

APPLYING

IT ALL  
ADDS  
UP

HATTON NATIONAL BANK PLC  
ANNUAL REPORT 2008

LEARNING

GROWING

WINNIM



Learning, Applying, Growing and Winning;  
Methodology that has shaped the way we  
do business and has imparted on us the  
importance of everything no matter how  
small. This is why to us; everything  
matters. It's why we still love to see  
our customers in-branch as much as  
we love them using our online services.  
It's why our customers have rewarded us  
with another successful year. Because  
from a click to a smile;

**IT ALL ADDS UP!**

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# Financial Highlights

	2007	2008	%
	Rs Mn	Rs Mn	Change
<b>Results for the Year</b>			
Income	29,995	<b>37,166</b>	+ 23.91
Net Profit Before Income Tax	4,335	<b>4,785</b>	+ 10.38
Income Tax on Profits	1,312	<b>1,566</b>	+ 19.36
Net Profit After Taxation	3,022	<b>3,219</b>	+ 6.52
Gross Dividends	824	<b>942</b>	+ 14.32
Profit Available After Appropriation	2,198	<b>2,277</b>	+ 3.59

## At the Year End

Shareholders' Funds			
(Capital and Reserves)	18,419	<b>20,581</b>	+ 11.74
Deposits from Customers	175,660	<b>186,770</b>	+ 6.32
Gross Advances to Customers Leasing, Bills of Exchange & Commercial Paper			
	168,827	<b>184,367</b>	+ 9.20
Total Assets	232,906	<b>255,270</b>	+ 9.60

## Information Per Ordinary Share

Earnings (Rs)	12.83	<b>13.67</b>	+ 6.55
Dividends (Rs)	3.50	<b>4.00</b>	+ 14.29
Dividend Yield (%)	2.86	<b>5.73</b>	+ 100.35
Net Asset Value (Rs)	78.20	<b>87.38</b>	+ 11.74
Market Value (Rs) - Voting	122.50	<b>69.75</b>	- (43.06)
Market Value (Rs) - Non Voting	53.25	<b>32.00</b>	- (39.91)

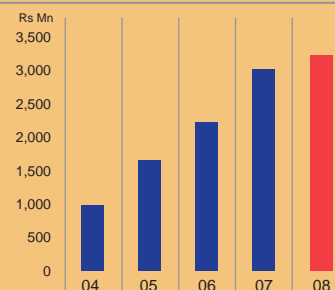
## Ratios

Return on Average			
Shareholders' Funds (%)	19.28	<b>16.51</b>	- (14.37)
Price Earning (Times)	9.55	<b>5.11</b>	- (46.49)
Dividend Cover (Times)	3.67	<b>3.42</b>	- (6.81)

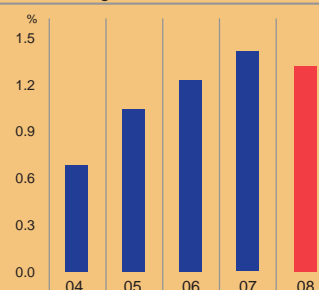
## Capital Adequacy Ratios

Tier 1 (%) (Statutory minimum ratio required is 5%)	10.32	<b>9.25</b>	- (10.37)
Tier 1 & 2 (%) (Statutory minimum ratio required is 10%)	12.08	<b>11.40</b>	- (5.63)

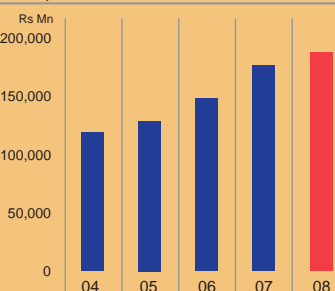
Net Profit After Taxation



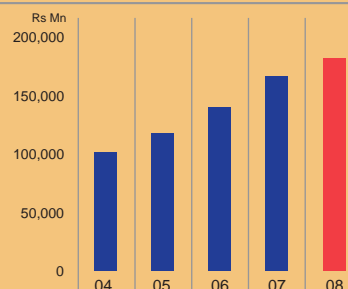
Return On Average Assets



Total Deposits



Total Advances



# Operational Highlights

## Customer Centres

177

## Automated Teller Machines (ATMs)

260

41% increase from 2007

## Mobile Banking Enabled Accounts

37%

Increase over 2007

## Internet Banking Enabled Accounts

55%

Increase over 2007

## Financial Goals & Performance

For the Year ended 31st December	2004	2005	2006	2007	2008	Medium Term Goals
Return on Average Assets (%)	0.7	1.0	1.2	1.4	1.3	Over 1.5
Return on Average Shareholders' Funds (%)	12.2	16.3	18.4	19.3	16.5	Over 20.0
Cost / Net Income Ratio (Excl. Financial VAT) (%)*	66.2	60.3	57.8	56.2	54.3	below 50.0
<b>Capital Adequacy</b>						
Tier 1 Capital Ratio (%)						
(Statutory minimum ratio required is 5%)	9.83	10.87	10.23	10.32	9.25	9.00
Total Capital Ratio (%)						
(Statutory minimum ratio required is 10%)	11.26	11.55	11.32	12.08	11.40	12.50

\* Operating expenses consist of personnel expenses, provisions for employee retirement benefits, premises costs and establishment expenses and other overhead expenses.

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







# Management Information



Decisions that **all add up**





# Chairman's Message

I take pleasure in welcoming you to the fortieth Annual General Meeting of Hatton National Bank PLC and to present the Annual Report and a comprehensive review of the bank's activities for the year 2008.

It is a significant factor that this report has been compiled in the backdrop of a year which saw the emergence of a real global economic and financial market crisis causing all of us in the sector to face immense challenges.

Despite the macro economic milieu with visible signs of drawbacks for progress, I am happy to report a robust performance by your Bank in 2008. Despite this most uneven and negative situation, our Bank's inherent strengths and values maintained over the years, helped the Bank to perform well above normal expectations. Our after tax profit of over Rs 3.2 Bn was the highest on record. We saw modest growth in other areas of productivity which I believe is satisfactory in the light of the constraints faced by us in the local banking scene.

Detailed information of the Bank's performance indicators and financials are presented in the CEO's Review, other reports and the Financial Statements.

## Global Scenario

The collapse of several financial institutions which were hitherto considered organisations with enormous strengths and stability, shook the very foundation of the western economies and brought chaos to the world financial community at its core. The technical reasons for the crisis can be best understood and articulated only by those who were involved in the policy enforcement and management of these organisations. In my view, our immediate task is to ask ourselves when the much needed recovery will occur. Though predictions are many, the overriding factor is that the crisis in the United States of America and United Kingdom is taking time to spread to other parts of the world, particularly to the Asian countries. The situation in the United States of America with the new administration having a changed approach to its relationship with the rest of the world, and the United Kingdom under the current leadership endeavouring to put in place a carefully planned recovery process, are considered positive factors.

In this scenario, the year 2009 is expected to experience a flat growth. After the bitter experiences that the world population

went through with the rising oil prices, the entire world seeking alternate sources of energy is a much needed effort to the renaissance which we expect to witness in the global economy in the current year, albeit slowly.

There is also a belief that with the recovery of the worst recession experienced since the 1930s the balance of economic power and strength will gradually shift to the Asian region. However, China, Japan and India who were billed to lead the way are also severely affected by this crisis. Nevertheless, with their progressive attitudes, these Asian giants might position themselves to move on a fast track towards recovery. In such a scenario, Sri Lanka can be a resultant beneficiary and could be poised to avail itself of the opportunities that will arise through appropriate strategies. Towards this goal, our country should make a concrete effort to review its economic policies to take advantage of the positive factors and more importantly, maintain the best of international relationships particularly with our giant neighbour.

## The Sri Lankan Economy

Amidst an environment of high inflation, prohibitive interest rates, an exacerbating war footing, alarming oil prices and tight monetary controls, the Central Bank of Sri Lanka predicted an economic growth of approximately 6%, downgrading a previous forecast of 7%. Whilst in the first half of the year, the economy displayed a robustness to continue towards the forecasted growth percentage, with the global recession, price collapse of our major commodity exports like tea and rubber, and downturn in the apparel industry, a decline in the predicted growth rates became inevitable.

The overall budget deficit in 2008 is approximately 7% of GDP, despite decrease in revenue and increase in expenditure. The government's revised expectation on revenues for the year was recorded at Rs 709.3 Bn compared to the initial budget expectation of Rs 750.7 Bn whilst the revised current expenditure rose to Rs 743.34 Bn against the forecast of Rs 712.9 Bn at the beginning of the year. Capital expenditure was also expected to decrease in 2008 to Rs 278.2 Bn from the originally recorded figure of Rs 335.7 Bn.

An expansionary fiscal policy has been a hallmark of Sri Lanka's budgetary process and it was no surprise that inflation continued to rise. When consumer inflation rose to an unprecedented 28.2% (Point to Point) in June 2008, the authorities announced a changed formula to work out the

“ Your Bank’s performance was in accordance with expectations and projections made at the beginning of 2008. The Bank charted a carefully planned course to accomplish its goals. The availability of large resources coupled with our inherent strengths enabled us to cushion the negative effects and record extremely satisfactory results for the year 2008. ”



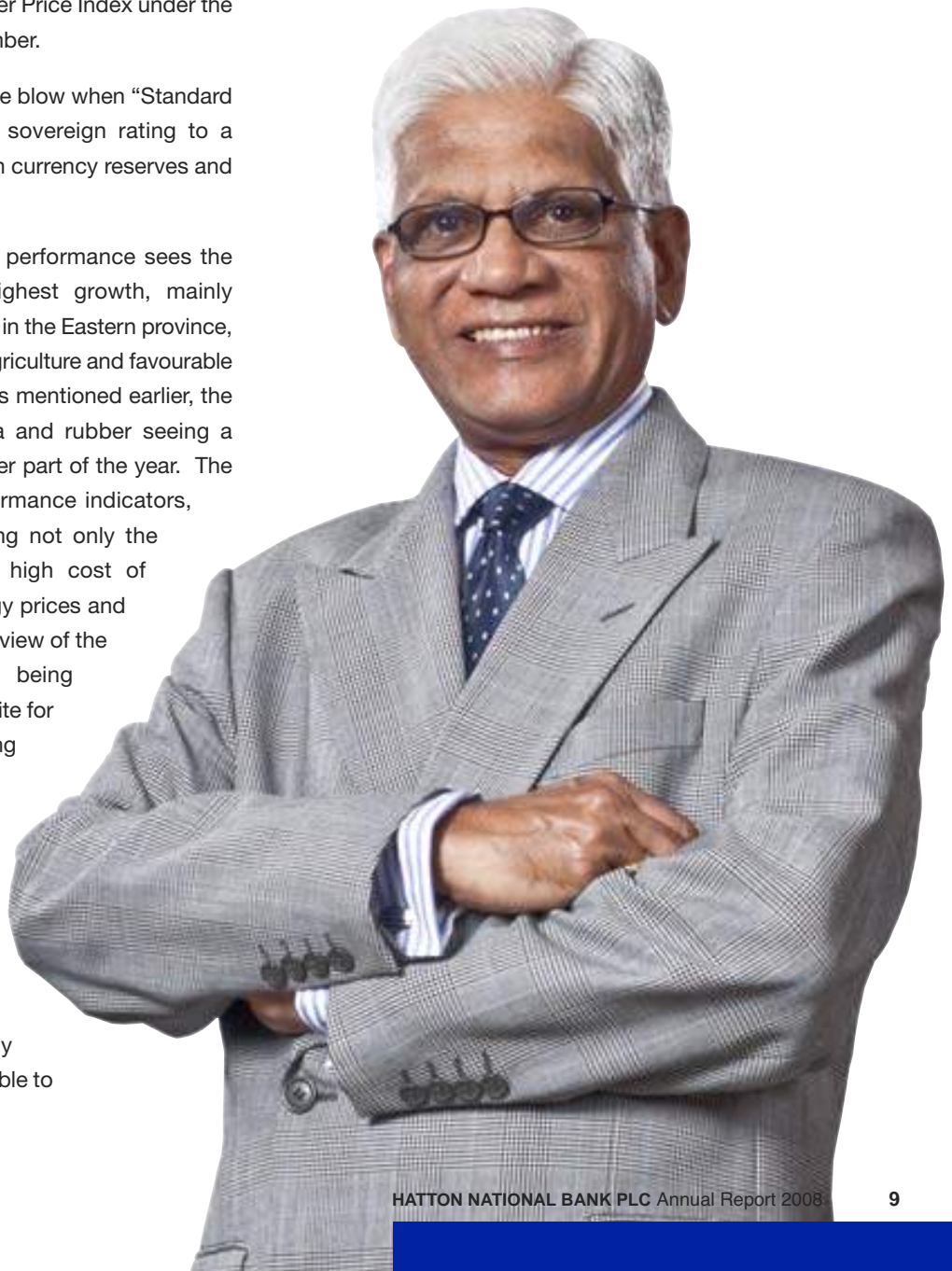
**Rienzie T. Wijetilleke**  
Chairman

inflation index. The Colombo Consumer Price Index under the new system stood at 14.4% in December.

However, Sri Lanka faced a confidence blow when “Standard & Poor” downgraded the country’s sovereign rating to a ‘B’ from a ‘B+’, citing declining foreign currency reserves and the high fiscal deficit.

