,494	34,870
Changes in revaluation surplus		1,465,117	4,391	2,397,293	4,391
Other comprehensive income for the year, net of tax		2,412,029	(3,295,723)	3,360,046	(3,297,176)
Total comprehensive income for the year		10,115,400	2,968,942	11,631,209	3,603,211
Total comprehensive income attributable to:					
Equity holders of the Bank		10,115,400	2,968,942	11,460,588	3,521,598
Non-controlling interests		-	-	170,621	81,613
Total comprehensive income for the year		10,115,400	2,968,942	11,631,209	3,603,211
Earnings per share on profit	19				
Basic earnings per ordinary share (Rs)		19.36	16.60	21.19	18.65
Diluted earnings per ordinary share (Rs)		19.34	16.49	21.16	18.51
DIVIDEND PER SHARE (Rs)		*8.50	7.50	*8.50	7.50

The Notes to the Financial Statements from pages 214 to 323 form an integral part of these Financial Statements.

*Calculated on interim dividend paid and final dividend proposed, which is to be approved at the Annual General Meeting.

Consolidated Statement of Financial Position

As at	Note	BANK 31.12.2012 Rs 000	BANK 31.12.2011 Rs 000	BANK 01.01.2011 Rs 000	GROUP 31.12.2012 Rs 000	GROUP 31.12.2011 Rs 000	GROUP 01.01.2011 Rs 000
ASSETS							
Cash and cash equivalents	21	8,769,206	7,542,767	6,556,338	8,848,746	7,576,224	6,648,617
Balances with central banks	22	19,933,463	18,683,405	12,491,644	19,950,040	18,698,197	12,506,052
Placements with banks	23	10,321,832	7,220,151	11,551,945	11,667,417	8,243,999	12,047,493
Derivative financial instruments	24	344,552	496,643	231,124	344,552	496,643	231,124
Other financial assets held for trading	25	474,083	1,160,499	1,457,448	1,078,124	2,407,725	2,998,591
Non-current assets held for sale	26	-	-	-	2,875	2,875	2,875
Loans and receivables to other customers	27	302,760,980	257,198,343	202,253,018	303,922,092	257,435,480	201,579,582
Financial investments - Available-for-sale	28	57,869,546	51,239,058	49,379,877	58,929,296	51,434,979	49,626,920
Financial investments - Held-to-maturity	29	-	-	-	1,643,852	1,697,640	1,616,424
Financial investments - Loans and receivables	30	20,030,669	14,665,997	15,370,787	20,904,172	15,362,143	15,739,393
Investments in Associates	31	-	83,674	83,651	386,172	384,319	196,009
Investment in Joint Venture	32	655,000	655,000	655,000	-	-	-
Investments in Subsidiaries	33	2,357,285	2,357,285	2,179,086	-	-	-
Investment properties	34	349,708	349,374	353,563	164,598	169,029	173,595
Property, plant and equipment	35	9,417,915	7,834,866	7,427,555	17,815,411	15,415,636	15,115,760
Intangible assets	36	556,171	549,503	577,015	689,501	670,776	702,931
Deferred tax assets	47	369,726	313,785	506,348	372,193	318,895	508,534
Other assets	37	12,092,197	10,133,295	8,633,367	12,679,956	10,982,310	9,905,711
Total Assets		446,302,333	380,483,645	319,707,766	459,398,997	391,296,870	329,599,611
LIABILITIES							
Due to banks	38	30,400,980	19,885,436	10,421,179	30,400,980	19,885,436	10,421,179
Derivative financial instruments	39	1,436,443	617,702	166,521	1,436,443	617,702	166,521
Due to other customers	40	341,423,986	291,356,578	239,033,783	340,847,606	290,911,558	238,838,573
Dividends payable	41	221,455	168,080	49,558	223,251	169,876	51,120
Other borrowings	42	4,950,535	7,008,741	12,573,000	6,747,144	8,876,197	14,143,564
Debt securities issued	43	-	-	-	150,000	-	-
Current tax liabilities		1,755,429	1,021,619	2,587,421	1,839,714	1,093,787	2,718,781
Bills payable		1,430,578	1,404,158	1,305,161	1,430,578	1,404,158	1,305,161
Subordinated debentures	44	4,585,568	5,023,216	2,849,143	4,563,011	4,989,350	2,816,548
Insurance provision - Life	45	-	-	-	3,626,239	3,021,331	2,415,214
Insurance provision - General	46	-	-	-	969,441	944,322	743,049
Deferred tax liabilities	47	1,478,341	1,174,862	890,602	1,556,312	1,225,349	960,016
Other provisions		4,240,493	5,812,370	8,397,841	4,400,098	5,876,883	8,491,344
Other liabilities	48	7,902,786	9,027,153	10,658,135	8,614,281	9,924,156	11,986,945
Total Liabilities		399,826,594	342,499,915	288,932,344	406,805,098	348,940,105	295,058,015
EQUITY							
Stated capital	50	12,579,479	11,451,451	5,318,550	12,579,479	11,451,451	5,318,550
Statutory reserves		4,530,562	2,778,337	1,510,000	4,530,562	2,778,337	1,510,000
Retained earnings		4,225,948	3,009,553	2,252,516	5,321,845	3,504,132	2,120,000
Other reserves		25,139,750	20,744,389	21,694,356	29,192,575	23,840,620	25,009,480
Total equity attributable to equity holders of the Bank		46,475,739	37,983,730	30,775,422	51,624,461	41,574,540	33,958,030
Non-controlling interests		-	-	-	969,438	782,225	583,566
Total Equity		46,475,739	37,983,730	30,775,422	52,593,899	42,356,765	34,541,596
Total Liabilities and Equity		446,302,333	380,483,645	319,707,766	459,398,997	391,296,870	329,599,611
Commitments and contingencies	51	164,367,012	152,589,043	124,170,550	164,367,012	152,589,043	124,170,550

The Notes to the Financial Statements from pages 214 to 323 form an integral part of these Financial Statements.

I certify that these Financial Statements are in compliance with the requirements of Companies Act No 7 of 2007.

Ajantha de Vas Gunasekara
Chief Financial Officer

For and on behalf of the Board

Rajendra Theagarajah
Managing Director /
Chief Executive Officer

Ranee Jayamaha
Chairperson

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

21st February 2013
Colombo

Statement of Changes in Equity

BANK
For the year ended 31st December 2012

	Stated Capital		Statutory Reserves		Other Reserves					
	Voting Shares Rs 000	Non-Voting Shares Rs 000	Statutory Reserve Rs 000	Investment Fund Account Rs 000	Capital Reserve Rs 000	Available for sale reserve Rs 000	General Reserve Rs 000	ESOP Reserve Rs 000	Retained earnings Rs 000	Total Rs 000
Balance as at 31st December 2010	3,854,980	1,463,570	1,510,000	-	3,024,969	-	13,000,000	-	4,420,248	27,273,767
Impact of adopting SLFRSs as at 1st January 2011	-	-	-	-	-	5,669,387	-	-	(2,167,732)	3,501,655
Restated balance as at 1st January 2011	3,854,980	1,463,570	1,510,000	-	3,024,969	5,669,387	13,000,000	-	2,252,516	30,775,422
Total comprehensive income for the year										
Net profit for the year 2011	-	-	-	-	-	-	-	-	6,264,665	6,264,665
Other comprehensive income, net of tax	-	-	-	-	4,391	(3,334,984)	-	-	34,870	(3,295,723)
Total comprehensive income for the year	-	-	-	-	4,391	(3,334,984)	-	-	6,299,535	2,968,942
Transactions with equity holders, recognised directly in equity										
Contributions by and distributions to equity holders										
Final dividend for 2010	-	-	-	-	-	-	-	-	(1,310,975)	(1,310,975)
Interim dividend for 2011	-	-	-	-	-	-	-	-	(582,560)	(582,560)
Shares issued under ESOP	59,702	6,400	-	-	-	-	-	-	-	66,102
Rights issue and private placement	5,228,644	838,155	-	-	-	-	-	-	-	6,066,799
Total contributions by and distributions to equity holders	5,288,346	844,555	-	-	-	-	-	-	(1,893,535)	4,239,366
Transfer of revaluation reserve for disposal of property, plant and equipment	-	-	-	-	(19,374)	-	-	-	19,374	-
Transfers during the year 2011	-	-	290,000	978,337	-	-	2,400,000	-	(3,668,337)	-
Balance as at 31st December 2011	9,143,326	2,308,125	1,800,000	978,337	3,009,986	2,334,403	15,400,000	-	3,009,553	37,983,730
Total comprehensive income for the year										
Net profit for the year 2012	-	-	-	-	-	-	-	-	7,703,371	7,703,371
Other comprehensive income, net of tax	-	-	-	-	1,465,117	359,418	-	-	587,494	2,412,029
Total comprehensive income for the year	-	-	-	-	1,465,117	359,418	-	-	8,290,865	10,115,400

BANK
For the year ended 31st December 2012

	Stated Capital		Statutory Reserves		Other Reserves					
	Voting Shares	Non-Voting Shares	Statutory Reserve	Investment Fund Account	Capital Reserve	Available for sale reserve	General Reserve	ESOP Reserve	Retained earnings	Total
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Transactions with equity holders, recognised directly in equity										
Contributions by and distributions to equity holders										
Final dividend for 2011 - Cash (Note 41)	-	-	-	-	-	-	-	-	(1,166,032)	(1,166,032)
Final dividend for 2011 - Scrip (Note 41)	840,958	208,471							(1,166,032)	(116,603)
Interim dividend for 2012 (Note 41)	-	-	-	-	-	-	-	-	(595,870)	(595,870)
ESOP allocation 2012	-	-	-	-	-	-	-	176,515	-	176,515
Shares issued under ESOP	64,975	13,624	-	-	-	-	-	-	-	78,599
Total contributions by and distributions to equity holders	905,933	222,095	-	-	-	-	-	176,515	(2,927,934)	(1,623,391)
Transfer of revaluation reserve for disposal of property, plant and equipment	-	-	-	-	(5,689)	-	-	-	5,689	-
Transfers during the year 2012	-	-	430,000	1,322,225	-	-	2,400,000	-	(4,152,225)	-
Balance as at 31st December 2012	10,049,259	2,530,220	2,230,000	2,300,562	4,469,414	2,693,821	17,800,000	176,515	4,225,948	46,475,739

Statement of Changes in Equity

GROUP
For the year ended 31st December 2012

	Attributable to Equity Holders of the Bank													
	Stated Capital		Statutory Reserves				Other Reserves							
	Voting Shares	Non-Voting Shares	Statutory Reserve Fund	Investment Fund Account	Capital Reserve	Available for sale reserve	Treasury shares	General Reserve	Exchange Equalisation Reserve	Life policy holder reserve Fund	ESOP Reserve	Retained Earnings	Non Controlling Interest	Total
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Balance as at 31st December 2010	3,854,980	1,463,570	1,510,000	-	5,791,791	-	-	13,000,000	2,744	-	-	4,355,024	588,592	30,566,701
Impact of adopting SLFRSs as at 1st January 2011	-	-	-	-	626,741	5,704,378	(147,224)	-	-	31,050	-	(2,235,024)	(5,026)	3,974,895
Restated balance as at 1st January 2011	3,854,980	1,463,570	1,510,000	-	6,418,532	5,704,378	(147,224)	13,000,000	2,744	31,050	-	2,120,000	583,566	34,541,596
Total comprehensive income for the year														
Net profit for the year 2011	-	-	-	-	-	-	-	-	-	-	-	6,818,923	81,464	6,900,387
Other comprehensive income, net of tax	-	-	-	-	4,391	(3,339,576)	-	-	2,989	-	-	34,870	150	(3,297,176)
Total comprehensive income for the year	-	-	-	-	4,391	(3,339,576)	-	-	2,989	-	-	6,853,793	81,614	3,603,211
Transactions with equity holders, recognised directly in equity														
Contributions by and distributions to equity holders														
Final dividend for 2010	-	-	-	-	-	-	-	-	-	-	-	(1,260,743)	(39,205)	(1,299,948)
Interim dividend for 2011	-	-	-	-	-	-	-	-	-	-	-	(559,955)	-	(559,955)
Shares issued under ESOP	59,702	6,400	-	-	-	-	-	-	-	-	-	-	-	66,102
Rights issue and private placement	5,228,644	838,155	-	-	-	-	(163,714)	-	-	-	-	-	156,250	6,059,335
Total contributions by and distributions to equity holders	5,288,346	844,555	-	-	-	-	(163,714)	-	-	-	-	(1,820,698)	117,045	4,265,534
Change in contract liabilities life fund	-	-	-	-	-	-	-	-	-	(47,427)	-	-	-	(47,427)
Transfer to life policy holders' reserve fund	-	-	-	-	-	-	-	-	-	(6,149)	-	-	-	(6,149)
Transfer of revaluation reserve for disposal of property, plant and equipment	-	-	-	-	(19,374)	-	-	-	-	-	-	19,374	-	-
Transfers during the year 2011	-	-	290,000	978,337	-	-	-	2,400,000	-	-	-	(3,668,337)	-	-
Balance as at 31st December 2011	9,143,326	2,308,125	1,800,000	978,337	6,403,549	2,364,802	(310,938)	15,400,000	5,733	(22,526)	-	3,504,132	782,225	42,356,765
Total comprehensive income for the year														
Net profit for the year 2012	-	-	-	-	-	-	-	-	-	-	-	8,110,969	160,194	8,271,163
Other comprehensive income, net of tax	-	-	-	-	2,397,293	359,690	-	-	5,142	-	-	587,494	10,427	3,360,046
Total comprehensive income for the year	-	-	-	-	2,397,293	359,690	-	-	5,142	-	-	8,698,463	170,621	11,631,209

GROUP
For the year ended 31st December 2012

	Attributable to Equity Holders of the Bank													
	Stated Capital		Statutory Reserves				Other Reserves							
	Voting Shares	Non-Voting Shares	Statutory Reserve Fund	Investment Fund Account	Capital Reserve	Available for sale reserve	Treasury shares	General Reserve	Exchange Equalisation Reserve	Life policy holder reserve Fund	ESOP Reserve	Retained Earnings	Non Controlling Interest	Total
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Transactions with equity holders, recognised directly in equity														
Contributions by and distributions to equity holders														
Final dividend for 2011 - Cash (Note 41)	-	-	-	-	-	-	-	-	-	-	-	(1,120,823)	(51,046)	(1,171,869)
Final dividend for 2011 - Scrip (Note 41)	840,958	208,471	-	-	-	-	-	-	-	-	-	(1,166,032)	-	(116,603)
Interim dividend for 2012 (Note 41)	-	-	-	-	-	-	-	-	-	-	-	(572,619)	-	(572,619)
ESOP allocation 2012	-	-	-	-	-	-	-	-	-	-	176,515	-	-	176,515
Shares issued under ESOP	64,975	13,624	-	-	-	-	-	-	-	-	-	-	-	78,599
Total contributions by and distributions to equity holders	905,933	222,095	-	-	-	-	-	-	-	-	176,515	(2,859,474)	(51,046)	(1,605,977)
Transfer to life policy holder reserve fund	-	-	-	-	-	-	-	-	-	21,335	-	-	-	21,335
Write off of subsidiary investment	-	-	-	-	-	-	-	-	3,665	-	-	(3,665)	-	-
Disposal of associate company	-	-	-	-	-	-	-	-	(5,996)	-	-	52,052		46,056
Deemed disposal gain through joint venture	-	-	-	-	-	-	-	-	-	-	-	76,873	67,638	144,511
Transfer of revaluation reserve for disposal of property, plant and equipment	-	-	-	-	(5,689)	-	-	-	-	-	-	5,689	-	-
Transfers during the year 2012	-	-	430,000	1,322,225	-	-	-	2,400,000	-	-	-	(4,152,225)	-	-
Balance as at 31st December 2012	10,049,259	2,530,220	2,230,000	2,300,562	8,795,153	2,724,492	(310,938)	17,800,000	8,544	(1,191)	176,515	5,321,845	969,438	52,593,899

The Notes to the Financial Statements from page 214 to 323 form an integral part of these Financial Statements.

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, 2007 and 2012 and includes the surplus on revaluation of those assets.

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

Exchange equalisation reserve consists of foreign exchange differences resulting from translation of foreign Subsidiary and Associate financial statements to functional currency of the Group (Sri Lankan Rupees).

Investment Fund Account consists of 8% of the profits calculated for the payment of Value Added Tax and 5% of the Profit Before Tax calculated for payment of Income Tax purposes during the year.

ESOP reserve consists of the liability recognised on account of the ESOP allocation during 2012 [Note 4.15.3 (b) i]

Cash Flow Statement

For the year ended 31st December	Bank 2012 Rs 000	Bank 2011 Rs 000	Group 2012 Rs 000	Group 2011 Rs 000
Cash Flows from Operating Activities				
Interest & Commission Receipts	43,830,000	32,124,704	44,122,146	32,619,731
Interest Payments	(24,728,933)	(14,224,010)	(24,856,302)	(14,315,333)
Receipts from other Operating Activities	1,641,013	1,085,283	4,575,925	3,538,563
Cash Payments to Employees	(6,385,313)	(5,755,443)	(6,896,173)	(6,281,654)
Cash Payments to Suppliers	(2,482,706)	(2,308,761)	(2,249,916)	(2,072,901)
Recovery of loans written off in prior years	11,192	4,071	11,192	4,071
Cash Payments to Other Operating Activities	(6,693,598)	(6,835,305)	(8,328,294)	(7,946,368)
Operating Profit before Changes in Operating Assets and Liabilities	5,191,655	4,090,539	6,378,578	5,546,109
Increase in Operating assets				
Deposits held for Regulatory or Monetary Control Purpose	(1,250,058)	(6,191,761)	(1,250,058)	(6,191,761)
Loans and receivables to other customers	(44,961,367)	(54,199,207)	(45,863,570)	(55,050,244)
Other Short Term assets	(902,569)	(1,382,675)	(981,135)	(1,281,723)
	(47,113,994)	(61,773,643)	(48,094,763)	(62,523,728)
Increase/(Decrease) in Operating Liabilities				
Deposits from Customers	48,819,348	50,073,031	48,687,988	49,829,714
Other Liabilities	(568,538)	(599,694)	(316,089)	(789,290)
	48,250,810	49,473,337	48,371,899	49,040,424
Net Cash Generated from/(used in) Operating Activities before Income Tax	6,328,471	(8,209,767)	6,655,714	(7,937,195)
Income Taxes Paid	(929,178)	(2,645,086)	(966,030)	(2,725,563)
Net Cash Generated from/(used in) Operating Activities	5,399,293	(10,854,853)	5,689,684	(10,662,758)
Cash Flows from Investing Activities				
Dividend Income	246,733	399,487	221,175	397,553
Net proceeds from Sale, Maturity and Purchase of Financial Investments	(6,616,307)	(1,491,319)	(6,670,428)	(1,505,697)
Improvements to Investment Properties	(5,085)	(395)	(139)	-
Purchase of Property, Plant and Equipment	(872,396)	(1,210,302)	(925,940)	(1,260,080)
Purchase of Intangible Assets	(181,982)	(145,402)	(208,214)	(155,408)
Investment in Associate Company	-	-	(20,000)	(199,661)
Net proceeds from sale of Associate company	58,815	-	58,815	-
Investment in Subsidiary Company	-	(234,320)	-	-
Proceeds from Sale of Property Plant and Equipment	36,038	84,389	37,237	90,044
Proceeds from deemed disposal of subsidiary company through Joint Venture	-	-	144,511	-
Net Cash Flows used in Investing Activities	(7,334,184)	(2,597,862)	(7,362,983)	(2,633,249)
Cash Flows from Financing Activities				
Increase/(Decrease) in Debentures	(375,724)	2,000,000	(363,725)	2,000,000
Increase of Long Term Borrowings	8,390,915	3,795,333	8,320,328	4,086,130
Issue of preference shares	-	-	150,000	-
Dividends Paid	(1,825,130)	(1,775,013)	(1,807,716)	(1,741,148)
Proceeds from right issue and private placement	-	6,066,799	-	5,903,086
Proceeds from issue of shares to minority share holders	-	-	-	156,250
Proceeds from issue of shares under ESOP	78,599	66,102	78,599	66,102
Share issue expenses	(5,649)	(45,871)	(8,247)	(50,300)
Net Cash Generated from Financing Activities	6,263,011	10,107,350	6,369,239	10,420,120
Net Increase/(Decrease) in Cash and Cash Equivalents	4,328,120	(3,345,365)	4,695,940	(2,875,887)
Cash and Cash Equivalents at the Beginning of the year	14,762,918	18,108,283	15,820,223	18,696,110
Cash and Cash Equivalents at the End of the year	19,091,038	14,762,918	20,516,163	15,820,223

For the year ended 31st December	BANK 2012 Rs'000	BANK 2011 Rs'000	GROUP 2012 Rs'000	GROUP 2011 Rs'000
Note (a)				
Reconciliation of operating profit before changes in operating assets and liabilities				
Profit before income tax	10,045,706	8,387,868	10,692,594	9,056,464
Dividend income	(246,733)	(399,487)	(221,175)	(397,553)
Profit on sale of property, plant and equipment	(14,816)	(19,062)	(14,986)	(17,309)
Depreciation of Investment properties	4,751	4,584	4,569	4,566
Depreciation of property, plant and equipment	795,635	737,628	965,630	889,860
Amortisation of Intangible assets	175,314	172,914	189,099	185,624
Impairment for loans and other losses	1,162,231	(445,373)	1,162,231	(501,494)
(Gain)/Loss on marked to market valuation financial investments	(71,638)	256,080	(59,323)	287,180
Capital (gain)/loss from financial investment	216,990	(71,455)	198,922	(93,858)
Profit from sale of Associate company	(38,393)	-	(38,393)	-
Loss on FCBU revaluation	19,291	18,234	19,291	18,234
Notional tax credit and WHT credit	(564,615)	(325,101)	(605,321)	(359,397)
Share issue expenses	5,649	45,871	8,247	50,300
Non life insurance reserve fund	-	-	630,027	799,356
Share of associate (profit)/loss	-	-	(16,632)	15,729
Net income from sale of apartments	-	-	(91,133)	(70,758)
Negative goodwill on investment in subsidiaries/associates	-	-	-	(2,213)
Accrual for Interest receivable	(6,684,126)	(3,551,719)	(6,907,642)	(3,723,838)
Accrual for other receivable	(47,918)	(68,804)	(66,899)	(74,070)
Accrual for other payables	(1,605,152)	(2,879,815)	(1,501,594)	(2,754,151)
Accrual for Interest payable	2,058,757	2,228,176	2,058,499	2,233,436
Accrual for employee retirement benefits	(229,817)	-	(237,972)	-
Fair value of the options granted under ESOP	176,515	-	176,515	-
Net loss arising on derecognition of financial assets measured at amortised cost	34,024	-	34,024	-
	5,191,655	4,090,539	6,378,578	5,546,109

The Notes to the Financial Statements from pages 214 to 323 form an integral part of these Financial Statements.

Notes to the Financial Statements

1. REPORTING ENTITY

Hatton National Bank PLC ("Bank"/"HNB") is a public quoted company incorporated on 5th March 1970 with limited liability and domiciled in Sri Lanka. It is a Licensed Commercial Bank regulated under the Banking Act No. 30 of 1988 and amendments thereto. The Company was re-registered under the Companies Act No. 07 of 2007. The registered office of the Bank is situated at No 479, T B Jayah Mawatha, Colombo 10. The shares of the Bank have a primary listing on the Colombo Stock Exchange. The staff strength of the Bank as at 31st December 2012 is 4,679 (2011- 4,584).

The Consolidated Financial Statements of the Bank as at and for the year ended 31st December 2012 include the Bank and its Subsidiaries (together referred to as the "Group" and individually as "Group entities") and the Group's interest in its Associate and Joint Venture. The Financial Statements of all companies in the Group have a common financial year which ends on December 31 except for Lanka Ventures PLC a subsidiary of Acuity Partners (Pvt) Limited, the joint venture, with a financial year ending March 31.

The Bank does not have an identifiable parent of its own.

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

1.1 Principal Activities

1.1.1 Bank

The principal activities of the Bank continued to be banking and related activities such as accepting deposits, corporate and retail banking, personal financial services, off shore banking, foreign currency operations, trade services, investment banking, development banking, rural finance, project finance, dealing in government securities etc.

1.1.2 Subsidiaries

Name of Subsidiary	Principal Activities
HNB Assurance PLC	Insurance services
Sithma Development (Pvt) Ltd	Property development
Majan Exchange LLC	Provision of remittances and foreign currency related services

The commercial activities of Commercial Interlink Services Inc were ceased on 1st October 2010 and the Bank's investment in the company was written off against the provision during 2012.

1.1.3 Associate

Name of Associate	Principal Activities
Delma Exchange	Provision of remittances and foreign currency related services

Bank disposed its investments in Delma Exchange on 17th December 2012.

1.1.4 Joint Venture

Name of Joint venture	Principal Activities
Acuity Partners (Pvt) Ltd	Operating as an investment company and providing financial services.

1.1.5 Special Purpose Entity

Name of Special Purpose Entity	Principal Activities
Employee Share Benefit Trust	Administering the employee share Benefit scheme

2. BASIS OF PREPARATION

2.1 Statement of Compliance

The Institute of Chartered Accountants of Sri Lanka has issued a new volume of Sri Lanka Accounting Standards which became applicable for financial periods beginning on or after 1st January 2012. The Consolidated Financial Statements of the Group and the Financial Statements of the Bank which comprise the Statement of Financial Position, Statement of Comprehensive Income, Statement of Changes in Equity, Statement of Cash Flows and Notes thereto have been prepared in accordance with these Sri Lanka Accounting Standards (SLFRSs and LKASs) 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. These are the Group's first consolidated financial statements prepared in accordance with SLFRSs and SLFRS 1 First-time Adoption of Sri Lanka Financial Reporting Standards has been applied.

An explanation of how the transition to SLFRSs has affected the reported financial position, financial performance and cash flows of the Bank/Group is provided in note 57.

2.2 Approval of Financial Statements by Directors

The Consolidated and Bank's Financial Statements were authorised for issue by the Board of Directors in accordance with the resolution of the Directors on 21st February 2013.

2.3 Basis of Measurement

The Consolidated Financial Statements have been prepared on the historical cost basis and applied consistently subject to the impact in note 2.1, with no adjustments being made for inflationary factors affecting the Financial Statements, except for the following;

- Derivative financial instruments are measured at fair value.
- Financial instruments designated at fair value through profit and loss are measured at fair value
- Available for sale financial assets are measured at fair value
- Liabilities for cash settled share based payment arrangements are measured at fair value
- 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.
- Non-current assets held for sale are measured at lower of its carrying amount and fair value less costs to sell.
- Liability for defined benefit obligations is recognised as the present value of the defined benefit obligation less the net totals of the plan assets and unrecognised past service cost.

2.4 Functional and Presentation Currency

The Consolidated 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.

Each entity in the Group determines its own functional currency and items included in the Financial Statements of each individual entity are measured using that functional currency. There was no change in the Group's presentation and functional currency during the year under review.

2.5 Use of Estimates and Judgements

The preparation of Consolidated Financial Statements in conformity with Sri Lanka Accounting Standards requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

Information about significant areas of estimation, uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amounts recognised in the Financial Statements are described in the relevant notes as follows.

- Identification, measurement and assessment of impairment (refer Note 4.5.8)
- Recognition and measurement of financial instruments (refer Note 4.5.1 and 4.5.2)
- Employee Retirement Benefits (Refer Note 4.15)
- Classification of Investment Property (Refer Note 4.11)

3. MATERIALITY AND AGGREGATION

Each material class of similar items is presented separately in the Consolidated 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 and in preparing the opening statement of financial position as at 1st January 2011 for the purposes of the transition to SLFRSs, unless otherwise indicated. The accounting policies of the Bank have been consistently applied by the Group entities where applicable and deviations if any, have been disclosed accordingly.

4.1 Basis of Consolidation

4.1.1 Business combinations

Acquisitions on or after 1st January 2012

The Group measures goodwill as the fair value of the consideration transferred including the recognised amount of any non-controlling interest in the acquiree, less the net recognised amount (generally fair value) of the identifiable assets acquired and liabilities assumed, all measured as of the acquisition date. When the excess is negative, a bargain purchase gain is recognised immediately in profit or loss.

The group elects on a transaction-by-transaction basis whether to measure non-controlling interest at its fair value, or at its proportionate share of the recognised amount of the identifiable net assets, at the acquisition date.

The consideration transferred does not include amounts related to the settlement of pre-existing relationships. Such amounts are generally recognised in profit or loss.

Transaction costs, other than those associated with the issue of debt or equity securities, that the Group incurs in connection with a business combination are expensed as incurred.

Notes to the Financial Statements

Acquisitions prior to 1st January 2012

As part of its transition to SLFRSs, the Group elected not to restate those business combinations that occurred prior to 1st January 2012. In respect of acquisitions prior to 1st January 2012, goodwill represents the amount recognised under the previous Sri Lanka Accounting Standards.

4.1.2 Subsidiaries

Subsidiaries are entities, including special purpose entities (SPE) 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 presently 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 Non Controlling Interest is presented in the Consolidated Statement of Financial Position within equity, separately from the equity attributable to the Equity Holders of the Bank. Non controlling Interest in the profit or loss of the Group is disclosed separately in the Consolidated Statement of Comprehensive Income.

The Consolidated Financial Statements are prepared to common financial year end of 31st December. The accounting policies of Subsidiaries have been changed whenever necessary to align them with the policies adopted by the Bank.

Where Subsidiaries have been sold or acquired during the year, their operating results have been included to the date of disposal or from the date of acquisition.

Upon the loss of control, the Group derecognises the assets and liabilities of the subsidiary, any non-controlling interests and the other components of equity related to the subsidiary. Any surplus or deficit arising on the loss of control is recognised in the Statement of Changes in Equity. If the Group retains any interest in the previous subsidiary, then such Interest is measured at fair value at the date that control is lost. Subsequently it is accounted for as an equity-accounted investee or In accordance with the Group's accounting policy for financial Instruments depending on the level of influence retained.

There are no significant restrictions on the ability of the Subsidiaries to transfer funds to the Bank in the form of cash dividends or repayment of loans and advances.

All Subsidiaries of the Bank have been incorporated in Sri Lanka except Majan Exchange LLC in Oman.

A list of Subsidiaries within the Group is provided in Note 33.

4.1.3 Special purpose entity (SPE)

Special purpose entities (SPEs) are entities that are created to accomplish a narrow and well-defined objective. An SPE is consolidated if, based on an evaluation of the substance of its relationship with the Group and the SPE's risks and rewards, the Group concludes that it controls the SPE.

The Bank operates an Employee Share Ownership Plan covering specific employees who after having served for a minimum service period are allotted a specific number of shares of the Bank. HNB has set up a trust (Employee Share Benefit Trust (ESBT)) to administer the plan and has given an advance to the Trust at concessional rate of interest. The Trust has purchased equity shares (non-voting) of HNB from open market for meeting the obligations under the Plan. Accordingly the ESBT is treated as a special purpose entity and included in the Consolidated Financial Statements.

4.1.4 Associates

Associate is an entity in which the Group has significant influence, but no control over the financial and operating policies. Significant influence is presumed to exist when the Group holds between 20 and 50 percent of the voting power of another entity.

Investments in associates are accounted for using the Equity method and are recognised initially at cost. The Group's investment includes goodwill identified on acquisition, net of any accumulated impairment losses. The Consolidated Financial Statements include the Group's share of the income and expenses and equity movements of the Associate, after adjustments being made to align the accounting policies with those of the Group from the date that significant influence effectively commences.

When the Group's share of losses exceeds its interest in the Associate, the carrying amount of that interest, including any long-term investments, is reduced to nil, and the recognition of further losses is discontinued except to the extent that the Group has an obligation or has made payments on behalf of the Associate. If the Associate subsequently reports profits, the Group resumes recognising its share of those profits only after its share of the profits equals the share of losses not recognised.

The Group discontinues the use of the Equity method from the date that it ceases to have significant influence over an Associate and accounts for the investment in accordance with The Group's accounting policy for financial instruments.

There are no significant restrictions on the ability of the Associate to transfer funds to the Bank in the form of cash dividends or repayment of loans and advances.

Details of the Associate within the Group are provided in Note 31.

4.1.5 Joint Venture

Joint Venture is an entity over whose activities the Group has joint control, established by contractual arrangement and requiring unanimous consent for strategic, financial and operating decisions. The Group 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 Group 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.

There are no significant restrictions on the ability of the Joint Venture to transfer funds to the Bank in the form of cash dividends or repayment of loans and advances.

Details of the Joint Venture are provided in Note 32.

4.1.6 Transactions Eliminated on Consolidation

Intra-group balances, and income and expenses arising from intra-group transactions are eliminated in preparing the Consolidated Financial Statements. Unrealised gains arising from transactions with equity accounted investees are eliminated to the extent of the Group's interest in the investee against the investment in the investee. 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.

4.1.7 Material Gains or Losses, Provisional Values or Error Corrections

There were no material gains or losses, provisional values or error corrections recognised during the year in respect of business combinations that took place in previous periods.

4.2 Foreign Currency Translation

4.2.1 Foreign Currency Transactions

Transactions in foreign currencies are translated to Sri Lankan Rupees at the middle rate of exchange ruling at the dates of the transactions.

Monetary assets and liabilities denominated in foreign currencies at the Balance Sheet date are translated to Sri Lankan Rupees at the middle rate of exchange ruling at that date. The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortised cost in foreign currency translated at the exchange rate at the end of the reporting period. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to Sri Lankan Rupees at the exchange rates ruling at the date that the fair value was determined.

Foreign currency differences arising on retranslation are recognised in profit or loss, except for differences arising on the retranslation of available-for-sale equity instruments, a financial liability designated as a hedge of the net investment in a foreign operation, or qualifying cash flow hedges, which are recognised in other comprehensive income. Non monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction.

4.2.2 Foreign Operations

The Financial Statements of foreign entities within the Group whose functional currency is different to presentation currency, are translated to Sri Lankan Rupees as follows:

- Assets (including goodwill and fair value adjustment arising on acquisition) and liabilities are translated at the middle rate of exchange at the date of the Statement of Financial Position.
- Income and expenses are translated at the average exchange rate ruling during the period under consideration.
- All resulting foreign exchange differences are recognised in other comprehensive income.

When a foreign operation is disposed of, the relevant amount in the exchange equalisation reserve is transferred to retained earnings.

ASSETS AND LIABILITIES AND BASIS OF MEASUREMENT

4.3 Cash and Cash Equivalents

Cash and cash equivalents include notes and coins on hand, unrestricted balances with Central Banks ,balances with banks, placements with banks, money at call and short notice with less than three months maturity from the date of acquisition.

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 22.

Notes to the Financial Statements

4.5 Financial Assets and Financial Liabilities

4.5.1 Recognition and initial measurement

The Group initially recognises all financial assets and liabilities on the settlement date.

However for financial assets/liabilities held at fair value through profit and loss any changes in fair value from the trade date to settlement date is accounted in the Consolidated Statement of Income while for available for sale financial assets any changes in fair value from the trade date to settlement date is accounted in the Statement of Other Comprehensive Income.

A financial asset or a financial liability is measured initially at fair value plus, for an item not at fair value through profit or loss, transaction costs that are directly attributable to its acquisition or issue.

4.5.2 Classification and subsequent measurement

Financial assets

At inception a financial asset is classified in one of the following categories:

- at fair value through profit or loss (either as held for trading or designated at fair value through profit or loss)
- loans and receivables
- held to maturity financial assets
- available-for-sale financial assets

Financial liabilities

The Group initially recognises all financial liabilities on the date that they are originated and classifies its financial liabilities as measured at amortised cost or fair value through profit or loss.

Financial assets and financial liabilities at fair value through profit or loss

A financial asset or a financial liability is classified as fair value through profit or loss if it is classified as held for trading or is designated as such upon initial recognition. Financial assets and financial liabilities are designated as fair value through profit or loss when;

- The designation eliminates or significantly reduces measurement or recognition inconsistency that would otherwise arise from measuring assets or liabilities on a different basis
- A group of financial assets and/or liabilities is managed and its performance evaluated on a fair value basis
- The asset or liabilities include embedded derivatives and such derivatives are required to be recognised separately

Upon initial recognition attributable transaction costs are recognised in profit or loss as incurred. Financial assets and financial liabilities at fair value through profit or loss are measured at fair value, and changes therein are recognised in profit or loss.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and that the Group does not intend to sell immediately or in the near term. Loans and receivables are subsequently carried at amortised cost using the effective interest rate method.

Loans and advances, bills of exchange, commercial papers and lease receivables are classified as loans and receivables.

Held to maturity financial assets (HTM)

Held-to-maturity investments are non-derivative assets with fixed or determinable payments and fixed maturity that the Group has the positive intent and ability to hold to maturity, and which were not designated as at fair value through profit or loss or as available-for-sale.

Held-to-maturity investments are carried at amortised cost using the effective interest method. A sale or reclassification of a more than insignificant amount of held-to-maturity investments would result in the reclassification of all held-to-maturity investments as available-for-sale, and would prevent the Group from classifying investment securities as held to maturity for the current and the following two financial years. However, sales and reclassifications in any of the following circumstances would not trigger a reclassification:

- sales or reclassifications that are so close to maturity that changes in the market rate of interest would not have a significant effect on the financial asset's fair value;
- sales or reclassifications after the Group has collected substantially all of the asset's original principal; and
- sales or reclassifications attributable to non-recurring isolated events beyond the Group's control that could not have been reasonably anticipated.

Available for sale financial assets (AFS)

Available-for-sale investments are non-derivative investments that were designated as available-for-sale or are not classified as another category of financial assets. Unquoted equity securities whose fair value cannot reliably be measured are carried at cost. All other available-for-sale investments are carried at fair value.

Interest income on AFS financial assets is recognised in profit or loss using the effective interest method. Dividend income is recognised in profit or loss when the Group becomes entitled to the dividend. Foreign exchange gains or losses on available-for-sale debt security investments are recognised in profit or loss.

Other fair value changes are recognised in other comprehensive income until the investment is sold or impaired, whereupon the cumulative gains and losses previously recognised in other comprehensive income are reclassified to profit or loss as a reclassification adjustment.

Financial liabilities measured at amortised cost

Financial liabilities not classified as fair value through profit or loss are classified as amortised cost instruments. Deposit liabilities including non interest bearing deposits, savings deposits, term deposits, deposits redeemable at call and certificates of deposit and borrowings are classified as financial liabilities measured at amortised cost.

4.5.3 Amortised cost measurement

The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initial amount recognised and the maturity amount, minus any reduction for impairment.

4.5.4 Fair value measurement

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction on the measurement date.

When available, the Group measures the fair value of an instrument using quoted prices in an active market for that instrument. A market is regarded as active if quoted prices are readily and regularly available and represent actual and regularly occurring market transactions on an arm's length basis.

If a market for a financial instrument is not active, then the Group establishes fair value using a valuation technique. Valuation techniques include using recent arm's length transactions between knowledgeable, willing parties (if available), reference to the current fair value of other instruments that are substantially the same, discounted cash flow analyses and option pricing models. The chosen valuation technique makes maximum use of market inputs, relies as little as possible on estimates specific to the Group, incorporates all factors that market participants would consider in setting a price, and is consistent with accepted economic methodologies for pricing financial instruments. Inputs to valuation techniques reasonably represent market expectations and measures of the risk-return factors inherent in the financial instrument. The Group calibrates valuation techniques and tests them for validity using prices from observable current market transactions in the same instrument or based on other available observable market data.

The best evidence of the fair value of a financial instrument at initial recognition is the transaction price, i.e. the fair value of the consideration given or received, unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument, i.e. without modification or repackaging, or based on a valuation technique whose variables include only data from observable markets. When transaction price provides the best evidence of fair value at initial recognition, the financial instrument is initially measured at the transaction price and any difference between this price and the value initially obtained from a valuation model is subsequently recognised in profit or loss on an appropriate basis over the life of the instrument but not later than when the valuation is supported wholly by observable market data or the transaction is closed out.

Any difference between the fair value at initial recognition and the amount that would be determined at that date using a valuation technique in a situation in which the valuation is dependent on unobservable parameters is not recognised in profit or loss immediately but is recognised over the life of the instrument on an appropriate basis or when the instrument is redeemed, transferred or sold, or the fair value becomes observable.

Assets and long positions are measured at a bid price; liabilities and short positions are measured at an asking price. Fair values reflect the credit risk of the instrument and include adjustments to take account of the credit risk of the Group entity and the counterparty where appropriate. Fair value estimates obtained from models are adjusted for any other factors, such as liquidity risk or model uncertainties, to the extent that the Group believes a third-party market participant would take them into account in pricing a transaction.

4.5.5 Reclassifications

Reclassifications of financial assets, other than as set out below, or of financial liabilities between measurement categories are not permitted following initial recognition.

Held for trading non-derivative financial assets are transferred out of the held at fair value through profit or loss category in the following circumstances:

- to the available-for-sale category, where, in rare circumstances, they are no longer held for the purpose of selling or repurchasing in the near term; or

- to the loan and receivables category, where they are no longer held for the purpose of selling or repurchasing in the near term and they would have met the definition of a loan and receivable at the date of reclassification and the Group has the intent and ability to hold the assets for the foreseeable future or until maturity.

Financial assets are transferred out of the available-for-sale category to the loan and receivables category where they would have met the definition of a loan and receivable at the date of

Notes to the Financial Statements

reclassification and the Group has the intent and ability to hold the assets for the foreseeable future or until maturity.

Held-to-maturity assets are reclassified to the available-for sale category if the portfolio becomes tainted following the sale of other than an insignificant amount of held-to-maturity assets prior to their maturity.

Financial assets are reclassified at their fair value on the date of reclassification. For financial assets reclassified out of the available-for-sale category into loans and receivables, any gain or loss on those assets recognised in shareholders' equity prior to the date of reclassification is amortised to the income statement over the remaining life of the financial asset, using the effective interest method.

4.5.6 Derecognition

The group derecognises financial asset when the contractual rights to the cash flows from the financial asset expires, or when it transfers the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred or in which the Group neither transfers nor retains substantially all the risks and rewards of ownership and it does not retain control of the financial asset. Any interest in transferred financial assets that qualify for derecognition that is created or retained by the Group is recognised as a separate asset or liability in the Consolidated Statement of Financial Position. On derecognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset transferred), and consideration received (including any new asset obtained less any new liability assumed) is recognised in profit or loss.

The Group derecognises a financial liability when its contractual obligations are discharged or cancelled or expire.

4.5.7 Offsetting

Financial assets and liabilities are offset and the net amount presented in the Consolidated Statement of Financial Position when, and only when, the Group has a legal right to set off the recognised amounts and it intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

Income and expenses are presented on a net basis only when permitted under LKASs/SLFRSs, or for gains and losses arising from a group of similar transactions such as in the Group's trading activity.

4.5.8 Identification, measurement and assessment of impairment

At each reporting date the Group assesses whether there is objective evidence that financial assets not carried at fair value through profit or loss are impaired. A financial asset or a group of financial assets is impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset(s), and that the loss event has an impact on the future cash flows of the asset(s) that can be estimated reliably.

Objective evidence that financial assets (including equity securities) are impaired can include significant financial difficulty of the borrower or issuer, default or delinquency by a borrower, restructuring of a loan or advance by the Group on terms that the Group would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group. In addition, for an investment in an equity security, a significant or prolonged decline in its fair value below its cost is objective evidence of impairment.

The Group considers evidence of impairment for loans and advances and held-to-maturity investment securities at both a specific asset and collective level. All individually significant loans and advances and held-to-maturity investment securities are assessed for specific impairment. All individually significant loans and advances and held-to-maturity investment securities found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Loans and advances and held-to-maturity investment securities that are not individually significant are collectively assessed for impairment by grouping together loans and advances and held-to-maturity investment securities with similar risk characteristics.

In assessing collective impairment the Group uses of historical trends of the probability of default, adjusted for management's judgement as to whether current economic and credit conditions are such that the actual losses are likely to be greater or less than suggested by historical data.

Impairment losses on assets carried at amortised cost are measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the asset's original effective interest rate. Impairment losses are recognised in profit or loss and reflected in an allowance account against loans and advances. Interest on impaired assets continues to be recognised through the unwinding of the discount. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through profit or loss.

Impairment losses on available-for-sale investment securities are recognised by transferring the cumulative loss that has been recognised in other comprehensive income to profit or loss as a reclassification adjustment. The cumulative loss that is reclassified from other comprehensive income to profit or loss is the difference between the acquisition cost, net of any principal repayment and amortisation, and the current fair value, less any impairment loss previously recognised in profit or loss. Changes in impairment provisions attributable to time value are reflected as a component of interest income.

If, in a subsequent period, the fair value of an impaired available-for-sale debt security increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, then the impairment loss is reversed, with the amount of the reversal recognised in profit or loss. However, any subsequent recovery in the fair value of an impaired available-for-sale equity security is recognised in other comprehensive income.

The Group writes off certain loans and advances and investment securities when they are determined to be uncollectible.

4.5.9 Rescheduled Loans

Loans whose original terms have been modified including those subject to forbearance strategies are considered rescheduled loans. If the renegotiations are on terms that are not consistent with those readily available on the market, this provides objective evidence of impairment and the loan is assessed accordingly.

4.6 Sale and repurchase agreements

Securities sold subject to repurchase agreements (repos) remain on the balance sheet; the counterparty liability is included under borrowings. Securities purchased under agreements to resell (reverse repos) are recorded as loans and advances to other banks or customers, as appropriate. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method.

4.7 Derivative financial instruments

Derivatives are financial instruments that derive their value in response to changes in interest rates, financial instrument prices, commodity prices, foreign exchange rates, credit risk and indices. Derivatives are categorised as trading unless they are designated as hedging instruments. Bank has not designated any derivatives as hedging instruments and has not followed hedge accounting as at the reporting date.

All derivatives are initially recognised and subsequently measured at fair value, with all revaluation gains or losses recognised in profit and loss. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

4.8 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 Statement of Financial Position 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 re-measurement are recognised in the Income Statement.

4.9 Finance Leases

Assets leased to customers which transfer substantially all the risks and rewards associated with ownership other than legal title, are classified as finance leases. Amounts receivable under finance leases are included under Lease Receivable. Leasing balances are stated in the Statement of Financial Position after deduction of initial rentals received, unearned lease income and the Impairment for rentals doubtful of recovery.

4.9.1 Identification and Measurement of Impairment for Lease Receivables

Lease receivables are collectively assessed for impairment as stated above in Note 4.5.8.

4.10 Intangible Assets

An intangible asset is an identifiable non monetary asset without physical substance held for use in the production or supply of goods or services, for rental to others or for administrative purposes.

4.10.1 Basis of Recognition

An intangible asset is recognised if it is probable that the future economic benefits that are attributable to the asset will flow to the entity and the cost of the assets can be measured reliably. An intangible asset is initially measured at cost.

4.10.1 (a) Goodwill

Goodwill that arises upon the acquisition of subsidiaries is included in intangible assets. Goodwill is measured at initial recognition in accordance with Note 4.1.1.

Notes to the Financial Statements

Subsequent measurement

Goodwill is measured at cost less accumulated impairment losses. In respect of equity accounted investees, the carrying amount of goodwill is included in the carrying amount of the investment, and an impairment loss in such investment is not allocated to any asset, including goodwill, that forms part of the carrying amount of the equity accounted investee.

Any gain on bargain purchase is recognised immediately in the Statement of Income.

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 Statement of Financial Position under the category Intangible Assets and carried at cost less accumulated amortisation and any accumulated impairment losses.

4.10.2 Subsequent Expenditure

Expenditure incurred on software is capitalised only when it is probable that this expenditure will enable the asset to generate future economic benefits in excess of its originally assessed standard of performance and this expenditure can be measured and attributed to the asset reliably. All other expenditure is expensed as incurred.

4.10.3 Amortisation

Intangible assets, except for goodwill, are amortised on a straight line basis in the Statement of Income from the date when the asset is available for use, over the best estimate of its useful economic life based on a pattern in which the asset's economic benefits are consumed by the Bank. The estimated useful life of software is six years. Expenditure on an intangible item that was initially recognised as an expense by the Bank in previous Annual Financial Statements or Interim Financial Reports are not recognised as part of the cost of an intangible asset at a later date. Amortisation methods, useful lives and residual values are reviewed at each financial year-end and adjusted if appropriate.

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 (LKAS 40) "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 35 (a)]	
Sithma Development (Pvt) Ltd*	
Freehold buildings	2.5% per annum
[Refer Note 35 (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 (LKAS 40) "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.

4.11.5 Investment property leased within the group

Any property leased out to parent or subsidiary is considered as owner-occupied from the perspective of the group and adjustments are made for consolidation purposes and changes are disclosed in Note 34 (b) to the Financial Statements.

4.12 Property, Plant and Equipment

Property, plant and equipment are tangible items that are held for use in the production or supply of goods or services, for rental to others 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 five years on a roll over basis to ensure that the carrying amounts do not differ materially from the fair values at the reporting date. On revaluation of an asset, any increase in the carrying amount is recognised in Other Comprehensive Income and accumulated in equity, under capital reserve or used to reverse a previous revaluation decrease relating to the same asset, which was charged to the Statement of Income. In this circumstance, the increase is recognised as income to the extent of the previous write down. Any decrease in the carrying amount is recognised as an expense in the Statement of Income or debited in the Other Comprehensive Income to the extent of any credit balance existing in the capital reserve in respect of that asset. The decrease recognised in Other Comprehensive Income reduces the amount accumulated in equity under capital reserves. Any balance remaining in the revaluation reserve in respect of an asset is transferred directly to Retained Earnings on retirement or disposal of the asset.

4.12.5 Reclassification to investment property

When the use of property changes from owner-occupied to investment property, the property is remeasured to fair value and reclassified as investment property. Any gain arising on re-measurement is recognised in profit or loss to the extent that it reverses a previous impairment loss on the specific property, with any remaining gain recognised in other comprehensive income and presented in revaluation reserve in equity. Any loss is recognised immediately in the Income Statement.

4.12.6 Subsequent Costs

The subsequent cost of replacing a component of an item of property, plant and equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within that part will flow to the Group and its cost can be reliably measured. The costs of day to day servicing of property, plant and equipment are charged to the Statement of Income as incurred. Costs incurred in using or redeploying an item are not included under carrying amount of an item.

4.12.7 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 de-recognition of an item of property, plant and equipment is included in Statement of Income 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.

4.12.8 Depreciation

The Group provides depreciation from the date the assets are available for use up to the date of disposal, at the following rates on a straight line basis over the periods appropriate to the estimated useful lives based on the pattern in which the asset's future economic benefits are expected to be consumed by the Bank of the different types of assets, except for which are disclosed separately. Depreciation of an asset ceases at the earlier of the date that the asset is classified as held for sale or the date that the asset is derecognised. Depreciation does not cease when the assets become idle or is retired from active use unless the asset is fully depreciated.

Notes to the Financial Statements

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
Furniture and fittings	10

Change in estimates

During the year ended 31st December 2012 the Group conducted an operational efficiency review and there were changes in the expected usage of the chillers and building management system used by Sithma Development (pvt) Ltd. These items had a previous expected useful life of 25 years which are now expected to be used for 20 and 14 years respectively from the date of purchase. As a result the expected useful lives of these assets decreased. The effect of this change on depreciation expense, recognised in premises, equipment and establishment expenses, in current and future periods is as follows.

Rs Mn	2012	2013	2014	2015	2016
Increase in depreciation expense	3.6	10.8	10.8	10.8	10.8

Depreciation methods, useful lives and residual values are reassessed at each reporting date and adjusted if appropriate.

4.12.9 Capital Work-in-Progress

Capital work-in-progress is stated at cost. These are expenses of a capital nature directly incurred in the construction of buildings, major plant and machinery and system development, awaiting capitalisation. Capital work-in-progress would be transferred to the relevant asset when it is available for use i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Capital work-in-progress is stated at cost less any accumulated impairment losses.

4.12.10 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 23 (LKAS 23) "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 Impairment of non-financial assets

The carrying amounts of the Group's non-financial assets, other than investment property and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. For goodwill and intangible assets that have indefinite useful lives or that are not yet available for use, the recoverable amount is estimated each year at the same time. An impairment loss is recognised if the carrying amount of an asset or its Cash Generating Unit (CGU) exceeds its estimated recoverable amount.

The recoverable amount of an asset or CGU is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or CGU.

For the purpose of impairment testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or CGU. Subject to an operating segment ceiling test, for the purposes of goodwill impairment testing, CGUs to which goodwill has been allocated are aggregated so that the level at which impairment testing is performed reflects the lowest level at which goodwill is monitored for internal reporting purposes. Goodwill acquired in a business combination is allocated to groups of CGUs that are expected to benefit from the synergies of the combination.

The Group's corporate assets do not generate separate cash inflows and are utilised by more than one CGU. Corporate assets are allocated to CGUs on a reasonable and consistent basis and tested for impairment as part of the testing of the CGU to which the corporate asset is allocated.

Impairment losses are recognised in profit or loss. Impairment losses recognised in respect of CGUs are allocated first to reduce the carrying amount of any goodwill allocated to the CGU (group of

CGUs) and then to reduce the carrying amount of the other assets in the CGU (group of CGUs) on a pro rata basis.

An impairment loss in respect of goodwill is not reversed. In respect of other assets, impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

Liabilities and provisions

4.14 Dividends Payable

Provision for final dividends is recognized at the time the dividend recommended and declared by the Board of Directors, is approved by the shareholders. Interim dividends payable is recognised when the Board approves such dividend in accordance with the Companies Act No. 7 of 2007.

4.15 Employee Retirement Benefits

4.15.1 Defined Benefit Plan

A defined benefit plan is a post employment benefit plan other than a defined contribution plan.

4.15.1 (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 be the payments to staff who satisfy the criteria as per the Gratuity Act at the time of leaving the services of the Bank without pension rights. The requirement under the Payment of Gratuity Act No 12 of 1983, payment of gratuities to employees who have completed more than five years of service is covered through the Bank's own non-contributory pension scheme which is in force.

The Bank's obligation in respect of defined benefit pension plan is calculated by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods and discounting that benefit to determine its present value, then deducting the fair value of any plan assets and past service cost not yet recognised. The value of any defined benefit asset is restricted to the sum of any past service cost not yet recognised and the present value of any economic benefits available in the form of refunds from the plan or reductions in the future contributions to the plan. 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 (LKAS 19) "Employee Benefits".

When the benefits of a plan are improved, the portion of the increased benefit relating to past service by employees is recognised in the Statement of Income 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 Statement of Income.

To determine the net amount in the Statement of Financial Position, any unrecognised past service costs are deducted from the excess of total defined benefit obligation over fair value of plan assets.

The Bank recognises the total actuarial gains and losses that arise in calculating the Bank's obligation in respect of a plan in Other Comprehensive Income during the period in which it occurs.

The demographic assumptions underlying the valuation are retirement age (55 yrs), early withdrawals from service and retirement on medical grounds, death before and after retirement etc.

The Subsidiaries do not operate pension funds.

4.15.1 (b) Other long-term employee benefits

The Bank's net obligation in respect of long-term employee benefits other than pension funds is the amount of future benefit that employees have earned in return for their service in the current and prior periods; that benefit is discounted to determine its present value. The discount rate is the yield at the reporting date on government bonds that have maturity dates approximating to the terms of the Bank's obligation. The calculation is performed using the projected unit credit method. Any actuarial gains and losses are recognised in profit or loss in the period in which they arise. The Bank's liability towards the portion of the accumulated leave which is expected to be utilised beyond one year from the end of the reporting period is treated as other long-term employee benefits.

4.15.1 (c) 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.

Notes to the Financial Statements

4.15.1 (d) 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.

4.15.1 (e) Employees' Provident Fund - Bank

The Bank and employees contribute 12% and 8% respectively on the salary of each employee to the approved private Provident Fund.

4.15.2 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 Statement of Income as and when they are due.

4.15.2 (a) Employees' provident fund – group companies

The Group entities and their employees contribute 12% and 8% respectively on the salary of each employee to Employees' Provident Fund. [except for the bank as explained in note 4.15.1 (e)]

4.15.2 (b) Employees' Trust Fund

The Bank / Group contributes 3% of the salary of each employee to the Employees' Trust Fund.

4.15.2 (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 an expense in the Statement of Comprehensive Income as and when they are due.

4.15.3 Share Based Payment Transactions

4.15.3 (a) Cash Settled Share Based Payment Transactions

The Employee Share Benefit Trust is treated as a cash settled share based payment transaction. It was introduced in 2005 and 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 Benefit Trust has no potential dilutive effect on the earnings per share of the Bank. The fair value of the amount payable to employees in respect of share appreciation rights settled in cash is recognised as an expense with a corresponding increase in liabilities. The liability is remeasured at each reporting date. Any changes in the fair value of the liability are recognised as personnel expenses in profit or loss. The trust is treated as a subsidiary and the shares held by the trust are treated as treasury shares which are eliminated against reserves in the Consolidated Statement of Financial Position.

4.15.3 (b) Equity Settled Share Based Payment Transactions

4.15.3 (b) i Equity settled share based payments granted after 1st January 2012

The grant date fair value of equity-settled share-based payment awards granted to employees is recognised as an employee expense, with a corresponding increase in equity, over the period in which the employees unconditionally become entitled to the awards. The amount recognised as an expense is adjusted to reflect the number of share awards for which the related service and non-market performance vesting conditions are expected to be met such that the amount ultimately recognised as an expense is based on the number of share awards that do meet the related service and non-market performance conditions at the vesting date. For share-based payment awards with non-vesting conditions, the grant-date fair value of the share-based payment is measured to reflect such conditions and there is no true-up for difference between expected and actual outcomes.

4.15.3 (b) ii Equity settled share based payments granted prior to 1st January 2012

In respect of employee share options granted prior to 1st January 2012 SLFRS 2 Share Based Payment standard is not applicable.

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 Benefit Trust enabling the staff in the management rank and above of the Bank to take part in the voting and non voting ordinary shares of the Bank. The total number of share options available to the eligible employees per year will be 1.25% of shares issued by the Bank up to a maximum limit of 5% of the shares issued (both voting and non voting) by the Bank in 4 years. The benefits under ESOP will accrue to eligible employees of the Bank in any particular year only if the conditions set out in the ESOP are met.

An eligible employee will qualify to receive share options in a particular year by achieving a positive performance rating in the annual performance assessment. The amount of share options to be granted to each qualified eligible employee will depend on his / her seniority in the Bank. This employee share option plan has potential dilutive effect on the earnings per share of the Bank.

Details of share options are given in Note 50 (c) i.

4.16 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.

4.17 Financial guarantees

Financial guarantees are contracts that require the Group to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument. Financial guarantee liabilities are recognised initially at their fair value, and the initial fair value is amortised over the life of the financial guarantee. The financial guarantee liability is subsequently carried at the higher of this amortised amount and the present value of any expected payment when a payment under the guarantee has become probable. Financial guarantees are included within other liabilities.

4.18 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 reporting date, taking into account the risks and uncertainties that surround the events and circumstances that affect the provision.

4.19 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 Statement of Financial Position but are disclosed unless they are remote.

4.20 Interest

Interest income and expense are recognised in profit or loss using the effective interest method. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or liability (or, where appropriate, a shorter period) to the carrying amount of the financial asset or liability. When calculating the effective interest rate, the Group estimates future cash flows considering all contractual terms of the financial instrument, but not future credit losses.

The calculation of the effective interest rate includes all transaction costs and fees that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or liability.

Interest income and expense presented in the Statement of Comprehensive Income include:

- interest on financial assets and financial liabilities measured at amortised cost calculated on an effective interest basis;
- the effective portion of fair value changes in qualifying hedging derivatives designated in cash flow hedges of variability in interest cash flows, in the same period that the hedged cash flows affect interest income/expense;
- the ineffective portion of fair value changes in qualifying hedging derivatives designated in cash flow hedges of interest rate risk; and
- fair value changes in qualifying derivatives, including hedge ineffectiveness, and related hedged items in fair value hedges of interest rate risk.

Fair value changes on other derivatives held for risk management purposes, and all other financial assets and liabilities carried at fair value through profit or loss, are presented in net trading income in the Statement of Comprehensive Income.

Interest income on available-for-sale investment securities calculated on an effective interest basis is also included in interest income.

Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

4.21 Dividend Income

Dividend income is recognised in the Statement of Income on an accrual basis when the Bank's right to receive the dividend is established.

Notes to the Financial Statements

This is usually on the ex-dividend date for equity securities. Dividends are presented in net trading income or net gain/(loss) from financial investments based on the underlying classification of the equity investment.

4.22 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.

4.23 Discount on Bills of Exchange

Income on discounting bills of exchange is recognised proportionately over the period of the instrument.

4.24 Fee and Commission

Fees and commission income and expense that are integral to the effective interest rate on a financial asset or liability are included in the measurement of the effective interest rate.

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.

Other fees and commission expense relate mainly to transaction and service fees, which are expensed as the services are received. Fee and commission expenses are recognised on an accrual basis.

4.25 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.

4.26 Profit / Loss from Sale of Investment Properties

Any profits or losses on retirement or disposal of investment properties are recognised in the month of retirement or disposal.

4.27 Rental Income

Rental income is recognised on an accrual basis.

4.28 Revenue Recognition on Sale of Apartments – Residential Apartment Complex

Revenue from sale of apartments is recognised in the Statement of Income when significant risks and rewards of ownership transfer to the buyer.

4.29 Lease Payments

Total Payments made under operating leases are recognised in the Statement of Income on a straight line basis over the term of the lease.

The future monthly commitments on operating leases are shown in Note 51 (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.

4.30 Income Tax Expense

Income tax expense comprises of current and deferred tax. Income tax expense is recognised in the Statement of Income except to the extent that it relates to items recognised directly in equity or in other comprehensive income.

4.30.1 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 reporting 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 18 (g).

Provision for taxation on overseas Subsidiaries/Associates is made on the basis of the profit for the year as adjusted for taxation purposes in accordance with the provisions of the relevant statutes in those countries.

4.30.2 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 is not recognised for:

- temporary differences on the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss;
- temporary differences related to investments in subsidiaries to the extent that it is probable that they will not reverse in the foreseeable future; and
- temporary differences arising on the initial recognition of goodwill.

Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

A deferred tax asset is recognised for unused tax losses, tax credits and deductible temporary differences to the extent that it is probable that future taxable profits will be available against which they 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.

Details of the deferred tax assets and liabilities as at the reporting date are given in Note 47.

4.30.3 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.

4.30.4 Withholding Tax on Dividends (WHT)

Dividend distributed out of taxable profit of the local Subsidiaries attracts a 10% deduction at source and is not available for set off against the tax liability of the Bank. Thus, the withholding tax deducted at source is added to the tax expense of the Subsidiaries in the Consolidated Financial Statements as a consolidation adjustment.

Withholding tax that arise from the distribution of dividends by the Bank are recognised at the same time as the liability to pay the related dividend is recognised.

4.30.5 Value Added Tax on Financial Services (VAT)

The base for the computation of Value Added Tax on Financial Services is the accounting profit before VAT and income tax adjusted for the economic depreciation and emoluments of employees computed on prescribed rate.

4.30.6 Economic Service Charges (ESC)

As per provisions of the Economic Service Charge (ESC) Act No 13 of 2006, ESC was payable at 1% on Bank's liable turnover and was deductible from income tax payable. With effect from 1st April 2012 as per the ESC amendment Act No 11 of 2012 ESC is payable only on exempt turnover of the Bank and is deductible from income tax payable. ESC is not payable on turnover on which income tax is payable.

4.31 Earnings per Share (EPS)

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.

4.32 Segment Reporting

An operating segment is a component of the Group that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of the Group's other components, whose operating results are reviewed regularly by the chief operating decision maker to make decisions about resources allocated to each segment and assess its performance, and for which discrete financial information is available.

4.33 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 (LKAS 7) " Statement of Cash Flows". 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.

4.34 Regulatory provisions

4.34 (a) Deposit Insurance Scheme

In terms of the Banking Act Direction No 5 of 2010 "Insurance of Deposit Liabilities" issued on 27th September 2010 and subsequent amendments there to all Licensed Commercial Banks are required to insure their deposit liabilities in the Deposit Insurance Scheme operated by the Monetary Board in terms of Sri Lanka Deposit Insurance Scheme Regulations No 1 of 2010 issued under Sections 32A to 32E of the Monetary Law Act with effect from 1st October 2010. Deposits to be insured include demand, time and savings deposit liabilities and exclude the following.

Notes to the Financial Statements

- deposit liabilities to member institutions
- deposit liabilities to Government of Sri Lanka
- deposit liabilities to Directors, key management personnel and other related parties as defined in Banking Act Direction No 11 of 2007 on Corporate Governance of Licensed Commercial Banks
- deposit liabilities held as collateral against any accommodation granted
- deposit liabilities falling within the meaning of abandoned property in terms of the Banking Act and dormant deposits in terms of the Finance Companies Act funds of which have been transferred to Central Bank of Sri Lanka

Licensed Commercial Banks are required to pay a premium of 0.10% on eligible deposit liabilities if the bank maintains a capital adequacy ratio of 14% or above as at the end of the immediately preceding financial year and a premium of 0.125% on eligible deposit liabilities for all other Licensed Commercial Banks calculated on the total amount of eligible deposits as at the end of the quarter within a period of 15 days from the end of the quarter.

4.34 (b) Investment Fund Account

As proposed in the budget proposals of 2011 every person or partnership who is in the business of banking or financial services is required to establish and operate an Investment Fund Account.

As and when taxes are paid after 1st January 2011 Licensed Commercial Banks are required to transfer the following funds to the Investment Fund Account and build a permanent fund in the bank.

- 8% of the profits calculated for the payment of Value Added Tax (VAT) on Financial Services on dates as specified in the VAT Act for payment of VAT
- 5% of the profit before tax calculated for payment of income tax purposes on dates specified in Section 113 of the Inland Revenue Act for the self-assessment payments of tax

  Licensed Commercial Banks shall utilise the funds in the Investment Fund Account in the following manner.

- Invest in long term government securities and/or bonds with maturities not less than seven years
- Lend on maturities not less than five years at interest rates not exceeding 5 year treasury bond rates plus 2%
- Lend only for the following purposes:

  I. Long term loans for cultivation of plantation crops/ agriculture crops including fruits, vegetables, cocoa and spices and for livestock and fisheries

  II. Factory/mills modernisation/establishment/expansion

  III. Small and medium enterprises

  Loans up to Rs. 200 Mn to enterprises with annual turnover less than Rs. 600 Mn

  IV. Information technology related activities and business process outsourcing

  V. Infrastructure development

  VI. Education – vocational training and tertiary education

  VII. Housing up to Rs. 2 Mn per customer for construction of a house for residential purposes

  VIII. Construction of hotels and for related purposes

  IX. Restructuring of loans extended for the above purposes

PRESENTATION

Assets and liabilities are grouped by nature and listed in an order that reflects their relative liquidity and maturity pattern. Where appropriate, the significant accounting policies are disclosed in the succeeding Notes.

4.35 Offsetting Income and Expenses

Income and expenses are not offset unless required or permitted by accounting standards.

4.36 Offsetting Assets and Liabilities

Assets and liabilities are offset and the net amount reported in the Statement of Financial Position 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.

4.37 Events Occurring after the Reporting Period

Events after the reporting period are those events, favourable and unfavourable, that occur between the reporting date and the date the Financial Statements are authorised for issue.

All material and important events that occurred after the reporting date, including the final dividend declared on Ordinary Shares have been considered and appropriate disclosures are made in Note 55 to the Financial Statements.

5 SIGNIFICANT ACCOUNTING POLICIES THAT ARE SPECIFIC TO THE BUSINESS OF THE SUBSIDIARY – HNB ASSURANCE PLC (HNBA)

As permitted by SLFRS 4 “Insurance Contracts”, HNBA continues to apply the existing accounting policies for Insurance Contracts that were applied prior to the adoption of SLFRS.

5.1 Product classification

SLFRS 4 requires contracts written by insurers to be classified as either "insurance contracts" or "investment contracts" depending on the level of insurance risk transferred.

Insurance contracts are those contracts where the entity (the insurer) has accepted significant insurance risk from another party (the policyholders) by agreeing to compensate the policyholders if a specified uncertain future event (the insured event) adversely affects the policyholders. As a general guideline, HNBA determines whether it has significant insurance risk, by comparing benefits paid with benefits payable if the insured event did not occur. Insurance contracts can also transfer financial risk.

Investment contracts are those contracts that transfer significant financial risk and no significant insurance risk. Financial risk is the risk of a possible future change in one or more of a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of price or rates, credit rating or credit index or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract.

Once a contract has been classified as an insurance contract, it remains an insurance contract for the remainder of its lifetime, even if the insurance risk reduces significantly during this period, unless all rights and obligations are extinguished or expire. Investment contracts can, however, be reclassified as insurance contracts after inception if insurance risk becomes significant.

All the products sold by HNBA are insurance contracts and therefore classified as Insurance contracts under the SLFRS 4 – Insurance Contracts. Thus, HNBA does not have any investment contracts within its product portfolio as at the date of the Statement of Financial Position.

5.2 Deferred acquisition costs (DAC)

Those direct and indirect costs incurred during the financial period arising from the writing or renewing of insurance contracts are deferred and amortised over the period in which the related revenues are earned. All other acquisition costs are recognised as an expense when incurred.

The DAC is applicable only to General Insurance Contracts. No DAC is calculated for Life Insurance Contracts as the acquisition costs are incurred in line with the revenues earned.

In line with the available regulatory guidelines from the Insurance Board of Sri Lanka (IBSL), the DAC is calculated based on the 1/24th basis.

An impairment review is performed at each reporting date or more frequently when an indication of impairment arises. When the recoverable amount is less than the carrying value, an impairment loss is recognised in the income statement. No such indication of impairment was experienced during the year.

DAC is derecognised when the related contracts are either settled or disposed of.

5.3 Reinsurance

The Subsidiary cedes insurance risk in the normal course of business to recognised reinsurers through formal reinsurance arrangements.

Reinsurance assets include the balances due from reinsurance companies for paid and unpaid losses and loss adjustment expenses. Amounts recoverable from reinsurers are estimated in a manner consistent with the outstanding claims provision or settled claims associated with the reinsurer's policies and are in accordance with the related reinsurance contract.

Reinsurance is recorded gross in the Statement of Financial Position unless a right to offset exists.

Reinsurance assets are reviewed for impairment at each reporting date, or more frequently, when an indication of impairment arises during the reporting year. Impairment occurs when there is objective evidence as a result of an event that occurred after initial recognition of the reinsurance asset that the entity may not receive all outstanding amounts due under the terms of the contract and the event has a reliably measurable impact on the amounts that the entity will receive from the reinsurer. The impairment loss, if any is recorded in the income statement.

Ceded reinsurance arrangements do not relieve the entity from its obligations to policyholders.

Reinsurance assets or liabilities are derecognised when the contractual rights are extinguished or expire or when the contract is transferred to another party.

5.4 Premium Receivable

Insurance receivables are recognised when due and measured on initial recognition at the fair value of the consideration receivable. Collectability of premiums is reviewed on an ongoing basis.

According to the Premium Payment Warranty (PPW) directive issued by the Insurance Board of Sri Lanka (IBSL), all Non-Life insurance policies are issued subject to PPW and are cancelled upon the expiry of 60 days if not settled.

The entity decided to account for life insurance premiums on accrual basis with the implementation of new/revised SLFRS/LKAS. Accordingly, due Life Insurance premiums (only the premiums due in the 30 day grace period) are recognized at each reporting date and will be reversed if the premiums are not settled during the subsequent month, and thus the policies will be lapsed as per the entity policy.

Notes to the Financial Statements

5.5 Insurance Contract Liabilities

5.5.1 Insurance Provision – Life Insurance

Life insurance liabilities are recognised when contracts are entered into and premiums are charged. These liabilities are measured by using the net premium method as specified by the Insurance Board of Sri Lanka (IBSL) based on the recommendation of the Independent Consultant Actuary. The liability is determined as the sum of the discounted value of the expected future benefits, less the discounted value of the expected future premiums that would be required to meet the future cash outflows based on the valuation assumptions used. The liability is computed based on IBSL specified guidelines and current assumptions which vary based on the contract type.

Furthermore, adjustments are performed to capture the likely liabilities that may arise due to currently lapsed contracts reviving in the future.

As required by the SLFRS 4- Insurance Contracts, the entity performed a Liability Adequacy Test (LAT) in respect of Life Insurance contract liabilities with the assistance of an external actuary. In performing the adequacy test, current best estimates of future contractual cash flows, including related cash flows such as claims handling and policy administration expenses, policyholder options and guarantees, as well as investment income from assets backing such liabilities, are used.

5.5.2 Insurance Provision – General Insurance

General Insurance contract liabilities include the outstanding claims provision including IBNR and IBNER, the provision for unearned premium and the provision for premium deficiency.

The outstanding claims provision is based on the estimated ultimate cost of all claims incurred but not settled at the reporting date, whether reported or not, together with related claims handling costs and reduction for the expected value of salvage and other recoveries. Delays can be experienced in the notification and settlement of certain types of claims, therefore, the ultimate cost of these cannot be known with certainty at the reporting date.

The valuation of Unearned Premium Reserve are measured in accordance with guidelines of the Regulation of Insurance Industry Act, No. 43 of 2000 (i.e. based on the 1/24th basis).

The Incurred But Not Reported (IBNR) and Incurred But Not Enough Reported (IBNER) claims reserve are actuarially computed.

The liability is not discounted for the time value of money. No provision for equalisation or catastrophe reserves is recognised. The liabilities are derecognised when the obligation to pay a claim expires, is discharged or is cancelled.

As required by the SLFRS 4- Insurance Contracts, the entity performed a Liability Adequacy Test (LAT) in respect of General Insurance contract liabilities with the assistance of the external actuary.

5.6 Title Insurance Reserve

Title insurance reserve is maintained by the entity to pay potential claims arising from the title insurance policies. Title insurance policies are normally issued for a long period such as 5 years or more. Thus, no profit is recognised in the first year of the policy given the higher probability of claims occurring in that year. From the 2nd year onwards, profit is recognised by amortising the premium received and will be distributed throughout the remaining period of the policy using the straight line method. Profit for the first year will be recognised in the 2nd year and therefore it is periodically recognised.

If the corresponding loan of the Title Insurance Policy issued is settled before the maturity, full premium of such policies remaining as at the date of settlement of such loan is recognised in profits upon confirmation of the same by the respective Bank.

5.7 Revenue recognition

5.7.1 Insurance Premiums

Life insurance business

Gross recurring premiums on life insurance contracts are recognised as revenue when payable by the policyholder (policies within the 30 day grace period are considered as due). Any premiums received in advance is not recorded as revenue and recorded as a liability until the premium is due. Benefits and expenses are provided against such revenue to recognize profits over the estimated life of the policies.

For single premium business, revenue is recognised on the date on which the policy is effective.

General insurance business

Gross general insurance written premiums comprise the total premiums received /receivable for the whole period of cover provided by contracts entered into during the accounting period. Gross Written Premium is generally recognized is 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.

Rebates that form part of the premium rate, such as no-claim rebates, are deducted from the gross premium.

Unearned premiums are those proportions of premiums written in a year that relate to periods of risk after the reporting date. Unearned premiums are calculated on 1/24th basis in accordance with the Regulation of Insurance Industry Act, No. 43 of 2000.

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. The proportion attributable to subsequent periods is deferred as a provision for unearned premiums which is included under liabilities.

5.7.2 Reinsurance premiums

Gross reinsurance premiums on insurance contracts are recognised as an expense on the earlier of the date when premiums are payable or when the policy becomes effective. Reinsurance premiums are decided based on rates agreed with reinsurers.

Unearned reinsurance premiums are those proportions of premiums written in a year that relate to periods of risk after the reporting date. Unearned reinsurance premiums are deferred over the term of the underlying direct insurance policies for risks-attaching contracts (using 1/24th basis in accordance with the Regulation of Insurance Industry Act, No. 43 of 2000).

5.7.3 Fees and commission income

Insurance and investment contract policyholders are charged for policy administration services and other contract fees. These fees are recognised as revenue upon receipt or becoming due.

5.8 Benefits, claims and expenses

5.8.1 Gross benefits and claims

Life insurance business

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.

Expenses on Life Insurance relates to the acquisition expenses and expenses for maintenance of Life Insurance business, investment related expenses not treated as a part of the capital cost of investment, etc which are accounted on accrual basis.

General insurance business

General insurance claims include all claims occurring during the year, whether reported or not together with claims handling costs that are directly related to the processing and settlement of claims, a reduction for the value of salvage and other recoveries, and any adjustments to claims outstanding from previous years. Claims outstanding are assessed by review of individual claim files and estimating changes in the ultimate cost of settling claims.

The provision in respect of Claims Incurred But Not Reported (IBNR) and Claims Incurred But Not Enough Reported (IBNER) is actuarially valued to ensure a more realistic estimation of the future liability based on the past experience and trends. Actuarial valuations are performed on a semi-annual basis.

Whilst the Directors of HNBA consider that the provisions for claims are fairly stated on the basis of information currently available, the ultimate liability will vary as a result of subsequent information and events. This may result in adjustments to the amounts provided. Such amounts are reflected in the Financial Statements for that period.

The methods used to estimate claims and the estimates made are reviewed regularly.

5.8.2 Reinsurance claims

Reinsurance claims are recognised when the related gross insurance claim is recognised according to the terms of the relevant contract.

5.8.3 Net Deferred Acquisition Expenses

Acquisition expenses, representing commissions, which vary with and are directly related to the production of business, are deferred and amortised over the period in which the related written premiums are earned.

Reinsurance commission is also treated in the same manner within deferred acquisition costs.

5.9 Actuarial Valuation of Life Insurance Fund

The Directors of HNBA agree to the long term insurance provision for the entity 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.

5.10 Premium Income (GWP) and other Sundry Sales related taxes

Revenues, expenses and assets are recognised net of the amount of sales taxes and premium taxes except where the premium or sales tax incurred on the purchase of assets or services is not recoverable from the taxation authority, in which case, the sales tax is recognised as a part of the cost of acquisition of the asset or as a part of the expense item, as applicable.

Outstanding net amounts of sales or premium tax recoverable from, or payable to, the taxation authority are included as a part of receivables or payables in the Statement of Financial Position.

Notes to the Financial Statements

6. COMPARATIVE INFORMATION

The comparative information is re-classified wherever necessary to conform with the current year's classification in order to provide a better presentation. The details of such re-classifications have been provided in Note 57.

7 FINANCIAL RISK MANAGEMENT

7.1 Introduction and overview

The Group has exposure to the following risks from financial instruments:

- credit risk
- liquidity risk
- market risks
- operational risks.

This note presents information about the Bank's exposure to each of the above risks (except market risk), the Bank's objectives, policies and processes for measuring and managing risk, and the Bank's management of capital. Since the Bank (ultimate parent) accounts for more than 90% of the total assets, liabilities, income and expenses of the Group, only the Bank's exposure has been discussed under this note.

7.2 Risk management framework

The Board of Directors has overall responsibility for the establishment and oversight of the Bank's risk management framework. In discharging its governance responsibility it operates through two key committees the Board Integrated Risk Management Committee and the Audit Committee.

The BIRMC provides the Board the assurance that risk management strategies, policies and processes are in place to manage events / outcomes that have the potential to impact significantly on earnings performance, reputation and capital. The approach entails active monitoring of the level of risk exposure against the parameters set in the risk appetite. The BIRMC also assists the Board by assessing and approving significant credit and other transactions beyond the discretion of executive management.

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

- Executive Risk Management Committee
- Asset and Liability Committee (ALCO)
- Credit Policy Committee
- Investment Committee
- IT Steering Committee
- Sustainability Committee
- Staff Committee

The Audit Committee is responsible for monitoring compliance with the Bank's risk management policies and procedures, and for reviewing the adequacy of the risk management framework in relation to the risks faced by the Bank. The Audit Committee is assisted in these functions by Internal Audit. Internal Audit undertakes both regular and ad-hoc reviews of risk management controls and procedures, the results of which are reported to the Audit Committee.

The Audit Committee provides its assessment on the effectiveness of internal audit and external disclosure of accounting policies and financial reporting to the Board.

Risk management policies and systems are reviewed regularly to reflect changes in market conditions, products and services offered.

7.3 Credit risk

Credit risk is the risk of financial loss to the Bank if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Bank's loans and advances to customers and other banks, and investment in debt/equity securities. For risk management reporting purposes the Bank considers and consolidates all elements of credit risk exposure (such as individual obligor default risk, industry risk and geographical risk etc.).

For risk management purposes, credit risk arising on trading assets is managed independently and information thereon is disclosed below.

Management of credit risk

The Credit Risk Policy plays a central role in managing daily business activities. The Bank has developed a policy which defines the principles encompassing client selection, due diligence, early alert reporting, tolerable levels of concentration risk and portfolio monitoring in line with Bank's risk appetite. The approach is to avoid large credit risk on a counterparty or portfolio level by applying stringent underwriting standards combined with sound collateralisation where feasible. The policy is reviewed at least annually and approved by the Board of Directors ensuring consistency with the Bank's business strategy. A monthly Credit Policy Meeting chaired by the Chief Executive Officer, drives policy decisions and implementation plans.

Bank manages credit risk by focusing on following stages. Regular audits of business units undertaken by Internal Audit in order to ensure smooth functioning of each of these stages.

Loan Origination and Risk Appraisal

The loan origination process comprises initial screening and credit appraisal. The evaluation focuses on the borrower's ability to meet its obligations in a timely manner. Efforts are made to ensure consistent standards are maintained in credit approval. Collateral and guarantees form an important part of the credit risk mitigation process and internal policy dictates margins in our favor by type of security offered, standards for periodic valuations and assessment of realisable value of collateral.

A suite of internal risk rating models (scientifically developed with the assistance of external consultants) is in place for corporate and retail customer segments. The internal risk rating is an important part of the risk assessment of customers and incorporated in the credit decision process. Significant strides have been made in internalizing this approach with a view to giving due prominence to lending based on cash flow repayment ability as distinct from collateral based lending.

Loan Approval and Sanction

The Bank has established clear guidelines for loan approvals / renewals by adopting a committee based approval structure, where all approval signatories carry equal responsibility for credit risk. Individual credit facilities beyond a minimum threshold require an independent risk signatory with no revenue targets in respective committees (process ensures over 85% of loans, excluding cash and gold backed facilities, are approved in this manner).

Credit Administration and Disbursement

HNB's Corporate Banking loan portfolio is administered through a centralized Credit Administration Division which ensures efficient and effective post sanction customer support including disbursement, settlements, processing renewal notices and advising customers on interest rate amendments. This division independently reports to the Risk Management Unit to ensure clear segregation of duties from business origination and disbursements only after stipulated conditions have been met and relevant security documents obtained.

Credit Measurement and Monitoring

To safeguard the Bank against possible losses, problem loans need to be identified early. The Credit Risk Management Division measures and tracks the status of the credit portfolio, undertakes impact studies and detects early warning signals pointing to deterioration in the financial health of a borrower.

A credit risk dashboard is prepared monthly to review high level credit portfolio concentration and assess performance against internal limits (board risk appetite) and regulatory requirements. An internally developed Business Intelligence system ('KPI Wizard') is in place to evaluate credit risk indicators at branch, regional, zonal and bank level. Accountability for credit risk performance is vested with individual business units and unhealthy trends addressed at all levels.

Recoveries

Problem loans are managed by the Recoveries and Credit Quality Division. This unit is responsible for all aspects of an overdue facility, restructuring of the credit, monitoring the value of the applicable collateral and liquidation, scrutiny of legal documents and liaising with the customer until all recovery matters are finalised. This division's activities are seamlessly integrated with Credit Administration and Credit Risk Management to ensure effective follow up and learning transfer.

Back Office recovery functions representing problem loans classification, rescheduling, provisioning and valuation of collateral on delinquent assets was centralized during the last year to ensure standardisation and accuracy. The Bank strictly conforms to regulatory requirements in problem loan classification and management.

7.3.1 Loans and advances to customers

The transition to fair value based accounting (LKAS 32 and 39) with effect from 01st January 2012 required the present age wise classification to be replaced with a cash flow based approach. The approach adopted was to classify loans in to individually significant exposures and other loans in to homogenous portfolios by segment / product for necessary computations as appropriate.

As at	Note	31.12.2012 Rs 000	31.12.2011 Rs 000	01.01.2011 Rs 000
Carrying amount at amortised cost	27	302,760,980	257,198,343	202,253,018
Individually significant - impaired		5,765,347	5,233,052	5,598,834
Allowance for impairment as at		(1,808,383)	(2,057,850)	(2,507,000)
Carrying amount		3,956,964	3,175,202	3,091,834

The Bank holds collateral against loans and advances to customers in the form of mortgage interests over property, other registered securities over assets, and guarantees. Estimates of fair value are based on the value of collateral assessed at the time of borrowing, and generally are not updated except when a loan is individually assessed as impaired.

Notes to the Financial Statements

7.3.1 Loans and advances to customers (Contd.)

As at	31.12.2012 Gross loan amount Rs 000	31.12.2011 Gross loan amount Rs 000	01.01.2011 Gross loan amount Rs 000
Collateral wise analysis of Individually impaired loans			
Secured by movable assets	-	-	-
Secured by immovable assets	4,737,306	4,162,724	3,856,900
Secured by cash/shares	105,922	94,570	90,548
Other Securities	686,899	622,766	1,322,579
Clean	235,220	352,993	328,812
	5,765,347	5,233,053	5,598,839
Individually significant unimpaired			
Watch listed	8,649,790	3,042,974	4,874,985
Others	113,856,075	95,442,949	77,457,706
	122,505,865	98,485,923	82,332,691
Allowance for impairment as at	(571,281)	-	-
Carrying amount	121,934,584	98,485,923	82,332,691

As at	31.12.2012 Rs 000	31.12.2011 Rs 000	01.01.2011 Rs 000
Collateral wise analysis of Individually significant unimpaired loans			
Secured by movable assets	1,830,919	287,181	479,195
Secured by immovable assets	48,240,516	43,221,550	26,593,690
Secured by cash/shares	2,656,310	1,684,116	2,674,284
Other Securities	35,625,972	29,183,232	27,614,537
Clean	34,152,148	24,109,844	24,970,985
	122,505,865	98,485,923	82,332,691
Collectively Impaired			
Collectively impaired	182,113,462	160,144,276	122,034,167
Allowance for impairment as at	(5,244,030)	(4,607,058)	(5,205,674)
Carrying amount	176,869,432	155,537,218	116,828,493

As at	31.12.2012		31.12.2011		01.01.2011	
	Gross Loans Rs 000	Impairment provision Rs 000	Gross Loans Rs 000	Impairment provision Rs 000	Gross Loans Rs 000	Impairment provision Rs 000
Collectively impaired comprises						
0-30 days	168,387,721	219,903	149,634,321	129,839	111,437,162	184,762
31-60 days	6,771,650	96,236	4,565,752	35,809	3,891,691	55,358
61-90 days	968,162	66,835	768,878	24,296	872,127	51,750
91-120 days	531,907	91,447	259,923	20,723	327,020	35,536
121-150 days	397,392	158,801	334,863	138,504	382,967	193,849
151-180 days	527,119	81,297	351,666	29,014	487,476	48,695
Above 180 days	4,529,511	4,529,511	4,228,873	4,228,873	4,635,724	4,635,724
	182,113,462	5,244,030	160,144,276	4,607,058	122,034,167	5,205,674

7.3.1 Loans and advances to customers (Contd.)

Allowances for impairment

The Bank established an allowance for impairment losses on assets carried at amortised cost/available for sale that represents its estimate of incurred losses in its loan and investment debt/equity security portfolio. The main components of this allowance are a specific loss component that relates to individually significant exposures, and, for assets measured at amortised cost, a collective loan loss allowance established for groups of homogeneous assets as well as for individually significant exposures that were subject to individual assessment for impairment but not found to be individually impaired. Assets carried at fair value through profit or loss are not subject to impairment testing as the measure of fair value reflects the credit quality of each asset.

Write-off policy

The Bank writes off a loan or an investment debt/equity security balance, and any related allowances for impairment losses, when it determines that the loan or security is uncollectible. This determination is made after considering information such as the occurrence of significant changes in the borrower's/issuer's financial position such that the borrower/issuer can no longer pay the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure. For smaller balance standardized loans, write-off decisions generally are based on a product-specific past due status.

The Bank's policy is to pursue timely realisation of the collateral in an orderly manner. The Bank generally does not use the non-cash collateral for its own operations.

Concentrations of credit risk

The Bank monitors concentrations of credit risk by sector and by geographic location. An analysis of concentrations of credit risk from loans and advances as at the reporting date is shown below.

As at	31.12.2012 Rs 000	%	31.12.2011 Rs 000	%	01.01.2011 Rs 000	%
Concentration by sector						
Agriculture and fishing	31,306,579	10.09	28,965,719	10.98	25,338,467	12.07
Manufacturing	38,851,459	12.52	29,373,274	11.13	24,291,183	11.57
Tourism	18,731,165	6.03	16,378,499	6.21	12,189,811	5.81
Transport	5,034,068	1.62	10,210,733	3.87	11,992,130	5.71
Construction	40,234,886	12.96	38,583,493	14.62	33,780,242	16.09
Traders	49,636,247	15.99	40,804,323	15.46	32,868,660	15.65
New economy	4,675,435	1.51	3,424,704	1.30	2,623,994	1.25
Financial and business services	23,051,027	7.43	21,505,529	8.15	15,581,646	7.42
Infrastructure	8,923,369	2.87	7,072,183	2.68	5,600,478	2.67
Other services	23,469,029	7.56	24,645,018	9.34	13,166,509	6.27
Credit card	2,778,069	0.90	2,355,722	0.89	1,877,220	0.89
Pawning	48,447,062	15.61	34,377,453	13.03	23,223,488	11.06
Other	15,246,279	4.91	6,166,601	2.34	7,431,864	3.54
	310,384,674	100.00	263,863,251	100.00	209,965,692	100.00

As at	31.12.2012 Rs 000	%	31.12.2011 Rs 000	%	01.01.2011 Rs 000	%
Concentration by location						
Western	207,254,789	66.77	175,524,531	66.51	126,275,867	60.14
Southern	13,641,985	4.40	11,307,776	4.29	10,577,256	5.04
Uva	5,914,993	1.91	5,270,609	2.00	3,471,150	1.65
North Central	6,712,992	2.16	5,732,445	2.17	10,927,618	5.20
North Western	14,411,984	4.64	12,688,117	4.81	19,836,658	9.45
Eastern	11,265,987	3.63	9,094,598	3.45	6,083,158	2.90
Northern	15,343,983	4.94	12,333,439	4.67	8,147,759	3.88
Sabaragamuwa	8,789,991	2.83	7,591,597	2.88	5,707,015	2.72
Central	21,558,976	6.95	16,722,539	6.34	10,427,152	4.97
Overseas	5,488,994	1.77	7,597,600	2.88	8,512,059	4.05
	310,384,674	100.00	263,863,251	100.00	209,965,692	100.00

Concentration by location for loans and advances is measured based on the location of the customer centre granted the facility, which has a high correlation with the location of the borrower except for loans granted by the Foreign Currency Banking Unit (FCBU).

Notes to the Financial Statements

	As at	Note	31.12.2012 Rs 000	31.12.2011 Rs 000	01.01.2011 Rs 000
7.3.2	**Financial Investments**	28, 30	77,900,215	65,905,055	64,750,664
	Investment in debt securities at amortised cost				
	AA-		926,932	1,095,400	365,400
	A+		18,000	92,000	-
	A		389,778	150,000	270,000
	A-		686,000	700,000	-
	Unrated		489,000	489,000	489,000
			2,509,710	2,526,400	1,124,400
	Investment in local/foreign government securities at amortised cost				
	Sri Lanka Development Bonds		17,520,959	11,460,121	9,600,234
	Sri Lanka Sovereign Bonds		-	679,476	647,745
	CBSL Securities		-	-	3,998,408
			17,520,959	12,139,597	14,246,387
	Investments in equity securities at Available for Sale				
	AAA		-	180,000	360,000
	AA		4,251,708	4,224,630	6,428,250
	Unrated		225,456	231,156	297,956
			4,477,164	4,635,786	7,086,206
	Investments in local/foreign government securities at Available for Sale				
	Government of Sri Lanka Treasury Bills		47,804,967	35,929,393	33,525,659
	Government of Sri Lanka Treasury Bonds		5,587,415	10,598,527	8,627,064
	Bonds issued by the Government of Greece		-	75,352	140,948
			53,392,382	46,603,272	42,293,671

	As at	Note	31.12.2012 Rs 000	31.12.2011 Rs 000	01.01.2011 Rs 000
7.3.3	**Investment held at fair value through profit or loss**	25			
	Equity Securities		452,847	723,316	576,280
	Government securities		21,236	437,183	881,168
			474,083	1,160,499	1,457,448

7.3.3 Investment held at fair value through profit or loss (Contd.)

Analysis of equity securities held at fair value through profit of loss based on external risk ratings

As at	31.12.2012 Cost Rs 000	31.12.2012 Market Value Rs 000	%	31.12.2011 Cost Rs 000	31.12.2011 Market Value Rs 000	%	01.01.2011 Cost Rs 000	01.01.2011 Market Value Rs 000	%
AAA	146,247	147,643	32	74,855	60,863	8	77,644	84,417	15
AA	104,496	76,833	17	124,700	91,467	13	112,019	111,405	19
AA-	62,084	49,508	11	124,578	100,239	14	40,053	54,853	10
A+	17,494	16,701	4	-	-	-	7,513	9,471	2
A	34,754	25,654	6	-	-	-	29,792	28,391	5
A-	-	-	-	-	-	-	40,230	52,167	9
BBB+	7,060	6,531	1	27,715	17,735	2	29,322	28,755	5
Unrated	187,875	129,977	29	548,144	453,012	63	165,904	206,821	35
	560,010	452,847	100	899,992	723,316	100	502,477	576,280	100

Risk ratings are based on the external ratings as published by the Fitch Ratings Lanka Ltd & RAM Ratings Lanka (Pvt) Limited.

Sector wise analysis of the equity securities held at fair value through profit or loss

As at	31.12.2012 Cost Rs 000	31.12.2012 Market Value Rs 000	%	31.12.2011 Cost Rs 000	31.12.2011 Market Value Rs 000	%	01.01.2011 Cost Rs 000	01.01.2011 Market Value Rs 000	%
Banks, Finance and Insurance	132,300	116,502	26	189,038	146,097	20	146,558	171,805	30
Beverage, Food and Tobacco	63,805	50,572	11	172,055	158,441	22	74,215	83,295	14
Diversified Holdings	208,659	183,714	40	243,036	183,417	25	153,410	160,872	28
Health Care	-	-	-	-	-	-	37,305	37,862	7
Manufacturing	79,938	55,427	12	124,131	94,161	13	38,076	47,117	8
Motors	-	-	-	60,676	50,968	7	-	-	-
Oil and Palms	39,755	25,789	6	42,979	41,200	6	-	-	-
Power and Energy	35,553	20,843	5	67,954	49,032	7	-	-	-
Trading	-	-	-	-	-	-	52,778	75,329	13
Odd lots and delisted shares	-	-	-	123	-	-	135	-	-
	560,010	452,847	100	899,992	723,316	100	502,477	576,280	100

Total Investment in securities issued by Government of Sri Lanka

As at	31.12.2012 Rs 000	31.12.2011 Rs 000	01.01.2011 Rs 000
Loans and Receivables (at amortised cost)	17,520,959	12,139,597	14,246,387
Fair Value through Profit or Loss	21,236	437,183	881,168
Available for Sale	53,392,382	46,527,920	42,152,723
	70,934,577	59,104,700	57,280,278
Government securities as a % of total trading assets and financial investments	90.5	88.1	86.5

Notes to the Financial Statements

7.3.4 Derivative assets/liabilities held for Risk Management

The bank holds derivative assets/liabilities (Forward exchange contracts and Swaps) for risk management purposes. An analysis of the credit quality of such derivative assets/liabilities, based on rating agency ratings where applicable, is as follows:

Fair value as at	Note	31.12.2012 Rs 000	31.12.2011 Rs 000	01.01.2011 Rs 000
Derivative assets held for risk management purposes	24	344,552	496,643	231,124
Derivative liabilities held for risk management purposes	39	(1,436,443)	(617,702)	(166,521)
		(1,091,891)	(121,059)	64,603
Analysis of derivative assets/liabilities based on the external risk ratings of the counterparts				
AAA		(676,018)	(113,400)	72,508
AA+		4,317	5,653	(2,431)
AA		(512,398)	46,075	7,241
AA-		1,202	44,168	1,470
A+		(21)	-	(22)
A		66,272	(71,307)	(1,591)
A-		26,985	(398)	16,494
BBB+		4,620	-	-
BBB		-	772	658
BBB-		40,000	(123,576)	11,652
BB+		(25)	-	1,351
unrated *		(46,825)	90,954	(42,727)
		(1,091,891)	(121,059)	64,603

*Unrated includes derivatives with unrated international banks /financial institutions, unrated local banks, individuals and corporates.