A synopsis of the country’s sectoral performance sees the agriculture sector recording the highest growth, mainly attributed to prevailing peace situation in the Eastern province, the government’s efforts to promote agriculture and favourable prices for agricultural produce. But as mentioned earlier, the global recession took its toll on tea and rubber seeing a decline in the growth curve in the latter part of the year. The industrial sector too faced low performance indicators, with manufacturing industries battling not only the global market downturns but also high cost of production including prohibitive energy prices and increased market competition. The review of the GSP+ preferential trade access being deferred until 2011 brought some respite for the beleaguered apparel manufacturing sector.

The exports grew by 6.8% during the first eleven months of 2008, however the trade deficit widened during the same period by 60.7% due to the huge increase in imports of 24.6%. Increase in imports was primarily due to the highly priced oil imports. We have not been able to



benefit from the steep decline in the world market prices for oil due to some irrational decisions, creating medium term commitments at exorbitant rates.

### **The Way Forward**

The year 2009 will no doubt be another challenging year for the country. As a policy your Bank will make every endeavour to maintain the quality of its assets, keep a close watch on our balance sheet, the portfolio of investments etc. and keep the bottom line profitability as a factor to be considered not at the expense of undue risks and weakening of our medium term resources. Above all your Board will ensure that we at all times fulfill our fiduciary responsibility to our stakeholders, especially to our depositors and other customers, while maintaining the highest levels of ethics and values, through conscience driven decision making within accepted corporate core values. With the prospect of peace in the North and East of the country we expect major opportunities for participation in the development of these areas, with our well established network of branches. However I wish to emphasize that the authorities should have in place strategies and a plan for accelerated infrastructure development of the newly liberated areas and get the private sector institutions to play its role in assisting the government institutions to promote economic activity particularly in the areas of agriculture, small and medium industries and trading. People in the North and East have been waiting long enough yearning for a peaceful environment for them to co exist and it is our bounden duty to give them that long overdue opportunity in the quickest possible time. Linking of the North East economic activity with those of the rest of the country will undoubtedly bring visible results to the overall community as was the case until the crisis commenced in the 1980s. Despite the world recession our friendly countries and the donor agencies will give priority by offering us assistance for the rehabilitation and reconstruction of the war torn areas.

Another matter of serious concern has been the efforts by the monetary authorities to keep a weakening Sri Lankan Rupee afloat using artificial means. This policy is clearly not in the best long term interests of the country. Borrowing dollars at commercial rates to keep the Rupee strong is not healthy at all. The wiser path would have been for the authorities to encourage exporters to earn the much needed foreign currency which in turn will strengthen the rupee in the medium term. The policy in question has not done our exporters any

good but instead seen the apparel and commodity sectors being further affected. Quite understandably, authorities were concerned about spiraling inflation and cost of living. Creation of opportunities for enhanced income, employment and savings through increased economic activity would, to a great extent, cushion the negative effects of the rising cost of living.

Sri Lanka should endeavour to obtain surplus goods and services available with the three Asian giants due to their decline in exports to the West, on favourable credit terms or as grants which in turn could be utilised for rural infrastructure development thereby creating economic activity in those areas.

### **2009 and Beyond**

As already mentioned the main focus in the current year will be to continue our stable and strong position among the banking sector organisations. Efforts will also be made to expand our retail deposit base and look at areas to reduce cost of funding and preservation of the portfolio quality. The Management will continue to further strengthen the relationship with key clients and also offer whatever assistance to our customers facing financial setbacks during this crisis time. Our CSR Committee will focus on the urgent social needs such as sanitation, education with the younger people, emphasis on technology development etc.

The new American administration is expected to focus attention as a priority to climate change and its global impact. Although a small country, we too will have to join in to ensure least effects of any major impact of climate change on our people.

### **Appreciations**

Prior to my conclusion of this note I have a solemn duty, to record the passing away of two of our former directors during the year. Dr V P Vittachi, who joined our Board in November 1988 and became Deputy Chairman in March 1998, had a very long and fruitful association with Hatton National Bank. He resigned in August 2008 and passed away soon after. I wish to record my deep appreciation for the valuable contribution he made over the years towards the progress of the Bank.

Mr Ratneswara Sivaratnam, who joined the Board in December 2004, also stepped down from the Board due to ill health in April 2008 and passed away in July 2008. His wide experience in the commercial sector enabled him to make a valuable contribution towards the decision making on our

Board and I wish to record my deep appreciation for his services during his tenure in office.

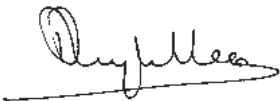
I would like to take this opportunity to thank my fellow Directors who have given me their unstinted co-operation and support. The Management and staff worked tirelessly to post encouraging results despite unsettled conditions in the country.

I take this opportunity to thank all members of the Management and staff for a job well done.

None of this would be possible if we did not have a loyal clientele who continued to be with us despite strong pressures from our competitors.

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

On behalf of the Board of Directors, I wish to pledge that we will continue to add to shareholder wealth through prudent and carefully planned business strategies.



**Rienzie T. Wijetilleke**  
Chairman

Colombo, Sri Lanka  
13th February 2009

# Chief Executive Officer's Review

The year under review has been one where unprecedented situations arose with both the developed and emerging economies scrambling to weather the storm. Sri Lanka, though not immediately hit with the global recession that ensued post the collapse of some of the larger champions in international finance, did feel the cascading effects towards the latter part of the year, with key sectors like commodities, tourism and apparel which are heavily reliant on global prosperity seeing relative dips. Meanwhile at home, while victories on the battlefield and an imminent end to the war sent market sentiment and business confidence edging upwards, alarming inflation, a high interest regime and uneconomical cost of oil which prevailed during most of 2008 continued to batter the economy.

When it comes to challenges however, the Bank has always considered these as opportunities. This is probably the crux of the winning formula we have espoused for years and it has given us the impetus to grow above industry norms, consistently and continually. This year was certainly an year that impelled us to think on our feet. With the external dynamics evolving at a rapid pace and each day bringing new challenges with it, the Bank, like its counterparts, was most often driven to make decisions fast but with greater prudence. The litmus test as we saw it, gave us even more opportunity to use the fundamentals of the winning formula that had made us the winning bank – that of the quality learning culture we possess, applying best practices, innovation and excellence to everything we do, growing with passion and winning with distinction, leading us to set benchmarks and be a true leader in the industry.

While the details of our performance, innovations, processes, compliance initiatives and financials are explained in expansive detail further on in this report, I will for the most part, synopsis the rudiments of the Bank's overall operations in my review.

“ While it has been a challenging year, we have always stated that the real test is not to win when things are positive, but rather to win in an environment that constantly poses trials and challenges. This is where the strong will prove its mettle and be separated from the weak. ”



**Rajendra Theagarajah**  
Managing Director / CEO



### **Overall performance**

Your Bank continued its consistent growth paradigm in a difficult milieu as mentioned above. With a tight and controlled monetary policy regime now instituted, the balance sheet posted a modest growth in deposits and advances, of 6% and 9% respectively. However, what is most exciting in this environment where growth has remained flat or marginal in most cases industry-wide, is that the Bank recorded what is probably one of the highest after tax profits in the entire banking industry this year. Our bottom line this year has ended up with more than Rs 3.2 Bn in after tax profit, a remarkable achievement considering the circumstances under which it was generated and also showcased definite proof that the Bank has the right formula for stability and growth.

However the Group's profit after tax for the year was less than that of the Bank's by Rs 333.2 Mn, as expected. This was mainly due to the divestiture of 100% and 50.01% shareholdings in the Bank's fully owned subsidiaries namely HNB Stockbrokers (Pvt) Ltd and HNB Securities Ltd, to the newly formed joint venture with DFCC Bank which released Rs 475.5 Mn by way of profit on disposal and dividend income.

I would like to reflect on some interesting facets of our portfolio given the high inflationary regime, which topped 28.2% (Point to Point) in June but was brought to a relative low of 14.4% in December 2008, due to a slew of controls infused by the Central Bank of Sri Lanka. While the Bank was not able to escape the challenges cascading from the macro environment and our Non Performing Advances (NPA) at the end of 2008 notched just under 7%, what is positive in this light is that the Bank possesses one of the highest provision covers in the industry at 66%, a very healthy and satisfying confidence building measure for our stakeholders. Another aspect is our cost management initiative, undoubtedly one of the best in the industry. Our recipe is not one of cost cutting but of cost management and one we aggressively pursued to rein in growth at under 14%. This again is remarkable given that our staff strength is retained at around 4,300 and the fact that our operating environment involves expansion, continuous technological advancement and unremitting modernisation to retain the winning flavour.

To us, delivering on our promises is de rigueur. One of the most noteworthy milestones in that portfolio of promises was an undertaking made last year to establish 250 Automated Teller Machines (ATM) by the end of 2008. The milestone was achieved with the infusion of 76 new ATMs into our network, making a total of 260 and one of the largest amongst banks in Sri Lanka. Another pledge, that banking has to be accessible

to everyone, is fast being made a reality. We continued our aggressive expansion plan, even though the general corporate sentiment was one of consolidation and certainly not of expansion given the macro circumstances. We firmly believe in transforming challenges into opportunities and that a down time would be the most appropriate scenario to showcase our strengths and abilities. Our branch network, which is penetrative in any case, was further expanded based on our aggressive expansion plan. With 10 new customer centers launched this year, our entire network is now 177, located strategically around the country and accessible in some of the most difficult areas as well.

### **Etching our presence offshore**

Our offshore operations too gathered momentum with our presence in the Middle East etching new dimensions this year. Creating history, we ventured into Oman not as a Sri Lankan business house but rather as an international one. Positioned to serve the Asian region. Majan Exchange LLC has an investment of 40% by HNB and will concentrate on remittance business for the whole of Pan Asia. We have just completed regulatory formalities for two more similar operations in the UAE and Canada with the launch of commercial operations due to begin in the first half of 2009 for both.

In South Asia, we signed a Memorandum of Understanding with the City Union Bank of India and now await regulatory clearance from Reserve Bank of India / Securities and Exchange Board of India (RBI / SEBI) to commence investment banking operations. We believe the economic meltdown permeating across the region slows regular processes but we have ample faith that we will get the necessary approvals and clearance to start operations soon as HNB has met the required criteria.

Another offshore presence which was mooted in 2008 but awaits clearance is in Bangladesh. While an application was lodged at the Bangladesh Bank (Central Bank), the political turmoil experienced there for most of 2008 slowed down the system. However, we are confident that given the change of political regime, we may see accelerated development of the economy, which would require a faster grasping of opportunities.

### **Domestic transformations**

Having established the foundation in 2007 for a historical partnership, this year etched the fruition of this winning partnership with the formation of Acuity Partners (Pvt) Ltd. An equally owned Joint Venture between DFCC Bank and HNB,

the joint venture is an investment of Rs 500 Mn, collating the synergies of HNB Stockbrokers (Pvt) Ltd, DFCC Stockbrokers (Pvt) Ltd (now known as Acuity Stockbrokers (Pvt) Ltd) and HNB Securities Ltd under one powerful umbrella.

### **Operational deliverables fulfilled**

We have posted a highly satisfactory year with regard to operational deliverables aligned to the plans laid out at the beginning of 2008. After two years of extensive planning and unbridled anticipation, we finally began migrating to our new Core Banking Applications using the most advanced systems, namely Finacle version 7.6, supported by one of the world's most sophisticated IT companies Infosys. The rollout now includes the entirety of the Head Office as well as 14 customer centres, beyond the target envisaged for the year. The complete branch network will be included by mid 2009, bringing the entire Bank on to one operational platform and setting the stage for the innovative ideas, solutions, products and services we aim to continue infusing into our winning stance.

Collating our strengths and leveraging those synergies on a single focus platform has been a challenge we have faced over the last few years and during this time of economic challenge, it would be perceptive of us to utilise that quietude to invest astutely in our plans for tomorrow.

### **Setbacks**

As one of the leading banks in the country which is upheld as an ethical business entity whose standards, practices and benchmarks are emulated by others, we have striven to retain those values and principles and be a model corporate citizen. However, sometimes, the equation is not reciprocated. Over the last three years, our books have continued to show a deep dent in excess of Rs 2.7 Bn as outstanding from Kabool Lanka and Lanka Synthetic Fibre Ltd. The state has acquired properties vested with the Bank (which were taken as collateral for facilities extended to these companies). Repeated requests have not yielded any results in receiving compensation due to the Bank by law, on account of these acquisitions. We strongly believe that in these times of a financial crunch where high interest rates and scarce capital abound, these monies could be reinvested in our business, paving the way for investing in the future, benefitting not only the Bank but the larger picture in general. We do hope the request will be heeded to in the coming year at least giving us some leeway with these funds which would be most useful especially in these times.

### **Our sustainable initiatives**

Corporate Sustainability Reporting continues with an institutionalised focus as we feel this is vital for ensuring a sustainable platform. Sanitation, clean drinking water, healthcare, education, literacy and the environment are all being planned out and given a logical organised approach with the ultimate goal of ensuring sustainability of our business model. A comprehensive sustainability report within this Annual Report gives detailed information of our efforts, supported by quantitative and qualitative data.