Analysis of derivative assets/liabilities by counterparts/products is given below:

Fair value as at	31.12.2012 Rs 000	31.12.2011 Rs 000	01.01.2011 Rs 000
Banks and financial Institutions			
Local			
Forward Exchange Contracts	6,642	(143,679)	117,407
Swaps	(1,201,834)	72,621	(7,132)
International			
Forward Exchange Contracts	44	(54)	(19,322)
Swaps	112,239	(140,905)	20,292
Others (Individuals and corporates)	(8,982)	90,958	(46,642)
	(1,091,891)	(121,059)	64,603

7.3.5 Cash and cash equivalents/placements with other banks

The Bank held cash and cash equivalents/placements with other banks of Rs 19.091 Bn as at 31 December 2012 which represents its maximum credit exposure on these assets. The cash and cash equivalents consisted of cash on hand (Rs 8.368 Bn), placements with banks and financial institution which are rated AA- to AAA based on rating agency ratings (Rs 10.184 Bn) and placements with other local/foreign banks and financial institutions (Rs 539 Mn)

7.4 Liquidity risk

Liquidity risk is the risk that the Bank will encounter difficulty in meeting obligations associated with its financial liabilities that are settled by delivering cash or another financial asset.

Management of liquidity risk

The Bank's approach to managing liquidity is to ensure, that funds available are adequate to meet credit demands of its customers and to enable deposits to be repaid on demand or upon maturity as appropriate.

Treasury is responsible for the management of liquidity risk and funding. The Head of Treasury is responsible for the daily execution of the treasury operations and for ensuring that these are in accordance with the approved guidelines and risk limits. The main sources of the Bank's funding are capital, core deposits from customers and access to borrowed funds from the interbank market. The Bank also maintains a portfolio of readily marketable securities to further strengthen its liquidity position. The treasury and liquidity policies and compliance thereunder are reviewed and approved by the ALCO. A summary report, including any exceptions and remedial action taken, is submitted regularly to ALCO.

Exposure to liquidity risk

The bank monitors the following liquidity ratios to assess funding requirements.

	31.12.2012	31.12.2011
Net loans/Total assets	67.84%	67.60%
Gross Loans/Customer deposits	90.91%	90.56%
Liquid Asset Ratio (LAR)		
Average for the year	21.90%	22.69%
Maximum for the year	23.28%	24.48%
Minimum for the year	20.79%	20.99%

Liquid assets include cash and short term funds, bills purchased and short term investments. Short term liabilities include savings deposits, call and repo borrowings and current taxation.

The Bank also monitors the maturity profile of its assets and liabilities. Maturity analysis of assets and liabilities which is based on the remaining period as at the date of the Statement of Financial Position to the respective contractual maturity date is given in Note 53 to the financial statements.

To manage the liquidity risk arising from financial liabilities, the Bank holds liquid assets comprising cash and cash equivalents and investment grade investment securities for which there is an active and liquid market. These assets can be readily sold to meet liquidity requirements.

Detailed analysis of the Bank's Financial Investments is presented under credit risk.

Notes to the Financial Statements

7.5 Operational risks

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the Bank's involvement with financial instruments, including processes, personnel, technology and infrastructure, and from external factors other than credit, market and liquidity risks such as those arising from legal and regulatory requirements and generally accepted standards of corporate behaviour.

The Bank's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to the Bank's reputation with overall cost effectiveness and to avoid control procedures that restrict initiative and creativity.

The primary responsibility for the development and implementation of controls to address operational risk is assigned to senior management within each business unit. This responsibility is supported by the development of overall Bank's standards for the management of operational risk in the following areas:

- requirements for appropriate segregation of duties, including the independent authorisation of transactions;
- requirements for the reconciliation and monitoring of transactions;
- compliance with regulatory and other legal requirements;
- documentation of controls and procedures;
- requirements for the periodic assessment of operational risks faced, and the adequacy of controls and procedures to address the risks identified;
- requirements for the reporting of operational losses and proposed remedial action;
- development of contingency plans;
- training and professional development;
- ethical and business standards; and
- risk mitigation, including insurance where this is effective.

Compliance with Bank's standards is supported by a program of periodic reviews undertaken by Internal Audit. The results of Internal Audit reviews are discussed with the management of the business unit to which they relate, with summaries submitted to the Audit Committee and senior management of the Bank.

Provisions made by the Bank for operational losses for the last five years are given below along with the subsequent recoveries made out of such provisions.

Rs' 000	2008	2009	2010	2011	2012
Provisions made for operational losses	14,180	60,083	43,169	10,973	8,777
Operational losses recovered	-	-	7,024	18,360	4,006

7.6 Capital Management

The Banks' capital management objectives can be summarised as follows:

- maintain sufficient capital to meet minimum regulatory capital requirements
- hold sufficient capital to support the Bank's risk appetite;
- allocate capital to businesses to support the Bank's strategic objectives
- ensure that the Bank maintains capital in order to achieve debt rating objectives and to withstand the impact of potential stress events.

Regulatory Capital

The Bank manages its capital considering regulatory capital requirements. The Central Bank of Sri Lanka (CBSL) sets and monitors capital requirements for licensed banks in Sri Lanka based on the Basel Framework. Thus the Bank's operations are directly supervised by the CBSL and the Bank is required to comply with the Provisions of the Basel II framework in respect of regulatory capital. Commercial banks in Sri Lanka need to maintain a minimum Capital Adequacy Ratio (CAR) of 10% and a Core Tier 1 Capital Ratio of at least 5% .

7.6 Capital Management (Contd)

7.6.1 Capital Adequacy

The primary objective of the Capital Adequacy Ratio (CAR) defined under Basel II is to protect a bank's depositors, whilst maintaining confidence and giving stability to the world banking system. The regulators attempt to accomplish this by setting the capital reserves a bank needs to hold in relation to the risk the bank exposes itself through its business activities. Keeping in line with international standards, the Central Bank of Sri Lanka has supported these regulatory reforms by enhancing them in accordance with local funding and liquidity requirements.

The Bank computes CAR as a ratio of its capital to its risk weighted assets. Calculations of the risk weightings defined under credit risk and market risk are based on the standardized approach whereas operational risk is computed by using the basic indicator approach. As the Basel II guidelines are phased in and more sophisticated risk measurement systems and models are implemented, banks will be in a position to move from the standardized methods to the more refined and robust requirements of the advanced approaches.

As of 31st December 2012, HNB reported a Tier 1 ratio of 13.85% and a total CAR of 16.63 which remain comfortably above the CBSL's capital requirements.

In arriving at the above ratios, the Bank has used profits as per SLFRSs for the purpose of Tier I Capital. However all other balances are as per the accounting standards existed prior to 1st January 2012 (Previous GAAP - SLAS) including the risk weighted assets.

The Bank's policy is to maintain a strong capital base so as to ensure investor, creditor and market confidence and to sustain future development of the business. The impact of the level of capital on shareholders' return is also recognized and the Bank recognizes the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position.

HNB manages its capital structure and adjusts it accordingly in line with changes in global and local economic and market conditions and its overall risk appetite. In order to maintain or increase capital, the Bank may issue Tier 1 or Tier 2 securities, change the dividend payment to shareholders or obtain international funding. Accordingly the Bank in 2012 obtained USD 25 Mn foreign funding from DEG Germany to strengthen its supplementary capital.

CAPITAL BASE

As at 31st December	2012 Rs Mn	2011 Rs Mn
TIER 1		
Voting ordinary shares	10,049	9,143
Non-Voting ordinary shares	2,530	2,308
Statutory reserve fund	2,230	1,800
Published retained earnings (Note 1)	5,077	4,448
General and other reserves	20,101	16,379
Less: Deductions from Tier 1 capital (Note 2)	(2,322)	(2,245)
Eligible Tier 1 Capital	37,665	31,833
TIER II		
50% of approved asset revaluation reserves (Note 3)	1,029	1,032
General provision for loan losses	1,169	1,041
Approved subordinated term debt	7,208	4,157
Tier II Capital	9,406	6,230
Less: Deductions from Tier II capital (Note 2)	(1,846)	(1,846)
Eligible Tier II capital	7,560	4,384
Capital Base	45,225	36,217
Risk Adjusted capital ratios		
Tier 1 (Eligible Tier 1 capital / Total risk adjusted balance) *	13.85	12.76
Total (Capital base / Total risk adjusted balance) **	16.63	14.51

* Statutory minimum 5%   ** Statutory minimum 10%

Notes to the Financial Statements

7.6 Capital Management (Contd)

7.6.1 Capital Adequacy (Contd.)

Risk adjusted on - Balance Sheet Exposure

As at 31st December	Balance 2012 Rs Mn	Balance 2011 Rs Mn	Risk Weights %	Risk Adjusted Balance 2012 Rs Mn	Risk Adjusted Balance 2011 Rs Mn
Exposures					
- To Central Government and CBSL	95,015	81,519	0	-	-
- To banks / foreign sovereigns	11,064	8,060	20 - 150	2,511	1,779
- To financial institutions	9,760	7,994	20 - 150	5,513	3,997
- To corporates	79,796	76,793	20 - 150	72,318	74,394
- To retail sector (excluding claims secured by residential properties)	106,175	90,210	75 - 100	81,131	69,191
- Secured on residential property mortgages	25,491	24,063	50 - 100	17,329	16,391
- Non performing advances	6,775	7,150	50 - 150	7,246	7,769
- Other Exposures	1,130	1,805	20 - 150	1,130	1,805
- Cash and cash items in the process of collection	11,523	9,693	0 - 20	631	555
- Other Assets	20,406	15,556	100	20,406	15,556
Asset base for risk weight	367,135	322,843		208,215	191,437

Risk adjusted off - Balance Sheet Exposure

As at 31st December		Amount of Off-Balance Sheet Items 2012 Rs Mn	Credit Conversion Factor %	Credit Equivalent Amount 2012 Rs Mn	Risk Weights %	Risk Adjusted Balance 2012 Rs Mn	Risk Adjusted Balance 2011 Rs Mn
Financial guarantees, bank acceptances and other guarantees		13,319	100	13,319	0 -100	13,319	8,707
Performance related guarantees and warranties and stand by LCs related to particular transactions		18,669	50	9,334	0 -100	9,334	11,790
Shipping guarantees, documentary letter of credit and trade related acceptances		22,108	20	4,422	0 -100	4,422	3,933
Other commitments with an original maturity of	< 1 year	38,452	0 - 20	-	0 -100	-	6
	> 1 year	-	50	-	0 -100	-	-
Foreign exchange contracts		104,471	2	2,089	0 -100	2,089	1,805
Interest rate contracts		-	7	-	0 -100	-	4
Total off-balance sheet exposures		197,019		29,164		29,164	26,245

7.6 Capital Management (Contd)

7.6.1 Capital Adequacy (Contd.)

Capital Charge for Market Risk

	Capital charge		Risk Adjusted Balance	
As at 31st December	2012 Rs Mn	2011 Rs Mn	2012 Rs Mn	2011 Rs Mn
Interest rate	0.3	5.8	3	58
Equity	61.2	109.4	612	1,094
Foreign exchange and gold	40.7	100.2	407	1,002
Total risk adjusted balance for market risk	102.2	215.4	1,022	2,154

Capital Charge for Operational Risk

	Capital charge	
As at 31st December	2012 Rs Mn	2011 Rs Mn
Average gross income	22,376.4	19,786.5
15% of average gross income	3,356.5	2,967.9
Total capital charge for operational risk	3,356.5	2,967.9

As at 31st December	2012 Rs Mn	2011 Rs Mn
Total risk adjusted balance for operational risk	33,565	29,679
Total risk adjusted balances (credit risk, market risk, operational risk)	271,966	249,515

NOTES:

1. In computing the CAR for 2012, profits for the year was computed based on SLFRS.

2. Deductions

	Tier I		Tier II	
As at 31st December	2012 Rs Mn	2011 Rs Mn	2012 Rs Mn	2011 Rs Mn
Additional investment in Sithma Development (Pvt) Ltd.	450	450	450	450
Employee share option plan	476	399	-	-
Others	1,396	1,396	1,396	1,396
Total deductions	2,322	2,245	1,846	1,846

3. Revenue Reserves approved by CBSL is Rs 2,058 Mn.

Notes to the Financial Statements

For the year ended 31st December	Bank 2012 Rs 000	Bank 2011 Rs 000	Group 2012 Rs 000	Group 2011 Rs 000
8 INCOME				
Interest income [Note 9 (a)]	47,346,498	33,175,928	47,939,508	33,546,871
Fee and commission income (Note 10)	3,740,497	2,710,552	3,833,378	2,987,433
Net loss from trading (Note 11)	(1,632,528)	(347,078)	(1,624,049)	(426,335)
Net gain from financial investments (Note 12)	142,479	398,936	114,412	390,630
Other operating income (Note 13)	1,961,954	1,127,963	4,896,820	3,623,983
	51,558,900	37,066,301	55,160,069	40,122,582
9 NET INTEREST INCOME				
9 (a) Interest income				
Placements with banks	506,816	183,350	633,455	259,669
Loans and receivables to other customers	40,010,269	28,370,233	39,920,519	28,184,609
Other financial assets - Held for trading	96,421	60,753	137,396	214,429
Financial investments - Held to maturity	-	-	250,477	209,983
Financial investments - Available for sale	5,572,802	3,776,821	5,649,263	3,783,830
Financial investments - Loans and receivables	1,087,336	695,523	1,248,821	790,641
Other interest income	72,854	89,248	99,577	103,710
Total interest income	47,346,498	33,175,928	47,939,508	33,546,871
9 (b) Interest expenses				
Due to banks	1,939,946	1,043,103	1,939,746	1,043,103
Deposits from customers (Due to other customers)	22,336,872	14,006,242	22,305,703	13,994,262
Other borrowings	460,179	877,182	617,790	988,467
Subordinated debentures	600,132	435,545	599,342	432,385
Other interest expenses	31,303	168,181	32,760	168,255
Total interest expenses	25,368,432	16,530,253	25,495,541	16,626,472
Net interest income	21,978,066	16,645,675	22,443,967	16,920,399

Notional Tax Credit for Withholding Tax on Government Securities on Secondary Market Transactions

Section 137 of the Inland Revenue Act No 10 of 2006 provides that a company which derives interest income from the secondary market transactions in Government securities 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 534 Mn (2011 : Rs 308 Mn) for the Bank and Rs 574 Mn (2011 : Rs 340.70 Mn) for the Group.

9 (c) Net Interest Income from Sri Lanka Government Securities

For the year ended 31st December	Bank 2012 Rs 000	Bank 2011 Rs 000	Group 2012 Rs 000	Group 2011 Rs 000
Interest income	6,268,929	4,293,218	6,907,671	4,758,522
Less : Interest expenses	445,771	859,614	595,455	981,339
Net interest income from Sri Lanka government securities	5,823,158	3,433,604	6,312,216	3,777,183

		Bank		Group	
	For the year ended 31st December	2012 Rs 000	2011 Rs 000	2012 Rs 000	2011 Rs 000
10	**NET FEE AND COMMISSION INCOME**				
	Fee and commission income	3,740,497	2,710,552	3,833,378	2,987,433
	Less: Fee and commission expenses	53,407	34,521	64,032	56,292
	Net fee and commission income	3,687,090	2,676,031	3,769,346	2,931,141
	Comprising				
	Loans	488,061	333,239	488,061	333,239
	Cards	974,609	410,271	974,609	410,271
	Trade and remittances	865,230	849,104	865,230	849,104
	Deposits	327,996	137,252	327,996	137,252
	Guarantees	403,210	349,619	403,210	349,619
	Currency	392,862	288,100	428,402	314,452
	Others	235,122	308,446	281,838	537,204
	Net fee and commission income	3,687,090	2,676,031	3,769,346	2,931,141
11	**NET LOSS FROM TRADING**				
	Fixed income	3,575	(7,267)	11,164	(36,281)
	Equities	(96,845)	(166,796)	(95,955)	(217,039)
	Foreign exchange	(1,539,258)	(173,015)	(1,539,258)	(173,015)
		(1,632,528)	(347,078)	(1,624,049)	(426,335)
12	**NET GAIN FROM FINANCIAL INVESTMENTS**				
	Assets available for sale				
	Debt securities	(38,259)	-	(38,259)	-
	Equities	157,471	345,589	183,777	386,431
	Government Securities	-	-	2,918	4,199
	Net loss arising from derecognition of financial assets measured at amortised cost	(34,024)	-	(34,024)	-
	Dividend income from subsidiaries and associates	57,291	53,347	-	-
		142,479	398,936	114,412	390,630
13	**OTHER OPERATING INCOME**				
	Rent received	4,543	4,426	132,306	125,171
	Rent received from investment properties	54,255	48,424	46,279	46,698
	Auditorium hire income	4,195	3,149	4,195	3,149
	Profit from sale of property, plant and equipment	14,816	19,062	14,986	17,309
	Profit from sale of gold	1,524	4,987	1,524	4,987
	Recovery of loans written off in prior years	11,192	4,071	11,192	4,071
	Recovery of operational losses provided for in prior year	4,006	18,360	4,006	18,360
	Insurance premium income	-	-	2,630,385	2,292,245
	Net income from sale of apartments	-	-	91,133	70,758
	Gain on disposal of associate company [Note 31 (a)]	38,393	-	38,393	-
	Foreign exchange gain	1,812,186	1,007,492	1,832,781	1,014,764
	Miscellaneous	16,844	17,992	89,640	26,471
		1,961,954	1,127,963	4,896,820	3,623,983

Notes to the Financial Statements

	For the year ended 31st December	Bank 2012 Rs 000	Bank 2011 Rs 000	Group 2012 Rs 000	Group 2011 Rs 000
14	**IMPAIRMENT FOR LOANS AND OTHER LOSSES**				
	Loans and receivables to other customers	1,038,787	(501,494)	1,038,787	(501,494)
	Financial investments - Loans and receivables	53,032	-	53,032	-
	Property, plant and equipment	70,412	-	70,412	-
	Investment in subsidiaries [Note 33 (c)]	-	56,121	-	-
		1,162,231	(445,373)	1,162,231	(501,494)
15	**OPERATING EXPENSES**				
	Operating expenses, among others, include the following:				
	Legal expenses and professional fees	160,967	130,824	168,581	136,744
	Depreciation of investment property (Note 34)	4,751	4,584	4,569	4,566
	Depreciation of property, plant and equipment (Note 35)	795,635	737,628	965,630	889,860
	Amortisation of intangible assets (Note 36)	175,314	172,914	189,099	185,624
	Provision for operational risk event losses	8,777	10,973	8,777	60,988
	Provision for related party receivable - Exchange houses	-	18,663	-	-
	Directors' emoluments	95,360	116,979	95,520	117,139
	Auditors' remuneration [Note 15 (a)]	16,270	15,410	22,112	20,144
	Advertising and related expenses	294,227	301,897	335,337	336,942
	Donations	32,579	53,945	32,879	54,370
	Direct operating expenses on investment property	1,726	2,738	2,049	4,563
	Share issue expenses	5,649	45,871	8,247	50,300
	Deposit insurance premium	301,176	312,464	301,176	312,464
15 (a)	**Auditors' Remuneration**				
	Audit fees and expenses	7,678	7,476	11,055	10,562
	Audit related fee and expenses	3,580	3,846	5,504	4,643
	Non-audit services	5,012	4,088	5,553	4,768
	Audit fee and expenses - other auditors	-	-	-	171
		16,270	15,410	22,112	20,144
16	**PERSONNEL EXPENSES**				
	In addition to salaries, personnel expenses include the following				
	Contribution to Employees' Provident Fund	400,480	358,177	434,134	387,318
	Contribution to Employees' Trust Fund	100,281	89,547	108,708	96,195
	Provision charge for employee benefits [Note 16(a)]	303,944	610,032	317,179	625,027
	Equity-settled share-based payment transactions	176,515	-	176,515	-
	Cash-settled share-based payment transactions	292,116	(596,846)	292,116	(596,846)
	Increase in liability for EPF interest guarantee	2,814	1,219	2,814	1,219
	Increase/(Decrease) in liability for accumulated leave	(1,427)	7,243	(1,427)	7,243
16 (a)	**PROVISION CHARGE FOR EMPLOYEE BENEFITS**				
	Current service cost	402,934	427,275	402,934	427,275
	Interest on obligation	884,931	820,529	884,931	820,529
	Expected return on plan assets	(983,921)	(637,772)	(983,921)	(637,772)
	Provision made for gratuities	-	-	13,235	14,995
		303,944	610,032	317,179	625,027

	For the year ended 31st December	Bank 2012 Rs 000	Bank 2011 Rs 000	Group 2012 Rs 000	Group 2011 Rs 000
17	**SHARE OF PROFIT/(LOSS) OF ASSOCIATES (NET OF INCOME TAX)**				
	Share of profit / (loss) of Associates before income tax	-	-	23,810	(14,100)
	Income tax expense on share of operating results of Associates	-	-	(7,178)	(1,629)
	Share of profit/(loss) of Associates after income tax	-	-	16,632	(15,729)
18	**INCOME TAX EXPENSE**				
	Recognised in the Statement of Comprehensive Income				
18 (a)	**Current Tax Expense**				
	Current tax on profits for the year [Note 18 (e)]	2,918,036	2,080,541	2,971,349	2,141,282
	Over provision as per the taxes finalised for the Y/As 2008/09 and 2010/11 (2011 : Y/A 2008/09 and 2009/10)	(690,434)	(438,552)	(694,778)	(444,568)
		2,227,602	1,641,989	2,276,571	1,696,714
18 (b)	**Deferred Tax Expense**				
	Charge to deferred tax liability [Note 47 (a) i]	170,674	288,651	198,158	269,724
	Charge to deferred tax Asset [Note 47 (b)]	(55,941)	192,563	(53,298)	189,639
		114,733	481,214	144,860	459,363
	Total income tax expense	2,342,335	2,123,203	2,421,431	2,156,077

	For the year ended 31st December	Group 2012 Rs 000	Group 2011 Rs 000
18 (c)	**Current Tax on Profits of Subsidiaries**		
	HNB Assurance PLC	42,692	26,012
18 (d)	**Current Tax on Profits of Joint Venture**		
	Acuity Partners (Pvt) Ltd and Subsidiaries	10,621	34,729
	Total	53,313	60,741

Notes to the Financial Statements

18 INCOME TAX EXPENSE (Contd.)

For the year ended 31st December	Bank				Group			
	2012	2012	2011	2011	2012	2012	2011	2011
	%	Rs 000	%	Rs 000	%	Rs 000	%	Rs 000
18 (e) Reconciliation of effective tax rate								
Profit before income tax		10,045,706		8,387,868		10,692,594		9,056,464
Tax using the corporate tax rate	28.00	2,812,798	28.00	2,348,603	28.00	2,993,926	28.00	2,535,810
Effect of tax rates in Joint Venture	-	-	-	-	(0.13)	(13,379)	(0.16)	(14,535)
Disallowable expenses	9.82	986,313	9.41	789,261	9.83	1,050,926	9.05	819,765
Allowable expenses	(26.33)	(2,645,462)	(28.39)	(2,381,315)	(24.93)	(2,665,028)	(26.48)	(2,398,345)
Tax exempt income	(4.84)	(486,072)	(3.62)	(303,667)	(6.08)	(650,435)	(4.81)	(435,462)
Adjustments for leasing	22.40	2,250,459	22.88	1,919,300	21.05	2,250,459	21.19	1,919,300
Tax loss utilised	-	-	-	-	(0.03)	(2,790)	(0.16)	(14,107)
Tax loss incurred during the year	-	-	-	-	0.09	9,627	0.07	6,082
Adjustments	-	-	(3.48)	(291,641)	(0.02)	(1,957)	(3.06)	(277,226)
Current tax on profits for the year [Note 18(a)]	29.05	2,918,036	24.80	2,080,541	27.78	2,971,349	23.64	2,141,282
Over provided in prior years	(6.87)	(690,434)	(5.18)	(438,552)	(6.50)	(694,778)	(4.91)	(444,568)
Current tax on profits for the year	22.18	2,227,602	19.62	1,641,989	21.28	2,276,571	18.73	1,696,714
Charge to deferred tax liability on temporary differences	1.70	170,674	3.41	288,651	1.86	198,158	2.98	269,724
Charge to deferred tax asset on temporary differences	(0.56)	(55,941)	2.30	192,563	(0.50)	(53,298)	2.09	189,639
Total income tax expense	23.32	2,342,335	25.33	2,123,203	22.64	2,421,431	23.80	2,156,077

For the year ended 31st December	Group	
	2012	2011
	Rs 000	Rs 000
18 (f) Tax Losses Brought Forward and Utilised during the Year		
Tax losses brought forward	245,201	273,859
Adjustments for brought forward tax losses	19,747	-
Loss incurred during the year	42,820	21,725
Tax losses utilised during the year	(93,796)	(50,383)
Tax losses not utilised and carried forward	213,972	245,201

18 (g) Hatton National Bank PLC

The Bank is liable for taxation on its income from banking operations at the rate of 28% (2011: 28%) for the year.

18 (h) HNB Assurance PLC

HNB Assurance PLC is liable for income tax at the rate of 28% (2011 : 28%) on its taxable income. Provision has been made in the Financial Statements accordingly.

18 (i) Sithma Development (Pvt) Ltd

In accordance with the BOI agreement dated 28th December 1994, the profits and income of Sithma Development (Pvt) Ltd are exempt from taxation until Year of Assessment 2014 / 15. After the expiration of the said tax exempt period, the following options are available for the company for another 15 years;

(a) Income tax payable for the Year of Assessment shall be computed at 2% of the turnover of the Company, or

(b) The provisions of the Inland Revenue laws for the time being in force shall apply to the Company.

In the event the company elects option (a), no deferred tax liability will arise even after the expiration of the tax exempt period. The company needs to make the election only 90 days prior to the expiration of the said tax exemption period, after evaluating all tax implications prevailing at that time. Therefore, no provision has been made in the Financial Statements by the company for deferred tax liability which could arise after the tax exempt period in the event the company elects option (b).

18 INCOME TAX EXPENSE (Contd.)

18 (j) Acuity Partners (Pvt) Ltd

Acuity Partners (Pvt) Ltd is liable for income tax at the rate of 28% (2011 : 28%) on its taxable income. Provision has been made in the Financial Statements accordingly. Subsidiaries of Acuity Partners (Pvt) Ltd other than Lanka Ventures PLC (2012 : 12%, 2011 : 12%) are liable for income tax at the rate of 28% (2011 : 28%).

19 EARNINGS PER SHARE

19 (a) Basic Earnings per Share

Basic Earnings per Share has been calculated by dividing the profit for the year attributable to equity holders of the Bank by the weighted average number of ordinary shares on issue (both voting and non-voting) during the year, as per the requirements of the Sri Lanka Accounting Standard (LKAS 33) - "Earnings per Share".

19 (b) Diluted Earnings per Share

The calculation of Diluted Earnings per Share as at the reporting date was based on the profit attributable to equity holders of the Bank by the weighted average number of ordinary shares outstanding during the year, after adjusting for the effects of all potentially dilutive weighted average number of ordinary shares that would be issued on the conversion of all the dilutive ESOPs into ordinary shares.

The details of the options exercised and expired under Employee Share Option Plan during the year are given in Note 50 (c) i.

	Bank		Group	
For the year ended 31st December	2012	2011	2012	2011
Profit attributable to equity holders of the Bank (Rs 000)	7,703,371	6,264,665	8,110,969	6,818,923
Weighted average number of ordinary shares during the year used as the denominator ('000) for Basic EPS	397,811	377,302	382,699	365,696
Basic Earnings Per Share (Rs)	19.36	16.60	21.19	18.65
Profit attributable to equity holders of the Bank (Rs 000)	7,703,371	6,264,665	8,110,969	6,818,923
Weighted average number of ordinary shares during the year used as the denominator ('000) for Basic EPS	397,811	377,302	382,699	365,696
Weighted average number of shares under option ('000)	7,717	4,645	7,717	4,645
Weighted average number of ordinary shares that would have been issued at average market price ('000)	(7,179)	(1,992)	(7,179)	(1,992)
Weighted average number of ordinary shares during the year used as the denominator ('000) for Diluted EPS	398,349	379,955	383,237	368,349
Diluted Earnings Per Share (Rs)	19.34	16.49	21.16	18.51

The Basic and the Diluted Earnings Per Share of Bank / Group for 2011 have been adjusted for the effect of scrip dividend which was granted on 31st March 2012.

Notes to the Financial Statements

20 ANALYSIS OF FINANCIAL INSTRUMENTS BY MEASUREMENT BASIS

20 (a) Bank - 2012

	Held for trading Rs 000	Loans and receivables/ deposits at amortised cost Rs 000	Available for sale Rs 000	Total carrying amount Rs 000
Assets				
Cash and cash equivalents	-	8,769,206	-	8,769,206
Balances with Central Banks	-	19,933,463	-	19,933,463
Placements with banks	-	10,321,832	-	10,321,832
Other financial assets held for trading	474,083	-	-	474,083
Derivative financial instruments	344,552	-	-	344,552
Loans and receivables to other customers	-	302,760,980	-	302,760,980
Financial investments	-	20,030,669	57,869,546	77,900,215
Total financial assets	818,635	361,816,150	57,869,546	420,504,331
Liabilities				
Due to banks	-	30,400,980	-	30,400,980
Derivative financial instruments	1,436,443	-	-	1,436,443
Due to other customers	-	341,423,986	-	341,423,986
Other borrowings	-	4,950,535	-	4,950,535
Subordinated debentures	-	4,585,568	-	4,585,568
Total financial liabilities	1,436,443	381,361,069	-	382,797,512

20 (b) Bank - 2011

	Held for trading Rs 000	Loans and receivables/ deposits at amortised cost Rs 000	Available for sale Rs 000	Total carrying amount Rs 000
Assets				
Cash and cash equivalents	-	7,542,767	-	7,542,767
Balances with Central Banks	-	18,683,405	-	18,683,405
Placements with banks	-	7,220,151	-	7,220,151
Other financial assets held for trading	1,160,499	-	-	1,160,499
Derivative financial instruments	496,643	-	-	496,643
Loans and receivables to other customers	-	257,198,343	-	257,198,343
Financial investments	-	14,665,997	51,239,058	65,905,055
Total financial assets	1,657,142	305,310,663	51,239,058	358,206,863
Liabilities				
Due to banks	-	19,885,436	-	19,885,436
Derivative financial instruments	617,702	-	-	617,702
Due to other customers	-	291,356,578	-	291,356,578
Other borrowings	-	7,008,741	-	7,008,741
Subordinated debentures	-	5,023,216	-	5,023,216
Total financial liabilities	617,702	323,273,971	-	323,891,673

20 ANALYSIS OF FINANCIAL INSTRUMENTS BY MEASUREMENT BASIS (Contd.)

20 (c) Group - 2012

	Held for trading Rs 000	Held to maturity Rs 000	Loans and receivables/ deposits at amortised cost Rs 000	Available for sale Rs 000	Total carrying amount Rs 000
Assets					
Cash and cash equivalents	-	-	8,848,746	-	8,848,746
Balances with Central Banks	-	-	19,950,040	-	19,950,040
Placements with banks	-	-	11,667,417	-	11,667,417
Other financial assets held for trading	1,078,124	-	-	-	1,078,124
Derivative financial instruments	344,552	-	-	-	344,552
Loans and receivables to other customers	-	-	303,922,092	-	303,922,092
Financial investments	-	1,643,852	20,904,172	58,929,296	81,477,320
Total financial assets	1,422,676	1,643,852	365,292,467	58,929,296	427,288,291
Liabilities					
Due to banks	-	-	30,400,980	-	30,400,980
Derivative financial instruments	1,436,443	-	-	-	1,436,443
Due to other customers	-	-	340,847,606	-	340,847,606
Other borrowings	-	-	6,747,144	-	6,747,144
Subordinated debentures	-	-	4,563,011	-	4,563,011
Total financial liabilities	1,436,443	-	382,558,741	-	383,995,184

20 (d) Group - 2011

	Held for trading Rs 000	Held to maturity Rs 000	Loans and receivables/ deposits at amortised cost Rs 000	Available for sale Rs 000	Total carrying amount Rs 000
Assets					
Cash and cash equivalents	-	-	7,576,224	-	7,576,224
Balances with Central Banks	-	-	18,698,197	-	18,698,197
Placements with banks	-	-	8,243,999	-	8,243,999
Other financial assets held for trading	2,407,725	-	-	-	2,407,725
Derivative financial instruments	496,643	-	-	-	496,643
Loans and receivables to other customers	-	-	257,435,480	-	257,435,480
Financial investments	-	1,697,640	15,362,143	51,434,979	68,494,762
Total financial assets	2,904,368	1,697,640	307,316,043	51,434,979	363,353,030
Liabilities					
Due to banks	-	-	19,885,436	-	19,885,436
Derivative financial instruments	617,702	-	-	-	617,702
Due to other customers	-	-	290,911,558	-	290,911,558
Other borrowings	-	-	8,876,197	-	8,876,197
Subordinated debentures	-	-	4,989,350	-	4,989,350
Total financial liabilities	617,702	-	324,662,541	-	325,280,243

Notes to the Financial Statements

21 CASH AND CASH EQUIVALENTS

As at	Bank 31.12.2012 Rs 000	Bank 31.12.2011 Rs 000	Bank 01.01.2011 Rs 000	Group 31.12.2012 Rs 000	Group 31.12.2011 Rs 000	Group 01.01.2011 Rs 000
Local currency in hand	7,766,981	6,447,510	5,541,468	7,768,029	6,448,528	5,542,488
Foreign currency in hand	601,274	472,408	299,083	610,628	505,580	324,029
Balances with banks	400,951	622,849	715,787	470,089	622,116	782,100
	8,769,206	7,542,767	6,556,338	8,848,746	7,576,224	6,648,617

All cash and cash equivalent balances held by the Group entities were available for use by the Group.

22 BALANCES WITH CENTRAL BANKS

As at	Bank 31.12.2012 Rs 000	Bank 31.12.2011 Rs 000	Bank 01.01.2011 Rs 000	Group 31.12.2012 Rs 000	Group 31.12.2011 Rs 000	Group 01.01.2011 Rs 000
Statutory deposit with Central Bank of Sri Lanka	19,933,463	18,683,405	12,491,644	19,933,463	18,683,405	12,491,644
Statutory deposit with Central Bank of Oman	-	-	-	16,577	14,792	14,408
	19,933,463	18,683,405	12,491,644	19,950,040	18,698,197	12,506,052

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 8% as at 31st December 2012 (2011 : 8%).

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. This is not available for use in the ordinary course of business.

	As at	Bank 31.12.2012 Rs 000	Bank 31.12.2011 Rs 000	Bank 01.01.2011 Rs 000	Group 31.12.2012 Rs 000	Group 31.12.2011 Rs 000	Group 01.01.2011 Rs 000
23	**PLACEMENTS WITH BANKS**						
	Fixed deposits with banks	-	-	3,187,258	1,345,585	1,023,848	3,682,804
	Placements with banks	10,321,832	7,220,151	8,364,687	10,321,832	7,220,151	8,364,689
		10,321,832	7,220,151	11,551,945	11,667,417	8,243,999	12,047,493
24	**DERIVATIVE FINANCIAL INSTRUMENTS**						
	Foreign currency derivatives						
	Currency swaps	151,188	240,157	49,704	151,188	240,157	49,704
	Forward foreign exchange contracts	193,364	256,486	181,420	193,364	256,486	181,420
		344,552	496,643	231,124	344,552	496,643	231,124

25 OTHER FINANCIAL ASSETS HELD FOR TRADING

25 (a) Other financial assets held for trading - Summary

As at	31.12.2012 Market Value Rs 000	31.12.2011 Market Value Rs 000	01.01.2011 Market Value Rs 000
Quoted shares - Bank [Note 25 (b)]	452,847	723,316	576,280
Government of Sri Lanka treasury bills - Bank [Note 25 (c)]	19,790	17,727	877,840
Government of Sri Lanka treasury bonds - Bank [Note 25 (d)]	1,446	419,456	3,328
Total Other financial assets held for trading - Bank	474,083	1,160,499	1,457,448
Quoted shares - Subsidiaries [Note 25 (e)]	215,668	256,004	215,243
Government of Sri Lanka treasury bills - Subsidiaries and Joint Venture [Note 25 (f)]*	186,015	506,961	667,931
Government of Sri Lanka treasury bonds - Subsidiaries and Joint Venture [Note 25 (g)]*	54,968	414,146	615,056
Quoted Units in Unit Trusts - Subsidiaries [Note 25 (h)]	7,550	7,699	10,296
Unquoted Units in Unit Trusts - Subsidiaries [Note 25 (i)]	139,840	62,416	32,617
Total Other financial assets held for trading - Subsidiaries and Joint Venture	604,041	1,247,226	1,541,143
Total Other financial assets held for trading - Group	1,078,124	2,407,725	2,998,591

* Other financial assets held for trading through the Joint Venture reported above represent only 50% of the total other financial assets held for trading of the Joint Venture, being the shareholding of the Bank on the same.

Notes to the Financial Statements

25 OTHER FINANCIAL ASSETS HELD FOR TRADING (Contd.)

25 (b) Quoted Shares Held by the Bank

As at	31.12.2012				31.12.2011			01.01.2011		
	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	No of Ordinary Shares	Cost of Investment Rs 000	Market Value Rs 000
Banks, Finance and Insurance										
Central Finance Company PLC	102,899	17,494	3.12	16,701	-	-	-	-	-	-
Ceylinco Insurance PLC	15,600	10,128	1.81	13,352	15,600	10,128	11,648	4,000	700	1,080
Lanka Orix Leasing Company PLC	-	-	-	-	212,900	27,715	17,735	225,000	29,322	28,755
National Development Bank PLC	270,000	48,934	8.74	37,233	270,000	48,934	37,287	100,000	36,253	34,950
Nations Trust Bank PLC	296,800	16,787	3.00	16,620	-	-	-	-	-	-
Sampath Bank PLC	130,000	31,897	5.70	26,065	407,317	102,261	79,427	201,738	40,053	54,853
Singer Finance (Lanka) PLC	476,704	7,060	1.26	6,531	-	-	-	-	-	-
Seylan Bank PLC	-	-	-	-	-	-	-	533,400	40,230	52,167
Beverage, Food and Tobacco										
Cargils (Ceylon)PLC	100,000	23,204	4.14	14,550	163,000	37,822	33,089	-	-	-
Distilleries Company of Sri Lanka PLC	217,000	40,601	7.25	36,022	413,000	77,273	60,752	-	-	-
Lion Brewery Ceylon PLC	-	-	-	-	340,000	56,960	64,600	450,000	74,215	83,295
Diversified Holdings										
Aitken Spence PLC	330,000	55,562	9.92	39,600	450,000	75,766	54,180	450,000	75,766	76,455
Expo Lanka Holdings PLC	-	-	-	-	750,500	9,699	6,754	-	-	-
Hayleys PLC	77,395	30,189	5.39	23,443	55,500	22,317	20,812	-	-	-
John Keells Holdings PLC	507,600	105,646	18.87	111,621	357,600	74,855	60,863	282,900	77,644	84,417
Softlogic Holdings PLC	-	-	-	-	416,000	12,064	7,488	-	-	-
Vallibel One PLC	500,000	17,262	3.08	9,050	1,400,000	48,335	33,320	-	-	-
Health Care										
Lanka Hospitals PLC	-	-	-	-	-	-	-	298,742	7,513	9,471
Nawaloka Hospitals PLC	-	-	-	-	-	-	-	7,673,300	29,792	28,391
Manufacturing										
Chevron Lubricants Lanka PLC	82,500	14,053	2.51	16,665	-	-	-	-	-	-
Lanka Floortiles PLC	121,700	15,576	2.78	7,910	-	-	-	-	-	-
Lanka Walltiles PLC	114,423	8,078	1.44	6,957	-	-	-	-	-	-
ACL Cables PLC	-	-	-	-	224,400	20,307	16,606	-	-	-
Ceylon Grain Elevators PLC	-	-	-	-	-	-	-	352,800	18,062	26,354
Lanka Tiles PLC	-	-	-	-	301,700	38,614	24,226	-	-	-
Royal Ceramics Lanka PLC	150,100	24,266	4.33	14,860	175,100	28,308	24,777	-	-	-
Tokyo Cement Company (Lanka) PLC	315,900	17,965	3.21	9,035	648,900	36,902	28,552	377,500	20,014	20,763
Motors										
Diesel & Motor Engineering PLC	-	-	-	-	18,870	29,104	24,571	-	-	-
United Motors PLC	-	-	-	-	180,800	31,572	26,397	-	-	-
Oil & Palms										
Bukit Darah PLC	37,000	39,755	7.10	25,789	40,000	42,979	41,200	-	-	-
Power & Energy										
Vallibel Power Erathna PLC	3,206,655	35,553	6.35	20,843	6,129,100	67,954	49,032	-	-	-
Trading										
Browns & Co PLC	-	-	-	-	-	-	-	305,100	52,778	75,329
Odd lots and delisted shares	-	-	-	-	-	123	-	-	135	-
Total		560,010		452,847		899,992	723,316		502,477	576,280
Gain / (loss) from marked to market valuation		(107,163)				(176,676)			73,803	
Total Quoted Shares - Bank		452,847		452,847		723,316	723,316		576,280	576,280

25 OTHER FINANCIAL ASSETS HELD FOR TRADING (Contd.)

25 (c) Government of Sri Lanka Treasury Bills Held by the Bank

As at			31.12.2012		31.12.2011		01.01.2011	
			Cost of Investment Rs 000	Market Value Rs 000	Cost of Investment Rs 000	Market Value Rs 000	Cost of Investment Rs 000	Market Value Rs 000
Face Value	Year of Maturity	Carrying Value (Rs 000)						
Rs 20 Mn	2013	19,790	19,714	19,790	17,791	17,727	873,926	877,840
Gain / (loss) from marked to market valuation			76		(64)		3,914	
Total Government of Sri Lanka Treasury Bills - Bank			19,790	19,790	17,727	17,727	877,840	877,840

25 (d) Government of Sri Lanka Treasury Bonds Held by the Bank

As at			31.12.2012		31.12.2011		01.01.2011	
			Cost of Investment Rs 000	Market Value Rs 000	Cost of Investment Rs 000	Market Value Rs 000	Cost of Investment Rs 000	Market Value Rs 000
Face Value	Year of Maturity	Carrying Value (Rs 000)						
Rs 1 Mn	2015	1,446	1,395	1,446	421,727		3,403	
Gain / (loss) from marked to market valuation			51		(2,271)		(75)	
Total Government of Sri Lanka Treasury Bonds - Bank			1,446	1,446	419,456	419,456	3,328	3,328

25 (e) Quoted Shares Held by the Subsidiaries

As at	31.12.2012				31.12.2011			01.01.2011		
	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	No of Ordinary Shares	Cost of Investment Rs 000	Market Value Rs 000
Commercial Bank of Ceylon PLC	147,164	17,921	6.57	15,158	144,598	17,921	14,460	67,050	17,046	17,426
Hemas Holdings PLC	321,000	14,106	5.17	8,667	321,000	14,106	10,593	321,000	14,106	14,285
John Keells Holdings PLC	87,556	17,827	6.54	19,254	108,256	20,472	18,425	81,193	20,472	24,228
Dialog Axiata PLC	217,500	5,243	1.92	1,805	217,500	5,243	1,697	217,500	5,243	2,567
Asian Hotels & Properties PLC	-	-	-	-	-	-	-	5,000	167	970
National Development Bank PLC	78,200	9,519	3.49	10,784	78,200	9,519	10,799	17,100	2,646	5,976
John Keells Hotels PLC	92,700	1,564	0.57	1,279	92,700	1,564	1,251	-	-	-
Expo Lanka Holdings PLC	-	-	-	-	221,700	3,104	1,995	-	-	-
Softlogic Holdings PLC	-	-	-	-	170,600	4,947	3,071	-	-	-
Browns Investments PLC	-	-	-	-	142,200	711	597	-	-	-
Royal Ceramics Lanka PLC	183,000	26,095	9.57	18,117	183,000	26,095	25,895	12,000	633	3,659
Chemical Industries (Colombo) PLC	-	-	-	-	-	-	-	116,500	10,905	16,392
ACL Cables PLC	50,000	3,555	1.30	3,370	50,000	3,555	3,700	25,000	1,414	2,128
Dipped Products PLC	19,500	1,829	0.67	2,145	19,500	1,829	2,077	19,500	1,829	2,334
Peoples Leasing & Finance PLC	1,162,800	20,930	7.68	15,349	1,162,800	20,930	18,605	-	-	-
Renuka Agri Foods PLC	-	-	-	-	-	-	-	309,100	815	2,071
Aitken Spence Hotels Holdings PLC	-	-	-	-	75	3	5	23,375	820	2,471
DFCC Bank	43,000	5,390	1.98	4,855	43,000	5,390	4,855	43,000	5,390	8,609
Seylan Bank PLC - Non Voting	399,999	15,445	5.66	14,040	399,999	15,445	12,320	-	-	-
Riverina Hotels PLC	23,000	4,537	1.66	3,220	46,000	4,537	4,830	52,000	5,060	5,476

Notes to the Financial Statements

25 OTHER FINANCIAL ASSETS HELD FOR TRADING (Contd.)

25 (e) Quoted Shares Held by the Subsidiaries (Contd.)