### **Continuing to win**

Given our consistent performance over the years, it is no surprise that our AA- (lka) rating granted by Fitch Ratings Lanka was reaffirmed. But what is significant is that in a challenging year with a surfeit of global and local turbulence, our ratings remained on this same platform. This is indeed an important benchmark, signaling that the Bank is 'doing the right thing at the right time for the right reasons' – a tenet we would like to continue and improve upon.

The sustainability of our business relies primarily on Team HNB and they have continued to do us proud. The motivation, dynamism, solidarity and commitment showcases the true spirit of a winning team. The accolades received during the year both internationally and in Sri Lanka are ample testimony to this. For the first time in the history of the Sri Lankan banking industry, HNB, an indigenous Sri Lankan bank, won the Asian Bankers Award for the Best Retail Bank in Sri Lanka. In addition, the Bank won five awards at the National Business Excellence Awards giving us tremendous recognition within the corporate sphere of the country. We also notched awards at the Annual Report competitions organised by both the South Asian Federation of Accountants and the Institute of Chartered Accountants of Sri Lanka, while both Business Today and Lanka Monthly Digest (LMD) featured the Bank among the Top Ten corporate entities in the country.

One of the most significant tributes to the Bank in terms of human resource management was winning the Gold Award at the HR Awards this year.

### **Focus for 2009**

We do perceive further challenges in 2009 as it will continue to be a year of consolidation in the economic sphere. While the war may see a conclusion, we also see a tightening of purse strings leaving little or no disposable income among the public. With the budget deficit alarmingly high and interest



rates easing slightly but not showing any signs of abating, cost of living will spiral even though there is a promise by the regulatory authorities to decrease inflation to a single digit by mid 2009. Given the recession permeating among the developed economies, our primary industries will face difficulties, which may also result in unemployment rising.

In this backdrop, for the Bank, 2009 will reflect the overall message of cautious optimism. Retail mobilisation of deposits we believe, will be difficult but is an area that needs added focus as it infuses a savings culture and uplifts the overall economy while also reducing the Bank's cost of funds. We will have to concentrate on preserving the qualitative features of our portfolio and wherever possible, nurture and strengthen our existing relationships, a vital facet in good relationship management. Our performance strengths can only be sustained if we instill confidence and loyalty within our existing relationships, especially in times of difficulty, where we inspire and inculcate a deeper understanding of our customers, assuring them of our commitment to being a true partner.

Another panacea for challenging times is in managing costs, a premise we have used with added vigour in the last few years. At times when margins are challenged at the top line, any leverage we can obtain at the bottom line level is a good crisis management tool. We have to be pragmatic in our strategy and we feel it would be greatly advantageous if continue to leverage on our cost drivers to defend margins, which are undoubtedly going to contract further next year.

Looking at the physical presence of the Bank around the country, in a post war scenario we have already laid the groundwork in most parts. While we did have a physical presence in the Eastern Province, we deemed that the time was appropriate for expansion and more visibility. The micro financing and Small and Medium Enterprises spectrum has been augmented, while the Bank is also involved in larger infrastructure projects including the development of roads. In the North, the Bank has been a standard bearer for the province since the 1970s with 5 customer centers already located in the peninsula and two more envisaged in 2009 . With the A9 open to public traffic soon, we will definitely etch our presence further in that part of the country. Both the north and east pose immense opportunities in terms of development and will be an interesting focus in our future growth strategies.

#### **A Final Word**

While it has been a challenging year, we have always stated that the real test is not to win when things are positive, but

rather to win in an environment that constantly poses trials and challenges. This is where the strong will prove their mettle and be separated from the weak. The next year will prove to be more of a testing ground and we may see some unprecedented turns in the corporate arena.

Undoubtedly the excellent focus we have always maintained on risk management, seen in our comprehensive risk management report in this Annual Report, will affirm the unrelenting single mindedness we have employed in ensuring that risk management remains the vital nucleus in our business model.

We have never been complacent and never will be. We have always recognised that the world continues to evolve and with that the challenges are numerous and opportunities multi-faceted. We will however firmly build on the foundation of one team talking one language. We will focus on our core competencies and on our strengths and basically, consciously do what we are good at.

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



**Rajendra Theagarajah**  
Managing Director / CEO

Colombo, Sri Lanka  
13th February 2009

# The Board of Directors



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## 1 Chairman **Mr Rienzie T Wijetilleke**

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

Managing Director & Chief Executive Officer from July 1988 to December 2004 and counts over forty-nine years in Banking including overseas assignments. Appointed Chairman in March 2004. He is also the Chairman of HNB Assurance PLC, Sithma Development (Pvt) Ltd and Sunshine Holdings PLC, Director of Nawaloka Hospitals PLC, Ceylon Biscuits Ltd and Mahaweli Reach Hotels PLC, He was Chairman of HNB Stockbrokers (Pvt) Ltd (up to 3.11.2008) and HNB Securities Ltd (up to 4.11.2008). He was former Chairman and Director of the Colombo Stock Exchange.

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

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

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 24 years in Banking including overseas assignments. He is a Director of HNB Assurance PLC, HNB Securities Ltd, HNB Stockbrokers (Pvt) Ltd, Acuity Partners (Pvt) Ltd, Acuity Stockbrokers (Pvt) Ltd (formerly known as DFCC Stockbrokers (Pvt) Ltd), Sithma Development (Pvt) Ltd and Lanka Financial Services Bureau Ltd. He is the Chairman of Sri Lanka Banks' Association (Guarantee) Ltd. Chairman, Financial Ombudsman Sri Lanka (Guarantee) Ltd and Vice Chairman of the Asian Bankers Association.

## 3 Director **Mr D H S Jayawardena**

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

## 4 Director **Mr M V Theagarajah**

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

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

## 5 Director **Mr R K Obeyesekere**

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



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#### 6 Director **Ms Pamela C Cooray**

LL.B.

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

#### 7 Director **Mr Ranjeevan Seevaratnam**

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

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

#### 8 Former Deputy Chairman **Late Dr V P Vittachi**

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

Appointed Director in 1988. He was the past Head of Sri Lanka Customs, past Chairman of several public corporations and past Governing Council Member of the Peradeniya and Moratuwa Universities. He was Chairman of Lanka Milk Foods (CWE) PLC, and a Director of Stassen Group of Companies. Resigned with effect from 21st August 2008 and passed away in September 2008.

#### 9 Former Director **Late Mr Ratneswara Sivaratnam**

Appointed Director in December 2004. He was a Director of Aitken Spence PLC, Acme Printing & Packaging PLC and Lanka Aluminium Industries Ltd. Former Chairman and Managing Director of Aitken Spence Group of Companies, former Chairman – Employers Federation of Ceylon, on the Steering Committee of the Airports and Port Development and past Executive Chairman of the Sri Lanka Export Development Board. He was past President – Association of Group Tour Agencies, Past Vice President – Ceylon Tourist Hotels Association and Travel Association of Sri Lanka, past Consul General for Finland in Sri Lanka and was an Executive Committee Member of the Ceylon Chamber of Commerce. Resigned with effect from 24th April 2008 and passed away in July 2008.

#### 10 Board Secretary **Ms Indrani Goonesekera**

Attorney-At-Law

Appointed Board Secretary in April 2001. She is the Deputy General Manager (Legal) of the Bank and is a member of the Corporate Management of the Bank for over 12 years. She is also the Board Secretary of HNB Assurance PLC, HNB Securities Ltd, HNB Stockbrokers (Pvt) Ltd and Sithma Development (Pvt) Ltd.



# Corporate Management



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



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



**J D N Kekulawala** M.B.A. (Manchester), F.C.I.B.(London),F.C.A.(England & Wales)  
Chief Financial Officer



**C P Abeywickrema** B.Com. (Special) Sri Lanka  
Deputy General Manager - Personal Banking & Network Management



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



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



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



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



**Ms L L C C Thambiah**  
Deputy General Manager - Zone I



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



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



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



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



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



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



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



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



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



**M K Nambiyarooran M.B.A. (Sri J.), M.A. (Fin.Econ), F.C.M.A., F.S.C.M.A., F.I.B.(Sri Lanka)**  
Assistant General Manager - Treasury



**D A de Vas Gunasekara A.C.A, F.S.C.M.A**  
Assistant General Manager - Finance

# Senior Management

- 1 B J Sinniah**  
Chief Manager - Risk & Compliance
- 2 R M P Ratnayake**  
M.B.A. (Southern Queensland - Aus.), P.G. Dip. Busi. & Fin. Admin. (I.C.A.S.L. & Cranfield), A.I.B. (Sri Lanka), M.A.A.T., F.C.P.M.  
Chief Manager - International Operations/ Chief AML Officer
- 3 K L Wijesooriya**  
LL.B (Sri Lanka)  
Chief Manager - Remittances
- 4 D St E Fernando**  
Chief Manager - Operations
- 5 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 – Information Technology
- 6 T Govinthadas**  
M.B.A. (Colombo), B.Sc. (Hons) (P.F.T.) (Ceylon), A.C.I.B.(Lond.)  
Chief Manager- Network Banking
- 7 I H A Wickramasinghe**  
M.B.A. (Sri J.), A.M.I.E. (Sri Lanka),M.C.I.M. (UK), M.S.L.I.M.  
Chief Manager - Project Finance
- 8 B K Wijeratne**  
B.Sc. (Physical Science) Colombo  
Chief Manager - Leasing
- 9 N U Jumat**  
A.I.B. (Sri Lanka)  
Chief Manager - Trade Services
- 10 P G Wilson**  
B.Sc. (Kelaniya), Dip. in I.T. (N.I.B.M.)  
Chief Manager - IT Research & Development
- 11 R J Thambirajah**  
Chief Manager - Colombo Region
- 12 I A Baduge**  
Dip.in Bank Mgmt., A.I.C.M.  
Chief Manager - Corporate Banking
- 13 R M P Dayawansa**  
M.B.A. (Sri J.), F.I.B. (Sri Lanka), M.C.I.M. (UK), M.S.L.I.M.,  
Chief Manager - Greater Colombo Region
- 14 S Sivalingam**  
A.C.I.B. (London)  
Chief Manager - Procurement & Logistics
- 15 T M A Mutalip**  
A.I.B.(Sri Lanka), Dip. in Bank Mgmt., LL.B (Sri Lanka)  
Chief Manager - Operational Risk
- 16 A Goonesekere**  
M.B.A. (Sri J.), F.C.A. (Sri Lanka), F.S.C.M.A.  
Chief Accountant
- 17 N Premakumar**  
Senior Manager - Admin & Trade Services (City)
- 18 U N I Elapata**  
B.A. (Hons) - Univ. of Texas (Austin)  
Senior Manager - Head Office Branch
- 19 Ms N M C P Wettasinha**  
Attorney-at-Law & Notary Public  
Senior Manager - Legal
- 20 E C Alles**  
B. Sc. (Bangalore)  
Senior Manager - Special Projects [International]
- 21 R B Warnakulasuriya**  
B.Com. (Special) Kelaniya, M.A.A.T, A.I.C.M.  
Senior Manager - North Western Region
- 22 V Ratnasabapathy**  
A.C.I.B. (London)  
Senior Manager - Credit Risk 2
- 23 S Udayakumar**  
B.Sc. (AM) M.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)  
Senior Manager - Operational Risk [Zone II]
- 24 J T M Weeresinghe**  
Senior Manager - Credit Risk
- 25 N Premarajah**  
Higher Dip. in Int. Busi. Mgmt. - Chennai  
Senior Manager - Consumer Banking & Housing Finance
- 26 Ms M K Rambukwella**  
M.B.A. (Sri J.), M. Sc. (Peradeniya), B.A (Hons) Peradeniya., A.C.I.M. (UK), M.S.L.I.M., A.M.I.T.D. (Sri Lanka)  
Senior Manager - Training & Development
- 27 Ms R Prabhakaran**  
A.I.B. (Sri Lanka)  
Senior Manager - Treasury Operations
- 28 A G Gomez**  
Senior Manager - Treasury
- 29 Ms K Balasubramaniam**  
LL.B (Sri Lanka)  
Senior Manager - HR Management
- 30 H J A Ferdinando**  
Senior Manager - Centralized Operations
- 31 L S C L R Fernando**  
A.I.B (Sri Lanka)  
Senior Manager - Central Region
- 32 N M Kulatunga**  
M.B.A. (Sri J), A.I.B. (Sri Lanka)  
Senior Manager - Credit Administration
- 33 W J T Fernando**  
M.B.A. (Sri J), A.I.B. (Sri Lanka)  
Senior Manager - Uva Sabaragamuwa Region
- 34 D S L Ferdinando**  
Senior Manager - Corp. Account Relationships
- 35 A R Uduwela**  
M.B.A. (Sri J), B.Sc. Special (Peradeniya),  
Senior Manager - Business Dev.- City
- 36 B K Achan**  
M.Sc. (Bombay), B.Sc. (Hons) (Calcutta),C.A.I.I.B.(India)  
Chief Representative Officer - Chennai
- 37 A B Shahid**  
M.B.A, B.Sc. (Univ. of Karachi), F.I.B. (Pakistan)  
Chief Representative Officer - Karachi







# Management Discussion & Analysis

Diversity that **all adds up**

# Corporate Banking / Project Finance

“ We also took this opportunity to strengthen our customer relationships, using the tenets of learning, applying and growing to add up the positives into our bottom line. ”

It has certainly not been an easy year for the entire banking industry in Sri Lanka given the economic downturn, high inflation and spiraling interest rates seeing the impact permeating across the entirety of corporate Sri Lanka. With corporate banking perceived as an integral facet to the Bank's bottom line contribution, it became imperative that corporate banking rethink and re-strategise in the light of the challenges observed and envisaged in the current milieu. It was an year where the focus continued its emphasis on a qualitative portfolio with hands on monitoring leading towards account profitability. We also took this opportunity to strengthen our customer relationships, using the tenets of learning, applying and growing to add up the positives into our bottom line. We strengthened the processes infused last year with more flexibility and innovation for our customers, consolidating our portfolio on a qualitative platform, to pose a strong and stable

performance, which even with a low appetite for credit saw a marginal growth of about 5% by end of year.

The selection of proposals was based on acceptable levels of risk, taking into consideration the depressed market conditions both locally and globally and the negative economic signs envisaged. Further, mechanisms that would alert early warning signals were implemented to ensure awareness and effect tighter controls, with the department becoming more proactive and more vigilant of the entire portfolio. The preferred sectors for credit growth included power generation, health and infrastructure development, whilst the rest of the sectors went through a more rigorous selection and approval process.

In project financing, the astute strategies and focus on quality, monitoring, controls, prudent evaluation and follow up, obviously held us in good stead, considering that we posted a



significant growth figure in our domestic and overseas lending portfolio of 20.2%. This saw an increase in our total portfolio to Rs 10.6 Bn from Rs 8.8 Bn last year. Under Contract A of the EIB Credit Line (available for tsunami affected industries) for which HNB was the leading Bank in approving facilities, we have disbursed loans amounting to Rs 2.2 Bn.

Given the mega economies of the world facing economic downturns and even though it is widely theorised that Sri Lanka's financial markets are impacted minimally, we strongly believe that some of our industries will feel the negative permeation of this downturn and hence, 2009 will undoubtedly become increasingly challenging. The Bank however, has always prided itself on its strong and stable fundamentals and we will continue on the judicious tenets we have practiced to maintain our stakeholder confidence. Our credit quality will be cushioned with acceptable growth opportunities both locally and under Foreign Currency Banking Unit (FCBU), while being mindful of the global economic environment and possible influences on the macro economic vista. We also envisage interest and inflation spheres continuing to be challenging and hence aim to manage the interest rate spread and account profitability in line with our strong fundamentals and market competitiveness, with a higher concentration on fee based and exchange income also on the cards. Overarching the rudiments of the processes and measures already implemented, next year will see added emphasis on relationship management, where faster decision making, quality customer service and credit delivery will be further enhanced.

### **Small and Medium Enterprises (SME)**

Having already founded a strong and stable SME platform which has continued to grow from strength to strength, the Bank, using its winning strategy, continues to add value through innovation and increase of service levels towards higher levels of excellence each year. We also believe very strongly that the path to sustainable development is on a bottom up approach in developing the SME economy and hence, concentrating keenly on this area of banking has become a vital cog in the wheel of our progress.

This year, the Bank entered into an agreement with National Development Bank (NDB) to implement the Small and Micro Industries Leader and Entrepreneur Promotion Project II (SMILE II) Revolving Fund Credit Scheme which is funded by Japan Bank for International Co-operation (JBIC) with a primary focus on SMEs. The other significant achievement which has proven to be successful is the introduction of a Special SME Credit Scheme 'Purna', which contributed to a significant growth of 15% in our SME lending portfolio. We took the emphasis on marketing and promotion as a measure to gain market share even further with awareness programmes and roadshows held in Matara and Ratnapura, in partnership with International Financial Corporation (IFC) which considers HNB a 'Partner Bank' in their endeavour of uplifting the SME sector. This also gave us significant mileage in popularizing the concept of SME development, especially among our target rural population.

With the global economic crisis affecting our primary export earner, the tea industry, the Bank took the initiative to offer relief to the affected industrialists, especially the tea small holders, on a selective basis, after a detailed evaluation of the viability of each operation and their ability to withstand the present crisis.

Training and Development too took on new vigour during the year as we feel that the SME segment is a specialised area that needs to be updated and developed in line with trends seen in the economy. International resource persons were sourced on a cost share basis under the IFC Advisory Programme for the SEDF Southern Region of Sri Lanka to conduct three training programmes which was a successful knowledge garnering effort for our team.

“ With the biggest, largest and most valuable prize schemes on offer, Pathum Vimana continued to draw higher growth even though meeting our forecasted targets for the year was somewhat challenging. ”

Personal banking continued to be an area that posed more challenges with unprecedented events unfolding during the year including a global meltdown permeating local industry sectors which naturally saw a dip in disposable income, alarming inflation, high interest rates and a local economy struggling to survive. Meeting forecasted figures proved to be a challenge however, the Bank having foreseen the risks and trends early in the year, re-strategised and restructured its plans. Implementing them according to the events that unfolded, gave us some leeway in ensuring that our growth curve remained upwardly mobile. Having learned lessons along the way and applying these to our growth strategy, we undoubtedly were able to continue our winning streak, despite the industry pointing downward trends.

## Deposit Mobilisation

Despite a macro environment posting a challenging year for deposit mobilisation, the Bank managed its fundamentals well and maintained a good deposit mix, especially in the low cost area. Term deposits, which are high interest cost funds, naturally saw good growth while our flagship Pathum Vimana continued a consistent growth trend, albeit with some difficulty, given the fact that market rates kept showing upward movement and new products, including those launched by other financial institutions, entering the marketplace, shrinking an already depressed market. Hence, using our extensive customer centre network, excellent service standards and a comprehensive product portfolio, we saw at least 20,000 savings accounts being opened each month.

With the biggest, largest and most valuable prize schemes on offer, Pathum Vimana continued to draw higher growth even though meeting our forecasted targets for the year was somewhat challenging. Seeing the trend however, we changed our strategy to focus on the rural market as the urban market's savings power was gradually abating.

Our newest product, Capital Savings, was yet another measure we introduced to counter the lacklustre savings environment we were faced with during the year. Battling the unfavourable conditions, Capital Savings became the panacea that harnessed a high return of 14% as opposed to the regular rate of 4.5% and

brought in about Rs 3 Bn in just over six months since its introduction in June 2008.

Imbuing our concept of partnering our customers from cradle to their twilight years and even further, we re-launched our minor savings product to ensure that benefits will permeate to wider minor segments. From newborns to five years, to twelve years in Singithi Lama, to teenagers worked through HNB Teen, the restructured accounts offer attractive gift schemes and investment plans to encourage the savings habit, not only among the parents but also among the children. During the year the entire minor savings portfolio mobilised Rs 500 Mn in deposits, and we have seen a marked increase in savings among students, who use the Student Banking Units in schools. These units have also successfully instilled a strong savings culture among students which augurs well for the future development of the economy in a broader sense. Further, mindful of the fact that Sri Lanka holds the fastest ageing population in this part of the world, the Bank will in the next year, add on to the comprehensive product we already have for senior citizens, which currently imparts a higher rate of interest, free insurance cover and other added benefits.

## Expanding Our Customer Centre Network

Accessibility remains a key driver in the ethos of our customer centre expansion and having set ourselves some ambitious targets, we continued on course. We opened 10 customer centres through the year. The new customer centres also had 6 extension offices. Given the development surge we observe and anticipate in the East, the Batticaloa branch was relocated to larger premises to permeate better service levels and accessibility. One of our most strategic branches in the Western Province located at R A De Mel Mawatha also underwent a shift of location due to stringent security measures, which was a severe inconvenience to our customers. This branch is now at Green Path, Colombo 7 and will soon house the Bank's newest value addition, our priority banking centre.

## Alternate Delivery Channels

The Bank continued its strategy of expanding the electronic delivery channels during the year. We kept to our commitment



to expand the ATM network and exceeded the 250 ATM mark set for 2008 well ahead of schedule. This expansion included commissioning of our second “Drive-thru” ATM at our Greenpath Branch and many off-site ATMs located at strategic points throughout the country. The usage of SMS Banking and Mobile Banking (the only trilingual Internet Banking facility in the island) that operates on mobile handsets using GPRS/3G connectivity, has also recorded encouraging growth with over 1,900 transactions performed monthly valued at Rs 225 Mn. Mobile Banking provides the convenience of operating in one’s own language whilst providing rich features such as bill payments, mobile top-ups and 3rd party fund transfers within the Bank Network. The Bank’s Internet Banking service, “Virtual Branch” continues to be a popular transaction medium with over 6,420 financial transactions exceeding Rs 98 Mn in value performed monthly. With the integration of Virtual Branch to the Bank’s new Core Banking platform during 2009, we hope to provide more value additions targeting both corporate and retail customers. This would ultimately benefit in lower transaction cost and more flexibility in banking transactions for our customers.

### **Credit Card Business**

The Bank has achieved an impressive growth of 30% year-on-year in its merchant acquiring business ranking amongst the top two banks in Sri Lanka with a merchant network in excess of 6,000 spread over the island and the Maldives as well. The Bank has however, slowed its credit card

issuance during the year with the prevailing economic conditions not being conducive for aggressive issuance. Nevertheless, the Bank continued selective issuance of new credit cards during the year whilst promoting usage by the existing card base. Several promotions carried out during the year continued to add value to the HNB credit card showing a 100% growth in usage during the promotional periods. With the on-going rollout of the Bank’s new Core Banking solution, we have also commenced issuing “HNB Visa Debit” cards to our customers, which will replace the proprietary “Cashline” ATM card and will enable our customers to carry out direct purchase as well as ATM transactions both locally and internationally.

### **Housing Loans**

Shanthi Housing portfolio continued to grow despite the negative macro environment of high interest rates and inflation. The real estate sector while seeing a dip, did not live up to its projections of two years ago due to the overall vista not being conducive to a growth rate. However, the Bank reached the expected growth of 15% for the year which is the projected growth and positioned itself in an upwardly mobile position.

Concentrating essentially on a qualitative portfolio and taking into consideration the very high interest regime which spiralled from 17% to 23% we disbursed housing loans to about 2,700 customers in total, based on a set target made at the beginning of the year. While in earlier years the Bank disbursed loans up to

75% of the value of the security offered, given the current milieu, we readjusted our disbursement levels to 60% and also infused better monitoring controls to ensure that repayment structures are maintained.

We anticipate 2009 being even more challenging but are encouraged by the fact that housing continues to remain on top of the agenda for most. While we are very selective in financing of condominium and apartment complexes given the decreasing trend seen this year and further envisaged in the next, we do see potential in land and housing gathering momentum albeit gradually and aim to make use of those opportunities as they come about.

## Personal Loans

The Personal Loans portfolio of the bank did reflect a slight reduction due to the high interest rates regime and inflation. However, the Bank has been able to disburse loans up to 90% of its set target for the year.

The economic conditions and prevalent high cost of living resulted in the Bank not engaging in the promotion of the product, as a prudent measure. However, the Bank continued to serve its existing customers and other selected segments.

## Leasing

The leasing industry has faced a high interest regime, with the market shifting to a non-conducive year for leasing of commercial and personal vehicles, which in the medium term doesn't augur well for the macro development drive of the country. The imposition of a ceiling on the claimable input value added tax has also contributed to lower growth rates in the industry. The increasing non performing advances and the global meltdown also posed more challenges for the industry, a phenomenon we feel will continue in the next year as well.

But despite the macro trends, the Bank mainly focused on the quality of the its leasing portfolio. It currently stands at Rs 11,932 Bn having gained new business of Rs 3,454 Bn over the year and gross lease interest income of Rs 2,103 Bn. Given the challenging circumstances, the Bank made a concerted effort to enter leasing partnerships with vehicle dealers which would add to the strength of our leasing portfolio. The partnerships were worked through dealers in both commercial and personal vehicles and included popular Japanese, Indian and Chinese vehicles whose agents include AMW, DIMO, David Peiris Motor Company, Unimo Enterprises, Toyota Lanka, Indra Traders and United Motors. Conducting leasing fairs, branch

based sales promotions and awareness campaigns around the country and our earmarked promotional and marketing campaigns took on new vigour to ensure that set targets are met.

## Pawning

A significant contributor to the profitability of the Bank in 2008, pawning has emerged as one of our major retail business lines and as a major growth area even in the face of extreme market volatility and uncertainty. We have been successful in developing pawning as a hassle-free alternative source of credit not only for personal / consumption requirements but also for commercial / investment requirements. The Bank's well focused communication and promotional strategies in this high growth sector coupled with superior service quality have enabled the Bank to overcome intense competition in the market and to reach a new horizon in developing this relatively new line of business. It has now become another vibrant dimension to our growing retail banking activities.

The pawning portfolio this year has shown a growth of about 26% with a very significant increase of over Rs 4.35 Bn in absolute terms. We have been successful in achieving this excellent growth level with no compromise on the quality of the portfolio as evidenced by the incredibly low Non Performing Advances (NPA) level of around 1.5%. This excellent performance in terms of growth and recovery has led to an impressive 39% growth in gross interest income from this line of business.