As at	31.12.2012				31.12.2011			01.01.2011		
	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	No of Ordinary Shares	Cost of Investment Rs 000	Market Value Rs 000
The Lighthouse Hotel PLC	21,400	1,433	0.53	1,136	21,400	1,433	1,145	21,400	1,433	1,348
Sampath Bank PLC	76,125	17,088	6.27	15,263	74,399	17,088	14,508	92,724	19,945	25,212
Nations Trust Bank PLC	275,000	18,229	6.69	15,400	275,000	18,229	15,675	180,000	11,767	15,012
Singer Finance (Lanka) PLC	-	-	-	-	-	-	-	4,400	66	66
Richard Pieris and Company PLC	1,375,000	17,228	6.32	10,725	1,375,000	17,228	12,375	325,000	2,449	3,413
CIC Holdings PLC	95,000	9,603	3.52	6,109	95,000	9,603	10,593	-	-	-
Distilleries Company of Sri Lanka PLC	60,000	10,648	3.90	9,960	60,000	10,648	8,826	-	-	-
Hayleys PLC	-	-	-	-	-	-	-	22,000	7,258	7,590
Haycarb PLC	20,500	3,547	1.30	3,508	20,500	3,547	3,178	20,500	3,547	3,454
Chevron Lubricants Lanka PLC	24,000	3,619	1.33	4,848	24,000	3,619	4,080	24,000	3,619	3,828
Tokyo Cement Company (Lanka) PLC	402,912	19,402	7.12	11,523	402,912	19,402	17,728	304,512	12,764	16,748
Kelani Cables PLC	44,300	5,035	1.85	3,105	44,300	5,035	3,557	44,300	5,035	4,652
ACL Plastics PLC	-	-	-	-	3,600	372	450	3,600	372	586
Laugfs Gas PLC - (Voting Shares)	175,000	7,927	2.91	4,480	175,000	7,927	6,650	26,700	614	692
Laugfs Gas PLC - (Non Voting Shares)	-	-	-	-	-	-	-	19,200	288	355
PC House PLC	82,820	910	0.33	446	178,800	1,967	2,485	178,800	1,967	2,020
Renuka Holdings PLC	50,877	2,121	0.78	1,837	50,877	2,121	2,742	70,000	2,970	4,333
Textured Jersey Lanka PLC	428,500	6,428	2.36	3,814	428,500	6,428	4,371	-	-	-
Asiri Hospital Holdings PLC	-	-	-	-	700,000	6,021	6,020	928,200	7,990	8,168
Dolphin Hotels PLC	149,900	5,506	2.02	5,471	149,900	5,506	6,446	149,900	5,506	9,174
Total		272,685	100	215,668		291,545	256,004		174,136	215,243
(Loss)/Gain from marked to market valuation		(57,017)				(35,541)			41,107	
Total quoted shares - Subsidiaries		215,668		215,668		256,004	256,004		215,243	215,243

25 (f) Government of Sri Lanka Treasury Bills held by Subsidiaries and through Joint Venture

As at			31.12.2012		31.12.2011		01.01.2011	
			Cost of Investment Rs 000	Market Value Rs 000	Cost of Investment Rs 000	Market Value Rs 000	Cost of Investment Rs 000	Market Value Rs 000
Face Value	Year of Maturity	Carrying Value (Rs 000)						
Rs 200 Mn	2013	186,015	185,178	186,015	509,417	506,961	666,813	667,931
Gain / (loss) from marked to market valuation			837		(2,456)		1,118	
Total Government of Sri Lanka Treasury Bills - Joint Venture			186,015	186,015	506,961	506,961	667,931	667,931

25 OTHER FINANCIAL ASSETS HELD FOR TRADING (Contd.)

25 (g) Government of Sri Lanka Treasury Bonds held by Subsidiaries and through Joint Venture

As at			31.12.2012		31.12.2011		01.01.2011	
			Cost of Investment Rs 000	Market Value Rs 000	Cost of Investment Rs 000	Market Value Rs 000	Cost of Investment Rs 000	Market Value Rs 000
Face Value	Year of Maturity	Carrying Value (Rs 000)						
Rs 50.90 Mn	2013	52,189						
Rs 2.70 Mn	2014	2,545						
Rs 0.23 Mn	2015	234	54,871		439,138		581,904	
Gain/(loss) from marked to market valuation			97		(24,992)		33,152	
Total Government of Sri Lanka Treasury Bonds - Joint Venture			54,968	54,968	414,146	414,146	615,056	615,056

25 (h) Quoted Units in Unit Trusts Held by Subsidiaries

As at	31.12.2012			31.12.2011			01.01.2011		
	No of Units	Cost of Investment Rs 000	Market Value Rs 000	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	114,400	7,203	7,550	114,400	7,203	7,699	114,400	7,203	10,296
Gain from marked to market valuation		347			496			3,093	
Total Quoted Units - Subsidiaries and Joint Venture		7,550	7,550		7,699	7,699	7,203	10,296	10,296

25 (i) Unquoted Units in Unit Trusts Held by Subsidiaries

As at	31.12.2012			31.12.2011			01.01.2011		
	No of Units	Cost of Investment Rs 000	Market Value Rs 000	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 IPO Fund	1,000,000	9,750	10,270	1,000,000	9,750	9,700	-	-	-
Cey Bank	1,800,000	18,000	19,602	1,800,000	18,000	18,792	2,500,000	25,000	26,350
Ceylon Asset Management	664,622	6,500	4,333	1,195,729	6,500	4,486	-	-	-
FC Wealth Fund	3,851	4,000	4,349	3,851	4,000	4,172	-	-	-
Ceylon Income Fund	2,686,703	35,000	34,470	1,365,706	25,000	25,266	664,622	6,500	6,267
Guardian Acuity Fixed Income Fund	1,998,002	20,000	22,018	-	-	-	-	-	-
Comtrust Money Market Fund	383,877	4,000	4,131	-	-	-	-	-	-
Eagle Income Fund	969,932	10,000	10,417	-	-	-	-	-	-
Namal High Yield Fund	2,686,567	27,000	30,250	-	-	-	-	-	-
Gain/(loss) from marked to market valuation		5,590			(834)			1,117	
Total Unquoted Units in Unit Trusts - Subsidiaries		139,840	139,840		62,416	62,416		32,617	32,617

Notes to the Financial Statements

26 NON CURRENT ASSETS HELD FOR SALE

As at	Bank 31.12.2012 Carrying Amount Rs 000	Bank 31.12.2011 Carrying Amount Rs 000	Bank 01.01.2011 Carrying Amount Rs 000	Group 31.12.2012 Carrying Amount Rs 000	Group 31.12.2011 Carrying Amount Rs 000	Group 01.01.2011 Carrying Amount Rs 000
Non current assets held for sale	-	-	-	2,875	2,875	2,875

26 (a) Freehold Land*

As at	31.12.2012 Extent (perches)	31.12.2012 Cost of Land Rs 000	31.12.2011 Extent (perches)	31.12.2011 Cost of Land Rs 000	01.01.2011 Extent (perches)	01.01.2011 Cost of Land Rs 000
Lot - X, Survey plan - 6448, off Edirisinghe Rd, Mirihana*	10	2,875	10	2,875	10	2,875
Total - Group		2,875		2,875		2,875

* Value of the above land (10 perches) amounted to Rs 5.75 Mn as at 31st January 2011 based on the valuation carried out by Messrs K C B Condegama AIV (Sri Lanka). As this land is held by Acuity Partners (Pvt) Ltd, the Joint Venture, only 50% of the value has been taken to the Consolidated Financial Statements.

27 LOANS AND RECEIVABLES TO OTHER CUSTOMERS

As at	Bank 31.12.2012 Rs 000	Bank 31.12.2011 Rs 000	Bank 01.01.2011 Rs 000	Group 31.12.2012 Rs 000	Group 31.12.2011 Rs 000	Group 01.01.2011 Rs 000
Gross loans and receivables	310,384,674	263,863,251	209,965,692	311,545,786	264,100,388	209,292,256
Less: Individual impairment [Note 27 (e)]	1,808,383	2,057,850	2,507,000	1,808,383	2,057,850	2,507,000
Collective impairment [Note 27 (f)]	5,815,311	4,607,058	5,205,674	5,815,311	4,607,058	5,205,674
Net loans and receivables	302,760,980	257,198,343	202,253,018	303,922,092	257,435,480	201,579,582

27 (a) Product wise analysis of loans and receivables

	Bank 31.12.2012 Rs 000	Bank 31.12.2011 Rs 000	Bank 01.01.2011 Rs 000	Group 31.12.2012 Rs 000	Group 31.12.2011 Rs 000	Group 01.01.2011 Rs 000
Overdrafts	61,160,391	48,088,165	43,179,410	61,022,596	47,632,606	42,769,849
Bills of exchange	1,272,694	1,071,921	1,509,187	1,272,694	1,071,921	1,509,187
Commercial papers	527,779	24,986	158,963	681,526	90,018	158,963
Securities purchased under resale agreements	51,050	781,478	1,187,098	2,245,771	2,869,836	2,734,581
Short term loans	16,756,644	13,254,457	13,754,239	16,809,710	13,299,955	13,754,239
Trust receipts	13,059,931	11,152,041	8,414,353	13,059,931	11,152,041	8,414,353
Packing credit loans	3,277,487	4,900,866	6,162,575	3,277,487	4,900,866	6,162,575
Staff loans	6,196,877	5,707,453	5,195,738	6,386,355	5,865,701	5,367,325
Term loans	110,551,220	95,023,763	68,382,363	109,259,115	93,359,323	66,399,418
Lease rentals receivables [Note 27 (d)]	25,280,078	24,568,780	13,919,320	25,280,078	24,568,780	13,919,320
Housing loans	22,990,253	21,800,114	18,821,074	22,990,253	21,800,114	18,821,074
Pawning advances	49,260,270	37,489,227	29,281,372	49,260,270	37,489,227	29,281,372
	310,384,674	263,863,251	209,965,692	311,545,786	264,100,388	209,292,256

27 LOANS AND RECEIVABLES TO OTHER CUSTOMERS (Contd.)

27 (b) Currency wise analysis of loans and receivables

	Bank			Group		
As at	31.12.2012 Rs 000	31.12.2011 Rs 000	01.01.2011 Rs 000	31.12.2012 Rs 000	31.12.2011 Rs 000	01.01.2011 Rs 000
Sri Lankan Rupee	278,617,303	234,850,162	182,561,153	279,778,415	235,087,299	181,887,717
United States Dollar	30,243,653	27,320,484	26,091,570	30,243,653	27,320,484	26,091,570
Great Britain Pound	197,086	207,218	198,536	197,086	207,218	198,536
Euro	1,274,088	1,069,926	1,036,925	1,274,088	1,069,926	1,036,925
Others	52,544	415,461	77,508	52,544	415,461	77,508
	310,384,674	263,863,251	209,965,692	311,545,786	264,100,388	209,292,256

27 (c) Industry wise analysis of loans and receivables

	Bank 31.12.2012	Bank 31.12.2011	Bank 01.01.2011	Group 31.12.2012	Group 31.12.2011	Group 01.01.2011
Agriculture and fishing	31,306,579	28,965,719	25,338,467	31,306,579	28,965,719	25,338,467
Manufacturing	38,851,459	29,373,274	24,291,183	38,851,459	29,373,274	24,291,183
Tourism	18,731,165	16,378,499	12,189,811	18,731,165	16,378,499	12,189,811
Transport	5,034,068	10,210,733	11,992,130	5,034,068	10,210,733	11,992,130
Construction	40,234,886	38,583,493	33,780,242	39,102,119	36,771,684	31,585,033
Traders	49,636,247	40,804,323	32,868,660	49,636,247	40,804,323	32,868,660
New economy	4,675,435	3,424,704	2,623,994	4,675,435	3,424,704	2,623,994
Financial and business services	23,051,027	21,505,529	15,581,646	23,046,159	21,438,219	15,581,646
Infrastructure	8,923,369	7,072,183	5,600,478	8,923,369	7,072,183	5,600,478
Other services	23,469,029	24,645,018	13,166,509	23,469,029	24,645,018	13,166,509
Credit card	2,778,069	2,355,722	1,877,220	2,778,069	2,355,722	1,877,220
Pawning	48,447,062	34,377,453	23,223,488	48,447,062	34,377,453	23,223,488
Other	15,246,279	6,166,601	7,431,864	17,545,025	8,282,856	8,953,635
	310,384,674	263,863,251	209,965,692	311,545,786	264,100,388	209,292,256

27 (d) Lease rentals receivables

	Bank 31.12.2012	Bank 31.12.2011	Bank 01.01.2011	Group 31.12.2012	Group 31.12.2011	Group 01.01.2011
Gross lease rentals receivable	52,890,091	49,386,550	33,736,875	52,890,091	49,386,550	33,736,875
Initial rentals received	(100,621)	(102,215)	(85,923)	(100,621)	(102,215)	(85,923)
Lease rentals received	(21,951,473)	(19,121,395)	(16,357,491)	(21,951,473)	(19,121,395)	(16,357,491)
Total lease rentals receivable	30,837,997	30,162,940	17,293,461	30,837,997	30,162,940	17,293,461
Unearned lease income	(5,557,919)	(5,594,160)	(3,374,141)	(5,557,919)	(5,594,160)	(3,374,141)
Gross lease receivable	25,280,078	24,568,780	13,919,320	25,280,078	24,568,780	13,919,320
Impairment allowance for lease receivable - Collective [Note 27 (d) (iii)]	(302,133)	(217,385)	(205,600)	(302,133)	(217,385)	(205,600)
Net lease receivable	24,977,945	24,351,395	13,713,720	24,977,945	24,351,395	13,713,720
Gross lease receivable within one year [Note 27 (d) (i)]	8,783,462	7,374,729	4,849,915	8,783,462	7,374,729	4,849,915
Gross lease receivable after one year [Note 27 (d) (ii)]	16,194,483	16,976,666	8,863,805	16,194,483	16,976,666	8,863,805
	24,977,945	24,351,395	13,713,720	24,977,945	24,351,395	13,713,720

Notes to the Financial Statements

27 LOANS AND RECEIVABLES TO OTHER CUSTOMERS (Contd.)

27 (d) i Gross lease Receivable within One Year

As at	Bank 31.12.2012 Rs 000	Bank 31.12.2011 Rs 000	Bank 01.01.2011 Rs 000	Group 31.12.2012 Rs 000	Group 31.12.2011 Rs 000	Group 01.01.2011 Rs 000
Total lease rentals receivable within one year from reporting date	11,823,506	10,164,813	6,637,509	11,823,506	10,164,813	6,637,509
Unearned lease income	(2,933,799)	(2,724,250)	(1,714,883)	(2,933,799)	(2,724,250)	(1,714,883)
Impairment allowance for lease receivable	(106,245)	(65,834)	(72,711)	(106,245)	(65,834)	(72,711)
Balance as at	8,783,462	7,374,729	4,849,915	8,783,462	7,374,729	4,849,915

27 (d) ii Gross lease Receivable after One Year

	Bank 31.12.2012 Rs 000	Bank 31.12.2011 Rs 000	Bank 01.01.2011 Rs 000	Group 31.12.2012 Rs 000	Group 31.12.2011 Rs 000	Group 01.01.2011 Rs 000
Total lease rentals receivable after one year from reporting date	19,014,491	19,998,127	10,655,952	19,014,491	19,998,127	10,655,952
Unearned lease income	(2,624,120)	(2,869,910)	(1,659,258)	(2,624,120)	(2,869,910)	(1,659,258)
Impairment allowance for lease receivable	(195,888)	(151,551)	(132,889)	(195,888)	(151,551)	(132,889)
Balance as at	16,194,483	16,976,666	8,863,805	16,194,483	16,976,666	8,863,805

There were no lease receivables beyond five years.

27 (d) iii Movement in impairment allowance for Lease Receivable - Bank/Group

	2012 Rs 000 Collective	2011 Rs 000 Collective
Balance as at 1st January	217,385	205,600
Net impairment charge for the year	84,748	11,785
Balance as at 31st December	302,133	217,385

27 (e) Movement in individual impairment allowance for loans and advances - Bank/Group

	2012 Rs 000	2011 Rs 000
Balance as at 1st January	2,057,850	2,507,000
Net impairment reversal for the year	(249,467)	(449,150)
Balance as at 31st December	1,808,383	2,057,850

27 (f) Movement in collective impairment allowance for loans and advances

	2012 Rs 000	2011 Rs 000
Balance as at 1st January	4,607,058	5,205,674
Net impairment charge/(reversal) for the year	1,208,253	(598,616)
Balance as at 31st December	5,815,311	4,607,058

27 (g) Loans granted from Investment Fund Account

The details of loans granted from Investment Fund Account which were outstanding as at 31st December 2012 are as follows.

	Number of loans	Total amount outstanding Rs 000	Interest rate	Tenure
Agriculture	1	134,050	14.90% (LKR)	5 Years
Infrastructure development	5	693,996	13.65% (LKR) - 14.21% (LKR)	8 Years
Construction of hotels and related purposes	3	2,056,624	5.05% - 5.11% (US$) & 12.56% (LKR)	6-7 Years
		2,884,670		

Investment Fund Account was Rs 2,300.56 Mn as at 31st December 2012. This balance had been fully allocated against the loans granted. Further loans of Rs 584.11 Mn had been granted for this purpose which is in excess of the balance in the Investment Fund Account as at the reporting date.

28 FINANCIAL INVESTMENTS - AVAILABLE FOR SALE

As at	Market Value/ Directors Valuation 31.12.2012 Rs 000	Market Value/ Directors Valuation 31.12.2011 Rs 000	Market Value/ Directors Valuation 01.01.2011 Rs 000
Quoted shares - Bank [Note 28 (a)]	4,251,708	4,224,630	6,428,250
Quoted units - Bank [Note 28 (b)]	198,000	203,700	270,000
Unquoted shares - Bank [Note 28 (c)]	27,456	207,456	387,956
Government of Sri Lanka treasury bonds - Bank [Note 28 (d)]	5,587,415	10,598,527	8,627,064
Government of Sri Lanka treasury bills - Bank [Note 28 (e)]	47,804,967	35,929,393	33,525,659
Foreign government bonds - Bank [Note 28 (f)]	-	75,352	140,948
Total financial investments - Available for sale - Bank	57,869,546	51,239,058	49,379,877
Quoted shares - Joint Venture [Note 28 (g)]	3,644	3,875	3,974
Unquoted shares - Joint Venture [Note 28 (h)]	58,332	68,994	83,957
Quoted units in Unit Trust - Subsidiaries and Joint Venture [Note 28 (I)]	-	26,367	27,050
Unquoted units in Unit Trust - Joint Venture [Note 28 (J)]	24,094	-	-
Government of Sri Lanka treasury bonds - Subsidiaries [Note 28 (k)]	767,221	96,685	132,062
Government of Sri Lanka treasury bills - Subsidiaries [Note 28 (l)]	206,459	-	-
Total financial investments - Available for sale - Subsidiaries and Joint Venture	1,059,750	195,921	247,043
Total financial investments - Available for sale - Group	58,929,296	51,434,979	49,626,920

Financial investments - Available for sale through the Joint Venture reported above represent only 50% of the total investment securities of the Joint Venture, being the shareholding of the Bank on the same.

28 (a) Quoted Shares Held by the Bank

As at	31.12.2012			31.12.2011			01.01.2011		
	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	No of Ordinary Shares	Cost of Investment Rs 000	Market Value Rs 000
DFCC Bank	32,396,140	942,651	3,660,764	32,109,140	911,399	3,625,122	32,109,140	911,399	6,428,250
National Development Bank PLC	4,282,200	694,519	590,944	4,282,200	694,519	599,508	-	-	-
Total Quoted Shares - Bank		1,637,170	4,251,708		1,605,918	4,224,630		911,399	6,428,250

28 (b) Quoted Units in Unit Trusts held by the Bank

Namal Acuity Value Fund	3,000,000	150,000	198,000	3,000,000	150,000	203,700	3,000,000	150,000	270,000
Total Quoted Units in Unit Trusts - Bank		150,000	198,000		150,000	203,700		150,000	270,000

Notes to the Financial Statements

28 FINANCIAL INVESTMENTS - AVAILABLE FOR SALE (Contd.)

28 (c) Unquoted Shares Held by the Bank

As at	31.12.2012			31.12.2011			01.01.2011		
	No of Shares	Cost of Investment Rs 000	Directors' Valuation Rs 000	No of Shares	Cost of Investment Rs 000	Directors' Valuation Rs 000	No of Shares	Cost of Investment Rs 000	Directors' Valuation Rs 000
Browns' Group Motels Ltd*	-	-	-	-	-	-	50,000	500	500
Credit Information Bureau of Sri Lanka	5,300	530	530	5,300	530	530	5,300	530	530
Fitch Rating Lanka Ltd	62,500	625	625	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	2,200,000	22,000	22,000
Lanka Financial Services Bureau	225,000	2,250	2,250	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	21	2,051	2,051
Dialog Axiata PLC									
Rated cumulative redeemable preference shares	-	-	-	180,000,000	180,000	180,000	360,000,000	360,000	360,000
Magpek Exports Ltd**	359,000	14,360	-	359,000	14,360	-	359,000	14,360	-
Metal Recyclers Colombo Ltd	-	-	-	-	-	-	69	3	-
Impairment provision	-	(14,360)	-	-	(14,360)	-	-	(14,363)	-
Total Unquoted Shares - Bank		27,456	27,456		207,456	207,456		387,956	387,956

* During 2011 the investment in Browns' Group Motels Ltd was disposed and the resultant gain of Rs 0.444 Mn has been reported under Note 12 - Net gain/(loss) from financial investment.

** As shares of Magpek Exports Ltd has been de-listed, the market value is shown as nil. Impairment provision of Rs 14.36 Mn has been made in the Financial Statements.

28 (d) Government of Sri Lanka Treasury Bonds Held by the Bank

As at			31.12.2012		31.12.2011		01.01.2011	
Face Value	Year of Maturity	Carrying Value Rs 000	Cost of Investment Rs 000	Market Value Rs 000	Cost of Investment Rs 000	Market Value Rs 000	Cost of Investment Rs 000	Market Value Rs 000
Rs 3,376 Mn	2013	3,458,066						
Rs 2,150 Mn	2014	2,129,349						
Total Government of Sri Lanka Treasury Bonds - Bank			5,679,886	5,587,415	10,727,152	10,598,527	8,047,349	8,627,064

28 (e) Government of Sri Lanka Treasury Bills Held by the Bank

Face Value	Year of Maturity	Carrying Value Rs 000						
Rs 42,291 Mn	2013	47,804,967						
Total Government of Sri Lanka Treasury Bills - Bank			47,681,212	47,804,967	36,063,373	35,929,393	33,503,443	33,525,659

28 FINANCIAL INVESTMENTS - AVAILABLE FOR SALE (Contd.)

28 (f) Foreign Government Bonds Held by the Bank

As at	31.12.2012		31.12.2011		01.01.2011	
	Cost of Investment Rs 000	Market Value Rs 000	Cost of Investment Rs 000	Market Value Rs 000	Cost of Investment Rs 000	Market Value Rs 000
Total Foreign Government Bonds - Bank	-	-	150,753	75,352	145,537	140,948

These bonds were issued by the Government of Greece and the investment was fully provided for. During 2012 these bonds matured and the Bank received further bonds from the issuer which are classified as financial investments - Loans and receivables.

28 (g) Quoted Shares Held through Joint Venture

As at	31.12.2012			31.12.2011			01.01.2011		
	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	No of Ordinary Shares	Cost of Investment Rs 000	Market Value Rs 000
Hayleys PLC	7,491	558	2,269	7,491	558	2,809	7,491	1116	2,577
John Keels Holdings PLC	6,240	22	1,372	4,680	22	1,062	4,680	22	1,395
Central Finance PLC	16	-	3	3	-	4	3	-	2
Total Quoted Shares - Joint Venture		580	3,644		580	3,875		1,138	3,974

28 (h) Unquoted Shares Held through Joint Venture

As at	31.12.2012			31.12.2011			01.01.2011		
	No of Shares	Cost of Investment Rs 000	Market Value Rs 000	No of Shares	Cost of Investment Rs 000	Market Value Rs 000	No of Shares	Cost of Investment Rs 000	Market Value Rs 000
Durdans Heart Surgical Centre (Private) Ltd	-	-	-	750,000	7,313	7,313	750,000	7,313	7,313
Durdans Medical & Surgical Centre (Private) Ltd	1,061,225	13,357	13,357	1,000,000	12,500	12,500	1,000,000	12,500	12,500
Tudawe Brothers Limited (Preference Shares)	-	-	-	-	-	-	100,000	10000	10000
Nividhu (Private) Limited (Preference Shares)	1,640,000	16,490	44,975	1,640,000	16,490	49,181	1,640,000	16,490	54,144
Total Unquoted Shares - Joint Venture		29,847	58,332		36,303	68,994		46,303	83,957

28 (i) Quoted Units in Unit Trusts Held by Subsidiaries and through Joint Venture

As at	31.12.2012			31.12.2011			01.01.2011		
	No of Units	Cost of Investment Rs 000	Market Value Rs 000	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	-	-	-	2,436,870	25,000	26,367	2,436,870	25,000	27,050
Total Quoted Units - Subsidiaries and Joint Venture		-	-		25,000	26,367		25,000	27,050

Notes to the Financial Statements

28 FINANCIAL INVESTMENTS - AVAILABLE FOR SALE (Contd.)

28 (j) Unquoted Units in Unit Trusts Held through Joint venture

As at	31.12.2012 No of Units	31.12.2012 Cost of Investment Rs 000	31.12.2012 Market Value Rs.000	31.12.2011 No of Units	31.12.2011 Cost of Investment Rs 000	31.12.2011 Market Value Rs.000	01.01.2011 No of Units	01.01.2011 Cost of Investment Rs 000	01.01.2011 Market Value Rs.000
Guardian Acuity Fixed Income fund	2,250,000	22,500	24,094		-	-	-	-	-
Total Unquoted Units in Unit Trusts - Subsidiaries		22,500	24,094		-	-		-	-

28 (k) Government of Sri Lanka Treasury Bonds Held by Subsidiaries

Face Value	Year of Maturity	Carrying Value (Rs 000)	31.12.2012 Cost of Investment Rs 000	31.12.2012 Market Value Rs 000	31.12.2011 Cost of Investment Rs 000	31.12.2011 Market Value Rs 000	01.01.2011 Cost of Investment Rs 000	01.01.2011 Market Value Rs 000
Rs 150 Mn	2013	154,486						
Rs 150 Mn	2014	146,135						
Rs 150 Mn	2015	142,309						
Rs 100 Mn	2016	88,048						
Rs 150 Mn	2017	128,060						
Rs 125 Mn	2018	108,183						
Total Government of Sri Lanka Treasury Bonds - Subsidiaries and Joint Venture			742,266	767,221	98,268	96,685	123,272	132,062

28 (l) Government of Sri Lanka Treasury Bills Held by Subsidiaries

Face Value	Year of Maturity	Carrying Value (Rs 000)	31.12.2012 Cost of Investment Rs 000	31.12.2012 Market Value Rs 000	31.12.2011 Cost of Investment Rs 000	31.12.2011 Market Value Rs 000	01.01.2011 Cost of Investment Rs 000	01.01.2011 Market Value Rs 000
Rs 215 Mn	2013	206,459						
Total Government of Sri Lanka Treasury Bills - Subsidiaries			205,169	206,459	-	-	-	-

28 FINANCIAL INVESTMENTS - AVAILABLE FOR SALE (Contd.)

28 (m) Assets Pledged as Security

The following amount of financial investments - available for sale is pledged as security for re-purchase agreements entered into by the Bank / Group.

As at	Bank 31.12.2012 Rs 000	Bank 31.12.2011 Rs 000	Bank 01.01.2011 Rs 000	Group 31.12.2012 Rs 000	Group 31.12.2011 Rs 000	Group 01.01.2011 Rs 000
Treasury bills	4,027,950	5,867,639	10,926,033	5,860,845	7,280,925	11,666,907
Treasury bonds	543,333	691,449	1,025,694	705,810	1,396,260	1,996,589
	4,571,283	6,559,088	11,951,727	6,566,655	8,677,185	13,663,496

28 (n) Investment in government securities on behalf of Investment Fund Account

There were no investments in government securities on behalf of Investment Fund Account as at 31st December 2012.

29 FINANCIAL INVESTMENTS - HELD TO MATURITY

As at	Group Cost 31.12.2012 Rs 000	Group Cost 31.12.2011 Rs 000	Group Cost 01.01.2011 Rs 000
Government of Sri Lanka treasury bills - Subsidiaries and Joint Venture [Note 29 (a)]	34,902	155,989	906,621
Government of Sri Lanka treasury bonds - Subsidiaries and Joint Venture [Note 29 (b)]	1,533,066	1,466,644	631,095
Unquoted debentures - Joint Venture [Note 29 (c)]	71,593	70,831	74,493
Quoted debentures - Joint Venture [Note 29 (d)]	4,291	4,176	4,215
Total held-to-maturity investment securities - Group	1,643,852	1,697,640	1,616,424

Financial investment - held to maturity through the Joint Venture reported above represent only 50% of the total financial investments - Held to maturity of the Joint Venture, being the shareholding of the Bank on the same.

29 (a) Held-to-maturity Government of Sri Lanka Treasury Bills Held by Subsidiaries and through Joint Venture

As at			31.12.2012 Cost of Investment Rs 000	31.12.2012 Market Value Rs 000	31.12.2011 Cost of Investment Rs 000	31.12.2011 Market Value Rs 000	01.01.2011 Cost of Investment Rs 000	01.01.2011 Market Value Rs 000
Face Value	Year of Maturity	Carrying Value (Rs 000)						
Rs 35 Mn	2013	34,902						
Total Government of Sri Lanka Treasury Bills - Subsidiaries and Joint Venture			34,902	34,897	155,989	155,850	906,621	908,475

Notes to the Financial Statements

29 FINANCIAL INVESTMENTS - HELD TO MATURITY (Contd.)

29 (b) Government of Sri Lanka Treasury Bonds Held by Subsidiaries and through Joint Venture

As at			31.12.2012 Cost of Investment Rs 000	31.12.2012 Market Value Rs 000	31.12.2011 Cost of Investment Rs 000	31.12.2011 Market Value Rs 000	01.01.2011 Cost of Investment Rs 000	01.01.2011 Market Value Rs 000
Face Value	Year of Maturity	Carrying Value (Rs 000)						
Rs 608 Mn	2013	606,959						
Rs 150 Mn	2014	155,370						
Rs 310 Mn	2015	327,686						
Rs 300 Mn	2016	288,306						
Rs 175 Mn	2018	154,745						
Total Government of Sri Lanka Treasury Bonds - Subsidiaries and Joint Venture			1,533,066	1,498,605	1,466,644	1,498,441	631,095	754,158

29 (c) Unquoted Debentures Held by Subsidiaries and through Joint Venture

As at	31.12.2012 No of Debentures	31.12.2012 Cost of Investment Rs 000	31.12.2011 No of Debentures	31.12.2011 Cost of Investment Rs 000	01.01.2011 No of Debentures	01.01.2011 Cost of Investment Rs 000
Ceylon Hospital PLC (Rs 10/- each)	5,000,000	50,000	5,000,000	50,000	5,000,000	50,011
Neluwa Cascade Hydro Power (Private) Limited	2,000,000	21,593	2,000,000	20,831	2,000,000	24,482
Total Unquoted Debentures - Subsidiaries and Joint Venture	7,000,000	71,593	7,000,000	70,831	7,000,000	74,493

29 (d) Quoted Debentures Held by Subsidiaries and through Joint Venture

As at	31.12.2012 No of Debentures	31.12.2012 Cost of Investment Rs 000	31.12.2011 No of Debentures	31.12.2011 Cost of Investment Rs 000	01.01.2011 No of Debentures	01.01.2011 Cost of Investment Rs 000
Quoted Debentures Held by Subsidiaries and through Joint Venture						
Bank of Ceylon (Rs.100/- each)	40,000	4,291	40,000	4,176	40,000	4,215
Total Quoted Debentures - Subsidiaries and Joint Venture	40,000	4,291	40,000	4,176	40,000	4,215

30 FINANCIAL INVESTMENTS - LOANS AND RECEIVABLES

As at	Cost of Investment 31.12.2012 Rs 000	Cost of Investment 31.12.2011 Rs 000	Cost of Investment 01.01.2011 Rs 000
Sri Lanka Development bonds and Sovereign bonds - Bank [Note 30 (a)]	17,520,959	12,139,597	10,247,979
CBSL securities - Bank [Note 30 (b)]	-	-	3,998,408
Foreign government bonds - Bank [Note 30 (c)]	-	-	-
Other long term investments - Bank [Note 30 (d)]	2,509,710	2,526,400	1,124,400
Total financial investments - loans and receivables - Bank	20,030,669	14,665,997	15,370,787
Unquoted debentures - Subsidiaries [Note 30 (e)]	340,060	251,275	80,864
Quoted debentures - Subsidiaries [Note 30 (f)]	533,443	419,871	262,742
Unquoted units in Unit Trust - Subsidiaries [Note 30 (g)]	-	25,000	25,000
Total financial investments measured as loans and receivables - Subsidiaries	873,503	696,146	368,606
Total financial investments measured as loans and receivables - Group	20,904,172	15,362,143	15,739,393

30 FINANCIAL INVESTMENTS - LOANS AND RECEIVABLES (Contd.)

30 (a) Sri Lanka Development Bonds & Sovereign Bonds Held by the Bank

As at			31.12.2012 Cost of Investment Rs 000	31.12.2011 Cost of Investment Rs 000	01.01.2011 Cost of Investment Rs 000
Face Value	Year of Maturity	Carrying Value (Rs 000)			
Rs 2,553 Mn	2014	2,553,885			
Rs 14,679 Mn	2015	14,967,074			
Total Sri Lanka Development Bonds and Sovereign Bonds - Bank			17,520,959	12,139,597	10,247,979

30 (b) CBSL Securities Held by the Bank

As at	31.12.2012 Cost of Investment Rs 000	31.12.2011 Cost of Investment Rs 000	01.01.2011 Cost of Investment Rs 000
Total CBSL Securities - Bank	-	-	3,998,408

30 (c) Foreign Government Bonds Held by the Bank

As at			31.12.2012 Cost of Investment Rs 000	31.12.2011 Cost of Investment Rs 000	01.01.2011 Cost of Investment Rs 000
Face Value	Year of Maturity	Carrying Value (Rs 000)			
Rs 53 Mn	2042	53,032			
Impairment loss investments		(53,032)			
Total Foreign Government Bonds - Bank			-	-	-

These bonds are issued by the Government of Greece and the investment is fully provided for.

30 (d) Other Long Term Investments Held by the Bank

As at	31.12.2012 Cost Rs 000	31.12.2012 Directors' Valuation Rs 000	31.12.2011 Cost Rs 000	31.12.2011 Directors' Valuation Rs 000	01.01.2011 Cost Rs 000	01.01.2011 Directors' Valuation Rs 000
Long term non-negotiable bonds maturing on 14th November 2016	489,000	489,000	489,000	489,000	489,000	489,000
Central Finance PLC - securitised notes*	18,000	18,000	92,000	92,000	-	-
LB Finance PLC - securitised notes trust 19*	686,000	686,000	700,000	700,000	-	-
People's Leasing Co. Ltd. - securitised notes trust 71*	581,232	581,232	730,000	730,000	-	-
People's Leasing Co. Ltd. - securitised notes trust 65*	345,700	345,700	365,400	365,400	365,400	365,400
Singer Sri Lanka PLC Debentures*	389,778	389,778	150,000	150,000	270,000	270,000
Total Other Long Term Investments - Bank	2,509,710	2,509,710	2,526,400	2,526,400	1,124,400	1,124,400

*Rs 411 Mn out of these investments will be redeemed in 2013.

Notes to the Financial Statements

30 FINANCIAL INVESTMENTS - LOANS AND RECEIVABLES (Contd.)

30 (e) Unquoted Debentures Held by Subsidiaries

As at	31.12.2012		31.12.2011		01.01.2011	
	No of Debentures	Cost of Investment Rs 000	No of Debentures	Cost of Investment Rs 000	No of Debentures	Cost of Investment Rs 000
Abans (Pvt) Ltd	100,000	101,068	75,000	75,227	-	-
People's Leasing Co. Ltd	750,000	75,000	750,000	79,400	-	-
National Development Bank PLC	40,000	41,234	40,000	40,013	-	-
Seylan Bank PLC (Rs 100/- each)	-	-	-	-	150,000	15,228
Senkadagala Finance Co. Ltd (Rs 1000/-each)	-	-	40,000	40,135	40,000	40,136
DSI Holdings Ltd (Rs 1000/-each)	-	-	16,500	16,500	30,000	25,500
Ceylon Hospital PLC (Rs 10/- each)	-	-	-	-	-	-
Neluwa Cascade Hydro Power (Private) Limited	-	-	-	-	-	-
Singer (Sri Lanka) PLC	490,000	50,248	-	-	-	-
Sampath Leasing and Factoring Limited	385,000	72,510	-	-	-	-
Total Unquoted Debentures held by Subsidiaries		340,060		251,275		80,864

30 (f) Quoted Debentures Held by Subsidiaries

As at	31.12.2012		31.12.2011		01.01.2011	
	No of Debentures	Cost of Investment Rs 000	No of Debentures	Cost of Investment Rs 000	No of Debentures	Cost of Investment Rs 000
DFCC Bank (Rs 1000/- each)	5,000	5,698	5,000	5,694	10,000	10,976
Lanka Orix Leasing Company PLC	750,000	79,475	750,000	78,619	-	-
Merchant Bank of Sri Lanka PLC	675,000	71,515	675,000	68,482	-	-
National Development Bank PLC	-	-	-	-	-	-
Seylan Bank PLC (Rs 100/- each)	-	-	100,000	10,982	100,000	10,982
Sampath Bank PLC (Rs 100/- each)	283,100	29,334	250,000	25,535	250,000	25,594
Singer (Sri Lanka) PLC (Rs 100/- each)	302,170	30,217	240,000	24,708	240,000	24,726
Bank of Ceylon (Rs 100/- each)	1,800,000	183,039	700,000	71,724	550,000	56,337
Nations Trust Bank PLC (Rs 1000/- each)	17,000	18,764	17,000	18,759	17,000	18,759
Urban Development Authority (Rs 100/- each)	1,124,199	115,401	1,124,199	115,368	1,124,199	115,368
Total Quoted Debentures held by Subsidiaries		533,443		419,871		262,742

30 FINANCIAL INVESTMENTS - LOANS AND RECEIVABLES (Contd.)

30 (g) Unquoted Units in Unit Trusts Held by Subsidiaries

As at	31.12.2012 No of Debentures	31.12.2012 Cost of Investment Rs 000	31.12.2011 No of Debentures	31.12.2011 Cost of Investment Rs 000	01.01.2011 No of Debentures	01.01.2011 Cost of Investment Rs 000
Namal Giltedge Funds	-	-	1,000,000	10,000	1,000,000	10,000
Cey Bank	-	-	1,500,000	15,000	1,500,000	15,000
Total Unquoted Units - Subsidiaries				25,000		25,000

31 INVESTMENTS IN ASSOCIATES

31 (a) Bank

As at	Principal Activity	31.12.2012 % Holding	31.12.2012 Cost of Investment Rs 000	31.12.2012 Directors' Valuation Rs 000	31.12.2011 % Holding	31.12.2011 Cost of Investment Rs 000	31.12.2011 Directors' Valuation Rs 000	01.01.2011 % Holding	01.01.2011 Cost of Investment Rs 000	01.01.2011 Directors' Valuation Rs 000
Unquoted										
Browns Engineering (Pvt) Ltd (2,056,000 ordinary shares)	Engineering	-	-	-	-	-	-	32.64	20,560	-
Delma Exchange (simple limited partnership)	Dealing in foreign exchange	-	-	-	20.00	83,674	83,674	20.00	83,651	83,651
Impairment provision			-			-			(20,560)	
Total for the Bank			-			83,674			83,651	

Delma Exchange

Investment in Delma Exchange was disposed during the year and the gain on disposal is disclosed in Note 13 Other operating income.

Browns Engineering (Pvt) Ltd

Investment in Browns Engineering (Pvt) Ltd was written off against the provision during the year 2011.

Notes to the Financial Statements

31 INVESTMENTS IN ASSOCIATES (Contd.)

31 (b) Group

As at	Quoted Investments 31.12.2012 Rs 000	Quoted Investments 31.12.2011 Rs 000	Quoted Investments 01.01.2011 Rs 000	Unquoted Investments 31.12.2012 Rs 000	Unquoted Investments 31.12.2011 Rs 000	Unquoted Investments 01.01.2011 Rs 000	Total 31.12.2012 Rs 000	Total 31.12.2011 Rs 000	Total 01.01.2011 Rs 000
Investment in Associate companies (at cost)	-	-	132,326	391,955	192,271	71,730	391,955	192,271	204,056
Investment in Associate company through Joint Venture	-	-	-	-	-	59,870	-	-	59,870
Additional investment in Associate company by the Bank	-	-	-	-	23	12,171	-	23	12,171
Additional investment in Associate company held by Subsidiary	-	-	-	-	7,661	-	-	7,661	-
Additional investment in Associate company held through Joint Venture	-	-	-	20,000	192,000	48,500	20,000	192,000	48,500
Negative goodwill on acquisition recognised in Income Statement	-	-	5,830	5,629	5,629	3,416	5,629	5,629	9,246
Group share of Associate company	-	-	14,206	(16,422)	(693)	(4,648)	(16,422)	(693)	9,558
Current year's share of profits / (loss) after tax	-	-	(6,384)	16,632	(15,729)	3,955	16,632	(15,729)	(2,429)
Exchange effect on revaluation of investment	-	-	-	5,996	3,157	1,015	5,996	3,157	1,015
Disposal of Associate company	-	-	(145,978)	(37,618)	-	-	(37,618)	-	(145,978)
Group Investment in Associate companies (equity basis)	-	-	-	386,172	384,319	196,009	386,172	384,319	196,009

Splendor Media (Pvt) Ltd (Splendor Media)

The Bank's fully owned Subsidiary Sithma Development (Pvt) Ltd (Sithma) increased its holding in Splendor Media from 25% as at 31st December 2010 to 49.99% during 2011. Accordingly Splendor Media continues to be accounted for as an Associate of Sithma.

Associates through the Joint Venture reported above represent only 50% of the total investment in Associate, being the shareholding of the Bank on the same.

The Board of Directors carried out an internal assessment of impairment as at 31st December 2012 and concluded that there was no indication of impairment of these investment.

31 (c) Summarised Financial Information of Associates

31 (c) i Associates Held by the Bank

Delma Exchange

As at	31.12.2012 Rs 000	31.12.2011 Rs 000	01.01.2011 Rs 000
Revenue	83,964	50,014	17,670
Expenses	(138,993)	(147,771)	(97,057)
Tax	-	-	-
Loss after tax	(55,029)	(97,757)	(79,387)
Current assets	-	224,644	257,615
Non-current assets	-	47,422	45,568
Total assets	-	272,066	303,183
Current liabilities	-	60,204	2,683
Non-current liabilities	-	4,187	2,993
Total liabilities	-	64,391	5,676

*This associate was disposed on 17th December 2012.

31 INVESTMENTS IN ASSOCIATES (Contd.)

31 (c) Summarised Financial Information of Associates (Contd.)

31 (c) ii Associate Held by Subsidiary - Sithma Development (Pvt) Ltd

Splendor Media (Pvt) Ltd

As at	31.12.2012 Rs 000	31.12.2011 Rs 000	01.01.2011 Rs 000
Revenue	144,964	90,778	81,525
Expenses	(142,198)	(83,520)	(68,767)
Tax	(1,145)	(1,072)	(7,472)
Profit after tax	1,621	6,186	5,286
Current assets	111,480	102,924	115,195
Non-current assets	3,526	4,344	1,728
Total assets	115,006	107,268	116,923
Current liabilities	65,925	59,648	75,851
Non-current liabilities	1,397	1,096	483
Total liabilities	67,322	60,744	76,334

31 (c) iii Associates Held through Joint Venture - Acuity Partners (Pvt) Ltd

		Unit Energy Lanka (Pvt) Ltd			Hayleys Hydro Energy (Pvt) Ltd		Pavan Danavi (Pvt) Ltd*
As at	31.12.2012 Rs 000	31.12.2011 Rs 000	01.01.2011 Rs 000	31.12.2012 Rs 000	31.12.2011 Rs 000	01.01.2011 Rs 000	31.12.2012 Rs 000
Revenue	87,085	101,462	160,867	68,508	-	-	104,996
Expenses	(71,963)	(76,256)	(96,645)	(53,318)	(393)	(93)	(21,377)
Tax	(4,883)	(4,663)	(4,257)	(6,929)	-	-	(24,364)
Profit / (loss) after tax	10,239	20,543	59,965	8,261	(393)	(93)	59,255
Current assets	29,485	28,232	76,336	34,812	-	26	140,618
Non-current assets	451,792	469,744	487,697	475,335	119,100	119,100	2,650,748
Total assets	481,277	497,976	564,033	510,147	119,100	119,126	2,791,366
Current liabilities	91,037	20,807	32,886	65,729	1,212	844	334,632
Non-current liabilities	137,082	234,250	284,553	229,308	-	-	1,320,670
Total liabilities	228,119	255,057	317,439	295,037	1,212	844	1,655,302

The above companies are Associates of Lanka Ventures PLC which is a Subsidiary of Acuity Partners (Pvt) Ltd.

*This company commenced commercial operations in 2012.

31 (d) Movement in impairment provision during the year

	Bank		Group	
	2012 Rs 000	2011 Rs 000	2012 Rs 000	2011 Rs 000
Opening balance	-	20,560	-	-
Write off against the investment	-	(20,560)	-	-
Closing balance	-	-	-	-

Notes to the Financial Statements

32 INVESTMENT IN JOINT VENTURE

Bank

As at	Principal Activity	31.12.2012 % Holding	31.12.2012 Cost of Investment Rs 000	31.12.2012 Directors' Valuation Rs 000	31.12.2011 % Holding	31.12.2011 Cost of Investment Rs 000	31.12.2011 Directors' Valuation Rs 000	01.01.2011 % Holding	01.01.2011 Cost of Investment Rs 000	01.01.2011 Directors' Valuation Rs 000
Unquoted										
Acuity Partners (Pvt) Ltd	Investment banking	50.00	655,000	655,000	50.00	655,000	655,000	50.00	655,000	655,000
Total for the Bank			655,000	655,000		655,000	655,000		655,000	655,000

Bank's interest in Acuity Partners (Pvt) Ltd include:

	2012 Rs 000	2011 Rs 000	2010 Rs 000
Assets	3,353,510	3,327,626	3,031,399
Liabilities	2,118,402	2,268,998	2,054,071
Income	200,473	399,628	484,785
Expenses	163,646	211,062	225,641
Tax	11,258	25,694	69,569

Acuity Partners (Pvt) Ltd, the Joint Venture of the Bank entered into a Joint Venture "Guardian Acuity Asset Management Ltd" on 17th June 2011.

33 INVESTMENTS IN SUBSIDIARIES

33 (a) Quoted

As at	Principal Activity	31.12.2012 % Holding	31.12.2012 Cost of Investment Rs 000	31.12.2012 Market Value Rs 000	31.12.2011 % Holding	31.12.2011 Cost of Investment Rs 000	31.12.2011 Market Value Rs 000	01.01.2011 % Holding	01.01.2011 Cost of Investment Rs 000	01.01.2011 Market Value Rs 000
HNB Assurance PLC										
(29,993,000 shares) *	Insurance	60.00	384,285	1,469,657	60.00	384,285	1,709,601	60.00	149,965	1,754,591
Total Quoted			384,285			384,285			149,965	

*The Bank subscribed for the rights issue of HNB Assurance PLC during 2011. As a result the number of shares held by the Bank in HNB Assurance PLC increase from 22,494,750 to 29,993,000.

33 (b) Unquoted

As at	Principal Activity	31.12.2012 % Holding	31.12.2012 Cost of Investment Rs 000	31.12.2012 Directors' Valuation Rs 000	31.12.2011 % Holding	31.12.2011 Cost of Investment Rs 000	31.12.2011 Directors' Valuation Rs 000	01.01.2011 % Holding	01.01.2011 Cost of Investment Rs 000	01.01.2011 Directors' Valuation Rs 000
Sithma Development (Pvt) Ltd (206,000,000 ordinary shares)	Property development	100.00	1,973,000	1,973,000	100.00	1,973,000	1,973,000	100.00	1,973,000	1,973,000
Majan Exchange LLC (200,000 shares)	Dealing in foreign exchange	40.00	56,121	-	40.00	56,121	-	40.00	56,121	56,121
Commercial Interlink Services Inc (o/a Delma Exchange Canada) (100,001 shares)	Dealing in foreign exchange	-	-	-	100.00	10,063	-	100.00	10,063	-
Impairment provision			(56,121)			(66,184)			(10,063)	
Total Unquoted			1,973,000			1,973,000			2,029,121	
Total for the Bank [33 (a) and 33 (b)]			2,357,285			2,357,285			2,179,086	

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.

The Bank's investment in Majan Exchange LLC of Rs 56.121 Mn was fully provided for in 2011 in view of the continuous losses incurred by the subsidiary.

Bank's investment in Commercial Interlink Services Inc (o/a of Delma Exchange Canada) was written off against the provision during the year.