Although it is expected that the high market volatility and uncertainty will continue into 2009 as well in the context of increasing instability in the large economies of the world, we have set for ourselves challenging growth targets for 2009. This is in line with our vision of transforming pawning from a mere consumption-oriented lending avenue into a major line of activity catering to the commercial and investment requirements of a wider segment of society by offering this facility as an instant and relatively cheap source of credit for a variety of purposes.

The value of gold held by the people of this country has more than doubled during the last 3 years and it is in the interest of the country and the people that this appreciating asset should be put to a more productive use. Hence, our future plans and strategies will be focused on developing gold-based lending as a source of healthy credit growth, fulfilling the financial needs of a larger and more varied clientele.

# Development Banking

“ Micro financing has now become one of the Bank’s mainstays in sustainability banking and one of the most successful micro finance programmes in the country. ”

Hatton National Bank being an indigenous financial institution in Sri Lanka has been involved in rural development almost from the inception of the Bank in the year 1972. Since then, the Bank was involved in Rural Agri lending and Micro financing for variety of activities such as cultivation, animal husbandry, trading and other self employment projects.

## Rural / Agri Lending

Financing of rural agricultural activities grew by 12% during the year to Rs 3.7 Bn, with disbursements of loans amounting to Rs 1.2 Bn approximately. Nearly 18% of the total portfolio is for medium and long term agri projects covering tea, coconut and perennial crop development and most of these advances were backed by refinance funds.

## Micro Finance

In 1989, the Bank initiated the Microfinance programme ‘Gami Pubuduwa’ (Village Awakening) with a view of extending the Bank’s assistance to the rural youth in exploring self employment activities.

Micro financing has now become one of the Bank’s mainstays in sustainability banking and one of the most successful micro finance programmes in the country. Gami Pubuduwa which was a pioneer in micro financing, entered its second decade from its existence, posting a growth of 9% for 2008, despite the financial services industry showing a slide downwards. Strongly founded on the principles that rural development is a bottom up approach, Gami Pubuduwa, which delivers banking with affordability, gives accessibility of finance to the non-bankable population based on equality and meritocracy, devoid of discrimination. Financing during the year 2008



therefore grew to Rs 2.2 Bn, showcasing an impressive disbursement of Rs 860 Mn to 5,400 micro finance recipients.

Using our country wide branch network which brings banking literally to the doorstep of our target audience, we continued our concept of establishing closer linkages by recruiting qualified personnel to improve upon our philosophy. We also analysed the paradigms that exist within our rural branches which showed that approximately 90% of our business volumes arise from agro based business and micro finance. Seeing this potential, we believed that strengthening our human interaction and proactive stance will add value to the services we offer.

Being the first commercial bank in Sri Lanka to launch and sustain the idea of recruiting a dedicated qualified agricultural team to add value to our targets and goals, this year too we added a total of 17 officers into our micro finance and agriculture lending sectors. It is also notable at this point to mention that the Bank was the pioneer in giving due recognition to agricultural graduates, collating them into the banking fold and giving them employment in line with their speciality and expertise. Currently, the Bank has 37 agricultural professionals and 87 micro finance field officers, who for the first time this year, have undergone specialised training with three officers also trained in India for 10 days. We also introduced the concept of micro finance team leaders this year, promoting 5 who will support our field officers to drive our micro finance vision through the well established network we have now created.

Having been an active Participating Credit Institution for almost all credit lines funded by the Asian Development Bank, World Bank, International Fund for Agricultural Development

and the Japan Bank for International Co-operation plus the concessionary credit lines given by the Government of Sri Lanka, the fundamentals of providing comprehensive credit packages to develop the rural economy continue in our veins. Given the State's commitment to further the concept of micro finance and development banking as a thrust sector for the country's development, this year we embarked on tripartite agreements with leading corporates, infusing new ideas we garnered from our experiences and knowledge gathering exercises culled from overseas, especially in the areas of agricultural farming with special emphasis on dairy farming.

With micro finance gathering momentum the world over, the Bank has most often been called upon to share knowledge and experience on various global platforms and in fact our model, has been emulated in a number of countries as well. We have already laid the groundwork in Sri Lanka for the establishment of dedicated micro finance centers of which there are 110 in number and intend to add about 10 more centres during the course of 2009. By adding to the delivery points, our intention is to create as many mechanisms and avenues as possible to revive the rural economy.

### Micro Insurance

The Bank is continuously popularising the pioneering innovative micro insurance product launched jointly with HNB Assurance PLC, our subsidiary company, to provide relief to borrowers in the microfinance sector. A significant growth of 75% during the year 2008 compared to the year 2007 was achieved. I.e. number of policies as at end of year 2008 was 2,796 and same as at end of 2007 was 1,592.



# International Operations

“ We also had the honour of being appointed Super Agent in Sri Lanka for the internationally renowned MoneyGram money transfer service, which also rewarded the Bank at the South Asian Agents’ Conference in Goa, India as the ‘Most Productive Network’. ”

Having begun this year with the usual buoyancy forecasted based on the trends for 2008, the first three quarters of this year did, as predicted, progress in line with forecasts. The last quarter however spiralled downwards, reeling in shock, after the unprecedented global crisis which hit the entirety of the financial markets across the boards. The repercussions we believe will continue well into 2009 and will require new strategies to be implemented to get back on track.

Continuing its dominance in remittance handling and value adding to the service levels of a burgeoning Sri Lankan expatriate community, especially in the white collar segment, remittance income continues its upward growth trend, showing an increase of 29% over 2007. The thrust was aptly supported by multi media awareness and communication campaigns. We also had the honour of being appointed Super

Agent in Sri Lanka for the internationally renowned MoneyGram money transfer service, which also rewarded the Bank at the South Asian Agents’ Conference in Goa, India as the ‘Most Productive Network’. In line with our plans to etch ourselves further into the promising markets of the Gulf region, HNB now has a presence in Oman with a 40% stake in the Majan Exchange LLC and a 20% stake with the UAE’s Delma Exchange.

The expected growth in the foreign currency deposit base however, did not materialise this year, due to the sharp increase in Rupee deposit rates and the stable US exchange rate depriving depositors of the advantages of the currency depreciation, thus prompting savers to convert foreign currency into Rupees, maximizing interest spreads.



### Trade Services

International trade operations maintained the forecasted momentum, growing steadily and contributing 5% growth in the import sector, while exports, remained somewhat static at 1% growth. The global and local factors that permeated the performance of this sector and displayed a negative impact on volume and remuneration growth as well as import financing requirements were retardation of global export markets due to the recession and the stringent import controls imposed by the State during the last quarter of 2008. However, overall trade income did show positive signs despite the gloomy global economy, notching our income to Rs 2.2 Bn from both non-funded and funded income.

### What the Future Holds

Despite the challenges we faced during the year we intend to capitalize on our positive features especially in utilising the ISO certification and our new Core Banking platform as drivers to garner more business, using the advantages of the Free Trade Agreements (FTA) with India and Pakistan to facilitate more trade business harnessing our expansive customer centre network to promote trade business especially in the outskirts of the cities. Our inroads abroad, especially the investments in the UAE and Oman will be further strengthened with a larger presence offshore through branches as well as in other countries and territories that hold potential.

# Treasury Operations & Exchange Houses

“ Working on enhancing our strengths to give ‘more’ to our customers, this year our resources were invested in process management and establishing two exchange houses. ”

Given the macro economic challenges that not only Sri Lanka but the world faced throughout the year and specially in a situation where the local interest rates were volatile, retaining foreign currency deposits proved to be one of the biggest challenges faced in recent times. But having envisaged some of the trends and being prepared for them given our systematic trend analyses, we managed to stem the tide and retain our foreign deposit base infusing some judicious strategies including offering better rates. Also, in order to manage our operating balances overseas more efficiently, we invested prudently, lending against the available funds and increasing our yield, in addition to using the positives of a high yielding treasury bill milieu to mobilise our REPO deposits. However, we have perceived a lack of depth and lower trading volumes in the treasury bonds market even though there have been several attempts to revive the market during the year.

We also introduced a new capital savings product which offered an attractive interest rate (established between the

rates offered for savings and fixed deposits) to draw in those depositors whose needs are for a higher interest rate than the norm of a savings account but more liquidity, which is not possible with fixed deposits.

Summing up a challenging year, given the constant instability we observed in many markets throughout, the fact that we managed to restrict the conversion of foreign currency deposits to Sri Lankan Rupees, which is a commonality in this environment, managed operating balances overseas and maintained and improved our exchange income, are certainly achievements that could be lauded.

Relationship management was given an additional boost this year as we did feel that with times being challenging, customers do require assurances of stability and security in their strategic partnerships. Our ethos has always been one of adding up our positives to ensure that the larger picture is beneficial to all stakeholders and good relationship management remains a fundamental in this. We became



actively supportive of their business operations, offering value added services if the need arose, which in turn naturally permeated towards enhancing our business portfolio. We also began dispatching daily updates on exchange rates, forecasts and advice via email and SMS alerts as value additions to enhance the services we offer. We thus differentiated ourselves by maintaining a closer liaison with our corporate and high net worth customers, which in turn assisted us in maintaining and enhancing our business volumes and resultant exchange income.

Given the lean times we were faced with, we used the quietude as a positive opportunity to strengthen our middle office, which forms an essential conduit to seamless process flow between the front and back offices. Risk management therefore became a priority and a timely one given the riskier times that seemed to pan out over the year. The risk areas therefore were strengthened and more effective management processes were infused to ensure that risk management remains a fundamental on which the Bank's sustained stability and future performance rely.

The coming year will continue in the same vein unless there is a drastic improvement in economic management the world over. However, we also firmly believe that the slowdown of economy has given us the time to relook at some of our strategies objectively. While managing risks pertaining to exchange, interest rate, liquidity and asset liability remains a priority in 2009 with effective management of our cost of funds and maximisation of revenue within the Bank's defined risk profile, our focus is also on strengthening the following:

- Forecasting cash flows effectively and managing the surplus or shortfall of funds through investment / borrowings
- Managing interest rate exposure and maturity profiles
- Trading in approved products in both the local and global markets
- More concentrated efforts to market treasury products to corporate customers and high net worth individuals

## Strengthening Our Presence in the UAE and Beyond

Inward remittances into Sri Lanka remain a bloodline to our economy, one that keeps the country afloat and gives it amazing resilience even in the most challenging times. Having already identified the need to ensure that foreign remittances need to come through legal channels for the total benefit to permeate for the national advantage, the Bank had in past years placed representatives at primary exchange houses to ensure a seamless transition and ease of transaction for those expatriates requiring remittance services. However, working on enhancing our strengths to give 'more' to our customers, this year our resources were invested in process management and two exchange house locations were established using the synergies of a combination of local and Sri Lankan knowledge.

Positioning ourselves, not as a Sri Lankan business house but rather as an exchange house to serve mainly the Asian Region, Majan Exchange LLC (which gets its name from ancient Oman), is an investment of 40% on our part and commenced commercial operations in October 2008 in Oman, concentrating on the wider geographical sphere of Pan Asia including India, Pakistan, Bangladesh, Nepal and Sri Lanka. With value added services offering web based solutions, a loyalty card and SMS alerts on remittances, the model will be emulated in our second exchange, Delma Exchange based in Abu Dhabi, which is an equity partnership of 20% and billed to begin commercial operations in March 2009.

Our plans in the next two years include further branches in Oman and Abu Dhabi. Moving out further and looking at countries with higher concentrations of expatriates, we have already laid the groundwork in Canada which will be launched in March / April 2009.

# Investment Banking

“ Our greatest achievement this year was the fruition of the joint venture between DFCC Bank and Hatton National Bank PLC which collated the synergies of HNB Stockbrokers (Pvt) Ltd and HNB Securities Ltd and DFCC Stockbrokers (Pvt) Ltd under the common umbrella of Acuity Partners (Pvt) Ltd. ”

Our greatest achievement this year was the fruition of the joint venture between DFCC Bank and Hatton National Bank PLC which collated the synergies of HNB Stockbrokers (Pvt) Ltd and HNB Securities Ltd and DFCC Stockbrokers (Pvt) Ltd under the common umbrella of Acuity Partners (Pvt) Ltd. HNB is a bank that has constantly infused its learning, applying, growing, winning ethos into its strategies and the fruition of this partnership is one which recalls a historical business relationship between the two banks since the early 1990s. The focus under this structure will be the strategic business units of corporate finance, fixed income securities and equity / debt investments. Corporate finance will continue its functions under the holding company of Acuity Partners (Pvt) Ltd. The two broking arms will be merged into one unit under the Acuity brand name.

While this joint venture remained the high point in our year, corporate finance posted almost a dismal picture given the macro milieu we faced both in the global and local arenas. While we do believe that funds are available and opportunities abound, given the current waves we have seen in financial and capital markets, most are posting a ‘wait and see’ attitude and not quite allowing themselves to take the plunge into newer horizons, just yet. Given that we are a frontline sector, this is a trend we will have to unfortunately, ride with and hopefully weather the storm over the next two years at least.

HNB Securities Ltd, which was a subsidiary of the Bank till 30th June 2008 and became a subsidiary of the Joint Venture “Acuity Partners (Pvt) Ltd” from that date, sustained its earnings during the year and has been positioned as the unit that will specialise in fixed income securities.