33 INVESTMENTS IN SUBSIDIARIES (Contd.)

33 (c) Movement in impairment during the year

	Bank		Group	
	2012 Rs 000	2011 Rs 000	2012 Rs 000	2011 Rs 000
Balance as at 1st January	66,184	10,063	-	-
Charge to income statement	-	56,121	-	-
Write off against the investment	(10,063)	-	-	-
Balance as at 31st December	56,121	66,184	-	-

34 INVESTMENT PROPERTIES

	Bank			Group		
As at	31.12.2012 Rs 000	31.12.2011 Rs 000	01.01.2011 Rs 000	31.12.2012 Rs 000	31.12.2011 Rs 000	01.01.2011 Rs 000
Cost						
Opening Balance	377,145	376,750	369,503	248,746	248,746	243,250
Improvements	5,085	395	7,247	139	-	5,496
Closing Balance	382,230	377,145	376,750	248,885	248,746	248,746
Accumulated depreciation						
Opening Balance	27,771	23,187	18,743	79,718	75,151	70,695
Charge for the year	4,751	4,584	4,444	4,569	4,566	4,456
Closing Balance	32,522	27,771	23,187	84,287	79,717	75,151
Net book value as at	349,708	349,374	353,563	164,598	169,029	173,595

34 (a) Valuation of Investment Properties - Bank

			Cost / Carrying Amount			Fair Value		
As at 31st December 2012	Building sq.ft	Extent Perches	Land (Cost) Rs 000	Building (Net Book Value) Rs 000	Total Rs 000	Land Rs 000	Building Rs 000	Total Rs 000
23 & 23 1/1, Independence Avenue, Colombo 7	10,470	105	37,081	40,744	77,825	525,000	45,000	570,000
479 T B Jayah Mawatha, Colombo 10 *	Land	112.96	75,783	-	75,783	82,700	-	82,700
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 **	57,917	40	72,000	89,211	161,211	200,000	262,000	462,000
			219,753	129,955	349,708	847,630	307,000	1,154,630

Notes to the Financial Statements

34 INVESTMENT PROPERTIES (Contd.)

34 (b) Valuation of Investment Properties - Group

As at 31st December 2012	Building sq.ft	Extent Perches	Cost / Carrying Amount Land (Cost) Rs 000	Building (Net Book Value) Rs 000	Total Rs 000	Fair Value Land Rs 000	Building Rs 000	Total Rs 000
23 & 23 1/1, Independence Avenue, Colombo 7	10,800	105	37,084	40,744	77,828	525,000	45,000	570,000
Smart building, 21, 21A, 23 & 25, Janadhipathi Mawatha, Colombo 1	41,688	-	-	86,770	86,770	-	208,450	208,450
			37,084	127,514	164,598	525,000	253,450	778,450

The Bank carries investment properties at cost. Market valuations of the above investment properties were carried out as at 31st December 2012 by Messrs J M J Fernando, FIV, DIV (Sri Lanka) and K T D Tissera, FIV,FRICS (Eng), who are independent valuers not connected with the Bank.

Since the fair values of the investment properties were above the carrying value, the Board of Directors concluded that there was no impairment in investment properties.

* 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 Statement of Financial Position of the Bank. However, according to Sri Lanka Accounting Standard (LKAS 40) “Investment Property”, the said lands are treated as property, plant and equipment in the Consolidated Statement of Financial Position, since these are leased to a Group entity.

** 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 Statement of Financial Position of the Bank. However, according to Sri Lanka Accounting Standard (LKAS 40) “Investment Property”, the said building is treated as property, plant and equipment in the Consolidated Statement of Financial Position, since Group uses a significant portion of the building for use in the production or supply of goods and services.

35 PROPERTY, PLANT AND EQUIPMENT

Bank	Leasehold Buildings Note 35 (b) Rs 000	Freehold Land and Buildings Note 35 (a) Rs 000	Computer Equipment Rs 000	Equipment Furniture and Fixtures Rs 000	Motor Vehicles Rs 000	Capital Work-in Progress Rs 000	2012 Total Rs 000	2011 Total Rs 000
Cost / valuation								
as at 1st January	1,398,905	5,402,863	2,447,399	3,270,264	233,256	140,456	12,893,143	11,898,903
Revauation adjustment on accumulated depreciation	-	(267,947)	-	-	-	-	(267,947)	-
Revaluation surplus	-	1,597,923	-	-	-	-	1,597,923	-
Net impairment charge	-	(70,411)	-	-	-	-	(70,411)	-
Additions and improvements	41,398	51,756	193,881	273,757	17,960	293,644	872,396	1,210,302
Disposals during the year	(21,174)	(18,359)	(57,202)	(95,962)	(10,801)	-	(203,498)	(216,062)
Sub category transfers during the year	(33,676)	27,141	-	6,535	-	-	-	-
Transferred from capital work-in-progress	32,141	124,783	-	59,997	-	(216,921)	-	-
Cost / valuation as at 31st December	1,417,594	6,847,749	2,584,078	3,514,591	240,415	217,179	14,821,606	12,893,143
Accumulated depreciation as at 1st January	833,815	213,608	1,676,560	2,190,715	143,581	-	5,058,279	4,471,383
Revaluation adjustment on accumulated depreciation	-	(267,947)	-	-	-	-	(267,947)	-
Charge for the year	138,309	55,794	252,003	314,535	34,994	-	795,635	737,628
Sub category transfers during the Year	(4,625)	4,507	(2)	120	-	-	-	-
Disposals during the year	(19,451)	(1,284)	(56,945)	(94,082)	(10,514)	-	(182,276)	(150,734)
Accumulated depreciation as at 31st December	948,048	4,678	1,871,616	2,411,288	168,061	-	5,403,691	5,058,277
Net book value as at 31st December 2012	469,546	6,843,071	712,462	1,103,303	72,354	217,179	9,417,915	-
Net book value as at 31st December 2011	565,090	5,189,255	770,839	1,079,549	89,675	140,456	-	7,834,866

There were no capitalised borrowing costs related to the acquisition of property, plant and equipment during the year.

Notes to the Financial Statements

35 PROPERTY, PLANT AND EQUIPMENT (Contd.)

Group	Leasehold Buildings Note 34 (b) Rs 000	Freehold Land and Buildings Rs 000	Computer Equipment Rs 000	Equipment Furniture and Fixtures Rs 000	Civil Works Rs 000	Motor Vehicles Rs 000	Capital Work-in Progress Rs 000	2012 Total Rs 000	2011 Total Rs 000
Cost / valuation as at 1st January without exchange effect	1,418,959	11,443,112	2,600,999	5,495,691	6,610	256,452	140,779	21,362,602	20,333,437
Effect of movements in exchange rates	-	-	35	60	100	-	-	195	155
Cost / Valuation as at 1st January	1,418,959	11,443,112	2,601,034	5,495,751	6,710	256,452	140,779	21,362,797	20,333,592
Revaluation adjustment on accumulated depreciation	-	(597,385)	-	-	-	-	-	(597,385)	-
Revaluation surplus	-	2,530,099	-	-	-	-	-	2,530,099	-
Net impairment charge	-	(70,411)	-	-	-	-	-	(70,411)	-
Adjustment on accumulated Depreciation for changing remaining useful life	-	-	-	(110,310)	-	-	-	(110,310)	-
Additions and improvements	41,587	61,974	213,600	297,176	-	17,960	293,644	925,940	1,260,080
Disposals during the year	(21,174)	(18,359)	(61,478)	(99,696)	-	(12,664)	-	(213,370)	(231,528)
Written off during the year			(781)	(122)	-	-	-	(903)	-
Sub category transfers during the year	(33,676)	27,141	-	6,535	-	-	-	-	-
Transferred from capital work-in-progress	32,141	124,783	-	59,997	-	-	(216,921)	-	-
Effect of movements in exchange rates	-	-	1,346	560	810	-	-	2,716	653
Cost / Valuation as at 31st December	1,437,837	13,500,954	2,753,721	5,649,891	7,520	261,749	217,502	23,829,173	21,362,797
Accumulated depreciation as at 1st January without exchange effect	845,740	535,076	1,760,166	2,651,212	1,586	153,303	-	5,947,083	5,217,852
Effect of movements in exchange rates	-	-	34	21	24	-	-	79	(21)
Accumulated depreciation as at 1st January	845,740	535,076	1,760,200	2,651,233	1,610	153,303	-	5,947,162	5,217,831
Revaluation adjustment on accumulated depreciation	-	(597,385)	-	-	-	-	-	(597,385)	-
Adjustment on accumulated Depreciation for changing remaining useful life	-	-	-	(110,310)	-	-	-	(110,310)	-
Charge for the year	143,060	115,758	271,535	392,955	783	41,540	-	965,630	889,860
Sub category transfers during the year	(4,625)	4,507	(2)	120	-	-	-	-	-
Disposals during the year	(19,451)	(1,284)	(60,965)	(97,259)	-	(12,377)	-	(191,335)	(160,785)
Written off during the year	-	-	(781)	(122)	-	-	-	(903)	-
Effect of movements in exchange rates	-	-	490	221	189	-	-	900	256
Accumulated Depreciation as at 31st December	964,724	56,672	1,970,477	2,836,838	2,582	182,466	-	6,013,759	5,947,162
Net book value as at 31st December 2012	473,113	13,444,282	783,244	2,813,053	4,938	79,283	217,502	17,815,411	-
Net book value as at 31st December 2011	573,219	10,908,036	840,834	2,844,518	5,100	103,149	140,779	-	15,415,636

As set out in Note 4.12.4, the Bank / Group had revalued its freehold land and buildings as at 1st December 2012, 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 1,597.9 Mn / Rs 2,530.1 Mn had been credited to the revaluation reserve account in respect of Bank / Group respectively in 2012. Net impairment loss of Rs 70.4 Mn was recognised in 2012 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 2012, no provision was required to be made in the Financial Statements as at reporting date other than those disclosed above.

35 PROPERTY, PLANT AND EQUIPMENT (Contd.)

35 (a) Freehold Land and Buildings - Bank

As at 31st December 2012

	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 2012 Rs 000	Net Book Value 2011 Rs 000
14, Main Street, Akkaraipattu.	9,097	17.00	23,000	25,000	48,000	25	47,975	35,482
94/1, New Galle Road, Ambalangoda.	5,081	29.90	65,000	15,000	80,000	17	79,983	43,182
30, Maithripala Senanayake Mawatha, Anuradhapura.	9,505	58.99	65,114	24,886	90,000	33	89,967	60,651
15, 15 1/1, Udayaraja Mawatha, Badulla.	5,680	27.75	35,000	11,700	46,700	16	46,684	37,935
24, Maharagama Road, Boralesgamuwa.	5,107	30.34	60,600	29,400	90,000	32	89,968	47,062
16, Janadhipathi Mawatha, Colombo 1.	44,807	84.00	168,000	126,400	294,400	164	294,236	324,908
285, Galle Road, Colombo 04.	16,170	20.00	150,000	70,000	220,000	91	219,909	171,916
100 & 102, Galle Road, Colombo 06.	16,082	36.05	180,250	110,250	290,500	105	290,395	194,640
53/1, D S Senanayake Mawatha, Colombo 08.	10,102	28.00	119,000	89,000	208,000	95	207,905	144,614
90, Vinayalankara Mawatha, Colombo 10.	10,250	249.00	996,000	37,584	1,033,584	34	1,033,550	1,030,412
168, Panchikawatta Road, Colombo 10.	16,366	22.55	78,900	83,700	162,600	84	162,516	130,341
60, Sea Street Colombo 11.	9,608	6.93	55,440	42,039	97,479	55	97,424	70,786
88, Main Street, Colombo 11.	3,708	-	-	53,000	53,000	53	52,947	63,730
149-151, Main Street, Colombo 11.	11,460	13.03	130,000	70,000	200,000	91	199,909	124,852
11, Mohandiram's Road, Colombo 12.	7,377	42.57	96,800	23,600	120,400	31	120,369	125,011
182, St Joseph Street, Colombo 14.	11,221	24.00	66,000	71,000	137,000	78	136,922	56,535
700/B, Anuradhapura Road, Dambulla.	7,456	94.50	80,325	20,275	100,600	22	100,578	56,969
3, Wakwella Road, Galle.	7,035	13.80	41,000	19,000	60,000	25	59,975	60,372
148, Colombo Road, Gampaha.	16,779	25.00	50,000	158,200	208,200	206	207,994	134,441
12, Kandy Road, Gampola.	6,190	11.88	21,384	9,616	31,000	13	30,987	24,830

Notes to the Financial Statements

35 PROPERTY, PLANT AND EQUIPMENT (Contd.)

35 (a) Freehold Land and Buildings - Bank (Contd.)

As at 31st December 2012

	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 2012 Rs 000	Net Book Value 2011 Rs 000
142, Kandy Road, Gampola	12,130	17.05	34,000	78,061	112,061	822	111,239	28,028
Bank House -No 295/6,Dimbula Road, Hatton	4,113	53.80	16,140	5,860	22,000	8	21,992	1,605
Cottage-78, Dimbulla Road, Hatton.	2,114	42.20	13,752	2,748	16,500	4	16,496	6,034
No 88,90 &90A, Dimbula Road,Hatton	6,028	15.68	28,208	9,792	38,000	12	37,988	40,000
16, Mount Road Hatton	5,088	160.00	24,000	6,000	30,000	8	29,992	22,991
73,Old Negombo Road,Kanuwana Ja-Ela	5,017	19.00	33,200	21,800	55,000	23	54,977	22,852
212,214 Hospital Road Jaffna.	Under Construction	62.36	276,000	-	276,000	-	276,000	48,863
772 A, Main Street, Kahawatte.	10,554	16.14	16,000	25,763	41,763	45	41,718	50,650
30A, Batticaloa Road Kalmunai.	7,000	25.10	19,800	46774	66,574	682	65,892	19,779
1, Dalada Veediya, Kandy.	29,196	57.65	490,025	147,975	638,000	191	637,809	657,570
451, Kandy Road Kegalle.	Bare Land	58.70	27,500	-	27,500	-	27,500	15,600
225, Main Street, Kuliyapitiya.	3,815	32.80	37,440	10,560	48,000	13	47,987	33,185
6, St. Anne's Street, Kurunegala.	17,970	36.25	119,063	84,937	204,000	110	203,890	107,870
68, Main Street, Mannar.	5,680	23.00	20300	17,960	38,260	17	38,243	15,564
534, Colombo Road, Marawila.	7,286	43.80	32,850	27,250	60,100	35	60,065	34,545
7/11, New Town, Maskeliya.	7,382	20.32	6,072	20,428	26,500	26	26,474	34,689
58D, Esplanade Road, Matara.	9,580	26.00	39,000	31,000	70,000	40	69,960	52,932
41, Samarakkody Road Minuwangoda.	3,452	20.51	25,637	14,162	39,799	14	39,785	26,331
No 67/11,Kumaradola Road, Monaragala.	Bare Land	20.00	1,600	-	1,600	-	1,600	1,455
605, Galle Road, Mount Lavinia.	11,350	22.66	62,300	58,600	120,900	75	120,825	63,250

35 PROPERTY, PLANT AND EQUIPMENT (Contd.)

35 (a) Freehold Land and Buildings - Bank (Contd.)

As at 31st December 2012	Buildings Sq.ft.	Cost / Extent (perches)	Cost / Valuation of Land Rs 000	Valuation of Buildings Rs 000	Total Value Rs 000	Accumulated Depreciation Rs 000	Net Book Value 2012 Rs 000	Net Book Value 2011 Rs 000
92, Gampola Road, * Nawalapitiya.	-	-	-	-	-	-	-	12,284
18, Rajapakse Broadway, Negombo.	4,845	8.88	22,000	8,000	30,000	10	29,990	58,132
201, Colombo Road Negombo.	25,770	51.98	103,900	206,100	310,000	267	309,733	208,193
22, Kandy Road, Nittambuwa.	10,411	44.9	67,000	161,339	228,339	385	227,954	202,049
10, Puttalam Road, ** Nochchiyagama.	8,265	-	-	24,000	24,000	31	23,969	23,932
181, High Level Road, Nugegoda.	11,096	15.71	74,000	61,000	135,000	79	134,921	107,608
42, Queen Elizabeth Drive, Nuwara Eliya.	14,145	149.03	89,418	38,995	128,413	92	128,321	69,307
467, Main Street, Kaduruwela ** Polonnaruwa.	9,882	-	-	48,000	48,000	47	47,953	34,184
510, Nuwaraeliya Road, Pussellawa.	6,163	15.95	10,840	14,160	25,000	14	24,986	32,153
9 Senanayake Mw Ratnapura.	8,236	43.4	64,800	20,200	85,000	26	84,974	37,025
59, Ehamparam Road, Trincomalee.	9,156	31.75	47,625	32,376	80,001	33	79,968	43,221
43, Inner Circular Road, ** Vavuniya.	8,340	-	-	28,740	28,740	199	28,541	29,315
270, 270/1, Negombo Road, Wattala.	8,579	53	119,200	46,800	166,000	54	165,946	90,133
35, Nuwara Eliya Road, Welimada.	3,450	14.37	19,500	5,500	25,000	5	24,995	-
70, Kumaradasa Mawatha, Wellawaya.	6,560	30	12,110	18,126	30,236	41	30,195	19,257
Total freehold land and buildings			4,435,093	2,412,656	6,847,749	4,678	6,843,071	5,189,255

*Nawalapitiya Branch property was disposed in 2012.

**Building constructed on State Lands given on lease.

Notes to the Financial Statements

35 PROPERTY, PLANT AND EQUIPMENT (Contd.)

35 (b) Leasehold Buildings

As at	Bank				Group			
	31.12.2012			31.12.2011	31.12.2012			31.12.2011
	Cost of Buildings Rs 000	Accumulated Depreciation Rs 000	Net Book Value Rs 000	Net Book Value Rs 000	Cost of Buildings Rs 000	Accumulated Depreciation Rs 000	Net Book Value Rs 000	Net Book Value Rs 000
01 - 05 years	561,134	479,825	81,309	99,791	581,377	496,500	84,877	107,917
05 - 10 years	786,195	419,889	366,306	88,234	786,195	419,889	366,306	88,234
10 - 15 years	56,456	38,624	17,832	324,682	56,456	38,625	17,833	324,682
15 - 20 years	13,809	9,710	4,099	13,989	13,809	9,710	4,099	13,992
20 - 30 years	-	-	-	38,394	-	-	-	38,394
	1,417,594	948,048	469,546	565,090	1,437,837	964,724	473,113	573,219

35 (c) Fully Depreciated Property, Plant and Equipment - Bank

The initial cost of fully depreciated property, plant and equipment as at 31st December 2012, which are still in use as at reporting date is as follows.

As at	31.12.2012 Rs 000	31.12.2011 Rs 000
Motor vehicles	101,645	86,469
Leasehold building	353,105	286,834
Computer equipment	1,012,534	956,702
Equipment, furniture and fixtures	1,365,611	1,291,100
Intangible assets	624,313	609,964

35 (d) Temporarily Idle Property, Plant and Equipment - Bank

Two lands worth of Rs 29.100 Mn were idle as at 31st December 2012 (2011 : Rs 17.055 Mn) as these lands were not identified as available for immediate use. The Bank has identified plans to develop and sell these lands in the near future.

35 (e) Property, Plant and Equipment Retired from Active Use - Bank

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 2012 is Rs 0.282 Mn (2011 - Nil).

35 (f) Title Restriction on Property, Plant and Equipment - Bank / Group

There were no restrictions on the title of property, plant and equipments as at 31st December 2012.

35 (g) Property, Plant and Equipment Pledged as Security for Liabilities - Bank / Group

There were no items of property, plant and equipments pledged as securities for liabilities.

35 (h) Compensation from Third Parties for Items of Property, Plant and Equipment - Bank

Rs 5.9 Mn (2011 : Rs. 3.1 Mn) was received as compensation from third parties for items of property, plant and equipment that were impaired, lost or given up.

36 INTANGIBLE ASSETS

As at	Bank 31.12.2012 Rs 000	Bank 31.12.2011 Rs 000	Bank 01.01.2011 Rs 000	Group 31.12.2012 Rs 000	Group 31.12.2011 Rs 000	Group 01.01.2011 Rs 000
Cost						
Opening balance without exchange effect	1,614,977	1,469,575	1,399,071	1,798,083	1,645,230	1,470,140
Effect of movement in exchange rates	-	-	-	-	354	301
Opening balance	1,614,977	1,469,575	1,399,071	1,798,083	1,645,584	1,470,441
Additions and improvements during the year	181,982	145,402	70,504	208,214	155,408	102,426
Acquisitions of Subsidiaries by Joint Venture	-	-	-	-	-	2,475
Goodwill on acquisition through Joint Venture [Note 36 (a)]	-	-	-	-	-	70,188
Effect of movement in exchange rates	-	-	-	-	57	54
Disposals / write offs during the year	-	-	-	(919)	(2,966)	-
Closing balance	1,796,959	1,614,977	1,469,575	2,005,378	1,798,083	1,645,584
Accumulated amortisation						
Opening balance without exchange effect	1,065,474	892,560	723,799	1,127,309	942,590	760,385
Effect of movement in exchange rates	-	-	-	-	64	47
Opening balance	1,065,474	892,560	723,799	1,127,309	942,654	760,432
Amortisation for the year	175,314	172,914	168,761	189,099	185,624	179,997
Acquisition of Subsidiaries by Joint Venture	-	-	-	-	-	2,209
Effect of movement in exchange rates	-	-	-	-	6	15
Disposals / write offs during the year	-	-	-	(531)	(977)	-
Closing balance	1,240,788	1,065,474	892,560	1,315,877	1,127,307	942,653
Net book value as at	556,171	549,503	577,015	689,501	670,776	702,931

36 (a) Analysis of Intangible Assets

	Bank 31.12.2012 Rs 000	Bank 31.12.2011 Rs 000	Bank 01.01.2011 Rs 000	Group 31.12.2012 Rs 000	Group 31.12.2011 Rs 000	Group 01.01.2011 Rs 000
Computer Software	556,171	549,503	577,015	619,313	600,588	632,743
Goodwill [Note 36 (b)]	-	-	-	70,188	70,188	70,188
	556,171	549,503	577,015	689,501	670,776	702,931

As stated in Note 4.10.1 (b), all computer software costs incurred by the Bank / Group which are not integrally related to associated hardware have been classified as intangible assets.

There were no restrictions on the title of the intangible assets as at the reporting date. Further there were no items pledged as securities for liabilities.

36 (b) Goodwill

As at	Bank 31.12.2012 Rs 000	Bank 31.12.2011 Rs 000	Bank 01.01.2011 Rs 000	Group 31.12.2012 Rs 000	Group 31.12.2011 Rs 000	Group 01.01.2011 Rs 000
Opening balance	-	-	-	70,188	70,188	-
Goodwill recognised during the year	-	-	-	-	-	70,188
Closing balance	-	-	-	70,188	70,188	70,188

Goodwill was recognised during 2010 in respect of acquisition of Lanka Ventures PLC by the Joint Venture Acuity Partners (Pvt) Ltd. 50% of the goodwill created through this transaction has been recognised in Consolidated Financial Statements being the shareholding of the Bank in the Joint Venture.

Notes to the Financial Statements

37 OTHER ASSETS

As at	Bank 31.12.2012 Rs 000	Bank 31.12.2011 Rs 000	Bank 01.01.2011 Rs 000	Group 31.12.2012 Rs 000	Group 31.12.2011 Rs 000	Group 01.01.2011 Rs 000
Deposits, prepayments	5,611,526	4,922,541	4,407,385	5,187,829	4,501,137	4,154,843
Items in transit	3,237,945	3,037,183	2,540,450	3,237,945	3,037,183	2,540,450
VAT recoverable	1,379,435	1,598,932	1,109,223	1,379,456	1,601,378	1,109,518
Related party receivable - exchange houses *	-	-	11,937	-	-	-
Items held for use	52,152	137,709	141,023	52,152	137,709	141,023
Inventory - residential apartment complex **	-	-	-	162,990	557,710	941,055
Receivable from pension fund	513,748	-	-	513,748	-	-
Other debtors	1,297,391	436,930	423,349	2,145,836	1,147,193	1,018,822
	12,092,197	10,133,295	8,633,367	12,679,956	10,982,310	9,905,711

* Rs 18.885 Mn included under related party receivable from Commercial Interlink Services Inc (o/a Delma Exchange Canada) has been fully provided in 2010 while a further provision of Rs 4.767 Mn was made against the receivable from the said Subsidiary in 2011 which are reported in Note 15 - Operating Expenses.

Rs 13.896 Mn included under related party receivable from Majan Exchange LLC has been fully provided in 2011 and the provision has been reported in Note 15 - Operating Expenses.

** Rs 7.728 Mn has been charged as provision in the Consolidated Financial Statements for impairment of inventory - residential apartment complex held by the Subsidiary, Sithma Development (Pvt) Ltd in 2012.

38 DUE TO BANKS

As at	Bank 31.12.2012 Rs 000	Bank 31.12.2011 Rs 000	Bank 01.01.2011 Rs 000	Group 31.12.2012 Rs 000	Group 31.12.2011 Rs 000	Group 01.01.2011 Rs 000
Call and time deposits	530,000	-	-	530,000	-	-
Refinance borrowings	6,085,541	6,633,873	5,941,801	6,085,541	6,633,873	5,941,801
Foreign bank borrowings	15,012,146	8,177,847	4,478,359	15,012,146	8,177,847	4,478,359
Borrowings from local banks	8,773,293	5,073,716	1,019	8,773,293	5,073,716	1,019
	30,400,980	19,885,436	10,421,179	30,400,980	19,885,436	10,421,179

39 DERIVATIVE FINANCIAL INSTRUMENTS

	Bank 31.12.2012 Rs 000	Bank 31.12.2011 Rs 000	Bank 01.01.2011 Rs 000	Group 31.12.2012 Rs 000	Group 31.12.2011 Rs 000	Group 01.01.2011 Rs 000
Foreign exchange derivatives						
Currency swaps	1,240,783	308,441	36,543	1,240,783	308,441	36,543
Forward foreign exchange contracts	195,660	309,261	129,978	195,660	309,261	129,978
	1,436,443	617,702	166,521	1,436,443	617,702	166,521

40 DUE TO OTHER CUSTOMERS

As at	Bank 31.12.2012 Rs 000	Bank 31.12.2011 Rs 000	Bank 01.01.2011 Rs 000	Group 31.12.2012 Rs 000	Group 31.12.2011 Rs 000	Group 01.01.2011 Rs 000
Total amount due to other customers	341,423,986	291,356,578	239,033,783	340,847,606	290,911,558	238,838,573

40 (a) Product wise analysis of due to other customers

	Bank 31.12.2012	Bank 31.12.2011	Bank 01.01.2011	Group 31.12.2012	Group 31.12.2011	Group 01.01.2011
Current account deposits	23,390,690	21,771,048	25,008,108	23,073,949	21,648,708	24,928,389
Savings deposits	109,176,640	111,121,508	99,020,314	109,169,526	111,114,760	99,005,565
Time deposits	200,801,761	151,352,012	108,656,567	200,549,236	151,036,080	108,555,825
Certificates of deposit	8,054,895	7,112,010	6,348,794	8,054,895	7,112,010	6,348,794
	341,423,986	291,356,578	239,033,783	340,847,606	290,911,558	238,838,573

40 (b) Currency wise analysis of due to other customers

	Bank 31.12.2012	Bank 31.12.2011	Bank 01.01.2011	Group 31.12.2012	Group 31.12.2011	Group 01.01.2011
Sri Lankan rupee	280,644,472	243,138,771	196,671,010	280,191,283	242,799,572	196,558,408
United State Dollar	45,632,264	35,050,757	31,197,472	45,509,073	34,944,936	31,114,864
Great Britain Pound	4,313,126	3,839,231	3,755,676	4,313,126	3,839,231	3,755,676
Euro	5,815,462	4,981,406	4,039,456	5,815,462	4,981,406	4,039,456
Australian Dollar	4,254,395	3,534,034	2,625,534	4,254,395	3,534,034	2,625,534
Others	764,267	812,379	744,635	764,267	812,379	744,635
	341,423,986	291,356,578	239,033,783	340,847,606	290,911,558	238,838,573

41 DIVIDENDS PAYABLE

	Bank 31.12.2012	Bank 31.12.2011	Bank 01.01.2011	Group 31.12.2012	Group 31.12.2011	Group 01.01.2011
Balance as at 1st January	168,080	49,558	215,607	169,876	51,121	214,045
Final cash dividends declared in the prior year	1,166,032	1,310,975	1,179,807	1,217,078	1,350,180	1,209,965
Final scrip dividends declared in the prior year	116,603	-	-	116,603	-	-
Interim dividends declared during the year	595,870	582,560	338,570	595,870	582,560	338,570
Reversal of dividend declared in prior years	-	-	(175,712)	-	-	(175,712)
Dividends paid	(1,825,130)	(1,775,013)	(1,508,714)	(1,876,176)	(1,813,985)	(1,537,309)
Unclaimed balance of Subsidiary acquired by Joint Venture	-	-	-	-	-	1,561
Balance as at 31st December	221,455	168,080	49,558	223,251	169,876	51,120

41 (a) Proposed Final Dividend

The Directors recommend that a final cash dividend of Rs 7.00 per share (2011 : Rs 3.00 per share - cash and Rs 3.00 per share - scrip) on both voting and non-voting shares of the Bank, be paid for the financial year ended 31st December 2012.

Further this dividend is to be approved at the Annual General Meeting to be held on 28th March 2013. In accordance with Sri Lanka Accounting Standard (LKAS 10), "Events after the reporting period", this proposed final dividend has not been recognised as a liability as at 31st December 2012. 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 (2011 : Rs 1.50) was paid to the shareholders on 20th December 2012. Final dividends proposed for the year 2012 amounts to Rs 2,782.153 Mn (2011 : Rs 2,332.064 Mn).

41 (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 21st February 2013 has been audited by Messrs KPMG.

Notes to the Financial Statements

42 OTHER BORROWINGS

As at	Bank 31.12.2012 Rs 000	Bank 31.12.2011 Rs 000	Bank 01.01.2011 Rs 000	Group 31.12.2012 Rs 000	Group 31.12.2011 Rs 000	Group 01.01.2011 Rs 000
Securities sold under repurchase agreements	4,601,484	6,589,667	12,058,463	6,282,546	8,353,999	13,636,082
Refinance borrowings	343,025	411,504	493,664	343,025	411,504	493,664
Others	6,026	7,570	20,873	121,573	110,694	13,818
	4,950,535	7,008,741	12,573,000	6,747,144	8,876,197	14,143,564

43 DEBT SECURITIES ISSUED

	Face value Rs 000	Interest rate	Repayment terms	Issue date	Maturity date	Bank As at 31.12.2012 Rs 000	Bank As at 31.12.2011 Rs 000	Bank As at 01.01.2011 Rs 000	Group As at 31.12.2012 Rs 000	Group As at 31.12.2011 Rs 000	Group As at 01.01.2011 Rs 000
Issued through joint venture											
(i) Year of issuance 2012	30,000	AWPLR + 0.5%	6 Year	31st Dec 2012	30th Sep 2013	-	-	-	30,000	-	-
	30,000	AWPLR + 0.5%	6 Year	31st Dec 2012	30th Sep 2014	-	-	-	30,000	-	-
	30,000	AWPLR + 0.5%	6 Year	31st Dec 2012	30th Sep 2015	-	-	-	30,000	-	-
	30,000	AWPLR + 0.5%	6 Year	31st Dec 2012	30th Sep 2016	-	-	-	30,000	-	-
	30,000	AWPLR + 0.5%	6 Year	31st Dec 2012	30th Sep 2017	-	-	-	30,000	-	-
Total						-	-	-	150,000	-	-
Due within one year						-	-	-	30,000	-	-
Due after one year						-	-	-	120,000	-	-
Total						-	-	-	150,000	-	-

* Lanka Ventures PLC, a subsidiary of joint venture, Acuity Partners (Pvt) Ltd issued redeemable preference shares. Only 50% of the value is accounted for in the Consolidated Financial Statements.

44 SUBORDINATED DEBENTURES

	Face value Rs 000	Interest rate	Repayment terms	Issue date	Maturity date	Bank As at 31.12.2012 Rs 000	Bank As at 31.12.2011 Rs 000	Bank As at 01.01.2011 Rs 000	Group As at 31.12.2012 Rs 000	Group As at 31.12.2011 Rs 000	Group As at 01.01.2011 Rs 000
Issued by the Bank											
(i) Year of issuance 2002	112,594	14.20%	10 Year	11th Sep 2002	10th Sep 2012	-	118,814	118,638	-	118,814	118,638
	630	6 months net TB + 1.25%	10 Year	11th Sep 2002	10th Sep 2012	-	663	663	-	663	663
(ii) Year of issuance 2006	262,500	6 months net TB + 2.25%	6 Year	1st Apr 2006	31st Mar 2012	-	276,712	262,500	-	276,712	262,500
	250,000	6 months net TB + 2.25%	7 Year	1st Apr 2006	31st Mar 2013	250,000	263,535	250,000	250,000	263,535	250,000
	300,000	6 months net TB + 2.25%	8 Year	1st Apr 2006	31st Mar 2014	312,254	327,608	315,539	312,254	327,608	315,539
	217,658	11.00%	15 Year	1st Apr 2006	31st Mar 2021	217,658	196,088	176,656	202,463	169,244	151,147
	411,159	11.25%	18 Year	1st Apr 2006	31st Mar 2024	411,159	369,581	332,208	411,159	369,581	332,208
(iii) Year of issuance 2007	500,000	16.00%	10 Year	1st Aug 2007	31st Jul 2017	540,000	540,000	540,000	540,000	540,000	540,000
	700,000	16.75%	15 Year	1st Aug 2007	31st Jul 2022	758,625	758,625	758,625	758,625	758,625	758,625
(iv) Year of issuance 2008	89,704	1 year net TB + 1.00%	5 Year	5th Jun 2008	4th Jun 2013	95,872	93,454	94,314	88,510	86,432	87,228
(v) Year of issuance 2011	2,000,000	11.50%	10 Year	5th Sep 2011	4th Sep 2021	2,000,000	2,078,136	-	2,000,000	2,078,136	-
Total						4,585,568	5,023,216	2,849,143	4,563,011	4,989,350	2,816,548
Due within one year						250,000	396,189	381,801	250,000	396,189	381,801
Due after one year						4,335,568	4,627,027	2,467,342	4,313,011	4,593,161	2,434,747
Total						4,585,568	5,023,216	2,849,143	4,563,011	4,989,350	2,816,548

* Lanka Ventures PLC, a Subsidiary of Acuity Partners (Pvt) Ltd the Joint Venture holds Rs 13.5 Mn debentures of the Bank. 50% of this is recognised being the shareholding of the Bank in the Joint Venture.

HNB Assurance PLC, a Subsidiary of the Bank holds 75,000 debentures amounting to Rs 7.5 Mn.

45 INSURANCE PROVISION-LIFE

The insurance provision - life balance represents the life fund of the Subsidiary HNB Assurance PLC, which is carrying out life and general insurance business. This balance represents the amounts attributable to life policy holders included in the Group's net assets. The valuation of the insurance provision - life as at 31st December 2012 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 3,626.2 Mn as at 31st December 2012 (2011 : Rs 3,021.3 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 6th February 2013.

46 INSURANCE PROVISION - GENERAL

Insurance provision general represents the following which are included in the financial statements of HNB Assurance PLC, Subsidiary of the Bank, as required by the Statement of Recommended Practice of the Institute of Chartered Accountants of Sri Lanka and in accordance with the regulation of Insurance Industry Act No 43 of 2000.

		Group		Group		Group
As at	31.12.2012 Rs 000	31.12.2012 Rs 000	31.12.2011 Rs 000	31.12.2011 Rs 000	01.01.2011 Rs 000	01.01.2011 Rs 000
Unearned premium						
Gross		845,279		897,426		748,856
Reinsurance		(169,636)		(212,097)		(196,675)
Net		675,643		685,329		552,181
Deferred acquisition expenses		20,446		20,030		12,374
Unexpired risk reserve		80		179		267
		696,169		705,538		564,822
Claims outstanding - Gross	240,349		211,524		154,176	
Claims incurred but not reported - Gross	32,923	273,272	27,260	238,784	24,051	178,227
Total		969,441		944,322		743,049

47 DEFERRED TAX ASSETS/LIABILITIES

		Bank			Group	
As at	31.12.2012 Rs 000	31.12.2011 Rs 000	01.01.2011 Rs 000	31.12.2012 Rs 000	31.12.2011 Rs 000	01.01.2011 Rs 000
Deferred tax liabilities [Note 47 (a)]	1,478,341	1,174,862	890,602	1,556,312	1,225,349	960,016
Deferred tax assets [Note 47 (b)]	(369,726)	(313,785)	(506,348)	(372,193)	(318,895)	(508,534)
	1,108,615	861,077	384,254	1,184,119	906,454	451,482

47 (a) Deferred Tax Liabilities

47 (a) i Deferred Tax Liabilities on other Temporary Differences

	Bank				Group			
As at	31.12.2012		31.12.2011		31.12.2012		31.12.2011	
	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	4,195,941	1,174,862	3,180,727	890,602	4,197,156	1,175,204	3,183,139	891,279
Reversal of deferred tax liabilities attributable to revaluation surplus charged to equity	(9,050)	(2,534)	(15,682)	(4,391)	(9,050)	(2,534)	(15,682)	(4,391)
Deferred tax liability attributable to revaluation surplus charged to equity	483,357	135,339	-	-	483,357	135,339	-	-
Originating during the year	609,550	170,674	1,030,896	288,651	618,020	173,046	1,029,699	288,316
	5,279,798	1,478,341	4,195,941	1,174,862	5,289,483	1,481,055	4,197,156	1,175,204

Notes to the Financial Statements

47 DEFERRED TAX ASSETS/LIABILITIES (Contd.)

47 (a) ii Deferred Tax Liabilities on Undistributed Profits of Subsidiaries

	Bank				Group			
As at	31.12.2012		31.12.2011		31.12.2012		31.12.2011	
	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	-	-	-	-	501,450	50,145	687,370	68,737
Deferred tax liability attributable to undistributed profits of Subsidiaries	-	-	-	-	251,130	25,112	(185,920)	(18,592)
	-	-	-	-	752,580	75,257	501,450	50,145
		1,478,341		1,174,862		1,556,312		1,225,349

Deferred Tax Liability Charged Directly to Equity

According to Sri Lanka Accounting Standard (LKAS 12) "Income Taxes", deferred tax shall be charged or credited to equity through other comprehensive income 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 135.339 Mn have been charged to revaluation reserve through Other Comprehensive Income during the year (2007 : Rs 17,547 Mn). Reversals of Rs 2.534 Mn (2011 : Rs 4.091 Mn) have been credited to the revaluation reserve in the Statement of Changes in Equity from deferred tax liability. The reversal of deferred tax liability credited to revaluation reserve results from the excess depreciation resulting from the revaluation of property, plant and equipment that took place in 2007 and 2012.

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 18 (i).

47 (b) Deferred Tax Asset

	Bank				Group			
As at	31.12.2012		31.12.2011		31.12.2012		31.12.2011	
	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	1,120,660	313,785	1,808,385	506,348	1,138,911	318,895	1,816,193	508,534
Deferred tax asset recognised / (reversed) on deductible temporary differences	199,791	55,941	(687,725)	(192,563)	190,352	53,298	(677,282)	(189,639)
	1,320,451	369,726	1,120,660	313,785	1,329,263	372,193	1,138,911	318,895

Deferred tax asset of the Bank represents the income tax recoverable in future periods in respect of deductible temporary differences arising from cash settled share based payment transactions recognised as per SLFRS 2 "Share Based Payment".

48 OTHER LIABILITIES

As at	Bank 31.12.2012 Rs 000	Bank 31.12.2011 Rs 000	Bank 01.01.2011 Rs 000	Group 31.12.2012 Rs 000	Group 31.12.2011 Rs 000	Group 01.01.2011 Rs 000
Cheques sent on clearing	3,215,781	2,865,652	2,191,687	3,215,781	2,865,652	2,191,687
Items in transit	123,225	5,332	5,782	123,225	5,332	5,782
Margins	1,219,804	1,377,110	1,162,309	1,219,804	1,377,110	1,162,309
Refundable deposits and advances*	-	-	-	109,353	254,105	356,980
Balance held o/a of Pension Fund	237,474	1,245,519	2,207,605	237,474	1,245,519	2,207,605
Balance held o/a of Widows' / Widowers' and Orphans' Pension Fund (WW&OP)	16,878	20,792	41,047	16,878	20,792	41,047
Balance held o/a of Employees' Provident Fund (EPF)	105,143	43,235	110,365	105,143	43,235	110,365
Payable to pension fund	-	739,222	1,057,567	-	739,222	1,057,567
Liability for EPF interest guarantee [Note 48 (a)]	17,696	14,882	13,663	17,696	14,882	13,663
Liability for accumulated leave [Note 48 (b)]	109,174	110,601	103,358	109,174	110,601	103,358
Liability for cash settled share based payment [Note 48 (c)]	1,320,451	1,120,660	1,808,385	1,320,451	1,120,660	1,808,385
Provision for retiring benefits	-	-	-	56,119	46,434	33,777
Payable to vendors for lease equipments	144,605	414,884	640,469	144,605	414,884	640,469
Other creditors	1,392,555	1,069,264	1,315,898	1,938,578	1,665,728	2,253,951
	7,902,786	9,027,153	10,658,135	8,614,281	9,924,156	11,986,945

*Refundable deposits and advances include the advances taken from customers on account of the apartments in the Residential Apartments Complex which is developed by Sithma Development (Pvt) Ltd.

48 (a) Employee Provident Fund (EPF) Interest Rate Obligation

EPF is an approved provident fund which has been set up to meet the provident fund liabilities of the Bank. Staff members who are members of the fund are entitled to receive a minimum interest rate higher of one year fixed deposit rate of HNB or National Savings Bank on their balance on a semi annual basis. Accordingly this obligation was treated as a defined benefit liability and an actuarial valuation was conducted to value the Bank's obligation of the same with the following actuarial assumptions.

	31.12.2012
Discount rate as at	11.00%
Future salary increases	9.75%

48 (b) Liability for accumulated leave

Employees are entitled to accumulate annual leave upto a maximum of ninety days and such accumulated leave to be utilised prior to their retirement. This has been treated as other long term benefit in terms of LKAS 19 "Employee benefits" and an actuarial valuation has been conducted on the same with the following assumptions.

	31.12.2012
Discount rate as at	11.00%
Future salary increases	9.75%

48 (c) Liability for cash settled share based payments

In 2005 the Bank set up an Employee Share Benefit Trust for the benefit of the executive employees that entitle those employees to a cash payment. The amount of cash payment is determined based on the increase in the share price of the Bank between grant date and vesting date adjusted for interest and the related charges.

The benefits under Employee Share Benefit Trust are settled in cash.

	31.12.2012 Rs. 000	31.12.2011 Rs. 000	01.01.2011 Rs. 000
Total carrying amount of liabilities for cash-settled arrangements	1,320,451	1,120,660	1,808,385

The fair value of the liability under Employee Share Benefit Trust is determined using the Black-Scholes formula. The model inputs on the reporting dates are as follows.

	31.12.2012
Share price	Rs 112.50
Exercise price	Rs 0 - Rs 130.40
Expected volatility	30.20%
Expected dividends	30.00%
Term to maturity	2.10 Years
Risk-free interest rate	11.00%

The fair value of the liability is remeasured at each reporting date.

Notes to the Financial Statements

49 EMPLOYEE BENEFITS

49 (a) Pension Fund - Bank

An actuarial valuation of the Pension Fund was carried out as at 31st December 2012 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 (LKAS 19) "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.

49 (a) i Amounts Recognised in the Statement of Financial Position are as follows

As at	31.12.2012 Rs 000	31.12.2011 Rs 000	01.01.2011 Rs 000
Present value of unfunded obligation	-	-	-
Present value of funded obligation	9,469,694	9,315,060	8,415,678
Total present value of obligations	9,469,694	9,315,060	8,415,678
Fair value of plan assets	(10,063,990)	(8,575,838)	(7,358,111)
Present value of net obligations/(surplus)	(594,296)	739,222	1,057,567
Less: Unrecognised actuarial losses	-	-	-
Recognised liability/(asset) for defined benefit obligations	(594,296)	739,222	1,057,567

49 (a) ii Plan Assets Consist of the Following

As at	31.12.2012 Rs 000	31.12.2011 Rs 000	01.01.2011 Rs 000
Equity securities and debentures	825,211	322,549	402,302
Government bond	1,866,908	3,358,777	4,347,510
Balance with Hatton National Bank PLC	237,474	1,245,519	2,207,605
Fixed deposits	6,773,001	3,417,413	255,936
Others	361,396	231,580	144,758
	10,063,990	8,575,838	7,358,111

49 (a) iii Movement in the Present Value of Defined Benefit Obligations

	31.12.2012 Rs 000	31.12.2011 Rs 000	01.01.2011 Rs 000
Liability for defined benefit obligations as at	9,315,060	8,415,678	6,927,747
Actuarial (gains)/losses	(575,840)	45,996	741,662
Benefits paid by the plan	(557,391)	(394,418)	(373,470)
Current service cost and interest cost	1,287,865	1,247,804	1,119,739
Liability for defined benefit obligations as at	9,469,694	9,315,060	8,415,678

49 (a) iv Movement in Plan Assets

	31.12.2012 Rs 000	31.12.2011 Rs 000	01.01.2011 Rs 000
Fair value of plan assets as at	8,575,838	7,358,111	5,977,832
Contributions paid into plan	1,049,968	893,507	825,160
Benefits paid by the plan	(557,391)	(394,418)	(373,470)
Actuarial gains	11,654	80,866	408,190
Expected return on plan assets	983,921	637,772	520,399
Fair value of plan assets as at	10,063,990	8,575,838	7,358,111

49 EMPLOYEE BENEFITS (Contd.)

49 (a) v Actuarial Assumptions

As at	31.12.2012 %	31.12.2011 %	01.01.2011 %
Discount rate as at 31st December	10.50	9.50	9.75
Expected return on plan assets as at 1st January	9.87	8.33	8.38
Future salary increases	9.75	9.99	9.77
Future pension increases	Nil	Nil	Nil
Increase in cost of living allowance	10.00	5.00	10.00

The overall expected long term rate of return on assets is 9.87%.

The demographic assumptions underlying the valuation are retirement age (55 years), early withdrawals from service and retirement on medical grounds, death before and after retirement, etc.

49 (a) vi Historical Information

As at	31.12.2011 Rs 000	31.12.2010 Rs 000	31.12.2009 Rs 000	31.12.2008 Rs 000	31.12.2007 Rs 000
Present value of the defined benefit obligation	9,315,060	8,415,678	6,927,747	6,496,902	5,275,079
Fair value of plan assets	(8,575,838)	(7,358,111)	(5,977,832)	(4,338,509)	(3,857,705)
Deficit in the plan	739,222	1,057,567	949,915	2,158,393	1,417,374

49 (b) Widows', Widowers' and Orphans' Pension Fund

The results of the actuarial valuation of the Widows', Widowers' and Orphans' Pension Fund indicates that the actuarial present value of the promised benefit is Rs 292.92 Mn and that the fair value of the fund assets is Rs 745.04 Mn resulting in a past service surplus of Rs 452.11 Mn (2011 : Rs 317.2 Mn) in the Widows', Widowers' and Orphans' Pension Scheme as at 31st December 2012.

No contribution is made by the Bank and the members contribution during the period amounted to Rs 56 Mn.

50 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.

50 (a) Stated Capital

As at 31st December	2012		2011	
	Rs 000	Rs 000	Rs 000	Rs 000
Voting ordinary shares				
As at 1st January	9,143,326		3,854,980	
Issue of shares under ESOP	64,975		59,702	
Scrip dividend*	840,958		-	
Rights issue***	-		4,175,044	
Private placement****	-		1,053,600	
As at 31st December		10,049,259		9,143,326
Non-voting ordinary shares				
As at 1st January	2,308,125		1,463,570	
Issue of shares under ESOP	13,624		6,400	
Scrip dividend*	208,471		-	
Rights issue***	-		339,159	
Private placement****	-		498,996	
As at 31st December		2,530,220		2,308,125
Stated Capital as at 31st December		12,579,479		11,451,451

Notes to the Financial Statements

50 STATED CAPITAL (Contd.)

50 (b) Reconciliation of Number of Shares

As at 31st December	2012	2011
Voting ordinary shares		
As at 1st January	311,406,247	191,275,606
Issue of shares under ESOP	561,707	509,874
Scrip dividend*	5,682,148	-
Sub division of shares**	-	95,800,065
Rights issue***	-	19,020,702
Private placement****	-	4,800,000
As at 31st December	317,650,102	311,406,247
Non-voting ordinary shares		
As at 1st January	77,190,596	46,693,416
Issue of shares under ESOP	197,371	103,614
Scrip dividend*	2,208,380	-
Sub division of shares**	-	23,379,717
Rights issue***	-	2,838,149
Private placement****	-	4,175,700
As at 31st December	79,596,347	77,190,596

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.

*Pursuant to a resolution adopted by the shareholders of the Bank at the Annual General Meeting held on 30th March 2012 a scrip dividend was approved according to which a total of 7,890,528 new ordinary shares (comprising of 5,682,148 voting shares and 2,208,380 non-voting shares) were issued on 30th March 2012.

**Based on the resolution approved by the shareholders on the Annual General Meeting held on 31st March 2011 a sub division of shares took place on 5th April 2011 on the basis of one ordinary voting share for every existing two ordinary voting shares and one ordinary non-voting share for every existing two ordinary non-voting shares without making any changes to the Bank's Stated Capital.

***A resolution was approved by the shareholders at the Extra Ordinary General Meeting held on 1st July 2011 to issue 35,753,936 new ordinary shares comprising 28,740,020 shares (voting) and 7,013,916 shares (non-voting) by way of a rights issue on the basis of one ordinary voting share for every existing ten ordinary voting shares and one ordinary non-voting share for every existing ten ordinary non-voting shares (1:10) priced at Rs 219.50 per voting share and Rs 119.50 per non voting share. Based on shareholders' response, the Bank had issued 21,858,851 shares on 1st August 2011 comprising of 19,020,702 shares (voting) and 2,838,149 shares (non-voting).

****Further 8,975,700 shares were issued on 7th September 2011 by way of a private placement comprising of 4,800,000 shares (voting) and 4,175,700 shares (non-voting).

50 STATED CAPITAL (Contd.)

50 (c) Share-based payment transactions

On 28th March 2008 the Bank established an Employee Share Option Scheme that entitles employees in the rank of management and above to purchase shares in the Bank. On 20th April 2010 a further grant on similar terms (except for exercise price) was offered to these employee groups. In accordance with these programs, holders of vested options are entitled to purchase shares at the given exercise prices.

The recognition and measurement principles in SLFRS 2 “Share based payment” standard have not been applied to these grants based on the transitional provisions available in SLFRS 2 where by the standard is applied for share options granted after 1st January 2012 and have not yet vested on the effective date of SLFRS 2

The Bank made a further grant under the Employee Share Option Scheme on 30th March 2012, which is recognised and measured in terms of SLFRS 2

All options are to be settled by physical delivery of shares.

50 (c) i Employee Share Option Plan (Equity-settled share based payment scheme)

The number and weighted average exercise price of share options are as follows:

As at	31.12.2012		31.12.2011	
	Weighted average exercise price	Number of options	Weighted average exercise price	Number of options
Outstanding as at the beginning of the year	101.71	4,365,075	147.02	3,184,291
Granted during the year	133.01	4,818,863	-	-
Forfeited during the year	-	-	-	-
Exercised during the year	100.66	(926,656)	107.75	(613,488)
Expired during the year	-	-	-	-
Additional options due to share split, rights issue and scrip dividend	98.09	84,056	101.68	1,794,272
Outstanding as at 31st December	119.64	8,341,338	101.71	4,365,075
Exercisable as at 31st December	101.93	3,717,400	101.71	4,365,075

The options outstanding as at 31st December 2012 have an exercise price in the range of Rs. 35.07 to Rs. 145.79 (2011: Rs 35.07 to Rs 145.79) and a weighted average contractual life of 3.36 years (2011 : 3.25)

The weighted average share price at the date of exercise for share options exercised during the year ended 31st December 2012 was Rs 141.31 (2011: Rs 278.28).

The fair value of services received in return for share options granted is based on the fair value of share options granted, measured using a binomial lattice model, with the following inputs:

	Allocation 2012
Fair value of share options and assumptions	
Fair value at measurement date Rs. 000	176,515
Share price	Voting - Rs 153, Non voting - Rs 94.50
Exercise price	Voting - Rs 145.79, Non voting - Rs 81.43
Expected volatility*	Voting - 26%, Non voting - 30%
Option life (expected weighted average life)	5 Years
Expected dividends*	30.00%
Risk free interest rate (based on government bonds)	11.80%

* Annual rates

Notes to the Financial Statements

51 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.

51 (a) Capital Commitments

Capital expenditure approved by the Board of Directors for which provision has not been made in the accounts amounts to approximately Rs 477 Mn.

As at	Bank 31.12.2012 Rs 000	Bank 31.12.2011 Rs 000	Bank 01.01.2011 Rs 000	Group 31.12.2012 Rs 000	Group 31.12.2011 Rs 000	Group 01.01.2011 Rs 000
Approved and contracted for	357,263	641,514	297,780	357,263	669,014	495,780
Approved and not contracted for	119,893	104,427	49,163	119,893	104,427	49,163
	477,156	745,941	346,943	477,156	773,441	544,943

51 (b) Future Monthly Commitments on Operating Leases

As at	Bank 31.12.2012 Rs 000	Bank 31.12.2011 Rs 000	Bank 01.01.2011 Rs 000	Group 31.12.2012 Rs 000	Group 31.12.2011 Rs 000	Group 01.01.2011 Rs 000
0-1 year	1,576	1,959	-	29,131	28,381	17,721
1-5 years	75,765	63,114	61,631	112,287	89,707	71,982
6-10 years	11,957	10,507	7,233	13,093	11,124	7,233
11-15 years	799	828	304	799	828	304
16-20 years	15	15	15	15	15	15
	90,112	76,423	69,183	155,325	130,055	97,255

51 (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 46.53 Mn (2011 : Rs 48.46 Mn).

51 (d) Contingent Liabilities

As at	31.12.2012 Rs 000	31.12.2011 Rs 000	01.01.2011 Rs 000
Acceptances	7,568,098	6,715,619	6,487,793
Documentary credit	11,243,091	17,939,376	14,290,864
Guarantees	35,284,487	30,521,320	28,220,189
Bills for collection	5,800,704	7,140,247	5,842,576
Interest rate swap	-	105	394
	59,896,380	62,316,667	54,841,816
Forward exchange contracts	104,470,632	90,272,376	69,328,734
Total - Bank / Group	164,367,012	152,589,043	124,170,550

Contingent liabilities of Joint Venture as at 31st December 2012 was nil.

51 COMMITMENTS AND CONTINGENCIES - BANK AND GROUP (Contd.)

51 (e) Litigation against the Bank

The Bank confirms that there is no case (including the LT cases) filed against the Bank which is not disclosed which would have a material impact on the financial position of the Bank.

51 (f) Tax assessments against the Bank

The following tax assessments are outstanding, against which the Bank has duly appealed,

(1) VAT on financial services for 2003 and 2004, taxes amounting to Rs 207 Mn, on Assessment Nos. VATFS/06/0312/06, VATFS/U6/0401/01, VATFS/J6/0402/02, VATFS/U6/0403/03, VATFS/U6/0404/04 and VATFS/U6/0405/05. (Pursuant to the determination made by the Board of Review on the appeal made for VAT on financial Services, the Bank filed a case in the Court of Appeal - CA No.01/2010 – BRA/VAT- 06)

(2) PAYE taxes amounting to Rs 407 Mn on Assessments Nos.8018210, 8202714 & 8364152 for the years 2003, 2004 & 2005 respectively.

(3) VAT on financial services for 2010 taxes amounting to Rs 1,718.3 Mn, on Charge Nos. VATFS/BFSU/2013/377 to VATFS/BFSU/2013/388.

The Bank is of the view that the above assessments will not have any material impact on the Financial Statements.

52 RELATED PARTY DISCLOSURES

The Bank carries out transactions in the ordinary course of its business with parties who are defined as related parties in the Sri Lanka Financial Reporting Standard (LKAS 24) "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.

52 (a) Parent and Ultimate Controlling Party

The Bank does not have an identifiable parent of its own.

52 (b) Transactions with Key Management Personnel (KMP)

According to Sri Lanka Financial Reporting Standard (LKAS 24) "Related Party Disclosures", Key Management Personnel are those having authority and responsibility for planning, directing and controlling the activities of the entity. The Bank considered the members of its Corporate Management Team, Chief Accountant and Chief Manager-Operations as KMP with effect from 01st January 2012 since they have the authority and responsibility for planning, directing and controlling the activities of the Bank.

Accordingly, the Directors of the Bank (including executive and non-executive Directors), members of the Corporate Management, Chief Accountant, Chief Manager-Operations and their immediate family members have been classified as KMP of the Bank as at 31st December 2012.

Bank is the ultimate parent of its Subsidiaries listed out in Note 33. Thus the Board of Directors, the members of Corporate Management, Chief Accountant, Chief Manager- Operations have the authority and responsibility for planning, directing and controlling the activities of the Group. Accordingly the Board of Directors, members of Corporate Management, Chief Accountant, Chief Manager - Operations and their immediate family members have been identified as 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.

Immediate family member is defined as spouse or dependent. Dependent is defined as anyone who depends on the respective KMP for more than 50% of his / her financial needs.

Mr L U D Fernando, Mr D T S H Mudalige, Ms D S C Jayawardena & Mr R S Captain were appointed to the Board with effect from 02nd April 2012. Accordingly transactions with the Bank from the date of their appointment as Directors have been reported below.

Notes to the Financial Statements

52 RELATED PARTY DISCLOSURES (Contd.)

52 (b) Transactions with Key Management Personnel (KMP) (Contd.)

52 (b) i Compensation to KMP

	Bank		Group	
	2012 Rs' 000	2011 Rs' 000	2012 Rs' 000	2011 Rs' 000
Short term employment benefits				
Board of Directors (including MD/CEO)	85,920	83,393	86,080	83,553
Other KMP*	240,086	-	240,128	-
Post employment benefits				
Board of Directors (including MD/CEO)	9,440	8,586	9,440	8,586
Other KMP*	36,199	-	36,199	-
Termination benefits				
Board of Directors (including MD/CEO)	-	25,000	-	25,000
	371,645	116,979	371,847	117,139

* Other KMP includes members of the Corporate Management, Chief Accountant and the Chief Manager Operations. The Bank considered the members of its Corporate Management Team, Chief Accountant and Chief Manager-Operations as KMP with effect from 01st January 2012. Accordingly comparative figures have not been disclosed for Other KMP.

All employees including Other KMP are eligible for prior to retirement paid leave up to a maximum of 90 days provided such employees have unutilised accumulated leave at the time of retirement. As per LKAS 19, the Bank fair valued the above benefit and a total liability of Rs 109.174 Mn is accounted as provision for other long term benefits [Other Liabilities (Note 48)] being the total fair value of unutilised leave of all employees as at 31st December 2012.

In addition to their salaries / fees, the Bank provides non cash benefits to KMP. The Bank also contributes to a post employment defined benefit plan on behalf of KMP excluding non executive Directors who also participate in the Employee Share Option Plan and the Employee Share Benefit Trust.

Benefits offered to KMP under Employee Share Option Plan

		Bank		Group	
		2012	2011	2012	2011
MD/CEO					
Voting (No of shares)	- Exercised	-	-	-	-
	- Remaining	114,992	59,942	114,992	59,942
Non-voting (No of shares)	- Exercised	-	-	-	-
	- Remaining	28,418	14,626	28,418	14,626

Increase in number of shares in 2012 is due to new share options granted in 2012 and issue of scrip dividends.

		Bank		Group	
		2012	2011	2012	2011
Other KMP					
Voting (No of shares)	- Exercised	254,958	-	254,958	-
	- Remaining	1,426,804	-	1,426,804	-
Non-voting (No of shares)	- Exercised	91,344	-	91,344	-
	- Remaining	347,994	-	347,994	-

Bank has fair valued the options granted in 2012 and the total fair value of the options granted to all employees above management grade including Other KMP is accounted under Personnel Expenses (Note 16) "Equity settled share based payment transactions".

Benefits offered to KMP under Employee Share Benefit Trust

	Bank		Group	
	2012	2011	2012	2011
Non-voting (No of shares)				
MD/CEO	97,383	94,675	97,383	94,675
Other KMP	1,482,947	-	1,482,947	-

The Bank has fair valued the liability under Employee Share Benefit Trust as at 31st December 2012 and a total liability of Rs 1.32 Bn is accounted under Other Liabilities (Note 48) on behalf of all employees in the grades of executive and above including Other KMP.

Bank has paid Rs 22.584 Mn to Other KMP who retired during the year ended 31st December 2012 as termination benefits under Employee Share Benefit Trust.

52 RELATED PARTY DISCLOSURES (Contd.)

52 (b) Transactions with Key Management Personnel (KMP) (Contd.)

52 (b) ii Credit Card Facilities to KMP

As at 31st December	2012 Limit Rs 000	2012 Outstanding Balance Rs 000	2011 Limit Rs 000	2011 Outstanding Balance Rs 000
Board of Directors (including MD/CEO)	6,150	906	13,400	1,244
Other KMP	44,805	5,089	-	-
	50,955	5,995	13,400	1,244

From the total outstanding of Rs 5.995 Mn as at 31st December 2012 (2011 - Rs 1.244 Mn), Rs 0.552 Mn (2011 : Rs 0.995 Mn) is secured by cash as at that date.

52 (b) iii Lending Facilities Granted to KMP

	As at 31st December 2012 Aggregate Limit Rs 000	As at 31st December 2012 Amount of Accommodation Outstanding Rs 000	As at 31st December 2011 Aggregate Limit Rs 000	As at 31st December 2011 Amount of Accommodation Outstanding Rs 000	Security
Board of Directors (including MD/CEO)	21,000	15,000	20,000	19,000	EPF Balance
Other KMP	434,572	375,405	-	-	EPF Balance/Immovable Property/Movable Property/Lien over Deposit
	455,572	390,405	20,000	19,000	

No losses have been recorded against loan balances outstanding during the period with KMP and no provisions have been made for impairment losses on balances with KMP and their immediate family members as at the date of the Statement of Financial Position.

52 (b) iv Deposits held by KMP with the Bank

The aggregate deposits (including Treasury Bills and Repos) held by the KMP with the Bank are as follows:

As at 31st December	2012	2011
Board of Directors (including MD/CEO)		
SLRs ‘000	346,201	516,390
USD ‘000	220	238
GBP ‘000	97	97
EUR ‘000	147	-
Other KMP		
SLRs ‘000	212,591	-
USD ‘000	287	-
GBP ‘000	13	-
EUR ‘000	13	-
AUD ‘000	329	-
CAD ‘000	1	-
SGD ‘000	2	-

Notes to the Financial Statements

52 RELATED PARTY DISCLOSURES (Contd.)

52 (b) Transactions with Key Management Personnel (KMP) (Contd.)

52 (b) v Other Business Transactions by KMP with the Group

	2012 Rs 000	2011 Rs 000
Transactions with HNB Assurance PLC		
Board of Directors (including MD/CEO)		
Insurance Premium - General	101	541
Insurance Premium - Life	297	23
Claims - General	13	331
Other KMP		
Insurance Premium - General	1,396	-
Insurance Premium - Life	1,224	-
Claims - General	116	-

52 (c) Transactions with / between Subsidiaries

Details of the Subsidiaries are given in Note 33.

52 (c) i HNB Assurance PLC

HNB Assurance PLC ("Assurance"), is a 60% owned 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 250.785 Mn as at 31st December 2012. (2011 : 328.24 Mn)

The Company also held debentures of the Bank amounting to Rs 7.5 Mn as at 31st December 2012 (2011 : Rs 20.0 Mn).

(b) A summary of transactions of Assurance with the Group are given below:

For the year ended 31st December	2012		2011	
Transaction Type	HNB Rs 000	SITHMA Rs 000	HNB Rs 000	SITHMA Rs 000
Premium received	63,979	1,118	52,025	3,994
Claims incurred	6,573	570	8,156	43
Interest received	22,941	-	12,863	-
Office rent paid	22,660	-	16,409	-
Reimbursement of other administrative expenses	132,192	-	95,722	-
Dividend paid	62,985	-	40,491	-

52 RELATED PARTY DISCLOSURES (Contd.)

52 (c) Transactions with / between Subsidiaries (Contd.)

52 (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 2012 Limit Rs 000	As at 31st December 2012 Outstanding Rs 000	As at 31st December 2011 Limit Rs 000	As at 31st December 2011 Outstanding Rs 000	Security
Overdraft	AWPLR To be reviewed monthly.	750,000	125,300	750,000	455,558	Registered primary floating mortgage for Rs 3,000 Mn over the leasehold rights of the 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	2,000,000	999,840	2,000,000	1,349,920	Same as for the overdraft
	Interest payable		7,627		6,331	

(b) A summary of other transactions of Sithma with the Group are given below:

For the year ended 31st December Transaction Type	2012 HNB Rs 000	2012 HNB ASSURANCE Rs 000	2011 HNB Rs 000	2011 HNB ASSURANCE Rs 000
Lease rental received	660,764	-	660,342	-
Refundable deposit received	478,365	-	430,185	-
Advance payment received - rent	18,941	-	64,399	-
Interest expense on refundable deposit	48,181	-	43,328	-
Insurance premium paid	-	1,118	-	3,994
Claims received	-	570	-	43
Overdraft interest paid	42,550	-	47,961	-
Term loan interest paid	148,806	-	150,859	-
Ground rent paid	3,829	-	3,830	-

52 (c) iii Majan Exchange LLC

Majan Exchange LLC (Majan) is a 40% owned Subsidiary of the Bank.

The details of the transactions with the Bank are as follows:

Transaction Type	2012 Rs 000	2011 Rs 000
Deposits including current accounts	6,026	7,533
Guarantees issued	5,744	5,126
Advance payment made	13,896	13,896
Interest received	37	39
Interest paid	312	301

Bank has made a full provision against the investment of Rs 56.121 Mn (2011 : Rs 56.121 Mn) and the advance payment of Rs 13.896 Mn (2011 : Rs 13.896 Mn) as at 31st December 2012.

Notes to the Financial Statements

52 RELATED PARTY DISCLOSURES (Contd.)

52 (c) Transactions with / between Subsidiaries (Contd.)

52 (c) iv Commercial Interlink Services Inc (o/a of Delma Exchange Canada)

Commercial Interlink Services Inc (o/a of Delma Exchange Canada) was a wholly owned Subsidiary of the Bank. The company has ceased its commercial operations on 1st October 2010. The Bank made a full provision of Rs 33.715 Mn against it's investment and the amount due from the company as at 31st December 2011. This provision was written off from the books during the year ended 31st December 2012.

52 (d) Transactions with Associates

Details of the Associates are given in Note 31.

52 (d) i Delma Exchange

Delma Exchange was a 20% owned Associate of the Bank.

The details of the transactions with the Bank are as follows:

Transaction Type	2012 Rs 000	2011 Rs 000
Deposits including current accounts	13,957	21,108
Guarantees issued	97,310	86,826
Interest received	5	6
Interest paid	753	512

Bank sold its stake in Delma Exchange during the year ended 31st December 2012. The net gain on disposal of the Associate company amounting to Rs 38.393 Mn is accounted under Other Operating Income (Note 13) to the financial statements. 50% of the sales proceeds have already been received by the Bank and the balance amount (Rs 63.252 Mn) is to be received on deferred terms as per the sales and purchase agreement entered into with the buyer.

52 (d) ii Splendor Media (Pvt) Ltd

Splendor Media (Pvt) Ltd is a 49.99% owned Associate of Sithma, a fully owned Subsidiary of the Bank.

Summary of transactions of Splendor Media (Pvt) Ltd with the Bank and the Group are given below:

	2012			2011		
Transaction Type	HNB Rs 000	Sithma Rs 000	HNB Assurance Rs 000	HNB Rs 000	Sithma Rs 000	HNB Assurance Rs 000
Advertising commission	51,164	239	1,140	65,016	745	-
Interest income	3,903	-	-	3,639	-	-
Rebate paid	7,223	42	-	6,839	111	-
Deposits including current accounts	48,412	-	-	45,458	-	-
Dividend paid	-	230	-	-	563	-
Insurance premium paid	-	-	-	-	-	122
Claims received	-	-	-	-	-	443

52 (e) Transactions with Joint Venture - Acuity Partners (Pvt) Ltd

Acuity Partners (Pvt) Ltd is the Joint Venture between DFCC Bank and HNB. Bank holds a 50% stake in Acuity Partners (Pvt) Ltd as at 31st December 2012.

Summary of transactions of the Bank with Acuity Partners (Pvt) Ltd are given below:

Transaction Type	2012 Rs 000	2011 Rs 000
Deposits including current accounts	2,107	7,293
Overdraft	9,736	75,399
Interest and bank charges received	3,528	5,101
Interest paid	208	-

52 RELATED PARTY DISCLOSURES (Contd.)

52 (f) Transactions with the Government of Sri Lanka/ Entities Controlled, Jointly Controlled, Significantly Influenced by the Government of Sri Lanka

The Government of Sri Lanka indirectly holds more than 25% of the voting rights of the Bank as at 31st December 2012 through Sri Lanka Insurance Corporation Ltd , Employee Provident Fund , National Savings Bank and Employee Trust Fund. The Bank has considered the Government of Sri Lanka and other entities which are controlled, jointly controlled or significantly influenced by the Government of Sri Lanka (government related entities) as Related Parties according to LKAS 24 " Related Party Disclosures".

During the year ended 31st December 2012, the Bank has carried out transactions with the Government of Sri Lanka and other Government related entities in the ordinary course of its business, the details of which are given below. The pricing applicable to such transactions was based on the assessment of risk and pricing model of the Bank and was comparable with what was applied to transactions between the Bank and its unrelated customers.

52 (f) i Transactions which are Individually Significant

Bank uses an internal threshold of 5% of total equity of the Bank in order to identify individually significant transactions with the Government and Government related entities. Accordingly the said threshold was Rs 2,324 Mn as at 31st December 2012. All transactions with the Government of Sri Lanka and Government related entities that exceeded the above threshold has been reported below.

Name of the Government Entity	Relationship with the Bank	Nature of the Transactions	Amount (Rs'000)
Government of Sri Lanka	Shareholder with significant influence	Government of Sri Lanka Treasury Bills [Note 25 (c)]	19,790
		Government of Sri Lanka Treasury Bonds [Note 25 (d)]	1,446
		Sri Lanka Development & Sovereign Bonds [Note 30 (a)]	17,520,959
		Government of Sri Lanka Treasury Bonds [Note 28 (d)]	5,587,415
		Government of Sri Lanka Treasury Bills [Note 28 (e)]	47,804,967

Interest income recognized during the year from the above investments is disclosed under Net Interest Income from Sri Lanka Government Securities [Note 9 (c)] to the financial statements.

Central Bank of Sri Lanka	Government related entity	Statutory deposit (Note 22)	19,933,463
Peoples' Bank	Government related entity	Short term placements	4,914,750
Bank of Ceylon	Government related entity	Short term placements	4,391,250

Interest income recognized during the year from the placements with Peoples' Bank and Bank of Ceylon is included under Interest Income [Note 9 (a)] to the financial statements.

NSB Fund Management Company Ltd (Wholly owned Subsidiary of the National Savings Bank)	Government related entity	Long term borrowings	4,000,000

Interest expense recognized during the year on borrowings from NSB Fund Management Ltd is included under Interest Expense [Note 9 (b)] to the financial statements.

Notes to the Financial Statements

52 RELATED PARTY DISCLOSURES (Contd.)

52 (f) Transactions with the Government of Sri Lanka/ Entities Controlled, Jointly Controlled, Significantly Influenced by the Government of Sri Lanka (Contd.)

52 (f) i Transactions which are Individually Significant (Contd.)

Name of the Government Entity	Relationship with the Bank	Nature of the Transactions	Amount (Rs'000)
Ministry of Finance	Government related entity	Foreign currency advances	3,339,672

Interest income recognised during the year on advances granted to Ministry of Finance is included under Interest Income [Note 9 (a)] to the financial statements.

Central Bank of Sri Lanka	Government related entity	Derivative contracts (Swaps : USD 100 Mn)	12,765,000

Net unrealised foreign exchange loss to the Bank from the above derivatives amounted to Rs 360.258 Mn as at 31st December 2012.

52 (f) ii Transactions which are not Individually Significant

Employee Provident Fund of the Government of Sri Lanka has invested Rs 2 Bn in HNB debentures details of which are given in [Note 44 (v)].

The Bank has granted/approved advances for a total value of Rs 4,345 Mn to Ministry of Defense and Urban Development Authority as at 31st December 2012. The total outstanding of the above advances as at the said date was only Rs 434.59 Mn.

The Bank has granted/approved advances for a total value of Rs 2,061 Mn to Road Development Authority as at 31st December 2012. The total outstanding of the above advances as at the said date was only Rs 309.12 Mn.

Apart from the transactions listed above, the Bank/Group has carried out transactions with the Government of Sri Lanka and other Government related entities in the form of loans and advances, deposits, short and long term borrowings, payment of taxes, payment of utility bills etc. during the year ended 31st December 2012. Such transactions were carried out on an arms length basis and on comparable terms which are applied to transactions between the Bank and its unrelated customers.

52 RELATED PARTY DISCLOSURES (Contd.)

52 g Transactions with Other Related Entities

52 (g) i Lending Transactions with Other Related Entities by the Bank

Company	Relationship	Nature of Transaction	Aggregate Amount of Accommodation as at 31st December 2012 Limit (Rs Mn)	as at 31st December 2012 Outstanding (Rs Mn)	as at 31st December 2011 Limit (Rs Mn)	as at 31st December 2011 Outstanding (Rs Mn)	Security
Acuity Stockbrokers (Pvt) Ltd	Subsidiary of the Joint Venture "Acuity"	Overdraft	130.00	-	130.00	-	-
		Total	**130.00**	**-**	**130.00**	**-**	
Acuity Securities Limited	Subsidiary of the Joint Venture "Acuity"	Overdraft	1,100.00	-	1,100.00	-	-
		Total	**1,100.00**	**-**	**1,100.00**	**-**	
CIC Holdings PLC	Mr R S Captain (Director having control over the company)	Letters of Credit	250.00	-	-	-	-
		Overdraft	(150.00)	148.02	-	-	
		Money Market Loan	(150.00)	-	-	-	
		Total	**250.00**	**148.02**	**-**	**-**	
Paints & General Industries (Pvt) Ltd	Mr R S Captain (Managing Director having control over the company)	Overdraft	2,208.00	2,046.02	-	-	Quoted company shares
		Letters of Credit	200.00	30.39	-	-	
		Total	**2,408.00**	**2,076.41**	**-**	**-**	
A K K Engineers (Pvt) Ltd	Dr L R Karunaratne (Director having control over the company)	Term Loan	3.50	3.50	6.50	6.50	Immovable property
		Overdraft	30.00	9.99	30.00	2.99	Cash deposits
		Letters of Guarantee	44.00	30.20	44.00	21.47	
		Total	**77.50**	**43.69**	**80.50**	**30.96**	
Chemanex PLC	Subsidiary of CIC Holdings PLC	Letters of Credit	50.00	-	-	-	Indemnity
		Money Market Loan / Short Term Loan/ Overdraft	100.00	98.09	-	-	
		Letters of Guarantee	5.00	-	-	-	
		Total	**155.00**	**98.09**	**-**	**-**	
CIC Agri Businesses (Pvt) Ltd	Subsidiary of CIC Holdings PLC	Letters of Credit	700.00	515.53	-	-	Negative pledge over stocks
		Overdraft	(200.00)	166.66	-	-	
		Money Market Loan	(200.00)	-	-	-	
		Money Market Loan	300.00	300.00	-	-	
		Short Term Loan	350.00	350.00	-	-	
		Total	**1,350.00**	**1,332.19**	**-**	**-**	
Link Natural Products (Pvt) Ltd	Subsidiary of CIC Holdings PLC	Letters of Credit	20.00	-	-	-	Immovable property
		Import Loan	(20.00)	-	-	-	
		Packing Credit	20.00	18.11	-	-	Primary Mortgage over motor vehicle
		Term Loan	8.31	8.31	-	-	
		Total	**48.31**	**26.42**	**-**	**-**	
CIC Cropguard (Pvt) Ltd	Subsidiary of CIC Holdings PLC	Letters of Credit	100.00	-	-	-	Negative pledge over stocks
		Overdraft / Money Market Loan	30.00	28.85	-	-	
		Total	**130.00**	**28.85**	**-**	**-**	

Transactions with those entities that deemed to be related to the Bank with the appointment of new Directors [Note 52 (b)] had been reported from the date of appointment of the Director. Accordingly comparative figures have not been reported for such entities.

No losses have been recorded against loan balances outstanding during the period with the above entities and no provisions have been made for impairment losses as at the date of the Statement of Financial Position.

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

Notes to the Financial Statements

52 RELATED PARTY DISCLOSURES (Contd.)

52 (g) Transactions with Other Related Entities (Contd.)

52 (g) II Other Business Transactions with Other Related Entities by the Bank

Company	Relationship	Nature of Transaction	Amount (Rs Mn) 2012	2011
Hatton National Bank Retirement Pension Fund	Post employment benefit plan	Investment in term deposits	6,637.57	3,417.41
		Investment in HNB debentures	8.86	36.15
		Balance held by the Bank on behalf of the fund	237.47	1,245.52
		Interest paid	564.23	150.07
		Contributions made	303.94	610.03
		Receivable from pension fund	513.75	-
		Payable to pension fund	-	739.22
Hatton National Bank Employee Provident Fund	Post employment benefit plan	Investment in term deposits	2,957.00	4,285.09
		Investment in Repos	-	704.00
		Balance held by the Bank on behalf of the fund	105.14	43.24
		Investment in HNB shares - Voting	4.84	4.51
		- Non-voting	16.31	14.80
		Contribution made	400.48	358.18
		Interest paid	425.93	348.18
		Dividends paid	2.84	3.03
Employee Share Benefit Trust	Post employment benefit plan	Overdraft	292.26	308.19
		Additional loan granted during the year	-	163.71
		Interest paid	29.27	20.03
		Dividends paid	68.46	72.84
		Benefits paid to employees	92.32	90.88
Widows', Widowers' and Orphans' Pension Fund	Post employment benefit plan	Balance held by the Bank on behalf of the fund	16.88	20.79
		Time deposits	706.66	-
		Interest paid	71.07	7.09
Acuity Securities Limited	Subsidiary of the Joint Venture "Acuity"	Interest received	-	0.06
		Commission and other charges received	1.39	1.20
		Interest paid	-	0.59
		Current account balance as at year end	8.45	70.01
Acuity Stockbrokers (Pvt) Ltd	Subsidiary of the Joint Venture "Acuity"	Bank charges	0.12	0.09
		Interest received	-	1.04
		Commission paid	-	18.46
		Current account balance as at year end	30.61	5.38
Guardian Acuity Asset Management Ltd	Joint Venture of "Acuity"	Repurchase agreements	9.39	35.24
		Interest on repurchase agreements	2.38	1.21
		Bank charges	0.78	-
		Deposits including current accounts	0.54	0.05
Lanka Ventures PLC	Subsidiary of the Joint Venture "Acuity"	Interest paid	17.20	3.95
		Bank charges and overdraft interest received	1.20	0.59
		Overdraft	-	58.40
		Deposits including current accounts	533.09	127.89
		Debentures	13.50	13.50

52 RELATED PARTY DISCLOSURES (Contd.)

52 (g) Transactions with Other Related Entities (Contd.)

52 (g) II Other Business Transactions with Other Related Entities by the Bank (Contd.)

Company	Relationship	Nature of Transaction	Amount (Rs Mn) 2012	2011
Rainforest Eco lodge (Pvt) Ltd	Associate of CIC Holdings PLC	Merchant Commission	0.01	-
Polypack Secco Ltd	Mr R S Captain (Managing Director having control over the company)	Customer Deposits	0.01	-
507 Holdings (Pvt) Ltd	Other KMP of the Bank having control over the company	Customer Deposits	1.36	-

Transactions with those entities that deemed to be related to the Bank with the appointment of new Directors [Note 52 (b)] had been reported from the date of appointment of the Director. Accordingly comparative figures have not been reported for such entities.

52 (g) III Other Business Transactions with Other Related Entities by the Group

Company	Relationship	Nature of Transaction	Amount (Rs Mn) 2012	2011
HNB Assurance PLC				
Acuity Stockbrokers (Pvt) Ltd	Subsidiary of "Acuity"	Insurance premium received	1.12	1.84
		Claims paid	1.07	0.37
		Brokerage fees	0.20	0.86
Acuity Securities Limited	Subsidiary of "Acuity"	Insurance premium received	0.53	0.30
		Claims paid	0.69	0.25
		Interest received	12.52	15.53
		Investments (Repo)	128.07	242.16
Acuity Partners (Pvt) Ltd	Subsidiary of "Acuity"	Insurance premium received	0.88	1.66
		Claims paid	0.69	0.16

Notes to the Financial Statements

53 MATURITY ANALYSIS

53 (a) Maturity Analysis - Bank

	Upto 3 Months Rs. 000	3--12 Months Rs. 000	1--3 years Rs. 000	3--5 Years Rs. 000	More than 5 years Rs. 000	Total 2012 Rs. 000
Interest earning assets						
Cash and cash equivalents	300,205	-	-	-	-	300,205
Placements with banks	10,321,832	-	-	-	-	10,321,832
Other financial assets held for trading	21,235	-	-	-	-	21,235
Loans and receivables to banks	-	-	-	-	-	-
Loans and receivables to other customers	101,579,257	54,101,386	75,607,561	37,431,802	34,040,974	302,760,980
Financial investments - Available-for-sale	26,528,142	24,734,891	2,129,349	-	-	53,392,382
Financial investments - Held-to-maturity	-	-	-	-	-	-
Financial investments - Loans and receivables	122,400	503,000	18,916,269	489,000	-	20,030,669
	138,873,071	79,339,277	96,653,179	37,920,802	34,040,974	386,827,303
Non interest earning assets						
Cash and cash equivalents	8,469,001	-	-	-	-	8,469,001
Balances with Central Banks	19,933,463	-	-	-	-	19,933,463
Derivative financial instruments	281,269	63,283	-	-	-	344,552
Other financial assets held for trading	452,848	-	-	-	-	452,848
Financial investments - Available-for-sale	-	-	-	-	4,477,164	4,477,164
Investments in Associates	-	-	-	-	-	-
Investment in Joint Venture	-	-	-	-	655,000	655,000
Investments in Subsidiaries	-	-	-	-	2,357,285	2,357,285
Investment properties	-	-	-	-	349,708	349,708
Property, plant and equipment	-	-	-	-	9,417,915	9,417,915
Intangible assets	-	-	-	-	556,171	556,171
Deferred tax assets	-	-	-	-	369,726	369,726
Other assets	4,770,525	754,195	2,008,092	-	4,559,385	12,092,197
	33,907,106	817,478	2,008,092	-	22,742,354	59,475,030
Total assets	172,780,177	80,156,755	98,661,271	37,920,802	56,783,328	446,302,333
Percentage - 31st December 2012	38.71	17.96	22.11	8.50	12.72	100
Percentage - 31st December 2011	42.12	16.89	17.34	10.83	12.83	100
Interest bearing liabilities						
Due to banks	9,597,009	2,103,364	6,492,974	7,738,140	4,469,493	30,400,980
Due to other customers	225,659,802	81,395,823	8,349,977	1,318,064	1,309,630	318,033,296
Other borrowings	4,644,289	306,246	-	-	-	4,950,535
Subordinated debentures	250,000	89,705	300,000	500,000	3,445,863	4,585,568
	240,151,100	83,895,138	15,142,951	9,556,204	9,224,986	357,970,379
Non- interest bearing liabilities						
Derivative financial instruments	493,358	943,085	-	-	-	1,436,443
Due to other customers	23,390,690	-	-	-	-	23,390,690
Dividends payable	221,455	-	-	-	-	221,455
Current tax liabilities	-	1,755,429	-	-	-	1,755,429
Bills payable	1,430,578	-	-	-	-	1,430,578
Deferred tax liabilities	-	-	-	-	1,478,341	1,478,341
Other provisions	1,336,762	-	2,903,731	-	-	4,240,493
Other liabilities	7,902,786	-	-	-	-	7,902,786
Shareholders' funds	-	-	-	-	46,475,739	46,475,739
	34,775,629	2,698,514	2,903,731	-	47,954,080	88,331,954
Total Liabilities & shareholders' funds	274,926,729	86,593,652	18,046,682	9,556,204	57,179,066	446,302,333
Percentage - 31st December 2012	61.60	19.40	4.04	2.14	12.81	100
Percentage - 31st December 2011	62.82	18.89	4.34	1.65	12.31	100

* Upto 3 months deposits include the Bank's Savings Deposit Base of Rs. 109.177 billion (2011 - Rs. 111.122 billion)

53 MATURITY ANALYSIS (Contd.)

53 (b) Maturity Analysis - Group

	Upto 3 Months Rs 000	3--12 Months Rs 000	1--3 years Rs 000	3--5 Years Rs 000	More than 5 years Rs 000	Total 2012 Rs 000
Interest earning assets						
Cash and cash equivalents	379,745	-	-	-	-	379,745
Placements with banks	10,791,633	749,042	126,742	-	-	11,667,417
Other financial assets held for trading	625,276	-	-	-	-	625,276
Loans and receivables to banks	-	-	-	-	-	-
Loans and receivables to other customers	103,719,697	54,040,310	75,151,818	37,254,105	33,756,162	303,922,092
Financial investments - Available-for-sale	26,604,930	25,019,050	2,441,885	216,108	170,159	54,452,132
Financial investments - Held-to-maturity	196,172	467,283	487,350	288,306	204,741	1,643,852
Financial investments - Loans and receivables	122,399	542,010	19,442,578	797,185	-	20,904,172
	141,439,852	80,817,695	97,650,373	38,555,704	34,131,062	393,594,686
Non interest earning assets						
Cash and cash equivalents	8,469,001	-	-	-	-	8,469,001
Balances with Central Banks	19,933,463	-	-	-	16,577	19,950,040
Derivative financial instruments	281,269	63,283	-	-	-	344,552
Other financial assets held for trading	452,848	-	-	-	-	452,848
Financial investments - Available-for-sale	-	-	-	-	4,477,164	4,477,164
Investments in Associates	-	-	-	-	386,172	386,172
Investment in Joint Venture	-	-	-	-	-	-
Investments in Subsidiaries	-	-	-	-	-	-
Investment properties	-	-	-	-	164,598	164,598
Property, plant and equipment	-	-	-	-	17,815,411	17,815,411
Intangible assets	-	-	-	-	689,501	689,501
Deferred tax assets	-	-	-	-	372,193	372,193
Non current assets held for sale	-	2,875	-	-	-	2,875
Other assets	5,288,208	1,154,007	2,147,703	131,330	3,958,708	12,679,956
	34,424,789	1,220,165	2,147,703	131,330	27,880,324	65,804,311
Total assets	176,864,641	82,037,860	99,798,076	38,687,034	62,011,386	459,398,997
Percentage - 31st December 2012	38.50	17.86	21.72	8.42	13.50	100
Percentage - 31st December 2011	41.86	16.89	17.10	10.72	13.43	100
Interest bearing liabilities						
Due to banks	9,597,009	2,103,364	6,492,974	7,738,140	4,469,493	30,400,980
Due to other customers	225,238,987	81,289,265	8,324,977	1,318,064	1,286,376	317,457,669
Other borrowings	6,328,657	347,988	10,499	60,000	-	6,747,144
Debt Securities Issued	-	-	-	-	150,000	150,000
Subordinated debentures	249,694	82,649	300,000	500,000	3,430,668	4,563,011
	241,414,347	83,823,266	15,128,450	9,616,204	9,336,537	359,318,804
Non- interest bearing liabilities						
Derivative financial instruments	493,358	943,085	-	-	-	1,436,443
Due to other customers	23,389,937	-	-	-	-	23,389,937
Dividends payable	223,251	-	-	-	-	223,251
Current tax liabilities	-	1,839,714	-	-	-	1,839,714
Bills payable	1,430,578	-	-	-	-	1,430,578
Insurance provisions - Life	-	-	-	-	3,626,239	3,626,239
Insurance provisions - General	-	969,441	-	-	-	969,441
Deferred tax liabilities	-	-	-	-	1,556,312	1,556,312
Other provisions	1,496,367	-	2,903,731	-	-	4,400,098
Other liabilities	8,146,376	317,730	31,280	86,263	32,632	8,614,281
Shareholders' funds	-	-	-	-	52,593,899	52,593,899
	35,179,867	4,069,970	2,935,011	86,263	57,809,082	100,080,193
Total Liabilities & shareholders' funds	276,594,214	87,893,236	18,063,461	9,702,467	67,145,619	459,398,997
Percentage - 31st December 2012	60.21	19.13	3.93	2.11	14.62	100
Percentage - 31st December 2011	61.79	18.71	4.25	1.61	13.64	100

* Upto 3 months deposits include the Bank's Savings Deposit Base of Rs. 109.177 billion (2011 - Rs. 111.122 billion)

Notes to the Financial Statements

54 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	
	2012 Rs.000	2011 Rs.000	2012 Rs.000	2011 Rs.000	2012 Rs.000	2011 Rs.000	2012 Rs.000	2011 Rs.000	2012 Rs.000	2011 Rs.000	2012 Rs.000	2011 Rs.000	2012 Rs.000	2011 Rs.000
Revenue from external customers :														
Interest	43,376,135	30,025,243	3,728,480	2,905,152	251,985	194,479	-	-	612,179	442,032	(29,271)	(20,035)	47,939,508	33,546,871
Fee and commission	3,739,489	2,700,158	-	-	93,889	287,275	-	-					3,833,378	2,987,433
Net gain/loss from trading	(1,632,528)	(347,078)	-	-	5,294	(10,357)	-	-	3,187	(68,900)	-	-	(1,624,049)	(426,335)
Net gain/loss from investments	142,479	398,936	-	-	26,099	87,701	207		2,918	4,199	(57,291)	(100,206)	114,412	390,630
Other operating income	1,935,432	1,107,724	-	-	79,885	9,706	163,159	142,317	2,648,036	2,297,874	70,308	66,362	4,896,820	3,623,983
Total revenue from external customers	47,561,007	33,884,983	3,728,480	2,905,152	457,152	568,804	163,366	142,317	3,266,320	2,675,205	(16,256)	(53,879)	55,160,069	40,122,582
Inter-segment revenue	269,413	276,166	-	-	9,712	17,552	660,770	660,342	95,841	78,006	-	-	1,035,736	1,032,066
Total revenue	47,830,420	34,161,149	3,728,480	2,905,152	466,864	586,356	824,136	802,659	3,362,161	2,753,211	(16,256)	(53,879)	56,195,805	41,154,648
Segment result	8,431,007	7,442,735	2,590,399	1,860,258	77,948	134,113	389,478	386,757	447,192	312,636	(100,764)	15,743	11,835,260	10,152,242
Unallocated expenses	-	-	-	-	-	-	-	-	-	-	-	-	(1,159,298)	(1,080,049)
Profit from operations	-	-	-	-	-	-	-	-	-	-	-	-	10,675,962	9,072,193
Income from associates	-	-	-	-	-	-	-	-	-	-	-	-	16,632	(15,729)
Income tax expense	-	-	-	-	-	-	-	-	-	-	-	-	(2,421,431)	(2,156,077)
Profit for the period	-	-	-	-	-	-	-	-	-	-	-	-	8,271,163	6,900,387
Non controlling interests	-	-	-	-	-	-	-	-	-	-	-	-	(160,194)	(81,464)
Profit for the Equity Holders of the Bank	-	-	-	-	-	-	-	-	-	-	-	-	8,110,969	6,818,923
Profit for the year	-	-	-	-	-	-	-	-	-	-	-	-	8,271,163	6,900,387
Other Comprehensive Income, Net of Tax	2,412,029	(3,295,723)			(4,210)	(5,745)	828,962		6,208		117,057	4,292	3,360,046	(3,297,176)
Total Comprehensive income	-	-	-	-	-	-	-	-	-	-	-	-	11,631,209	3,603,211
Non controlling interests	-	-	-	-	-	-	-	-	-	-	-	-	(170,621)	(81,613)
Profit for the Equity Holders of the Bank	-	-	-	-	-	-	-	-	-	-	-	-	11,460,588	3,521,598
Segment assets	395,526,386	333,855,469	24,977,945	24,351,395	3,492,733	3,453,168	7,917,607	7,660,291	7,034,877	6,044,856	(2,956,216)	(3,693,340)	435,993,332	371,671,839

Business segments - Group

	Banking		Leasing		**Dealing		Property		Insurance		Eliminations		Consolidated /Unallocated	
	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011
	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000	Rs.000
Investment in associates	-	-	-	-	-	-	-	-	-	-	-	-	386,172	384,319
Unallocated assets	-	-	-	-	-	-	-	-	-	-	-	-	23,019,493	19,240,712
Total Assets	-	-	-	-	-	-	-	-	-	-	-	-	459,398,997	391,296,870
Segment liabilities	359,250,145	300,944,437	24,977,945	24,351,395	2,179,859	2,382,470	1,806,928	2,651,285	5,167,788	4,451,449	(2,176,071)	(3,045,014)	391,206,594	331,736,022
Unallocated liabilities	-	-	-	-	-	-	-	-	-	-	-	-	15,598,505	17,204,081
Total liabilities													405,805,099	348,940,103
Cash flows from operating activities	6,110,592	(205,390)	(711,299)	(10,649,463)	(85,887)	(114,718)	689,745	400,421	287,646	661,810	(601,113)	(755,418)	5,689,684	(10,662,758)
Cash flows from investing activities	(7,334,184)	(2,597,862)	-	-	81,681	(99,921)	(3,076)	(10,690)	(163,731)	(871,645)	56,327	946,869	(7,362,983)	(2,633,249)
Cash flows from financing activities	6,263,011	10,107,350	-	-	223,024	60,515	(356,411)	(435,727)	(105,000)	318,746	344,615	369,236	6,369,239	10,420,120
Capital Expenditure	1,059,416	1,355,832	47	267	6,751	23,156	3,076	3,029	63,174	33,111	1,829	93	1,134,293	1,415,488
Depreciation	799,355	741,132	1,031	1,080	12,080	13,861	116,688	110,612	40,154	33,344	891	(5,603)	970,199	894,426
Amortization	175,267	172,691	47	223	534	759	79	79	13,172	11,839		33	189,099	185,624

**Stock broking, securities dealings, remmitances, investment banking, venture capital business and foreign currency related services.

Notes to the Financial Statements

55 EVENTS OCCURRING AFTER THE REPORTING PERIOD

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:

55 (a) Proposed Dividends

Refer Note No 41 (a)

56 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 204 for the statement of the Directors' Responsibility for Financial Reporting.

57 EXPLANATION OF TRANSITION TO LKASs/SLFRSs

As stated in Note 2.1 these are the Bank's first consolidated financial statements prepared in accordance with LKASs/SLFRSs.

The accounting policies set out in Note 4 have been applied in preparing the financial statements for the year ended 31 December 2012, the comparative information presented in these financial statements for the year ended 31 December 2011 and in the preparation of an opening SLFRS statement of financial position as at 1st January 2011 (the Bank's date of transition).

In preparing its opening SLFRS statement of financial position, the Bank has adjusted amounts reported previously in financial statements prepared in accordance with previous SLAS. An explanation of how the transition from previous SLAS to SLFRSs has affected the Bank's financial position, financial performance and cash flows is set out in the following tables and the notes that accompany the tables.

57 (a) Explanation of transition to LKASs/SLFRSs - Bank

Reconciliation of comprehensive income for the year ended 31 December 2011

	Note	Previous SLAS Rs 000	Effect of transition to SLFRSs Rs 000	SLFRSs Rs 000
INCOME		37,968,762	(902,461)	37,066,301
Interest income	57 (a) i, ii, iii, iv, v, vi	33,141,598	34,330	33,175,928
Less: Interest expenses	57 (a) vi, viii	16,745,453	(215,200)	16,530,253
Net interest income		16,396,145	249,530	16,645,675
Fee and commission income	57 (a) vii	2,779,700	(69,148)	2,710,552
Less: Fee and commission expenses		34,520	-	34,520
Net fee and commission income		2,745,180	(69,148)	2,676,032
Net interest, fee and commission income		19,141,325	180,382	19,321,707
Foreign exchange profit	57 (a) xv	988,231	(988,231)	-
Dividend income	57 (a) xv	409,440	(409,440)	-
Other operating income (net)	57 (a) v, xv	649,793	478,170	1,127,963
Net gain/(loss) from trading	57 (a) vi, v, xvi	-	(347,078)	(347,078)
Net gain/(loss) from financial investments	57 (a) xv	-	398,936	398,936
Total Operating income		21,188,789	(687,261)	20,501,528
Less:				
Impairment for loans and other losses	57 (a) iii, v, xii, xx	-	(445,373)	(445,373)
Net operating income		21,188,789	(241,888)	20,946,901

57 EXPLANATION OF TRANSITION TO LKASs/SLFRSs (Contd.)

57 (a) Explanation of transition to LKASs/SLFRSs - Bank (Contd.)