# Information Technology (IT)

“ The Bank’s “Virtual branch” our progressive internet banking solution continues to grow in strength, with more customers being added each year. ”

We have used our unbeatable formula of learning, applying, growing and winning to our Information Technology innovations as well. We are proud of the milestones reached during the year which were driven by our endeavour to achieve the seamless integration of our services, and deliver high performance channel distribution and integration. Our efforts will culminate in our valuable customers being empowered to avail themselves of our primary delivery channel, which is our extensive Branch network, and supplementary channels including Internet Banking, SMS Banking and Telephone Banking with convenience, efficiency and speed.

## Core Banking Initiatives

To this end we took on the challenge of converting the Bank’s legacy applications to a single robust Core Banking platform. Having successfully completed the implementation phase, the roll out is expected to be completed within the year 2009. Our Core Banking implementation was built on the concept of centralization, and our back office operations will be merged into a centre of excellence through which we propose to achieve the customer service excellence that we strongly espouse.

In support of the Core Banking unification the Bank also made a substantial investment in infrastructure. We invested in a ‘State of the Art’ Data Centre which conforms to the 942 Telecommunication Infrastructure Standard for Data Centres. the Bank now has one of the best Data Centres in the country. A fully fledged Disaster Recovery site with on-line replication and a complete overhaul of the Bank’s network infrastructure were some of the projects completed during the year.

## New Developments

Customer service excellence is the axis upon which the Bank continues to succeed, and technology is used as the primary driver in this endeavor. We thus continued to introduce newer and better services throughout the year.

We are proud to have launched our very own pawning system with its centralised database for ease of on-line monitoring and improved Management Information. Given the skills of our IT team, our in-house developed Overseas Funds Remittance

system ‘Cashxpress’ was migrated to a web based solution for better customer service and speed of delivery.

## ATM Network Expansion

Having brought our entire ATM network onto a single switch, with advanced technology, we were able to deliver more services and superior performance. New ATM monitoring software contributed to managing ATM downtime and our 24x7x365 customer help desk added to our ever increasing service portfolio which we believe is absolutely essential for satisfying our existing customers and attracting new customers. We have also improved customer response time to queries, with the introduction of the electronic journal which provides transaction information.

We commissioned 76 new ATM’s this year, reaching a benchmark of 250 ATM’s. With this milestone the Bank elevated itself to the enviable position of becoming the second largest private ATM network in the country. Responding to our discerning customers aspirations, value additions were infused into the existing services including the convenience of Rs 2,000 denomination bills at selected ATM’s and a withdrawal enhancement of up to Rs 100,000 at all ATM’s. With the migration to our new Core Banking platform we have introduced balance enquiry / status which also displays uncleared effects, a mini statement of the last ten transactions and the transfer of funds to any HNB account. Bill payment is being introduced on credit card outstandings and will shortly include other service providers as well. We also commenced the migration of our proprietary ATM card to the globally accepted VISA Debit card.

## Future Plans

The Bank’s “Virtual branch”, our progressive internet banking solution continues to grow in strength, with more customers being added each year. We have ambitious plans to enhance our Internet Banking services with the completion of our Core Banking roll out, so that our customers may use the convenience of the Internet to fulfill their daily banking needs.

# Marketing

“ From a corporate brand perspective, the Bank took the position of the “Best Retail Bank in Sri Lanka” based on the award presented by the Asian Banker Magazine at the Excellence in Retail Financial Services Awards 2008. ”

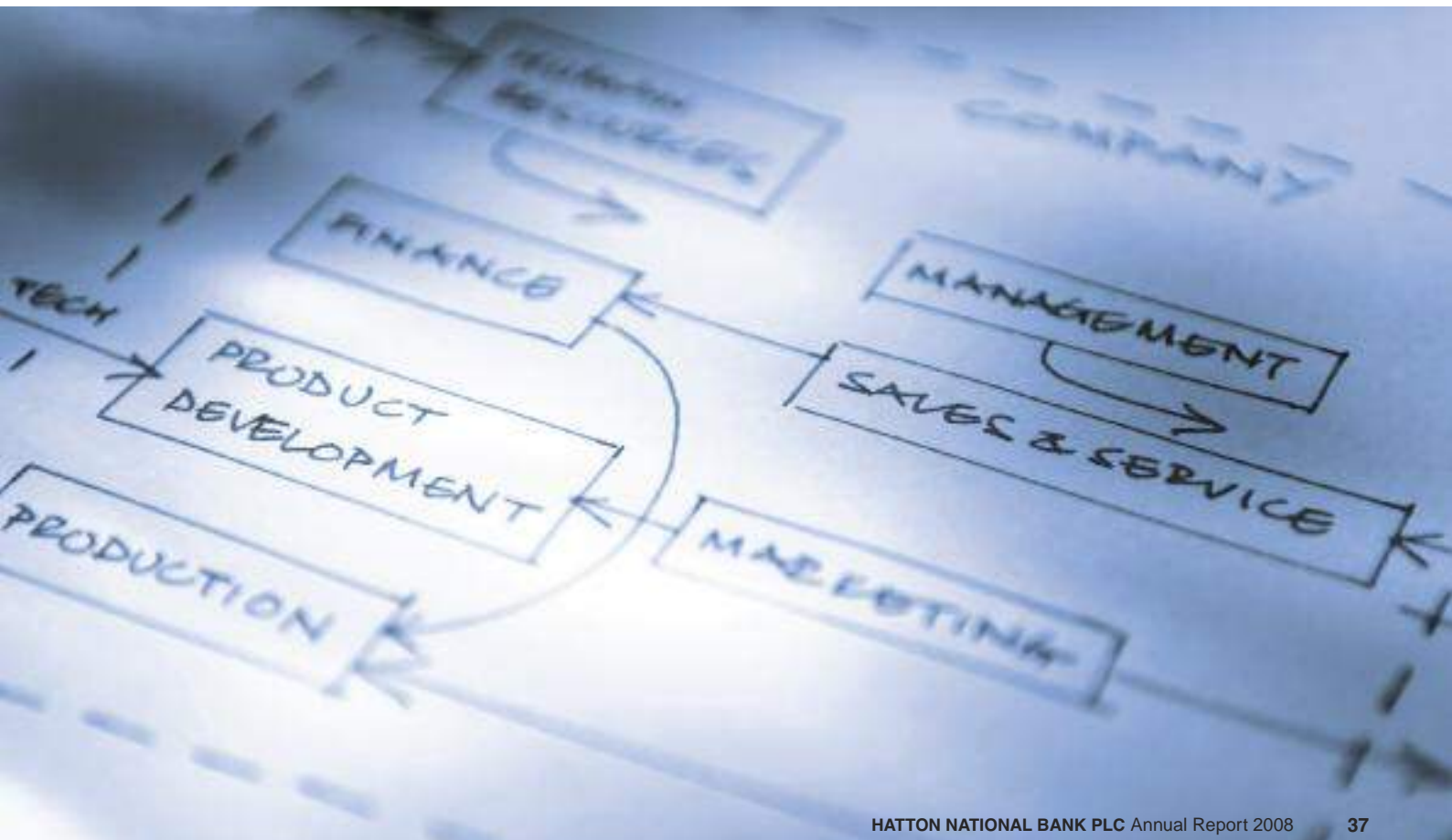
We continued and further built on the communication strategy we adopted last year ensuring that an ideal mix of corporate image building and brand building is maintained throughout the year. Believing strongly in “walking the talk” our communication strategy was continuously improved upon, having already infused our learning, applying, growing and winning formula.

In brand communication and marketing, emphasis was placed on deposit products and key liability products. The flagship brand Pathum Vimana was re-launched in January 2008 with a multi media communication campaign. The positioning of the brand was maintained as the biggest deposit draw in Sri Lanka giving more than 15,000 prizes. The brand was further extended during the year to attract the rural masses with the introduction of the Pathum Vimana Gamin Gamata draw in addition to the traditional year end and premium draws. The Pathum Vimana TV game show was a key driver in both

promoting the winners’ aspirations and promoting the prize structure. To further strengthen the deposit mobilisation strategies, the Bank launched and marketed the new capital savings account. The communication campaign was a simple interest based campaign to establish the interest rate of 14% and the other key benefit of unlimited withdrawals. The communication platform used was mainly focused on out door advertising to quickly communicate the product benefits.

The Pathum Udanaya foreign currency deposit draw maintained its position as the only deposit draw for foreign currency deposit accounts. The scheme was aggressively promoted to Sri Lakans living overseas through focused direct communication channels.

To further strengthen the deposit mobilisation drive, the Bank relaunched the minor savings scheme in two phases during the year. The Singithi Kirikatiyo scheme was launched



targeting new born babies and marketing of the scheme was introduced to a number of key nursing homes and hospitals. The Singithi general scheme was re launched under the brand name Singithi Lama and was actively promoted through the customer centre network and student savings units across 150 schools islandwide. The World Childrens day was used as the launch pad for the Singithi Lama scheme, where the bank ventured into a sponsorship with the Ministry of Education to conduct an All Island Competition titled “Lowa Dinana Singiththo” among school going children to enhance their talents in art, drama, singing, speech, short story writing etc. The Bank was successful in associating the Singithi brand to more than 150,000 children in over 9,800 schools only through this endeavour. The Singithi Lama scheme was re-positioned as a scheme which rewards all children with gifts when saving is initiated.

The top of the mind recall for HNB Leasing was maintained through the year by a number of joint promotions with vehicle agents. The joint promotions were communicated throughout the country by conducting a number of brand activation programmes.

The HNB credit card awareness levels were kept at a high level through the year by launching the Royalty 2008 programme giving free air tickets to Singapore, Malaysia and Dubai. The Bank also conducted a highly successful promotion jointly with Keells Super, built around the theme “October Swipe”. These two promotions kept usage at high levels for HNB credit cards.

The awareness and brand recall for HNB pawning was maintained at a high level during the year. The Bank used a gift based promotion to make HNB Pawning stand out among the competition as the best value proposition. In a challenging market environment we were able to maintain the desired levels of share of voice for the HNB brand within the top 4 banking brands in the country throughout the year. Continuous reminder type of advertising was pursued for HNB Shanthi Home loans and HNB Personal Loans.

From a corporate brand perspective, the Bank took the position of the “Best Retail Bank in Sri Lanka” based on the award presented by the Asian Banker Magazine at the Excellence in Retail Financial Services Awards 2008. HNB which is always considered a premier private commercial bank worked on augmenting its brand presence further in the upper echelons of the community through the sponsorship of elite golfing events like the HNB Millennium trophy tournament at the Royal Colombo Golf Club.



# Subsidiary Operations

## HNB Assurance PLC

Our performance has continued to prove strong, consistent and above industry average, displaying a 33% growth in profit after tax and a 25% growth in turnover for the year under review. The milestones we have achieved in the past years have signaled our reliance on the learning culture we have adopted, while also applying best practices to our growing company, all adding up to a sustainable business that we are proud to have nurtured over 7 years. Adding to our lengthening list of achievements, we are honoured to have been placed 57th in the LMD rankings of the top 100 brands in the country this year and to win the silver award for the insurance sector at the ICASL Annual Report awards ceremony held in November 2008, all momentous accolades for a company with just 7 years under its belt.

In line with our business vision, the distribution network continued on its expansion plan, adding 8 new branches to make up a total of 43 branches by the year-end. A significant achievement this year was a unique model we adopted for bancassurance with our parent HNB, stationing a dedicated HNB Assurance staff member within HNB branches to focus first hand on our life insurance products. The model is now emulated in 35 branches and resultant to this, we have seen a 15% growth in business in this sphere of business.

While new product development was not a priority this year, we focused on improving and adding value to the products we already have, which has proved to be very successful. Our popular motor insurance product MotorGuard was one such product, with a number of new value additions including an attractive no claims bonus that grows rapidly to a maximum of 75%, resulting in an increase of business to this segment. Our Five Year Investment product, Super Five, which was launched last year has shown noteworthy success too, bringing in Rs 100 Mn in premium income at the initial introduction. The success prompted us to launch the second series this year, which has also mobilised in excess of Rs 100 Mn, a feature that we believe also signals the confidence we have achieved among our customers.

Nurturing relationships too has been a primary facet in our sustainable growth performance despite a very challenging macro environment for the entire industry. We added two further entities this year to our existing strategic alliances and will continue to pursue these win-win partnerships. Micro insurance has been an emphatic area of our business purview as we feel that micro entrepreneurs have the capacity and capability to drive the rural economy. Tying up with the Citizen Welfare Development Foundation, a non-governmental organisation with a focus on micro entrepreneurial development, to supplement our existing relationships with the Bank and Sarvodaya Economic Enterprise Development Services (Guarantee) Ltd. (SEEDS), we strongly believe we can contribute to the sustainable development of this segment of the population.

Next year will see us focus on four strategic areas where we believe the growth and sustainability of our company lies. Firstly, we will concentrate on improving general insurance profitability which requires more focus given the macro milieu and competition; secondly, maintaining the good levels of profitability and high growth in the life insurance segment; thirdly, investing in information technology which we believe will be the driver of our future business, where our systems and processes will infuse better networking, flexibility, automation and astute decision making; and finally, a heavy concentration on brand development, where while we leverage on the positive brand image that our parent enjoys, we will position our brand as an independent entity that is stable, ethical and consistent in its business operations.



## Subsidiary Operations Sithma Development (Pvt) Ltd

Despite an increasingly challenging operating environment over the last three years from a macro industry perspective, Sithma Development displayed a steady growth from an operational facet. However this year, due to high finance costs, the operating profit of 22% was negated, positioning the company at a marginal loss.

However, despite the negative factors we have had to contend with, we maintained all the ratios worked on in the past, ensuring that it all added up to the larger picture of the Bank's performance. For example, our efficiency ratio (which is defined by dividing operational expenses by revenue) saw a significant improvement, a positive feature seen due to our prudent cost management strategies.

With the condominium industry ebbing towards an all time low, Sithma Development is extremely proud to be one of the very

few condominium projects to be completed in early 2009, with very positive responses from prospective buyers. Although sale of Spathodea Apartments, which has 48 apartments, has been relatively slow, we envisage all apartments being sold in 2009.

We await an improvement of the country situation in the next year, although currently we perceive a more consolidated approach by the corporate sector. Given the financial strength and backing we receive from HNB, our parent company, we are confident that while the year may require astute decision making, the company can continue to ride the wave and weather the storm.



## Majan Exchange LLC

Inward remittances into Sri Lanka remain a bloodline to our economy, one that keeps the country afloat and gives it amazing resilience even in the most challenging times. Having identified the need to ensure that foreign remittances come through legal channels for the total benefit to permeate for the national advantage, the Bank jointly with an Omani partner set up the Majan Exchange LLC and assumed management responsibility. The company commenced commercial operations on 25th October 2008.

Although the company incurred a loss during the year mainly due to the pre-incorporation expenses, with the ambitious branch expansion plan, it is likely to contribute towards the profitability of the Bank in the ensuing years.

# Joint Venture Operations Acuity Partners (Pvt) Ltd

One of the Bank's most epoch making partnerships was etched during the year with the formation of Acuity Partners (Pvt) Ltd on 7th February 2008 as an equally owned joint venture between DFCC Bank and Hatton National Bank PLC, making it a first in terms of magnitude and in terms of a smooth transition of operations given the Rs 500 Mn investment. Having laid the groundwork and strategy the year before, 2008 proved to be the year where the Bank's learning, applying, growing and winning strategy came into significance. In July 2008, Acuity Partners (Pvt) Ltd acquired Rs 100 Mn in net assets of HNB Stockbrokers (Pvt) Ltd and Rs 300 Mn in net assets of HNB Securities Ltd, which were both previously fully owned subsidiaries of the Bank, with the ownership under Acuity Partners (Pvt) Ltd being 100% and 50.1% respectively. Acuity Partners (Pvt) Ltd also acquired 100% of DFCC Stockbrokers (Pvt) Ltd., now known as Acuity Stockbrokers (Pvt) Ltd, a fully owned subsidiary of DFCC Bank with a net asset value of Rs 100 Mn.

The focus under the new structure is that the key strategic business units of corporate finance, fixed income securities and equity / debt brokering will continue as the key business drivers. While corporate finance will continue its activities under the holding company of Acuity Partners (Pvt) Ltd, HNB Securities (Pvt) Ltd focus will be on fixed income securities and the two stockbroking firms of Hatton National Bank PLC and DFCC Bank will have equity and debt markets as their business thrust.

Looking back over 2008, it must be noted that a less than favourable local economic environment coupled with unprecedented financial and economic meltdowns saw corporate finance, equity brokering and fixed income activities being drastically curtailed. The indicators overall have not proved positive and the year ahead, will have to weather the storm of such negativities before displaying a turnaround. But despite the turbulence, the Group achieved a notable post tax profit of Rs 17 Mn based on Group income of Rs 108 Mn, while company income notched post tax loss of Rs 12 Mn, from a turnover of Rs 9 Mn, the bulk of which is due to incorporation expenses.

With only one new IPO during the year and the only notable equity transactions being a few strategic deals, the markets continued their dismal performance throughout the year. The equity market declined with both retail and institutional investors adopting a 'wait and see' policy combined with the cascading effects felt by the global financial crisis, which exerted pressure on domestic valuations. The All Share Index which at the beginning of the year was 2,541, shed 1,017

points, to post a rather dismal 1,524 an unprecedented decline of 40%. Market capitalisation which stood at Rs 821 Bn at the beginning of the year, saw a decline of Rs 325 Bn, that is 37% to stand at Rs 496 Bn at the end of the year.

The loan syndication market which prior to the last two years had proved to be largely immune to market conditions was adversely affected for the second consecutive year. Large scale project investment remained unfeasible as the Prime Lending Rate (PLR) on Rupee lending was prohibitive, exceeding 20% per annum. The liquidity position was further exacerbated by the shortage of US dollars in the market, which resulted in the escalation of the LIBOR premium making foreign currency syndication unviable. Summarising performance over the year therefore, the number of corporate finance transactions for the year, was significantly below the earmarked levels and those achieved in previous years.

But while the milieu itself will remain challenging, the Bank's winning strategy continues, based on a framework of astute decision making and strategic initiatives. This year the Bank entered into an MOU with a well established private sector bank in South India to initiate a joint venture investment banking operation focused on exploiting the burgeoning South Indian market. This will give the Bank the diversification avenues for its revenue streams in addition to the capital raising opportunities we see in this growing market. Regulatory approvals are almost finalised and we hope to begin operations next year.

Corporate finance too is on the verge of expanding horizons, having recognised the need to diversify revenue streams given its vulnerability to the inherently cyclical nature of Sri Lanka's investment banking and capital markets. Preliminary identification and feasibility plans are underway and the overseas expansion effort should bear fruition within the next few years.

During the first quarter of 2009, the market will see the emergence of Acuity Stockbrokers (Pvt) Ltd, as a stronger and more competitive entity. Based on a brand new identity, the newly formed entity aims to leverage on the strengths it has individually and collectively use the inherent skills and advantages to create better economies of scale, astute utilisation of resources and reduction of operational overheads, making it a viable sustainable business model.



## Associate Operations Lanka Ventures PLC

It has not been an year in which any significant changes were apparent in our business, although our bottom line did face a few challenges in the short term. Having always been a profitable company which contributed to the growth of the Group's bottom line, a protracted court case on a tax dispute with the Department of Inland Revenue in respect of the Years of Assessment 1994/5 to 2001/2, for a sum of Rs 236 Mn did not go in our favour. This amount was reflected as a contingent liability in the company's previous financial statements. In September 2008, the Court of Appeal upheld the validity of assessments issued for those years and even though the company was granted special leave to appeal to the Supreme Court, the company made a provision of Rs 130 Mn in the financial statements representing the probable liability based on current information. The balance Rs 105 Mn will continue to be shown as a contingent liability. Hence, our profits which have been in the region of Rs 75 Mn in recent years are now in the red for the current financial year.

However, this is the exception rather than the norm and although our shareholders will not expect a dividend this year, we are confident that the next year will see us through on a

more positive note. Our operational profit before provisioning increased by 20% from Rs 62.3 Mn last year to Rs 75.0 Mn this year. Operational profit after provisioning however declined to Rs 60.0 Mn this year compared to Rs 62.3 Mn last year.

Also given the macro environment, we have been cautious in making equity investments and given the high risk nature of the business we are engaged in, we have focused more on quality rather than quantity of our investments. Another differentiation in our business is that once an investment is made, returns are realised only in the medium to long term. By and large we remain confident that our equity investment portfolio will yield above average returns in the long-term.

Energy remains a growth industry and we are currently concentrating on projects that are within this sector, even though the resultant rewards will take several years to add to our bottom line. Our investments in new projects in the sector over the last three years were around Rs 160 Mn and we expect returns on those to begin by next year, which we anticipate, will provide our shareholders a reasonable return.



## Browns Engineering (Pvt) Ltd

HNB has invested Rs 20.6 Mn in the ordinary shares of Browns Engineering (Pvt) Ltd. However this company is under liquidation and the Bank's investments in this company have been fully provided for.

# Global Correspondents



## **Americas**

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

## **Middle East & Africa**

Bahrain  
Botswana  
Egypt  
Ethiopia  
Ghana  
Israel  
Jordan  
Kenya  
Kuwait  
Lebanon  
Libya  
Mauritius  
Oman  
Qatar  
Saudi Arabia

Sierra Leone  
Somalia  
South Africa  
Sudan  
Swaziland  
United Arab Emirates  
Yemen  
Zambia  
Zimbabwe

## **Europe**

Austria  
Belgium  
Cyprus  
Czech Republic  
Denmark  
Finland  
France  
Germany  
Gibraltar  
Greece  
Hungary  
Ireland  
Italy  
Netherlands  
Norway  
Poland  
Portugal  
Romania  
Russian Federation

Serbia & Montenegro  
Spain  
Sweden  
Switzerland  
Turkey  
United Kingdom

## **Asia & Pacific**

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

# Customer Centre Network



➤ **Western Province**

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

Mathugama  
Minuwangoda  
Mirigama  
Mirihana  
Moratumulla  
Moratuwa  
Mt. Lavinia  
Mutwal  
Narahenpita  
Nawala  
Nawaloka Hospital  
Nawam Mawatha  
Negombo  
Negombo Extension Office  
Nittambuwa  
Nugegoda  
Overseas School of Colombo  
Padukka  
Panadura  
Panchikawatte  
Pettah  
Pettah – 3rd Office  
Piliyandala  
Ports Authority  
Ragama  
Ratmalana  
Sea Street  
Seeduwa  
Sri Jayawardenapura Hospital  
Sri Lankan Airlines Admn. Complex  
Talangama  
Thalawathugoda  
Thimbrigasyaya  
Wattala  
Wellawatte  
Wellawatte Extension Office  
Wijerama

➤ **North Western Province**

Alawwa  
Chilaw  
Dankotuwa  
Hettipola  
Kuliyapitiya  
Kurunegala  
Kochchikade  
Marawila

Nikaweratiya  
Nawinne Ext - Kurunegala  
Puttalam  
Wennappuwa  
Wariyapola

➤ **Northern Province**

Chunnakam  
Jaffna  
Jaffna – 2nd Office  
Mannar  
Manipay  
Nelliyady  
Vavuniya

➤ **North Central Province**

Anuradhapura  
Anuradhapura Ext. Office  
Galgamuwa  
Kekirawa  
Nochchiyagama  
Polonnaruwa  
Thambuttegama

➤ **Eastern Province**

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

➤ **Central Province**

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

Pilimathalawa  
Pussellawa  
Ragala  
Thalawakelle  
Warakapola

➤ **Sabaragamuwa Province**

Balangoda  
Embilipitiya  
Godakawela  
Kahawatte  
Kegalle  
Mawanella  
Middeniya  
Pelmadulla  
Pinnawela  
Ratnapura

➤ **Southern Province**

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

➤ **Uva Province**

Badulla  
Bandarawela  
Bibile  
Buttala  
Haputale  
Mahiyanganaya  
Moneragala  
Passara  
Welimada  
Wellawaya

# Financial Review

Having inducted 2007 as a year that was most challenging for the entire financial services industry, 2008 turned out to be even more challenging for the financial sector locally as well as globally. In 2008 the world faced its worst financial crisis since the great depression, which caused some of the world's biggest financial institutions to either file for liquidation or to be bailed out on the verge of collapse. The effects of the global financial meltdown on Sri Lanka were slower to permeate but were certainly apparent especially in the last quarter of the year. In 2008 the Country also witnessed significant fluctuations in key macro economic variables such as interest rates, inflation and exchange rates which adversely affected the growth and profitability of the financial industry.

HNB's learning, applying, growing and winning strategies thus came to the fore this year. Every principle, tenet and belief we had aligned our vision with, was culled and utilised to give us direction for running a strong sustainable business. One such is the innovation and launch of the Capital Savings product that would run in tandem with our tried and tested Pathum Vimana savings product which caters to the needs of interest sensitive clientele of the Bank.

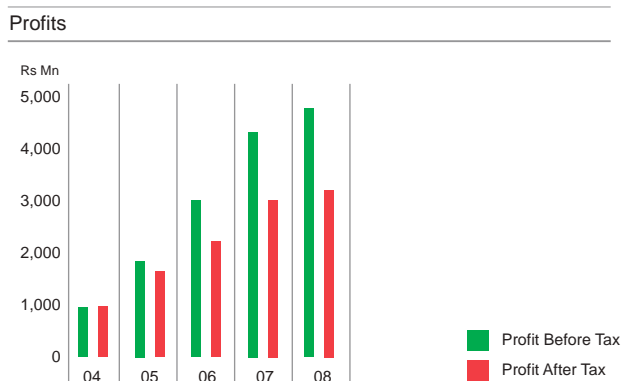
The best practices infused by the Bank over the years, where corporate governance, good risk management initiatives and the emphasis of a qualitative focus rather than a quantitative one, prepared the Bank to successfully face the challenges that ensued over this year, and will undoubtedly continue in 2009.





## Financial Performance

Despite the challenges, our pragmatic and astute policies and best practices established and implemented over the last few years, assisted us in riding the storm and continuing the growth momentum this year. Post tax profit recorded for the year edged to Rs 3.22 Bn, an increase of 6.5% over last year's Rs 3.02 Bn.



## Income

Total interest income this year showed a significant growth of 23.9% to reach Rs 37.17 Bn in 2008 despite the challenges mentioned above.