Bank

	Note	Previous GAAP Rs 000	Effect of transition to SLFRSs Rs 000	SLFRSs Rs 000
Less:				
OPERATING EXPENSES				
Personnel expenses	57 (a) iv, vi, ix, x, xvii	4,891,183	96,104	4,987,287
Premises, equipment and establishment expenses	57 (a) ii	3,191,644	85,360	3,277,004
Provision charge for employee benefits	57 (a) xi	893,507	(893,507)	-
Diminution in value of investment securities / Subsidiary	57 (a) xii	202,031	(202,031)	-
Loans written off	57 (a) v	2,005	(2,005)	-
Net impairment loss on loans and advances	57 (a) iii, v	(164,562)	164,562	-
Other overhead expenses	57 (a) xv	4,405,379	(1,334,781)	3,070,598
		13,421,187	(2,086,298)	11,334,889
Operating profit/(loss) before value added tax (VAT)		7,767,602	1,844,410	9,612,012
Less: Value added tax (VAT) on financial services	57 (a) xix, xxii	-	1,224,143	1,224,143
Operating profit/(loss) after value added tax (VAT)		7,767,602	620,267	8,387,869
Share of loss of Associates (net of income tax)		-	-	-
PROFIT BEFORE INCOME TAX		7,767,602	620,267	8,387,869
Less: Income tax expense	57 (a) xix	2,197,263	(74,060)	2,123,203
PROFIT FOR THE YEAR		5,570,339	694,327	6,264,666
OTHER COMPREHENSIVE INCOME, NET OF INCOME TAX	-			
Net change of financial assets measured at fair value through other comprehensive income:	-			
Net change in fair value on available-for-sale financial assets	57 (a) xiii	-	(3,334,984)	(3,334,984)
Defined benefit plans actuarial gains/(losses)	57 (a) xi	-	34,870	34,870
Revaluation of property, plant and equipment	-	-	4,391	4,391
Other comprehensive income for the year, net of tax		-	(3,295,723)	(3,295,273)
Total comprehensive income for the year		5,570,339	(2,601,396)	2,968,942

Material adjustments to the statement of cash flows for 2011

There are no material differences between the statement of cash flows presented under SLFRSs and the statement of cash flows presented under previous GAAP.

Notes to the Financial Statements

57 EXPLANATION OF TRANSITION TO LKASs/SLFRSs (Contd.)

57 (a) Explanation of transition to LKASs/SLFRSs - Bank (Contd.)

Reconciliation of equity - Bank

	Note	Previous SLAS Rs 000	Effect of transition to SLFRSs 1 January 2011 Rs 000	SLFRSs Rs 000	Previous SLAS Rs 000	Effect of transition to SLFRSs 31 December 2011 Rs 000	SLFRSs Rs 000
ASSETS							
Cash and cash equivalents	57 (a) xxiii	18,005,640	(11,449,302)	6,556,338	14,741,947	(7,199,180)	7,542,767
Balances with central banks		12,491,644	-	12,491,644	18,683,405	-	18,683,405
Placements with banks	57 (a) xiv, xxiii	-	11,551,945	11,551,945	-	7,220,151	7,220,151
Derivative financial instruments	57 (a) vi	-	231,124	231,124	-	496,643	496,643
Other financial assets held for trading	57 (a) xvi	1,457,502	(54)	1,457,448	1,142,064	18,435	1,160,499
Securities purchased under re-sale agreements	57 (a) xviii	1,185,831	(1,185,831)	-	781,193	(781,193)	-
Bills of exchange	57 (a) xviii	1,401,130	(1,401,130)	-	959,012	(959,012)	-
Commercial papers	57 (a) xviii	158,963	(158,963)	-	24,986	(24,986)	-
Lease receivable within one year	57 (a) xviii	4,630,492	(4,630,492)	-	7,138,715	(7,138,715)	-
Lease receivable after one year	57 (a) xviii	8,816,761	(8,816,761)	-	16,785,652	(16,785,652)	-
Loans and receivables to other customers	57 (a) iii, iv, v, xiv, xviii	188,033,851	14,219,167	202,253,018	233,521,000	23,677,343	257,198,343
Investment securities	57 (a) xxvii	58,704,102	(58,704,102)	-	62,942,501	(62,942,501)	-
Financial investments - Available for sale	57 (a) xiii, xiv, xxvii	-	49,379,877	49,379,877	-	51,239,058	51,239,058
Financial investments - Loans and receivables	57 (a) i, xiv, xxvii	-	15,370,787	15,370,787	-	14,665,997	14,665,997
Investments in Associates		83,651	-	83,651	83,674	-	83,674
Investment in Joint Venture		655,000	-	655,000	655,000	-	655,000
Investments in Subsidiaries		2,179,086	-	2,179,086	2,357,285	-	2,357,285
Investment properties		353,563	-	353,563	349,374	-	349,374
Property, plant and equipment	57 (a) xxiv	7,473,947	(46,392)	7,427,555	7,847,808	(12,942)	7,834,866
Intangible assets		577,015	-	577,015	549,503	-	549,503
Deferred tax assets	57 (a) xix	-	506,348	506,348	-	313,785	313,785
Other assets	57 (a) ii, iv, vi, xiv, xxiv	7,786,083	847,284	8,633,367	9,587,469	545,826	10,133,295
Total Assets		313,994,261	5,713,505	319,707,766	378,150,588	2,333,057	380,483,645
LIABILITIES							
Due to banks	57 (a) xiv, xxv	-	10,421,179	10,421,179	-	19,885,436	19,885,436
Derivative financial instruments	57 (a) vi	-	166,521	166,521	-	617,702	617,702
Due to other customers	57 (a) viii, xiv, xxvi	234,073,977	4,959,806	239,033,783	284,145,962	7,210,616	291,356,578
Dividends payable		49,558		49,558	168,080	-	168,080
Securities sold under re-purchase agreements	57 (a) xxv	11,951,727	(11,951,727)	-	6,559,088	(6,559,088)	-
Other borrowings	57 (a) xiv, xxv	10,810,554	1,762,446	12,573,000	19,998,527	(12,989,786)	7,008,741
Current tax liabilities	57 (a) xix	3,127,622	(540,201)	2,587,421	1,679,787	(658,168)	1,021,619
Bills payable		1,305,161	-	1,305,161	1,404,158	-	1,404,158
Subordinated debentures	57 (a) xiv	2,724,293	124,850	2,849,143	4,781,098	242,118	5,023,216
Deferred tax liabilities	57 (a) xix	735,884	154,718	890,602	1,168,800	6,062	1,174,862
Other provisions	57 (a) ii, vi, xiv, xix, xxvi	-	8,397,841	8,397,841	-	5,812,370	5,812,370
Other liabilities	57 (a) vi, vii, ix, x, xi, xvi, xxvi	21,941,718	(11,283,583)	10,658,135	21,157,225	(12,130,072)	9,027,153
Total Liabilities		286,720,494	2,211,850	288,932,344	341,062,725	(18,448,247)	342,499,915
EQUITY							
Stated capital		5,318,550	-	5,318,550	11,451,451	-	11,451,451
Statutory reserves		1,510,000	-	1,510,000	2,778,337	-	2,778,337
Retained earnings		4,420,248	(2,167,732)	2,252,516	4,448,089	(1,438,537)	3,009,552
Other reserves		16,024,969	5,669,387	21,694,356	18,409,986	2,334,404	20,744,390
Total equity attributable to equity holders of the Bank		27,273,767	3,501,655	30,775,422	37,087,863	895,867	37,983,730
Non-controlling interests		-	-	-	-	-	-
Total Equity		27,273,767	3,501,655	30,775,422	37,087,863	895,867	37,983,730
Total Liabilities and Equity		313,994,261	5,713,505	319,707,766	378,150,588	(17,552,380)	380,483,645

57 EXPLANATION OF TRANSITION TO LKASs/SLFRSs (Contd.)

57 (a) Explanation of transition to LKASs/SLFRSs - Bank (Contd.)

57 (a) i The Bank changed its method of recognising interest on Available for Sale treasury bills and bonds to Effective Interest Rate (EIR) method in accordance with LKAS 39 - Financial Instruments - Recognition & Measurement where by the interest was previously accounted for on a straight line basis.

The impact arising from the change is summarised as follows:

For the year ended 31st December	2011 Rs 000
Statement of comprehensive income	
Interest income	
Change of interest recognition	6,665
Adjustment before income tax	6,665

As at	31.12.2011 Rs 000	01.01.2011 Rs 000
Statement of financial position		
Financial investments - Available for sale	(2,771)	(8,191)
Financial investments - Loans and receivables	(3,758)	(5,003)
Adjustment to retained earnings	(6,529)	(13,194)

57 (a) ii The Bank valued the interest free deposits and the prepaid rent at fair value which were earlier held at nominal value. This resulted in recognition of higher rental expense while interest income is unwinded on these deposits.

The impact arising from the change is summarised as follows:

For the year ended 31st December	2011 Rs 000
Statement of comprehensive income	
Interest income	
Unwinding of interest income on interest free deposits	75,741
Premises, equipment and establishment expenses	
Rent expense	(85,360)
Adjustment before income tax	(9,619)

As at	31.12.2011 Rs 000	01.01.2011 Rs 000
Statement of financial position		
Other assets		
Prepaid rent	205,612	211,781
Interest free deposit	(190,931)	(200,349)
Other provisions		
Rent payable	61,687	48,819
Adjustment to retained earnings	(47,006)	(37,387)

Notes to the Financial Statements

57 EXPLANATION OF TRANSITION TO LKASs/SLFRSs (Contd.)

57 (a) Explanation of transition to LKASs/SLFRSs - Bank (Contd.)

57 (a) iii The Bank recognised an impairment provision in respect of loans, which are renegotiated because of financial difficulties of the borrower, based on the original effective interest rate before the modification of terms. Subsequent interest income is recognised at the original effective interest rate.

The impact arising from the change is summarised as follows:

For the year ended 31st December	2011 Rs 000
Statement of comprehensive income	
Interest income	
Unwinding of interest income on rescheduled loans	45,421
Impairment for loans and other losses	
Impairment on rescheduled loans	(96,057)
Adjustment before income tax	(50,636)

As at	31.12.2011 Rs 000	01.01.2011 Rs 000
Statement of financial position		
Loans and receivables to other customers	(120,650)	(70,014)
Adjustment to retained earnings	(120,650)	(70,014)

57 (a) iv The Bank measured the staff loans granted at reduced interest rates at fair value, based on the market interest rates that prevailed at the time of granting the loan. Accordingly the interest benefit accruing to the staff member is treated as a prepaid staff cost while interest is accounted for at the relevant market interest rate. The prepaid staff cost is amortised to the Statement of Comprehensive Income over the tenor of the loan.

The impact arising from the change is summarised as follows:

For the year ended 31st December	2011 Rs 000
Statement of comprehensive income	
Interest income	
Unwinding of interest income on staff loans at market interest rate	79,930
Personnel expenses	
Amortisation of prepaid staff cost	(74,457)
Adjustment before income tax	5,473

As at	31.12.2011 Rs 000	01.01.2011 Rs 000
Statement of financial position		
Loans and receivables to other customers		
Staff loans	(3,764,737)	(3,406,348)
Other assets		
Unamortised prepaid staff cost	3,834,917	3,471,055
Adjustment to retained earnings	70,180	64,707

57 EXPLANATION OF TRANSITION TO LKASs/SLFRSs (Contd.)

57 (a) Explanation of transition to LKASs/SLFRSs - Bank (Contd.)

57 (a) v The Bank charged an impairment provision for loans and advances in accordance with LKAS 39 - Financial Instruments - Recognition & measurement. The interest in suspense and the provisions made in accordance with Central Bank of Sri Lanka regulations were reversed. Further bad debts recovered was reclassified and netted off against impairment for loans and other losses.

The impact arising from the change is summarised as follows:

For the year ended 31st December	2011 Rs 000
Statement of comprehensive income	
Interest income	
Reversal of interest suspended/(charge of interest in suspense reversed) based on CBSL guidelines	(27,726)
Other income	
Bad debts recovered	(528,879)
Impairment for loans and other losses	
Reversal of loan loss provisions/(charge of loan loss provision reversals) based on CBSL guidelines	(1,141,652)
Bad debts recovered	528,879
Impairment provision for loans and advances	1,047,767
Adjustment before income tax	(121,611)

As at	31.12.2011 Rs 000	01.01.2011 Rs 000
Statement of financial position		
Loans and receivables to other customers		
Interest in suspense	1,670,016	1,697,742
Loan loss provision based on CBSL	4,187,324	5,328,976
Impairment provision	(6,664,907)	(7,712,674)
Adjustment to retained earnings	(807,567)	(685,956)

Notes to the Financial Statements

57 EXPLANATION OF TRANSITION TO LKASs/SLFRSs (Contd.)

57 (a) Explanation of transition to LKASs/SLFRSs - Bank (Contd.)

57 (a) vi The Bank accounted for the derivative contracts at fair value. This resulted in revaluation of forward exchange contracts at bid/offer rates as opposed to mid rates used earlier.

The impact arising from the change is summarised as follows.

For the year ended 31st December	2011 Rs 000
Statement of comprehensive income	
Interest income	
SWAP	(145,700)
Interest expense	
SWAP	274,286
Net loss from trading	
Derivative assets and liabilities	(314,248)
Reversal of unrealised loss on forward exchange contracts as per previous GAAP	99,075
Reversal of increase in interest payable SWAP	78,068
Reversal of increase in interest receivable SWAP	(16,648)
Adjustment before income tax	(25,167)

As at	31.12.2011 Rs 000	01.01.2011 Rs 000
Statement of financial position		
Derivative financial instruments (assets)	496,643	231,124
Derivative financial instruments (liabilities)	617,702	166,521
Other assets		
Interest receivable	(16,817)	(169)
Other provisions		
Interest payable	(104,850)	(26,782)
Other liabilities		
Unrealised loss on forward exchange contracts	(19,262)	79,813
Adjustment to retained earnings	(13,764)	11,403

57 (a) vii The Bank accounted for its off balance sheet items at fair value. Accordingly the commission income earned on these items have been amortised over the tenor of the relevant contracts as opposed to accounting for the commission income upfront under the previous GAAP.

The impact arising from the change is summarised as follows:

For the year ended 31st December	2011 Rs 000
Statement of comprehensive income	
Fee and commission income	
Amortisation of fee income on off balance sheet items	(69,148)
Adjustment before income tax	(69,148)

As at	31.12.2011 Rs 000	01.01.2011 Rs 000
Statement of financial position		
Other liabilities		
Unamortised fee income on off balance sheet items	163,027	93,879
Adjustment to retained earnings	(163,027)	(93,879)

57 EXPLANATION OF TRANSITION TO LKASs/SLFRSs (Contd.)

57 (a) Explanation of transition to LKASs/SLFRSs - Bank (Contd.)

57 (a) viii The Bank accounted for its deposits based on amortised cost as opposed to nominal cost under the previous GAAP.

The impact arising from the change is summarised as follows:

For the year ended 31st December	2011 Rs 000
Statement of comprehensive income	
Interest expense	
Deposits	(59,086)
Adjustment before income tax	(59,086)

As at	31.12.2011 Rs 000	01.01.2011 Rs 000
Statement of financial position		
Due to other customers	(384,988)	(444,074)
Adjustment to retained earnings	384,988	444,074

57 (a) ix The Bank carried out an actuarial valuation of its long term employee benefits given by way of accumulated leave to be utilised prior to retirement. The Bank accounted for the cost of such accumulated leave in the year of utilisation in the form of salaries under the previous GAAP.

The impact arising from the change is summarised as follows:

For the year ended 31st December	2011 Rs 000
Statement of comprehensive income	
Personnel expenses	
Other long term benefits	(7,243)
Adjustment before income tax	(7,243)

As at	31.12.2011 Rs 000	01.01.2011 Rs 000
Statement of financial position		
Other liabilities		
Provision for other long term employee benefits	110,601	103,358
Adjustment to retained earnings	(110,601)	(103,358)

57 (a) x The Bank had set up an Employee Share Benefit trust (ESBT) for the benefit of employees in the executive carder and above, where by the Bank had given a loan at a consessional interest to the trust in order to purchase shares on behalf of the employees covered by the plan. The employees are paid the appreciation in value of shares net of taxes, interest cost etc. The Bank treated such payments as further advances to the trust under the previous GAAP. The Bank carried out an option valuation of the trust in order to recognise the expense/liability in relation to the plan.

The impact arising from the change is summarised as follows:

For the year ended 31st December	2011 Rs 000
Statement of comprehensive income	
Personnel expenses	
Cash settled share based payments	596,846
Adjustment before income tax	596,846

As at	31.12.2011 Rs 000	01.01.2011 Rs 000
Statement of financial position		
Loans and receivables to other customers		
ESBT loan	(90,879)	-
Other liabilities		
Provision for cash settled share based payments	1,120,660	1,808,385
Adjustment to retained earnings	(1,211,539)	(1,808,385)

Notes to the Financial Statements

57 EXPLANATION OF TRANSITION TO LKASs/SLFRSs (Contd.)

57 (a) Explanation of transition to LKASs/SLFRSs - Bank (Contd.)

57 (a) xi On adoption of SLAS 16 (Revised 2006) - Employee benefits in 2008 the Bank made an irrevocable choice based on the transitional provisions to amortise the transitional liability of the pension fund as at 1st January 2008 on a straight line basis over a period of five years from 1st January 2008. Accordingly Rs. 283.475 Mn had to be to be amortised annually. On adoption of SLFRSs the previous unamortised transitional liability of the pension fund was charged against retained earnings as at 1st January 2011 and the amount charged to the Income Statement during 2011 was reversed. Further the Bank adopted the exemption in SLFRS 1 to recognised all cumulative unrecognised acturial gains and losses on the date of adoption of SLFRSs.

The impact arising from the change is summarised as follows:

For the year ended 31st December	2011 Rs 000
Statement of comprehensive income	
Personnel expenses	
Reversal of amortisation of pervious transitional liability	283,475
Actuarial gain/(loss) on defined benefit plans	34,870
Adjustment before income tax	318,345

As at	31.12.2011 Rs 000	01.01.2011 Rs 000
Statement of financial position		
Other liabilities		
Write off of remaining transitional deficit of pension fund	283,475	566,950
Write off of cumulative unrecognised acturial losses	455,747	490,617
Adjustment to retained earnings	(739,222)	(1,057,567)

57 (a) xii Bank made a prudential provision for the total value of its investment in the bonds issued by the Government of Greece during 2011. Since this provision was made in anticipation of a loss it was reversed on adoption of SLFRSs. This investments was classified as available-for-sale financial assets and measured at fair value.

The impact arising from the change is summarised as follows:

For the year ended 31st December	2011 Rs 000
Statement of comprehensive income	
Impairment for loans and other losses	
Reversal of provision made on investment in foreign government bonds	145,910
Adjustment before income tax	145,910

As at	31.12.2011 Rs 000
Statement of financial position	
Financial investments - Available for sale	145,910
Adjustment to retained earnings	145,910

57 (a) xiii Bank changed the basis of measurement for its available-for-sale investments portfolio from cost method to fair value method.

The impact arising from the change is summarised as follows:

For the year ended 31st December	2011 Rs 000
Statement of comprehensive income	
Gains and losses on re-measuring available for sale financial assets	
Net change in fair value on available-for-sale financial assets	(3,334,984)
Adjustment before income tax	(3,334,984)

As at	31.12.2011 Rs 000	01.01.2011 Rs 000
Statement of financial position		
Financial investments - Available for sale	2,334,404	5,669,388
Adjustment to available-for-sale reserve	2,334,404	5,669,388

57 EXPLANATION OF TRANSITION TO LKASs/SLFRSs (Contd.)

57 (a) Explanation of transition to LKASs/SLFRSs - Bank (Contd.)

57 (a) xiv Bank reclassified interest receivable and interest payable accounted for in other assets and other liabilities respectively to the related asset or the liability.

The impact arising from the change is summarised as follows:

As at	31.12.2011 Rs 000	01.01.2011 Rs 000
Statement of financial position		
Other financial assets held for trading	18,537	107
Financial investments - Available for sale	408,155	321,184
Financial investments - Loans and receivables	80,615	69,184
Loans and receivables to other customers	2,771,618	2,188,309
Placements with banks	20,971	102,644
Other assets		
Interest receivable	(3,299,896)	(2,681,428)
Due to banks	305,348	116,194
Other borrowings	31,213	115,702
Subordinated debentures	242,118	124,850
Deposits from customers	7,606,136	5,415,458
Other provisions		
Interest payable	(8,184,815)	(5,772,204)
Adjustment to retained earnings	-	-

57 (a) xv Bank reclassified all gains/(losses) on trading assets into net trading income/(expense) and all gains/(losses) on other financial assets as net gains/(losses) on other financial assets.

The impact arising from the change is summarised as follows:

For the year ended 31st December	2011 Rs 000
Statement of comprehensive income	
Foreign exchange profit	(988,231)
Dividend income	(409,440)
Net trading income/(expense)	(193,384)
Net gains/(losses) on financial assets	398,936
Other operating income (net)	1,007,049
Other overhead expenses	185,070
Adjustment before income tax	-

57 (a) xvi Bank changed the method of computing fair value of investments held at fair value through profit and loss from mid rate to bid rate.

The impact arising from the change is summarised as follows:

For the year ended 31st December	2011 Rs 000
Statement of comprehensive income	
Net trading income/(expense)	59
Adjustment before income tax	59

As at	31.12.2011 Rs 000	01.01.2011 Rs 000
Statement of financial position		
Trading assets	(102)	(161)
Adjustment to retained earnings	(102)	(161)

Notes to the Financial Statements

57 EXPLANATION OF TRANSITION TO LKASs/SLFRSs (Contd.)

57 (a) Explanation of transition to LKASs/SLFRSs - Bank (Contd.)

57 (a) xvii EPF is an approved provident fund which has been set up to take care of the provident fund liabilities of the Bank. Staff members who are members of the fund are entitled to receive a minimum interest rate higher of one year fixed deposit rate of HNB or National Savings Bank on a semi annual basis. Accordingly this was treated as a defined benefit liability and an acturial valuation was conducted to value the bank's obligation of the same.

The impact arising from the change is summarised as follows:

For the year ended 31st December	2011 Rs 000
Statement of comprehensive income	
Personnel expenses	(1,219)
Adjustment before income tax	(1,219)

As at	31.12.2011 Rs 000	01.01.2011 Rs 000
Statement of financial position		
Other liabilities	14,882	13,663
Adjustment to retained earnings	(14,882)	(13,663)

57 (a) xviii Bank reclassified bills of exchange, commercial papers, securities purchased under resale agreements and lease receivables as loans and advances.

The impact arising from the change is summarised as follows:

As at	31.12.2011 Rs 000	01.01.2011 Rs 000
Statement of financial position		
Bills of exchange	(959,012)	(1,401,130)
Commercial papers	(24,986)	(158,963)
Securities purchased under resale agreements	(781,193)	(1,185,831)
Lease receivables within one year	(7,138,715)	(4,630,492)
Lease receivables after one year	(16,785,652)	(8,816,761)
Loans and advances	25,689,558	16,193,177
Adjustment to retained earnings	-	-

57 (a) xix Bank changed the financial VAT expense, income tax expense, current tax liabilities and deferred tax liabilities based on adjusted profit and retained earnings.

The impact arising from the change is summarised as follows:

For the year ended 31st December	2011 Rs 000
Statement of comprehensive income	
Value added tax on financial services (VAT)	(74,432)
Adjustment before income tax	(74,432)
Income tax expense	74,060
Adjustment after income tax	74,060

As at	31.12.2011 Rs 000	01.01.2011 Rs 000
Statement of financial position		
Other provisions	(229,386)	(303,818)
Current tax liabilities	(658,168)	(540,201)
Deferred tax asset	313,785	506,348
Deferred tax liabilities	6,062	154,718
Adjustment to retained earnings	1,195,277	1,195,649

57 EXPLANATION OF TRANSITION TO LKASs/SLFRSs (Contd.)

57 (a) Explanation of transition to LKASs/SLFRSs - Bank (Contd.)

57 (a) xx Bank had reclassified provision charge/(release) for loan losses, diminution in value of investment securities/subsidiary and loans written off as impairment loss on loans and other losses

The impact arising from the change is summarised as follows:

For the year ended 31st December	2011 Rs 000
Statement of comprehensive income	
Provision charge/(release) for loans losses	164,562
Diminution in value of investment securities/subsidiary	(202,031)
Loans written off	(2,005)
Impairment for loans and other losses	39,474
Adjustment before income tax	-

57 (a) xxi Provision charge for employee benefits have been reclassified as personnel expenses

The impact arising from the change is summarised as follows:

For the year ended 31st December	2011 Rs 000
Statement of comprehensive income	
Personnel expenses	893,507
Provision charge/(release) for employee benefits	(893,507)
Adjustment before income tax	-

57 (a) xxii Financial VAT included in other overhead expenses has been reclassified as value added tax on financial services

The impact arising from the change is summarised as follows:

For the year ended 31st December	2011 Rs 000
Statement of comprehensive income	
Other overhead expenses	(1,149,711)
Value added tax on financial services	1,149,711
Adjustment before income tax	-

57 (a) xxiii Placements included in cash and cash equivalents have been reclassified as placements with banks

The impact arising from the change is summarised as follows:

As at	31.12.2011 Rs 000	01.01.2011 Rs 000
Statement of financial position		
Cash and cash equivalents	(7,199,180)	(11,449,302)
Placements with banks	7,199,180	11,449,302
Adjustment to retained earnings	-	-

Notes to the Financial Statements

57 EXPLANATION OF TRANSITION TO LKASs/SLFRSs (Contd.)

57 (a) Explanation of transition to LKASs/SLFRSs - Bank (Contd.)

57 (a) xxiv Investment securities have been reclassified as financial assets - Available for sale and financial assets - Loans and receivables

The impact arising from the change is summarised as follows:

As at	31.12.2011 Rs 000	01.01.2011 Rs 000
Statement of financial position		
Investment securities	(62,942,501)	(58,704,102)
Financial assets - Available for sale	48,353,360	43,397,497
Financial assets - Loans and receivables	14,589,141	15,306,605
Adjustment to retained earnings	-	-

57 (a) xxv Prepayments made for intangible assets included in capital work-in-progress has been reclassified as other assets

The impact arising from the change is summarised as follows:

As at	31.12.2011 Rs 000	01.01.2011 Rs 000
Statement of financial position		
Property, plant and equipment		
Capital work-in-progress	(12,942)	(46,392)
Other assets	12,942	46,392
Adjustment to retained earnings	-	-

57 (a) xxvi Borrowings from banks have been reclassified as due to banks and securities sold under repurchase agreements have been reclassified as other borrowings

The impact arising from the change is summarised as follows:

As at	31.12.2011 Rs 000	01.01.2011 Rs 000
Statement of financial position		
Due to banks	19,580,088	10,304,984
Securities sold under repurchase agreements	(6,559,088)	(11,951,727)
Other borrowings	(13,021,000)	1,646,743
Adjustment to retained earnings	-	-

57 (a) xxvii Provisions included in other liabilities have been reclassified as other provisions while key deposits included under due to customers have been reclassified as other liabilities

The impact arising from the change is summarised as follows:

As at	31.12.2011 Rs 000	01.01.2011 Rs 000
Statement of financial position		
Other provisions	14,269,734	14,451,827
Other liabilities	(14,259,202)	(14,440,249)
Due to customers	(10,532)	(11,578)
Adjustment to retained earnings	-	-

57 EXPLANATION OF TRANSITION TO LKASs/SLFRSs (Contd.)

57 (b) Explanation of Impact from Transition to LKASs/SLFRSs Group

Apart from the adjustments to the Bank figures reflected above and the reclassifications performed in the financial statements of group entities, following are the material changes to the consolidated financial statements from the transition to LKASs/SLFRSs.

57 (b) i Consolidation of Employee Share Benefit Trust (ESBT)

ESBT which had been set up to administer the employee share ownership plan has been treated as a special purpose entity and had been consolidated. Accordingly the shares held by the trust has been treated as treasury shares in the consolidated financial statements.

As at	31.12.2011 Rs 000	01.01.2011 Rs 000
Treasury shares	310,938	147,224

57 (b) ii Classification of securities based on LKAS 32 and 39, previously held in the trading and investment portfolio

Investments held in trading, investment portfolio and as treasury bills were classified as other financial assets held for trading, financial assets - held to maturity, financial assets - loans and receivables and financial assets - available for sale.

As at	31.12.2011 Rs 000	01.01.2011 Rs 000
Dealing securities accounted under previous GAAP	(725,304)	(1,046,781)
Transferred to financial assets - Fair value through PL	725,304	1,046,781
	-	-
Investment securities accounted under previous GAAP	(2,455,111)	(1,544,882)
Transferred to financial assets - Available for sale	160,152	184,946
Transferred to financial assets - Fair value through PL	70,453	38,703
Transferred to financial assets - Loans and receivables	677,420	358,920
Transferred to financial assets - Held to maturity	1,538,786	954,013
Transferred to financial assets - Other assets	8,300	8,300
	-	-
Treasury bills accounted under previous GAAP	(544,821)	(976,447)
Transferred to financial assets - Available for sale	388,832	-
Transferred to financial assets - Fair value through PL		99,604
Transferred to financial assets - Held to maturity	155,989	876,843
	-	-

57 (b) iii Revaluation impact on reclassification of investment properties as property, plant and equipment

Two properties accounted for as investment properties in the Bank are classified as property, plant & equipment in the consolidated financial statements. The revaluation impact on these properties have been accounted for in the consolidated financial statements.

As at	31.12.2011 Rs 000	01.01.2011 Rs 000
Increase in revaluation reserve	626,009	626,375

57 (b) iv Other material reclassifications performed in the consolidated financial statements are as follows

As at	31.12.2011 Rs 000	01.01.2011 Rs 000
Transfer of investment in securities purchased under resale agreements to loans and advances to other customers	2,148,673	1,527,760
Transfer of securities sold under re purchase agreement to other borrowings	1,752,352	1,571,386
Transfer of commercial papers to loans and advances to other customers	62,551	53,082

Consolidated Statement of
Comprehensive Income in US Dollars

	BANK		GROUP	
For the year ended 31st December	2012 US $ 000	2011 US $ 000	2012 US $ 000	2011 US $ 000
Income	403,909	290,377	432,122	314,319
Interest income	370,909	259,898	375,555	262,804
Less: Interest expenses	198,735	129,497	199,731	130,251
Net interest income	172,174	130,401	175,824	132,553
Fee and commission income	29,303	21,235	30,031	23,404
Less: Fee and commission expenses	419	271	502	441
Net fee and commission income	28,884	20,964	29,529	22,963
Net interest, fee and commission income	201,058	151,365	205,353	155,516
Net gain/(loss) from trading	(12,790)	(2,719)	(12,723)	(3,340)
Net gain/(loss) from financial investments	1,117	3,126	897	3,061
Other operating income	15,370	8,837	38,362	28,390
Total Operating income	204,755	160,609	231,889	183,627
Less: Impairment for loans and other losses	9,105	(3,490)	9,105	(3,929)
Net operating income	195,650	164,099	222,784	187,556
Less:				
OPERATING EXPENSES				
Personnel expenses	51,083	39,071	55,651	43,291
Premises, equipment and establishment expenses	28,012	25,672	27,272	23,160
Other overhead expenses	28,085	24,055	46,452	40,445
	107,180	88,798	129,375	106,896
Operating profit/(loss) before value added tax (VAT)	88,470	75,301	93,409	80,660
Less: Value added tax (VAT) on financial services	9,776	9,590	9,776	9,590
Operating profit/(loss) after value added tax (VAT)	78,694	65,711	83,633	71,070
Share of profit/(loss) of Associates (net of income tax)	-	-	131	(124)
PROFIT BEFORE INCOME TAX	78,694	65,711	83,764	70,946
Less: Income tax expense	18,350	16,634	18,970	16,891
PROFIT FOR THE YEAR	60,344	49,077	64,794	54,055
Profit attributable to:				
Owners of the parent	60,344	49,077	63,539	53,416
Non-controlling interests	-	-	1,255	639
PROFIT FOR THE YEAR	60,344	49,077	64,794	54,055
OTHER COMPREHENSIVE INCOME, NET OF INCOME TAX				
Gains and losses (arising from translating the financial statements of foreign operations)	-	-	109	34
Gains and losses on re-measuring available-for-sale financial assets				
Net change in fair value on available-for-sale financial assets	2,225	(26,127)	2,398	(26,175)
Transfer to long term insurance fund	-	-	(168)	49
Net amount transferred to profit or loss (available-for-sale financial assets)	591	-	602	(46)
Actuarial gains and losses on defined benefit plans	4,603	274	4,603	274
Changes in revaluation surplus	11,478	35	18,781	35
Other comprehensive income for the year, net of tax	18,897	(25,818)	26,325	(25,829)
Total comprehensive income for the year	79,241	23,259	91,119	28,226
Total comprehensive income attributable to:				
Equity holders of the Bank	79,241	23,259	89,782	27,586
Non-controlling interests	-	-	1,337	640
Total comprehensive income for the year	79,241	23,259	91,119	28,226
Earnings per share on profit				
Basic earnings per ordinary share (US$)	0.15	0.13	0.17	0.15
Diluted earnings per ordinary share (US$)	0.15	0.13	0.17	0.15
DIVIDEND PER SHARE (US$)	0.07	0.06	0.07	0.06

Exchange rate of US$ 1 was Rs 127.65 as at 31st December 2012 (Rs 113.9 as at 31st December 2011)

*Calculated on interim dividend paid and final dividend proposed, which is to be approved at the Annual General Meeting.

The Income Statement given on this page is solely for the convenience of the shareholders, bankers, investors, customers and other users of Financial Statements and do not form part of the audited Financial Statements.

Consolidated Statement of Financial Position in US Dollars

As at 31st December	BANK 31.12.2012 US$ 000	BANK 31.12.2011 US$ 000	BANK 01.01.2011 US$ 000	GROUP 31.12.2012 US$ 000	GROUP 31.12.2011 US$ 000	GROUP 01.01.2011 US$ 000
ASSETS						
Cash and cash equivalents	68,698	59,090	51,362	69,321	59,352	52,085
Balances with Central Banks	156,158	146,365	97,859	156,288	146,481	97,972
Placements with banks	80,861	56,563	90,498	91,402	64,583	94,380
Derivative financial instruments	2,700	3,891	1,811	2,700	3,891	1,811
Other financial assets held for trading	3,714	9,092	11,418	8,446	18,862	23,491
Non-current assets held for sale	-	-	-	23	23	23
Loans and receivables to other customers	2,371,806	2,014,872	1,584,435	2,380,902	2,016,730	1,579,159
Financial investments - Available-for-sale	453,346	401,403	386,839	461,648	402,938	388,774
Financial investments - Held-to-maturity	-	-	-	12,878	13,300	12,663
Financial investments - Loans and receivables	156,919	114,893	120,414	163,762	120,346	123,302
Investments in Associates	-	656	656	3,026	3,011	1,536
Investment in Joint Venture	5,132	5,132	5,132	-	-	-
Investments in Subsidiaries	18,467	18,467	17,071	-	-	-
Investment properties	2,740	2,737	2,770	1,290	1,325	1,360
Property, plant and equipment	73,780	61,378	58,187	139,565	120,765	118,416
Intangible assets	4,357	4,305	4,521	5,402	5,255	5,507
Deferred tax assets	2,897	2,459	3,967	2,916	2,499	3,984
Other assets	94,730	79,384	67,634	99,337	86,038	77,602
Total Assets	3,496,305	2,980,687	2,504,574	3,598,906	3,065,399	2,582,065
LIABILITIES						
Due to banks	238,159	155,781	81,639	238,159	155,781	81,639
Derivative financial instruments	11,253	4,840	1,305	11,253	4,840	1,305
Due to other customers	2,674,689	2,282,465	1,872,572	2,670,174	2,278,979	1,871,043
Dividends payable	1,735	1,317	389	1,749	1,331	401
Other borrowings	38,783	54,906	98,496	52,857	69,536	110,800
Debt securities issued	-	-	-	1,176	-	-
Current tax liabilities	13,752	8,004	20,270	14,413	8,569	21,299
Bills payable	11,208	11,001	10,225	11,208	11,001	10,225
Subordinated debentures	35,923	39,352	22,320	35,747	39,087	22,065
Insurance provision - Life	-	-	-	28,408	23,669	18,921
Insurance provision - General	-	-	-	7,595	7,398	5,821
Deferred tax liabilities	11,582	9,204	6,977	12,193	9,600	7,521
Other provisions	33,220	45,534	65,789	34,471	46,040	66,521
Other liabilities	61,912	70,720	83,497	67,484	77,746	93,905
Total Liabilities	3,132,216	2,683,124	2,263,479	3,186,887	2,733,577	2,311,466
EQUITY						
Stated capital	98,547	89,710	41,666	98,547	89,710	41,666
Statutory reserves	35,493	21,766	11,830	35,493	21,766	11,830
Retained earnings	33,106	23,577	17,647	41,691	27,452	16,608
Other reserves	196,943	162,510	169,952	228,693	186,766	195,923
Total equity attributable to equity holders of the Bank	364,089	297,563	241,095	404,424	325,694	266,027
Non-controlling interests	-	-	-	7,595	6,128	4,572
Total Equity	364,089	297,563	241,095	412,019	331,822	270,599
Total Liabilities and Equity	3,496,305	2,980,687	2,504,574	3,598,906	3,065,399	2,582,065
Commitments and contingencies	1,287,639	1,195,371	972,743	1,287,639	1,195,371	972,743

Exchange rate of US$ 1 was Rs 127.65 as at 31st December 2012 (Rs 110.965 as at 31st December 2011 and Rs 113.9 as at 31st December 2010)

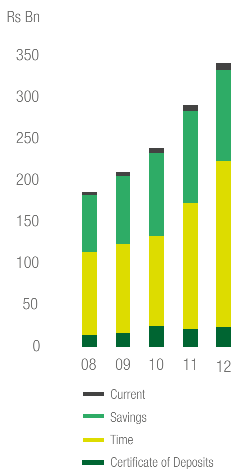
The Balance Sheet given on this page is solely for the convenience of the shareholders, bankers, investors, customers and other users of Financial Statements and do not form part of the audited Financial Statements.

Analysis of Deposits

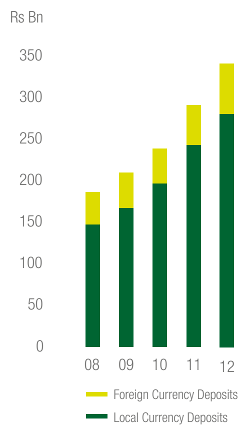
	2008 Rs 000	2009 Rs 000	2010 Rs 000	2011 Rs 000	2012 Rs 000
Analysis of Total Deposits					
Local currency deposits	147,392,211	167,182,907	196,671,010	243,138,771	280,644,472
Foreign currency deposits	39,377,651	43,323,898	42,362,773	48,217,807	60,779,514
	186,769,862	210,506,805	239,033,783	291,356,578	341,423,986
Product wise analysis of Deposits					
Current	14,271,363	16,282,068	25,008,108	21,771,048	23,390,690
Savings	68,723,307	80,795,773	99,020,314	111,121,508	109,176,640
Time	99,505,199	107,989,147	108,656,567	151,352,012	200,801,761
Certificate of Deposit	4,269,993	5,439,817	6,348,794	7,112,010	8,054,895
	186,769,862	210,506,805	239,033,783	291,356,578	341,423,986
Refinance	6,424,054	6,169,445	6,428,566	7,045,377	6,435,465
Total Deposits and Refinance	193,193,916	216,676,250	245,462,349	298,401,955	347,859,451

*2008 and 2009 figures are based on SLAS (previous GAAP) and 2010, 2011 and 2012 are based on LKASs/SLFRSs.

Analysis of Product-wise Deposits



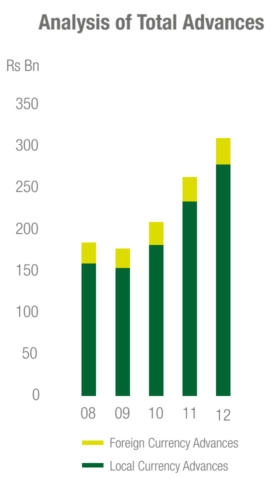
Analysis of Total Deposits

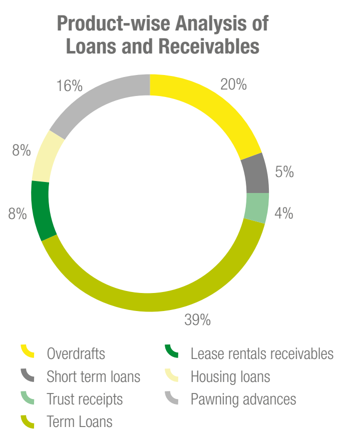


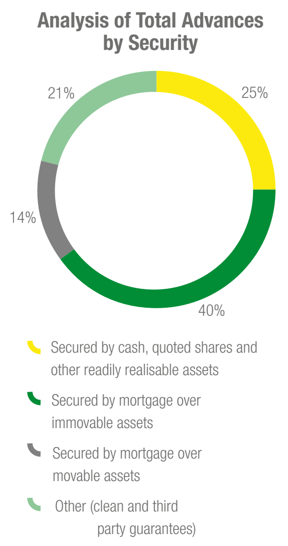
Analysis of Advances

	2008 Rs 000	2009 Rs 000	2010 Rs 000	2011 Rs 000	2012 Rs 000
Analysis of Advances (Gross)					
Local currency advances	159,292,224	153 ,569,886	181,374,060	234,068,684	278,566,254
Foreign currency advances	25,132,454	23,659,294	27,404,539	29,013,089	31,767,371
Total advances	184,424,678	177,229,180	208,778,599	263,081,773	310,333,625
Product wise analysis of loans and receivables (Gross)					
Overdrafts	38,330,896	33,723,102	43,179,410	48,088,165	61,160,391
Short term loans	7,656,837	10,297,431	13,754,239	13,254,457	16,756,644
Trust receipts	8,831,924	8,826,074	8,414,353	11,152,041	13,059,931
Term loans	77,792,891	74,905,923	81,408,831	106,728,989	121,826,058
Lease rentals receivables	12,038,851	9,398,642	13,919,320	24,568,780	25,280,078
Housing loans	18,643,341	18,163,102	18,821,074	21,800,114	22,990,253
Pawning advances	21,129,938	21,914,906	29,281,372	37,489,227	49,260,270
	184,424,678	177,229,180	208,778,599	263,081,773	310,333,625

*2008 and 2009 figures are based on SLAS (previous GAAP) and 2010, 2011 and 2012 are based on LKASs/SLFRSs.





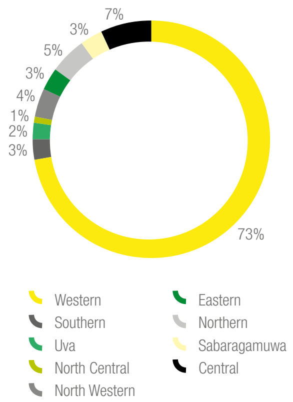


Province-wise Analysis of Deposits and Advances

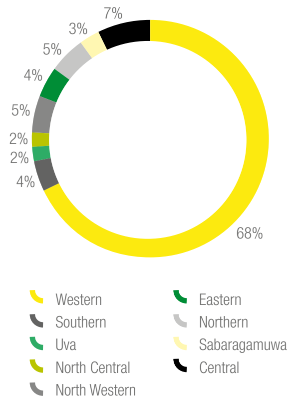
As at 31st December 2012

PROVINCE	No of Branches	Deposits (Rs Mn)	%	Advances Including Leasing (Rs Mn)	%	Deposit Utilisation %
WESTERN	100	247,864	72	211,242	68	85
SOUTHERN	24	11,711	3	13,722	4	117
UVA	11	6,085	2	5,949	2	98
NORTH CENTRAL	10	4,888	1	6,387	2	131
NORTH WESTERN	18	14,213	4	15,944	5	112
EASTERN	26	8,717	3	11,311	4	130
NORTHERN	22	15,887	5	15,395	5	97
SABARAGAMUWA	11	9,415	3	8,805	3	94
CENTRAL	25	22,643	7	21,630	7	96
Total	247	341,424	100	310,385	100	91

Province-wise Deposits



Province-wise Advances

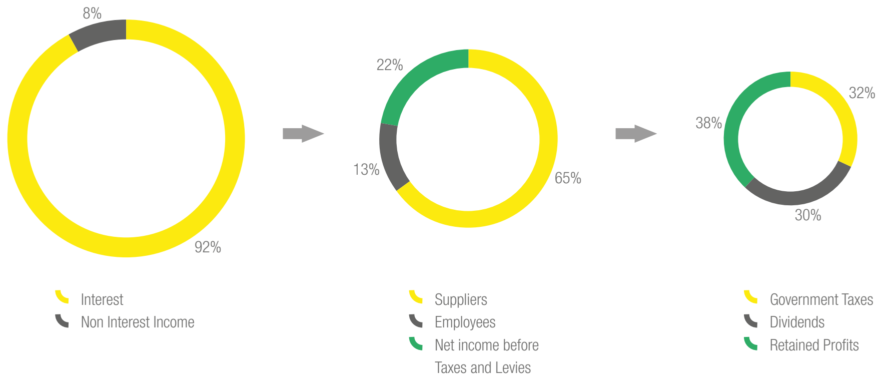


Sources and Utilisation of Income

	2008 Rs 000	2009 Rs 000	2010 Rs 000	2011 Rs 000	2012 Rs 000
Sources of Income					
Interest	32,431,158	34,620,276	30,249,230	33,175,928	47,346,498
Non interest income	4,183,998	4,190,823	4,621,188	3,855,852	4,158,995
Total	36,615,156	38,811,099	34,870,418	37,031,780	51,505,493
Utilisation of Income					
Employees					
Salaries and other payment to Staff	4,348,690	4,909,419	5,507,101	4,987,287	6,520,648
Suppliers					
Interest Paid	19,751,667	20,039,646	14,703,256	16,530,253	25,368,432
Other expenses	5,899,282	5,602,193	5,977,392	5,884,317	8,307,852
	25,650,949	25,641,839	20,680,648	22,414,570	33,676,284
Net Income before Government Taxes and Levies	6,615,517	8,259,841	8,682,669	9,629,923	11,308,569
Government					
Income Tax, VAT, Debit Tax, SRL (Incl. Deferred Tax)	3,343,547	3,770,452	4,188,491	3,365,258	3,605,190
Shareholders					
Dividends	942,118	1,533,222	1,649,547	2,914,484	3,378,023
Retained Profits	2,329,852	2,956,166	2,844,631	3,350,181	4,325,348
Total	36,615,156	38,811,099	34,870,418	37,031,780	51,505,493

*2008 and 2009 figures are based on SLAS (previous GAAP) and 2010, 2011 and 2012 are based on LKASs/SLFRSs.

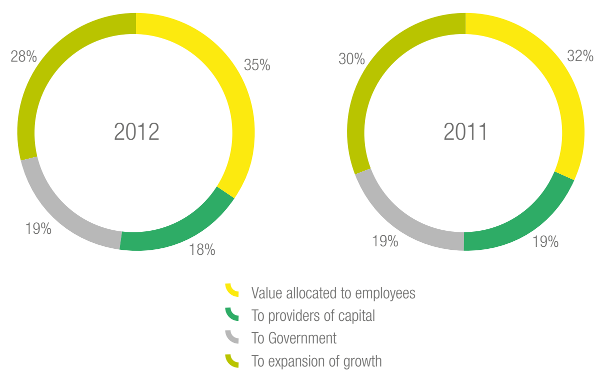
Sources and Utilisation of Income



Value Added Statement

		2012 Rs 000	%		2011 Rs 000	%
Value Added						
Income earned by providing banking services		52,910,373			36,898,043	
Cost of services		31,591,760			21,979,338	
Value added by banking services		21,318,613			14,918,705	
Non-banking income		138,576			116,400	
Net Gain/(loss) from Trading & Financial investment		(1,490,049)			51,858	
Impairment for loans and other losses		(1,162,231)			445,373	
		18,804,909			15,532,336	
Value allocated to employees						
Salaries,wages & other benefits		6,520,648	34.68		4,987,287	32.11
To providers of capital						
Dividends to shareholders		3,378,023	17.96		2,914,624	18.76
To Government						
Value Added tax	1,247,873			1,224,143		
Income tax	2,227,602			1,641,989		
Debit tax	-			2,964		
Stamp Duty	14,982	3,490,457	18.56	14,948	2,884,044	18.57
To expansion and growth						
Retained income		4,325,348	23.00		3,350,041	21.57
Depreciation & Amortisation		975,700	5.19		915,126	5.89
Deferred taxation		114,733	0.61		481,214	3.10
		18,804,909	100.00		15,532,336	100.0

Analysis of Value Addition



Ten Year
Statistical Summary

Year ended 31st December (Rs Mn)	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
OPERATING RESULTS										
Income	14,655	13,829	16,674	21,168	29,565	36,615	38,811	34,870	37,066	51,559
Interest Income	11,537	11,469	14,130	18,452	26,250	32,431	34,620	30,249	33,176	47,346
Interest Expense	6,909	5,962	7,281	9,797	15,190	19,752	20,040	14,703	16,530	25,368
Non Interest Income	3,119	2,237	2,427	2,614	3,237	4,131	4,053	4,591	3,856	4,159
Operating Expenses (Incl. VAT)	6,654	6,794	7,426	8,249	9,963	12,026	12,716	13,406	12,114	16,091
Profit before Income Tax	1,092	950	1,850	3,019	4,335	4,785	5,918	6,731	8,388	10,046
Income Tax on Profit	83	(26)	195	799	1,312	1,566	1,566	2,267	2,123	2,342
Profit after Taxation	1,008	976	1,655	2,220	3,022	3,219	4,352	4,464	6,265	7,703
LIABILITIES AND SHAREHOLDERS' FUNDS										
Customer Deposits	101,026	118,524	128,284	147,557	175,660	186,770	210,507	239,034	291,357	341,424
Refinance Borrowings	1,764	2,066	2,712	3,583	5,750	6,424	6,169	6,429	7,045	6,435
Other Liabilities	23,161	22,787	23,464	31,687	32,472	42,064	38,773	42,579	42,923	50,489
Deferred Taxation	387	350	314	314	606	872	939	891	1,175	1,478
Shareholders' funds	6,993	9,052	11,239	12,930	18,419	20,581	23,900	30,775	37,984	46,476
Total	133,331	152,780	166,012	196,070	232,906	256,711	280,289	319,708	380,484	446,302
ASSETS										
Loans and Receivables (Net)	82,823	97,510	112,500	133,460	160,343	174,808	169,639	202,253	257,198	302,761
Cash, Short Term Funds and Statutory Deposits with Central Bank of Sri Lanka	21,119	25,013	24,400	30,200	32,565	35,149	38,216	30,600	33,446	39,025
Property, Plant and Equipment	3,414	3,387	3,059	2,908	6,083	6,866	7,180	7,428	7,835	9,418
Other Assets	25,975	26,870	26,053	29,502	33,915	39,888	65,254	79,427	82,005	95,098
Total	133,331	152,780	166,012	196,070	232,906	256,711	280,289	319,708	380,484	446,302
RATIOS										
Return on Average Shareholders Funds (%)	14	12	16	18	19	17	20	16	18	18
Income Growth (%)	26	(6)	21	27	40	24	6	(10)	6	39
Return on Average Assets (%)	0.8	0.7	1.0	1.2	1.4	1.3	1.6	1.5	1.8	1.9
Dividend Cover (Times)	3.5	2.8	3.5	3.8	3.7	3.4	2.8	2.7	2.1	2.3
Property, Plant and Equipment to Shareholders' Funds (%)	49	37	27	22	33	33	30	24	21	20
Total Assets to Shareholders' Funds (Times)	19	17	15	15	13	12	12	10	10	10
(As specified in the Banking Act No. 30 of 1988)										
Capital Funds to Liabilities including Contingent Liabilities (%)	1.0	1.0	1.0	1.0	1.3	1.2	1.1	1.0	2.2	2.2
Liquid Assets to Liabilities (%)	27	25	24	22	22	22	29	24	22	22
SHARE INFORMATION										
Market Value per Share (Rs)										
-Voting	69.00	57.00	112.50	155.75	122.50	69.75	170.25	399.90	151.30	148.00
-Non Voting	36.75	32.75	41.50	70.00	53.25	32.00	104.75	214.60	83.20	112.50
Earnings per Share (Rs)	14.10	9.75	14.05	18.86	12.83	13.67	18.47	18.84	16.60	19.36
Earnings per Share (Adjusted) (Rs) *	2.53	2.45	4.16	5.58	7.60	8.09	10.94	11.22	15.75	19.36
Price Earnings Ratio	4.89	5.84	8.01	8.26	9.55	5.10	9.22	21.23	9.11	7.64
Net Assets per Share (Adjusted) (Rs) **	17.60	22.79	28.29	32.55	46.37	51.81	60.16	77.47	95.62	116.99
Dividend per share (Rs)	4.00	3.50	4.00	5.00	3.50	4.00	6.50	7.00	7.50	8.50
Gross Dividends (Rs Mn)	286	350	471	589	824	942	1,533	1,650	2,914	3,378
OTHER INFORMATION										
No of Employees	4,203	4,180	4,259	4,287	4,334	4,395	4,302	4,352	4,584	4,679
No of Customer Centres	138	142	148	151	167	177	186	205	240	247
No of Student Banking Centres	151	152	152	152	152	152	153	159	164	166
No of Other Financial Centres	110	110	113	113	114	114	115	121	123	132

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

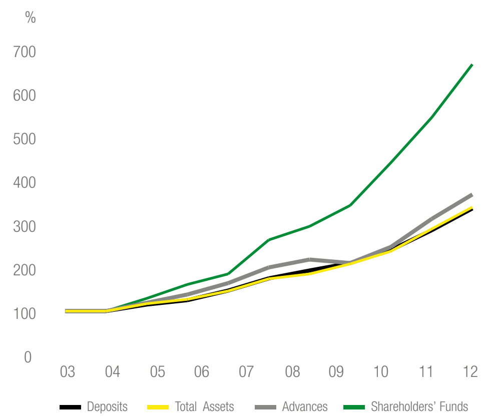
** Net Assets per share has been computed for the current number of shares issued as at 31st December 2012

Highlighted information is based on LKASs/SLFRSs.

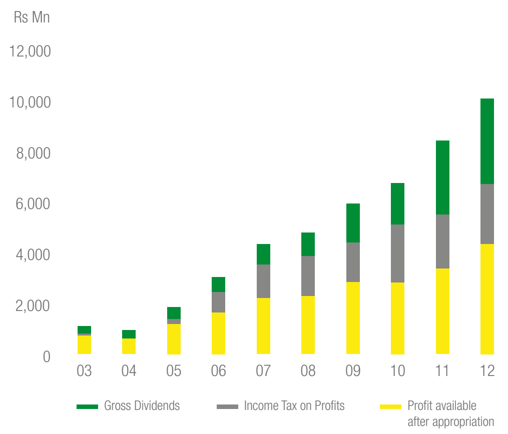
Ten Year
Graphical Review

Advances, Deposits and Re-Finance Borrowings

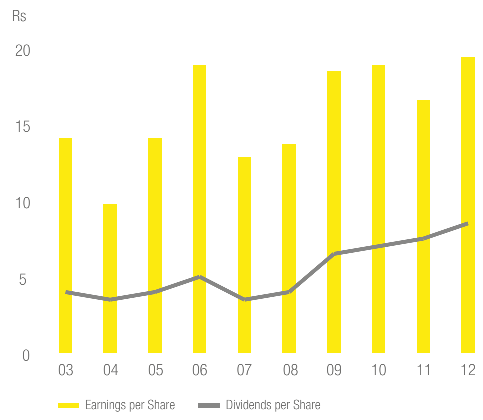
Balance Sheet Growth (Base year 2003)



Distribution of Profits



Earnings per Share and Dividends per Share



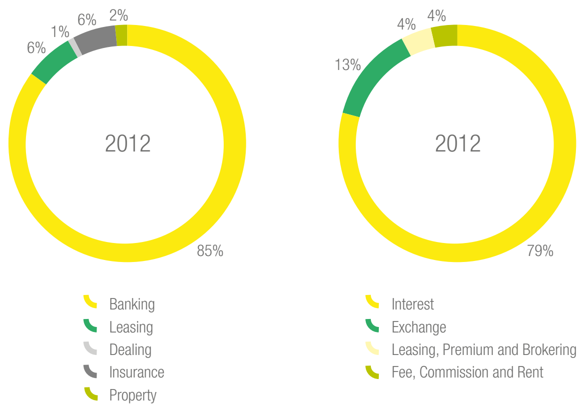
Segmental
Analysis

Business Segments

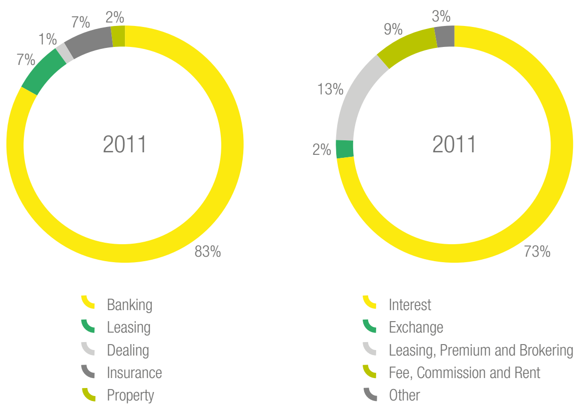
	Banking		Leasing		Dealings*		Property		Insurance		Total	
	2012 Rs 000	2011 Rs 000	2012 Rs 000	2011 Rs 000	2012 Rs 000	2011 Rs 000	2012 Rs 000	2011 Rs 000	2012 Rs 000	2011 Rs 000	2012 Rs 000	2011 Rs 000
Interest	43,618,018	30,270,776	-	-	261,598	201,977	-	-	641,380	462,662	44,520,996	30,935,415
Fee / Commission/Premium/Rent	3,799,295	2,763,402	-	-	93,988	288,806	800,569	796,026	2,697,024	2,349,621	7,390,876	6,197,855
Net Gain/(loss) from Trading & Financial Investment	1,490,049	51,858	3,728,480	2,905,152	31,393	77,344	207	-	6,104	(64,701)	2,276,135	2,969,653
Other Operating Income	1,903,156	1,075,113	-	-	79,885	18,229	23,360	6,633	17,653	5,629	2,024,054	1,105,604
Total Revenue	47,830,420	34,161,149	3,728,480	2,905,152	466,864	586,356	824,136	802,659	3,362,161	2,753,211	56,212,061	41,208,527

* Stock Broking, Securities dealings, Investment Banking, Venture Capital Business, Remittances and Foreign Currencies related services

Segmental Analysis of Revenue



Segmental Analysis of Revenue



Investor
Relations

1 STOCK EXCHANGE LISTING

The issued ordinary shares of Hatton National Bank PLC are listed with the Colombo Stock Exchange. The audited Income Statement for the year ended 31st December 2012 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 4,389 registered Voting Shareholders as at 31st December 2012 (2011 - 4,430) 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	2,458	711,968	0.29	37	12,830	0.02	2,495	724,798	0.23
1,001 - 10,000	1,266	3,971,818	1.62	42	155,012	0.21	1,308	4,126,830	1.30
10,001 - 100,000	461	13,060,979	5.34	21	618,034	0.84	482	13,679,013	4.31
100,001 - 1,000,000	65	15,587,273	6.38	16	4,679,047	6.40	81	20,266,320	6.38
Over 1,000,000	12	211,162,365	86.37	11	67,690,776	92.53	23	278,853,141	87.78
	4,262	244,494,403	100.00	127	73,155,699	100.00	4,389	317,650,102	100.00

ANALYSIS OF SHAREHOLDERS

Resident / Non-Resident

	31st December 2012			31st December 2011		
	No of Shareholders	No of Shares	%	No of Shareholders	No of Shares	%
Resident	4,262	244,494,403	76.97	4,307	235,850,442	75.74
Non-Resident	127	73,155,699	23.03	123	75,555,805	24.26
Total	4,389	317,650,102	100.00	4,430	311,406,247	100.00

Individuals / Institutions

	31st December 2012			31st December 2011		
	No of Shareholders	No of Shares	%	No of Shareholders	No of Shares	%
Individuals	4,088	46,978,110	14.79	4,126	41,589,266	13.36
Institutions	301	270,671,992	85.21	304	269,816,981	86.64
Total	4,389	317,650,102	100.00	4,430	311,406,247	100.00

As at 31st December 2012 the average size of holding of ordinary shareholding was 72,374 voting shares. (31st December 2011 - 70,295 voting shares)

As per the rule No. 7.6 (iv) of Colombo Stock Exchange, percentage of public holding as at 31st December 2012 was 67% approximately.

SHARE INFORMATION - NON VOTING

There were 11,360 registered Non Voting Shareholders as at 31st December 2012 (2011 - 11,828) distributed as follows.

	Resident			Non-Resident			Total		
	No of Share holders	No of Shares	%	No of Share holders	No of Shares	%	No of Share holders	No of Shares	%
1 - 1,000	6,556	2,363,310	3.77	52	21,435	0.13	6,608	2,384,745	3.00
1,001 - 10,000	4,014	12,107,673	19.31	76	262,659	1.56	4,090	12,370,332	15.54
10,001 - 100,000	566	14,072,885	22.44	21	605,534	3.58	587	14,678,419	18.44
100,001 - 1,000,000	54	13,480,617	21.50	11	3,027,720	17.92	65	16,508,337	20.74
Over 1,000,000	4	20,680,629	32.98	6	12,973,885	76.81	10	33,654,514	42.28
	11,194	62,705,114	100.00	166	16,891,233	100.00	11,360	79,596,347	100.00

ANALYSIS OF SHAREHOLDERS

Resident / Non-Resident

	31st December 2012			31st December 2011		
	No of Shareholders	No of Shares	%	No of Shareholders	No of Shares	%
Resident	11,194	62,705,114	78.78	11,667	64,478,903	83.53
Non-Resident	166	16,891,233	21.22	161	12,711,693	16.47
Total	11,360	79,596,347	100.00	11,828	77,190,596	100.00

Individuals / Institutions

	31st December 2012			31st December 2011		
	No Shareholders	No of Shares	%	No of Shareholders	No of Shares	%
Individuals	11,047	32,973,278	41.43	11,487	33,792,014	43.78
Institutions	313	46,623,069	58.57	341	43,398,582	56.22
Total	11,360	79,596,347	100.00	11,828	77,190,596	100.00

As at 31st December 2012 the average size of holding of ordinary shareholding was 7,007 non-voting shares. (31st December 2011 - 6,526 non- voting shares)

As per the rule No. 7.6 (iv) of Colombo Stock Exchange, percentage of public holding as at 31st December 2012 was 80% approximately.

3 SHARE TRADING

	2012	2011
VOTING		
Number of transactions	3,113	4,317
Number of shares traded (Mn)	12	19
Rank (As per CSE)	108	119
Value of shares traded (Rs Mn)	1,811	5,011
Rank (As per CSE)	21	27
NON VOTING		
Number of transactions	6,374	8,547
Number of shares traded (Mn)	15	15
Value of shares traded (Rs Mn)	1,444	2,046

Investor Relations

4 DIVIDENDS

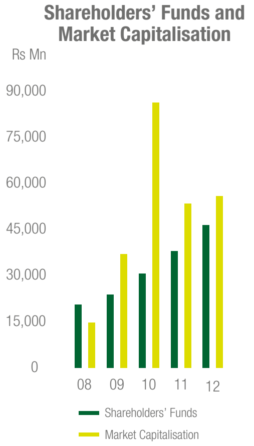
	2012		2011	
Interim (Rs)	1.50	Paid in December 2012	1.50	Paid in December 2011
Final (Rs) - Cash Dividend	7.00	Proposed to be paid in April 2013	3.00	Paid in April 2012
- Scrip dividend	-		3.00	Paid in March 2012
Dividend payout ratio (%)	43.85		46.52	

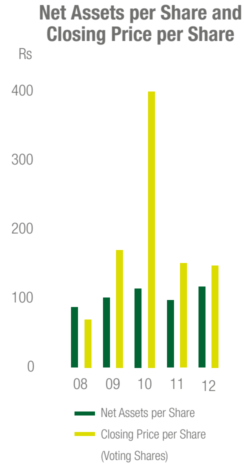
5 EARNINGS

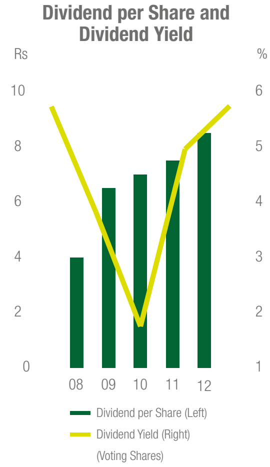
	2012	2011
Earnings per share (Rs)	19.36	16.60
Price earnings ratio (Times)	7.64	9.11

6 MARKET VALUE

		Highest Rs	Lowest Rs	Year End Rs
2008	- Voting	135.00	65.00	69.75
	- Non Voting	57.50	31.00	32.00
2009	- Voting	175.00	68.00	170.25
	- Non Voting	107.00	32.00	104.75
2010	- Voting	445.00	168.00	399.90
	- Non Voting	260.00	105.00	214.60
2011	- Voting	410.00	120.00	151.30
	- Non Voting	228.00	79.00	83.20
2012	- Voting	170.00	130.00	148.00
	- Non Voting	121.70	77.50	112.50







7 MARKET CAPITALISATION (As at 31st December)

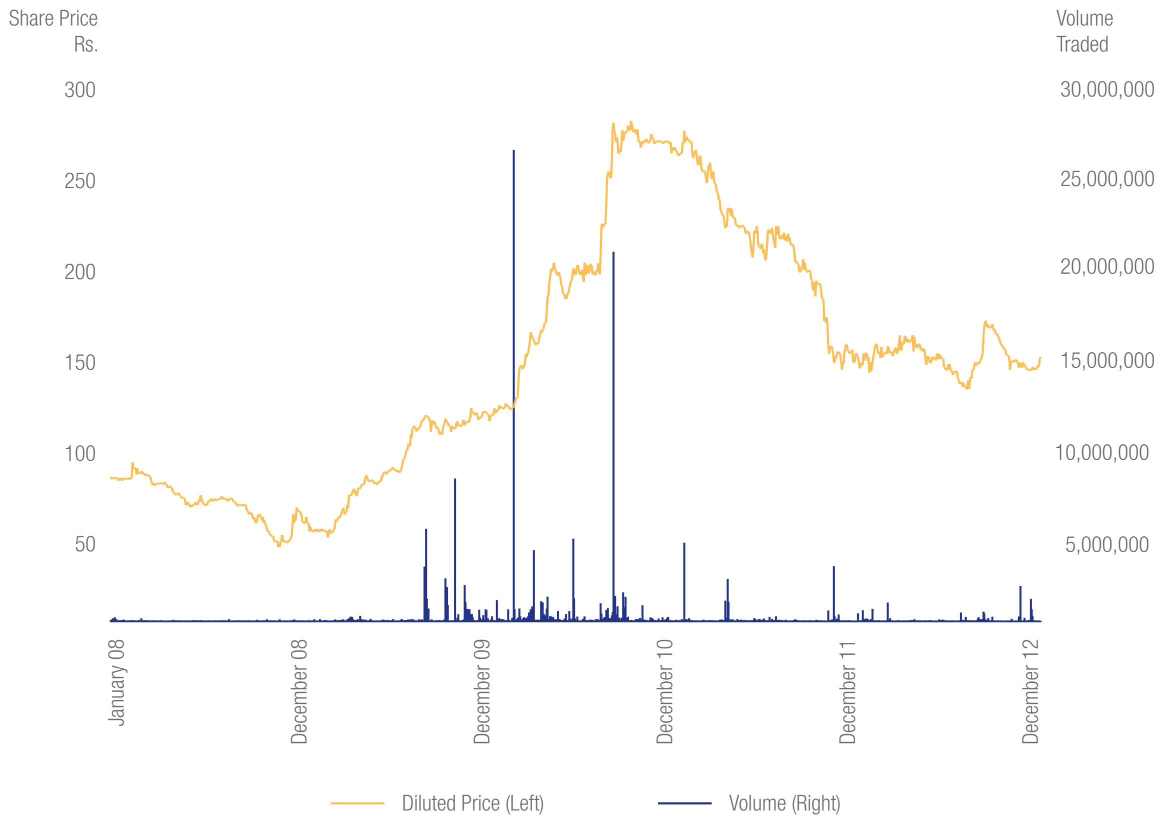
	Capital & Reserves Rs Mn	HNB Market Capitalisation* Rs Mn	CSE Market Capitalisation Rs Mn	HNB Market Capitalisation as a % of CSE Market Capitalization	Market Capitalisation Ranking
2008	20,581	14,684	488,813	3.00	7
2009	23,900	32,266	1,092,138	2.95	8
2010	31,387	76,491	2,210,452	3.46	7
2011	37,900	47,116	2,213,873	2.13	10
2012	47,496	47,012	2,167,134	2.17	11

* HNB Market Capitalisation includes only Voting shares

8 INFORMATION ON MOVEMENT IN SHARE CAPITAL

Year	Issue	Basis	No of Shares
	Prior to public issue		**50,000**
1971	Public issue		220,000
1977	Rights issue (@ Rs 10/-)	42:50	230,000
1980	Rights issue (@ Rs 10/-)	1:1	500,000
1982	Bonus	1:1	1,000,000
1988	Bonus	1:1	2,000,000
1990	Bonus	1:2	2,000,000
1993	Bonus	1:1	6,000,000
1996	Bonus	2:3	8,000,000
1998	Bonus	1:2	10,000,000
1999	Bonus	2:3	20,000,000
1999	Rights (non voting @ Rs 70/-)	3:10	15,000,000
2002	Bonus	1:10	6,500,000
2004	Rights (voting @ Rs 55.00 and non voting @ Rs 33.00)	2:5	28,600,000
2005	Issue of underlying shares for GDR		17,664,700
2007	Bonus	1:1	117,764,700
2009	Shares issued under ESOP		240,747
2010	Shares issued under ESOP		2,198,875
2011	Sub division of shares	1:2	119,179,782
2011	Rights (voting @ Rs 219.50 and non voting @ Rs 119.50)	1:10	21,858,851
2011	Private placement of unsubscribed rights		8,975,700
2011	Shares issued under ESOP		613,488
2012	**Scrip Dividend**		**7,890,528**
2012	**Shares issued under ESOP**		**759,078**
	Total		**397,246,449**

9 PRICE VOLUME CHART



Investor Relations

10 TWENTY MAJOR SHAREHOLDERS (VOTING) OF THE BANK AS AT 31ST DECEMBER 2012

	Name	% on total capital	% on total voting capital	No of Shares 2012	No of Shares 2011
1.	Sri Lanka Insurance Corporation Ltd.(General Fund)	11.99	15.00	47,635,487	46,940,572
2.	Employees Provident Fund	7.66	9.58	30,436,612	29,891,300
3.	Milford Exports (Ceylon) Ltd	6.50	**8.13	25,828,280	25,365,532
4.	Stassen Exports Ltd	5.64	**7.05	22,387,096	21,986,002
5.	Brown & Company PLC	5.58	6.98	22,186,122	21,788,629
6.	Mr.Sohli Edelji Captain	4.71	5.89	18,723,547	15,765,390
7.	Sonetto Holdings Ltd	3.70	4.63	14,697,921	14,434,589
8.	HSBC Intl Nom.Ltd - SSBT - Janus Overseas Fund	3.31	4.14	13,154,896	14,210,400
9.	Distilleries Co. of Sri Lanka Ltd	2.52	**3.15	10,016,272	9,836,818
10.	National Savings Bank	2.36	2.95	9,371,940	9,204,030
11.	Standard Chartered Bank Singapore S/A HL Bank Singapore Branch	1.57	1.96	6,235,188	6,099,640
12.	HSBC Intl Nom Ltd.- SSBT-Janus Aspen Series Overseas PortFol	1.50	1.88	5,961,060	6,438,600
13.	SBI VEN Holdings Pte Ltd	1.47	1.84	5,844,308	5,739,600
14.	The Bank of New York Mellon SA/NV-CF Ruffer Total Return Fund	1.29	1.62	5,138,289	5,046,230
15.	HSBC Intl Nominees Ltd-BBH-GMO Emerging Markets Fund	1.24	1.55	4,932,716	5,731,554
16.	FI-CIBLUX S/A Battery March Global Emerging Market Fund	1.12	1.40	4,448,908	4,369,200
17.	The Bank of New York Mellon SA/NV-CF Ruffer Absolute Return Fund	0.87	1.09	3,448,972	3,387,180
18.	Ms. Leesha Anne Captain	0.72	0.90	2,870,020	2,418,600
19.	BNY-CF Ruffer Investment Funds:CF Ruffer Pacific Fund	0.66	0.83	2,628,518	2,581,425
20.	Employees Trust Fund	0.51	0.64	2,020,976	1,572,269
	Sub total	64.94	81.21	257,967,128	-
	* Unregistered Shares	4.62	5.78	18,349,413	18,349,413
	Balance held by 4,369 voting shareholders (Total voting shareholders - 4,389)	10.40	13.01	41,333,561	-
	Total voting shares	79.96	100.00	317,650,102	311,406,247
	Shares held by 11,360 Non-voting shareholders	20.04		79,596,347	77,190,596
	Total No. of Ordinary shares	100.00		397,246,449	388,596,843

* An entity has been removed from the register of shareholders with effect from 19th August 2010 on a direction given by the CBSL in terms of Sec. 12(IC)(c) of the Banking Act.

** Pursuant to the provisions of the Banking Act Directions No. 1 of 2007, the total collective voting rights in the Bank, of Milford Exports (Ceylon) Limited, Stassen Exports Limited and Distilleries Company of Sri Lanka (who collectively hold 18.33% of the voting shares of the Bank) are limited to 10% of the total voting rights of the Bank with effect from 15th March 2012 as the voting rights in excess of such percentage is deemed invalid from that date.

11 TWENTY MAJOR SHAREHOLDERS (NON-VOTING) OF THE BANK AS AT 31ST DECEMBER 2012

	Name	% on total capital	% on total non-voting capital	No of Shares 2012	No of Shares 2011
1.	LegalInc Trustee Services (Pvt) Ltd	3.90	19.47	15,500,925	15,069,901
2.	HSBC Intl nominees Ltd-JPMLU-Franklin Templeton Invest	1.14	5.69	4,525,980	-
3.	Employees Trust Fund Board	0.66	3.31	2,633,690	1,639,795
4.	The Bank of New York Mellon SA/NV-CF Ruffer Total Return Fund	0.64	3.21	2,557,103	2,486,000
5.	HINL-JPMCB-Butterfield Trust (Bermuda) LTD	0.50	2.49	1,985,885	1,930,665
6.	The Bank of New York Mellon SA/NV-CF Ruffer Absolute Return Fund	0.43	2.14	1,703,364	1,656,000
7.	Mr. Sohli Edelji Captain	0.36	1.81	1,442,839	-
8.	Pershing LLC S/A Averbach Grauson & Co.	0.30	1.50	1,190,438	2,680,100
9.	National Savings Bank	0.28	1.39	1,103,175	1,072,500
10.	BNY-CF Ruffer Investment Funds : CF Ruffer Pacific Fund	0.25	1.27	1,011,115	983,000
11.	Akbar Brothers Pvt Ltd A/c No. 1	0.20	0.99	791,122	466,550
12.	CITI Bank NY S/A Forward International Dividend Fund	0.19	0.94	746,894	-
13.	DFCC Bank A/c 1	0.18	0.90	715,947	696,040
14.	Waldock Mackenzie Ltd/Mr. H M S Abdulhussein	0.16	0.81	641,487	623,650
15.	Bank of Ceylon A/c Ceybank Century Growth Fund	0.16	0.79	625,799	713,800
16.	CITI Bank NY S/A Forward Select EM Dividend Fund	0.16	0.78	619,916	-
17.	Hatton National Bank PLC A/c No.2	0.14	0.72	574,733	558,752
18.	Mr. Jayampathi Divale Bandaranayake	0.14	0.70	558,189	237,760
19.	Union Assurance PLC No. 1 A/c	0.13	0.65	521,346	506,850
20.	Asian Alliance Insurance PLC - Ac 02 (Life fund)	0.12	0.60	475,471	-
	Sub total	10.05	50.16	39,925,418	-
	Balance held by 11,340 Non-voting shareholders (Total Non-voting shareholders-11,360)	9.99	49.84	39,670,929	-
	Total Non-voting shares	20.04	100.00	79,596,347	77,190,596
	Shares held by 4,389 voting shareholders	75.34		299,300,689	293,056,834
	* Unregistered voting Shares	4.62		18,349,413	18,349,413
	Total voting shares	79.96		317,650,102	311,406,247
	Total No. of Ordinary shares	100.00		397,246,449	388,596,843

* An entity has been removed from the register of shareholders with effect from 19th August 2010 on a direction given by the CBSL in terms of Sec. 12(IC)(c) of the Banking Act.

12 RELATED PARTY TRANSACTIONS EXCEEDING 10% OF THE EQUITY OR 5% OF THE TOTAL ASSETS OF THE BANK

The Bank carried out transactions in the ordinary course of business with the following parties and the aggregate monetary value of these transactions exceeded 10% of the share holders' equity of the Bank as at 31st December 2012.

Government of Sri Lanka and other government related entities

Hatton National Bank Retirement Pension Fund

The details of these transactions are given in [Note 52 (f)] 'Transactions with the Government of Sri Lanka/ Entities Controlled, Jointly Controlled, Significantly Influenced by the Government of Sri Lanka' and [Note 52 (g) (ii)] 'Other Business Transactions with Other Related Entities by the Bank' respectively.

Investor Relations

13. DEBENTURE INFORMATION

HNB DEBENTURES 2006

i) Market Value

12 months ended 31st December 2012

These debentures have not traded during the year ended 31st December 2012

ii) Interest Rate

12 months ended 31st December	2012 Interest Rate	2012 Interest Rate of comparable Govt. Security	2011 Interest Rate	2011 Interest Rate of comparable Govt. Security
7 year Floating Rate (6 months TB + 2.25% p.a.) *	13.93	11.32	10.74	8.71
8 year Floating Rate (6 months TB + 2.25% p.a.) *	13.93	11.32	10.74	8.71
15 year Fixed Rate (11.00% p.a.)	11.00	12.18	11.00	N/Q
18 year Fixed Rate (11.25% p.a.)	11.25	12.38	11.25	10.04

* The floating rate debentures have a cap of 16.00% p.a. and a floor of 8.00% p.a.

N/Q – Not quoted for the period ended 31st December

HNB DEBENTURES 2007

i) Market Value

12 months ended 31st December 2012

These debentures have not traded during the year ended 31st December 2012

ii) Interest Rate

12 months ended 31st December	2012 Interest Rate	2012 Interest Rate of comparable Govt. Security	2011 Interest Rate	2011 Interest Rate of comparable Govt. Security
10 year Fixed Rate (16.00% p.a.)	16.00	11.83	16.00	N/Q
15 year Fixed Rate (16.75% p.a.)	16.75	12.17	16.75	N/Q

N/Q – Not quoted for the period ended 31st December

HNB DEBENTURES 2008

i) Market Value

12 months ended 31st December 2012

These debentures were not listed as at 31st December 2012

ii) Interest Rate

12 months ended 31st December	2012 Interest Rate	2012 Interest Rate of comparable Govt. Security	2011 Interest Rate	2011 Interest Rate of comparable Govt. Security
5 year Floating Rate (1 year TB + 1.00% p.a.)	13.75	11.69	8.35	8.68

HNB DEBENTURES 2011

i) Market Value

12 months ended 31st December 2012

These debentures have not traded during the year ended 31st December 2012

ii) Interest Rate

12 months ended 31st December	2012 Interest Rate	2012 Interest Rate of comparable Govt. Security	2011 Interest Rate	2011 Interest Rate of comparable Govt. Security
10 year Fixed Rate (11.50% p.a.)	11.50	12.17	11.50	N/Q

N/Q – Not quoted for the period ended 31st December

Ratios

	2012	2011
Subordinated Borrowings to Equity Ratio (%)	16.73	13.22
Subordinated Borrowings Interest Cover (Times)	15.27	20.26
Liquid Asset Ratio (LAR)	22.38	21.96

Note: Equivalent Govt. Security rates are net of 10% withholding tax

Glossary of Financial/Banking Terms

A

ACCOUNTING POLICIES

The specific principles, bases, conventions, rules and practices adopted by an entity in preparing and presenting Financial Statements.

ACCRUAL BASIS

Recognising the effects of transactions and other events when they occur without waiting for receipt or payment of cash or cash equivalent.

AMORTISATION

The systematic allocation of the depreciable amount of an intangible asset over its useful life.

AMORTISED COST

Amount at which the financial asset or financial liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount and minus any reduction for impairment or un-collectability.

ASSOCIATE

An associate is an entity, including an unincorporated entity such as a partnership, over which the investor has significant influence and that is neither a subsidiary nor an interest in a joint venture.

AVAILABLE FOR SALE FINANCIAL ASSETS

Available for sale financial assets are those non derivative financial assets that are designated as available for sale or are not classified as loans and receivables, held to maturity investments or financial assets at fair value through profit or loss.

B

BONUS ISSUE

The issue of new shares to existing shareholders in proportion to their shareholdings. It is a process for converting a company's reserves (in whole or part) in to issued capital and hence does not involve an infusion of cash.

C

CAPITAL ADEQUACY RATIO

The percentage of risk-adjusted assets supported by capital as defined under the framework of risk-based capital standards developed by the Bank for International Settlements (BIS) and as modified to suit local requirements by the Central Bank of Sri Lanka.

CAPITAL RESERVE

Capital Reserves consist of revaluation reserves arising from revaluation of properties owned by the Bank.

CASH EQUIVALENTS

Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

COLLECTIVELY ASSESSED LOAN IMPAIRMENT PROVISIONS

Also known as portfolio impairment provisions. Impairment assessment on a collective basis for homogeneous groups of loans that are not considered individually significant and to cover losses that has been incurred but has not yet been identified at the reporting date. Typically assets within the Consumer Banking business (Housing, personal, vehicle loans etc) are assessed on a portfolio basis.

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.

CONTINGENCIES

Conditions or situations at the reporting date, the financial effect of which are to be determined by the future events which may or may not occur.

CONTRACTUAL MATURITY

Contractual maturity refers to the final payment date of a loan or other financial instrument, at which point all the remaining outstanding principal will be repaid and interest is due to be paid.

CORPORATE GOVERNANCE

The process by which corporate entities are governed. It is concerned with the way in which power is exercised over the management and direction of entity, the supervision of executive actions and accountability to owners and others.

CORRESPONDENT BANK

A bank in a foreign country that offers banking facilities to the customers of a bank in another country.

COST METHOD

Cost method is a method of accounting for an investment whereby the investment is recognised at cost. The investor recognizes income from the investment only to the extent that the investor receives distributions from accumulated profits of the investee arising after the date of acquisition. Distributions received in excess of such profits are regarded as a recovery of investment and are recognised as a reduction of the cost of the investment.

COST-PUSH INFLATION

A continuous increase in average price levels due to an increase in production costs.

CREDIT RISK

Credit risk is the risk of financial loss to the Bank if a customer or counter party to a financial instrument fails to meet its contractual obligations, and arises principally from the loans and advances to customers and other banks and investment in debt/ equity securities.

CREDIT RATINGS

An evaluation of a corporate ability to repay its obligations or likelihood of not defaulting, carried out by an independent rating agency.

D

DEBT RESTRUCTURING / RESCHEDULING

This is when the terms and provisions of outstanding debt agreements are changed. This is often done in order to improve cash flow and the ability of the borrower to repay the debt. It can involve altering the repayment schedule as well as debt or interest charge reduction.

DEFERRED TAX

Sum set aside in the financial statements for taxation that may become payable in a financial year other than the current financial year.

DELINQUENCY

A debt or other financial obligation is considered to be in a state of delinquency when payments are overdue. Loans and advances are considered to be delinquent when consecutive payments are missed. Also known as 'Arrears'.

DERECOGNITION

Removal of a previously recognised financial asset or financial liability from an entity's statement of financial position.

DERIVATIVES

A derivative is a financial instrument or other contract, the value of which changes in response to some underlying variable (eg. an interest rate), that has an initial net investment smaller than would be required for other instruments that have a similar response to the variable, and that will be settled at a future date.

DEPRECIATION

The systematic allocation of the depreciable amount of an asset over its useful life.

DIVIDEND COVER

Profit after tax divided by gross dividends. This ratio measures the number of times dividend is covered by the current year's distributable profits.

DIVIDEND YIELD

Dividend earned per share as a percentage of its market value.

DOCUMENTARY LETTERS OF CREDIT (L/Cs)

Written undertakings by a bank on behalf of its customers, authorising a third party to draw on the bank up to a stipulated amount under specific terms and conditions. Such undertakings are established for the purpose of facilitating international trade.

E

EARNINGS PER SHARE (EPS)

Profit attributable to ordinary shareholders, divided by the number of ordinary shares in issue.

EFFECTIVE INTEREST RATE

Rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instruments or when appropriate a shorter period to the net carrying amount of the financial asset or financial liability.

EFFECTIVE TAX RATE

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 recognized 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.

FINANCE LEASE

A lease in which the lessee acquires all the financial benefits and risks attaching to ownership of the asset under lease.

FINANCIAL ASSET OR FINANCIAL LIABILITY AT FAIR VALUE THROUGH PROFIT OR LOSS

Financial asset or financial liability that is held for trading or upon initial recognition designated by the entity as 'at fair value through profit or loss'.

FINANCIAL INSTRUMENT

Financial Instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

FOREIGN EXCHANGE CONTRACT

Agreement between two parties to exchange one currency for another at a future date at a rate agreed upon today.

FOREIGN EXCHANGE INCOME

The realised gain recorded when assets or liabilities denominated in foreign currencies are translated into Sri Lankan Rupees on the reporting date at prevailing rates which differ from those rates in force at inception or on the previous reporting date. Foreign exchange income also arises from trading in foreign currencies.

G

GROSS DIVIDENDS

The portion of profit inclusive of tax withheld distributed to shareholders.

GROUP

A group is a parent and all its subsidiaries.

GUARANTEES

Primarily represent irrevocable assurances that a bank will make payments in the event that its customer cannot meet his / her financial obligations to third parties. Certain other guarantees represent non-financial undertakings such as bid and performance bonds.

H

HEDGING

A strategy under which transactions are effected with the aim of providing cover against the risk of unfavourable price movements (Interest Rate, Foreign exchange rate, commodity prices, etc.).

HELD TO MATURITY INVESTMENTS

Non derivative financial assets with fixed or determinable payments and fixed maturity that an entity has the positive intention and ability to hold to maturity.

I

IMPAIRMENT

This occurs when recoverable amount of an asset is less than its carrying amount.

IMPAIRED ASSETS COVER

Impaired Assets Cover is the ratio of total impairment provision to total impaired assets.

Glossary of Financial/Banking Terms

IMPAIRED ASSETS PORTFOLIO

Impaired Assets Portfolio is the total of the individually significant impaired loans and individually insignificant loans which are overdue above 180 days.

IMPAIRMENT ALLOWANCES

Impairment allowances are provisions held on the Statement of Financial Position as a result of the raising of a charge against profit for the incurred loss. An impairment allowance may either be identified or unidentified and individual (specific) or collective (portfolio).

INCREMENTAL COST

Costs that would not have been incurred if the entity had not acquired, issued or disposed of the financial instrument.

INDIVIDUALLY SIGNIFICANT LOAN IMPAIRMENT PROVISIONS

Also known as specific impairment provisions. Impairment is measured individually for assets that are individually significant to the Group. Typically assets within the Corporate Banking business of the Group are assessed individually.

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.

INTEREST RATE SWAP

An agreement between two parties (known as counterparties) where one stream of future interest payments is exchanged for another based on a specified principal amount.

INVESTMENT PROPERTIES

Investment property is property (land or a building - or part of a building - or both) held (by the owner or by the lessee under a finance lease) to earn rentals or for capital appreciation or both, rather than for use or sale.

J

JOINT CONTROL

Joint control is the contractually agreed sharing of the control over an economic activity and exists only when the strategic financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control.

JOINT VENTURE

A joint venture is a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control.

K

KEY MANAGEMENT PERSONNEL

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly.

L

LIQUID ASSETS

Assets that are held in cash or in a form that can be converted to cash readily, such as deposits with other banks, bills of exchange and treasury bills.

LOANS AND RECEIVABLES

Non derivative financial assets with fixed or determinable payments that are not quoted in an active market other than those intends to sell immediately or in the near term and designated as fair value through profit or loss or available sale on initial recognition.

LOSS GIVEN DEFAULT (LGD)

LGD is the percentage of an exposure that a lender expects to loose in the event of obligor default.

M

MARKET CAPITALISATION

Number of ordinary shares in issue multiplied by the market value of each share at the year end.

MARKET RISK

This refers to the possibility of loss arising from changes in the value of a financial instrument as a result of changes in market variables such as interest rates, exchange rates, credit spreads and other asset prices.

MATERIALITY

The relative significance of a transaction or an event, the omission or misstatement of which could influence the decisions of users of Financial Statements.

N

NET ASSET VALUE PER SHARE

Shareholders' funds divided by the number of ordinary shares in issue.

NET-INTEREST INCOME

The difference between what a bank earns on assets such as loans and securities and what it pays on liabilities such as deposits, refinance funds and inter-bank borrowings.

NET RATIO FOR IMPAIRED ASSETS

Net Ratio for Impaired Assets is the ratio of net impaired asset portfolio (Total impaired asset portfolio minus total impairment provision) as a percentage of gross loans and advances excluding reverse repurchase agreements.

O

OFF BALANCE SHEET TRANSACTIONS

Transactions that are not recognised as assets or liabilities in the Statement of Financial Position, but which give rise to contingencies and commitments.

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).

PROBABILITY OF DEFAULT (PD)

PD is an internal estimate for each borrower grade of the likelihood that an obligor will default on an obligation

R

RATIO FOR IMPAIRED ASSETS

Ratio for Impaired Assets is the ratio of total impaired assets as a percentage of total gross loans and advances excluding reverse repurchase agreements.

RETURN ON AVERAGE ASSETS (ROAA)

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 (ROAE)

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-WEIGHTED ASSETS

Used in the calculation of risk-based capital ratios. The face amount of lower risk assets is discounted using risk weighting factors in order to reflect a comparable risk per rupee among all types of assets. The risk inherent in off –balance sheet instruments is also recognised, first by adjusting notional values to balance sheet (or credit) equivalents and then by applying appropriate risk weighting factors.

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.

STATUTORY RESERVE FUND

Reserve created as per the provisions of the Banking Act No. 30 of 1988.

SUBSIDIARY

A subsidiary is an entity, including an unincorporated entity such as a partnership, that is controlled by another entity (known as the parent).

SWAPS (CURRENCY)

The simultaneous purchase of an amount of a currency for spot settlement and the sale of the same amount of the same currency for forward settlement. Alternatively a simultaneous spot sale and forward purchase of a currency.

T

TIER I CAPITAL

Consists of the sum total of paid up ordinary shares, non cumulative, non redeemable preference shares, share premium, statutory reserve fund, published retained profits, general and other reserves, less goodwill.

TIER II CAPITAL

Consists of the sum total of revaluation reserves, general provisions, hybrid capital instruments and approved subordinated debentures.

TOTAL CAPITAL

Total capital is the sum of Tier I capital and Tier II capital.

TRANSACTION COSTS

Incremental costs that is directly attributable to the acquisition, issue or disposal of a financial asset or financial liability

U

UNIT TRUST

An undertaking formed to invest in securities under the terms of a trust deed.

V

VALUE ADDED

Value added is the wealth created by providing banking services less the cost of providing such services. The value added is allocated among the employees, the providers of capital, to government by way of taxes and retained for expansion and growth

Notes

Corporate information

NAME OF COMPANY
HATTON NATIONAL BANK PLC

LEGAL FORM
A public limited Company incorporated on 5th March 1970 under the Laws of the Republic of Sri Lanka. The Company was re-registered under the Companies Act No 7 of 2007 on 27th September 2007. It is a Licensed Commercial Bank under the Banking Act.

COMPANY REGISTRATION NUMBER
PQ 82 (previous PBS 613)

ACCOUNTING YEAR END
31st December

STOCK EXCHANGE LISTING
The ordinary shares and the Unsecured Subordinated Redeemable Debentures of the Bank are listed on the Colombo Stock Exchange in Sri Lanka. Global Depository Receipts of the Bank which were listed on the Luxembourg Stock Exchange have been fully cancelled as at 1st December 2011.

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	: +94 11 2664664
	+94 11 2662772
	+94 11 4764764
Fax Nos	: +94 11 2662814
	+94 11 2662832
International Department	: +94 11 2446523
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
Dr Ranee Jayamaha (Chairperson)
Mr Rajendra Theagarajah
(Managing Director / CEO)
Ms Pamela C. Cooray (Senior Director)
Mr N G Wickremeratne
Ms M A R C Cooray
Dr W W Gamage
Dr L Rohan Karunaratne
Mr L U Damien Fernando
Mr Sujeewa Mudalige
Ms D S C Jayawardena
Mr Rusi S Captain

BOARD SECRETARY
Ms K A L Thushari Ranaweera
Attorney-at-Law, LL.M. (Cambridge), Dip in Int'l Affairs (BCIS)

AUDIT COMMITTEE
Mr Sujeewa Mudalige (Chairman)
Mr N G Wickremeratne
Ms Pamela C. Cooray
Ms M A R C Cooray
Mr Rusi Captain

NOMINATION COMMITTEE
Dr L Rohan Karunaratne (Chairman)
Dr W W Gamage
Dr Ranee Jayamaha
Ms M A R C Cooray

HR & REMUNERATION COMMITTEE
Ms Pamela C. Cooray (Chairperson)
Dr Ranee Jayamaha
Mr N G Wickremeratne
Dr W W Gamage
Mr L U D Fernando
Mr Sujeewa Mudalige

BOARD INTEGRATED RISK MANAGEMENT COMMITTEE
Ms M A R C Cooray (Chairperson)*
Dr Ranee Jayamaha*
Dr L Rohan Karunaratne*
Mr Rajendra Theagarajah
(Managing Director / CEO)**
Mr A J Alles (Deputy CEO)***
Mr J R P M Paiva
(DGM – Strategy & Compliance)***
Mr D A de Vas Gunasekara (CFO)***
Ms Shanti Gnanapragasam (AGM-Risk)***

* *Representatives of the Board*
** *Represents the Board & the Management*
*** *Representatives of the Management*

JOINT VENTURE COMPANIES

Acuity Partners (Pvt) Ltd	50.00%
Financial Services	

SUBSIDIARY COMPANIES

HNB Assurance PLC	60.00%
Insurance Services	
Sithma Development (Pvt) Ltd	100.00%
Property Development	
Majan Exchange LLC (Oman)	40.00%
Money transfers and Foreign Currency Related Services	

AUDITORS
KPMG,
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 DGM - Strategy & Compliance at:

"HNB Towers", Level 16,
No 479, T B Jayah Mawatha (Darley Road),
Colombo 10, Sri Lanka.

Telephone	: +94 11 2662705,
	+94 11 2661721
Fax	: +94 11 2662815
e-mail	: joseph.paiva@hnb.lk

Designed & produced by emagewise
Photography by Wildlight Private Limited, Dhanush de Costa & Taprobane Street
Digital Plates & Printing by Aitken Spence Printing & Packaging (Pvt) Ltd