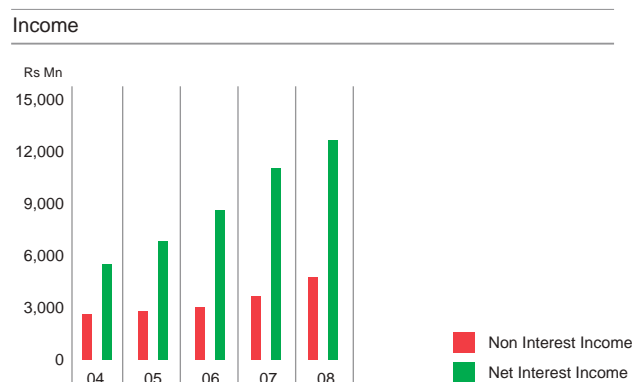
Interest Income was the predominant contributor towards the Bank's top line, which grew by 23.5% to Rs 32.43 Bn this year. Growth in interest income was mainly driven by the increase in yields as a result of the surge in interest rates in the Country, while growth in interest earning assets during 2008 was 12.2%.

Interest expense too witnessed a significant growth of 30% during 2008, as liabilities were re-priced at higher rates and the deposit mix tilted towards high cost funds. The resultant Net Interest Income (NII) grew by 14.6% to Rs 12.68 Bn this year.

Non interest income grew this year by 26.4% to Rs 4.73 Bn, resulting in the non interest income to net income ratio improving to 27% in 2008. Both commission income and exchange income witnessed a growth of 13.6% and 4.7% respectively.

Income from dividends witnessed a significant growth of 330% to Rs 538 Mn with main contributions coming from HNB Securities Ltd, DFCC Bank, HNB Assurance PLC, Commercial Bank PLC, HNB Stockbrokers (Pvt) Ltd & Dialog Telekom PLC preference share investment. HNB Securities Ltd and HNB Stockbrokers (Pvt) Ltd together contributed more than 50% of dividend income received during the year. The exceptional dividend payment made by these two companies in 2008 was a result of the restructuring that took place with the formation of the new joint venture with DFCC Bank named Acuity Partners (Pvt) Ltd. Other income also witnessed a significant improvement of 57% to Rs 665 Mn due to profit recognised through the sale of HNB's direct holding in HNB Stockbrokers (Pvt) Ltd and part of the direct holding in HNB Securities Ltd to Acuity Partners (Pvt)

Ltd. In addition the Bank was in receipt of a profit share from VISA Worldwide (Pvt) Ltd during the year amounting to Rs 123 Mn.



## Operating Expenses

The alarming inflationary trends continued to be an obstacle for the Bank during the year, although it must be pointed out that having already infused some cost management best practices into our working operations, the Bank was able to stem some of the negativities that abounded on the operational side. The increase in operating expenses, excluding provisions for loan losses and fall in value of investments, was better managed this year and saw a growth of only 17.3% (increase in operating expenses excluding above mentioned provisions and financial VAT is 13.6%) compared to last year's 23.4% increase over the figures of 2006. Operating expenses this year was recorded at Rs 11.22 Bn, which reflects well for our performance in comparison to general industry trends and the fact that inflation continued to remain in the 20% region and above.

As a result of continuous improvements made in operational productivity, staff cost increased by a mere 11% during 2008. The Bank managed to keep the headcount growth at a modest 1% despite expanding the customer centre network. Provision made for the staff retirement fund increased by 74% in 2008 to stand at Rs 787 Mn. Increase in provision for staff retirement was due to an additional provision of Rs 290 Mn made for the purpose of charging 1/5th of the transitional liability created due to the introduction of revised SLAS 16 applicable for financial periods beginning on or after 1st July 2007. This standard became applicable for the Bank from 1st January 2008. The deficit in the pension fund as at 31st December 2007 had to be charged to operating expenses over 5 years as a result of the provisions of the revised standard. Premises, equipment and establishment expenses too grew by 14% to Rs 2.42 Bn.

Despite high inflationary pressure, mainly due to prudent cost management initiatives of the Bank the cost to income ratio (excluding financial VAT) marginally improved this year to 54% compared with 56% in 2007. With the collective agreement due for negotiation in April 2009, we do see personnel costs in terms of salaries, remuneration and benefits seeing a probable increase

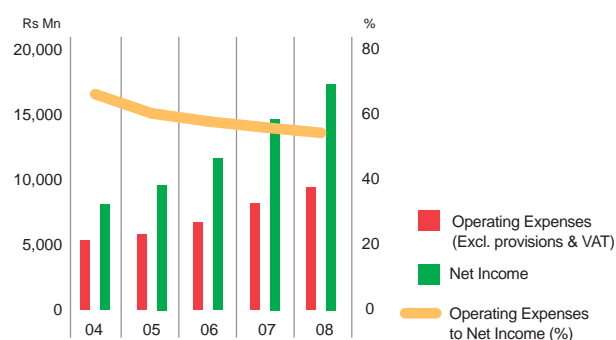
# Financial Review

next year. However the Bank will strive to achieve its medium term goal of bringing the cost to income ratio below 50%.

The provision for loan losses increased this year by 27.6%, to stand at Rs 1.16 Bn, maintaining a provision cover (total provisions to non performing loans) of 66%. Due to the prudent provisioning policy, the Bank has already achieved the 1% provisioning requirement mandated by the Central Bank of Sri Lanka, ahead of the deadline of 31st March 2009. This reflects the Bank's constant emphasis on a quality credit portfolio, which has now become the primary reason for the Bank's consistent and sustainable performance. The Bank's gross Non Performing Loan (NPL) ratio increased this year to 6.7% compared to 5.7% in 2007 due to high interest rates and inflation exerting pressure on the repayment capacity of borrowers. However the Bank has kept the NPL ratio at a manageable level due to the prudent risk management strategies, a committed recovery team and excellent monitoring and control systems implemented.

The taxation regime imposed especially on the financial services sector, as we continue to reiterate each year, remains non-conducive to growth in the industry. This year too we observed a sizeable slice being taken off our profits by the increase in Financial Services Value Added Taxation to Rs 1.77 Bn compared to last year's Rs 1.24 Bn, which the Bank can ill afford especially in times where the economy has shown signs of volatility and capital in short supply. With reduction of margins, increasing costs and high taxation will impose a challenge for the sector to maintain required capital requirements and will limit credit growth of the banking sector.

## Operating Income & Operating Expenses



## Balance Sheet

The Bank has always prided itself on its stability and strength and this year too, despite compelling challenges in the macro economic milieu, our balance sheet displayed the stability and strong fundamentals that are now a part of our winning strategy.

## Asset Growth

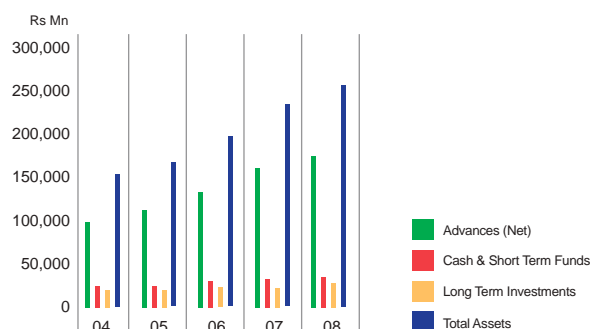
The Bank's total asset value depicted an increase of 9.6%, reaching Rs 255.3 Bn compared to last year's Rs 232.91 Bn,

retaining one of the highest bases among commercial banks in the Country. The assets are distributed among corporates, small and medium enterprises, individuals and other entities and are strongly constructed on a qualitative portfolio rather than quantitative which reduces our credit risk and increase our ability to sustain business in difficult times.

The total net loan portfolio increased from Rs 160.58 Bn to Rs 174.98 Bn, with pawning and short term loans being the largest contributors, recording a growth of 26% and 47% respectively.

Due to high interest rates continuing to dog the market, term loans and overdrafts did not grow substantially as they did last year, posting only a marginal growth of less than 7% YOY while leasing showed a decline of 13.5%. Despite the negative factors, Bank's housing portfolio managed a growth of 13.3%, to stand at Rs 18.64 Bn. Investments in securities recorded a growth of 27.7% YOY, standing at Rs 25.92 Bn compared to last year's Rs 20.3 Bn.

## Assets



## Liability Growth

Given that deposit mobilisation was a significant challenge this year, the fact that our LKR deposit portfolio displayed a growth of 7.7% YOY is commendable. The increase from Rs 136.91 Bn to Rs 147.39 Bn is collated through demand deposits, Capital Savings, Singithi Savings and time deposits. The new Capital Savings product we introduced during the year to capture the needs of the interest savvy market in the high inflationary environment, managed to stem the tide in the decrease in our Rupee deposit base.

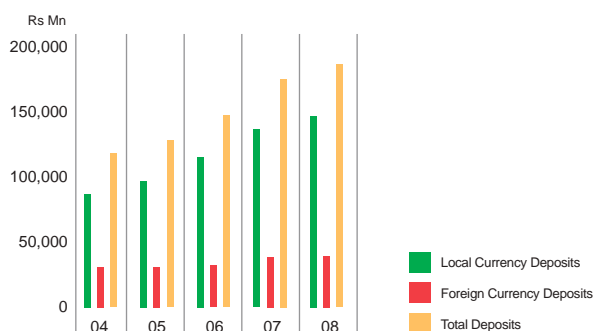
Growth in demand deposits remained marginal at 2.1% YOY standing at Rs 12.75 Bn. The main growth segment in our LKR deposit base came from time deposits, which grew a notable 13.5% YOY, from Rs 66.84 Bn to Rs 75.83 Bn.

Impact of the global economic downturn was felt on the foreign currency deposits. Investors were seen converting foreign currency deposits to Rupee deposits as the interest rate differential

widened between local and foreign currency deposits and the Rupee continued to be stable during most part of the year.

Total liabilities at end of the year are recorded at Rs 234.69 Bn compared to last year's Rs 214.49 Bn depicting a growth of 9.4%.

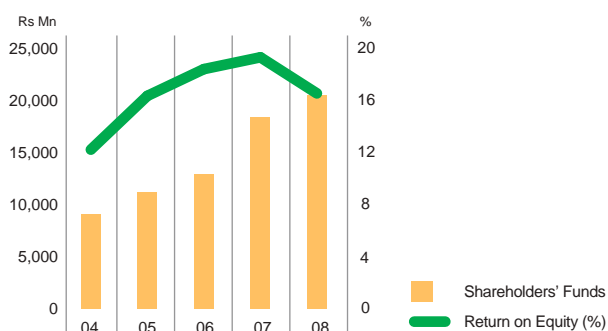
Deposits



### Shareholders' Funds

Shareholders' funds grew from Rs 18.42 Bn to Rs 20.58 Bn as the Bank retained part of the profits generated during 2008 to support future business growth. During 2008, the Bank declared a final dividend on 2007 profits of Rs 3.50 per share which amounted to Rs 824 Mn, while an interim dividend of Rs 1.00 per share was declared on 2008 profits which amounted to Rs 235 Mn. The Bank has further proposed a final dividend of Rs 3.00 per share on 2008 profits. Increase in free capital was also witnessed in 2008 which amounted to Rs 8.43 Bn, reflecting 41% of shareholders' funds.

Shareholders' Funds

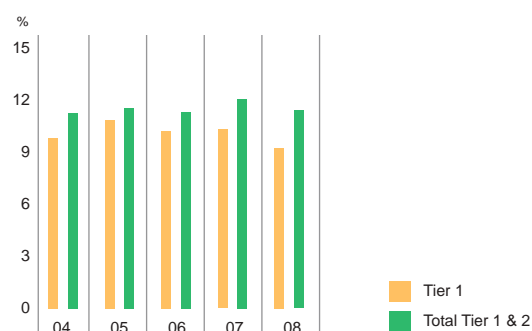


### Capital Adequacy

In 2008 the Bank's core capital and total capital base improved by 5% & 11% to Rs 16.23 Bn & Rs 20 Bn respectively. The Bank's total capital ratio which stood at 12.08% in 2007 slipped marginally to 11.40% in 2008. The decline shown in the ratio is mainly due to the introduction of operational risk under Basel II in 2008, while 2007 ratio was computed according to Basel I, which did not consider operational risk in computing capital adequacy ratios. Further in 2007 there was no interim dividend payment

whilst in 2008 an interim dividend of Rs 1.00 per share was paid during the year. This year the Bank did not raise a significant amount of new core or supplementary capital due to high interest rates, sluggish capital markets and slowdown in asset growth. Currently the Bank is comfortably positioned in terms of its capital ratios, however it will continue to closely monitor the growth projections and new developments in capital markets domestically as well as globally.

Capital Adequacy Ratio



### Return on Average Assets (ROAA)

Return on Average Assets this year stood at 1.32%, recording a marginal decline from 2007. However, the Bank is in line to achieve its medium term ROAA goal of 1.5% within three years. Return on Average Equity (ROAE) saw a dip from last year's standing of 19.3% to 16.5% this year.

Return on Average Assets



Next year will continue to be challenging with high interest rates, slowing domestic economy and weakening external sector creating a formidable journey for the financial services industry. However, having always retained an optimistic stance even in the most trying times in the past and also having established and implemented strategies and paradigms that we feel will hold us in good stead to weather the challenges, the Bank will continue to strive towards sustainable growth, profitability and good returns.

# Risk Management

## Vision and Strategy for Risk Management

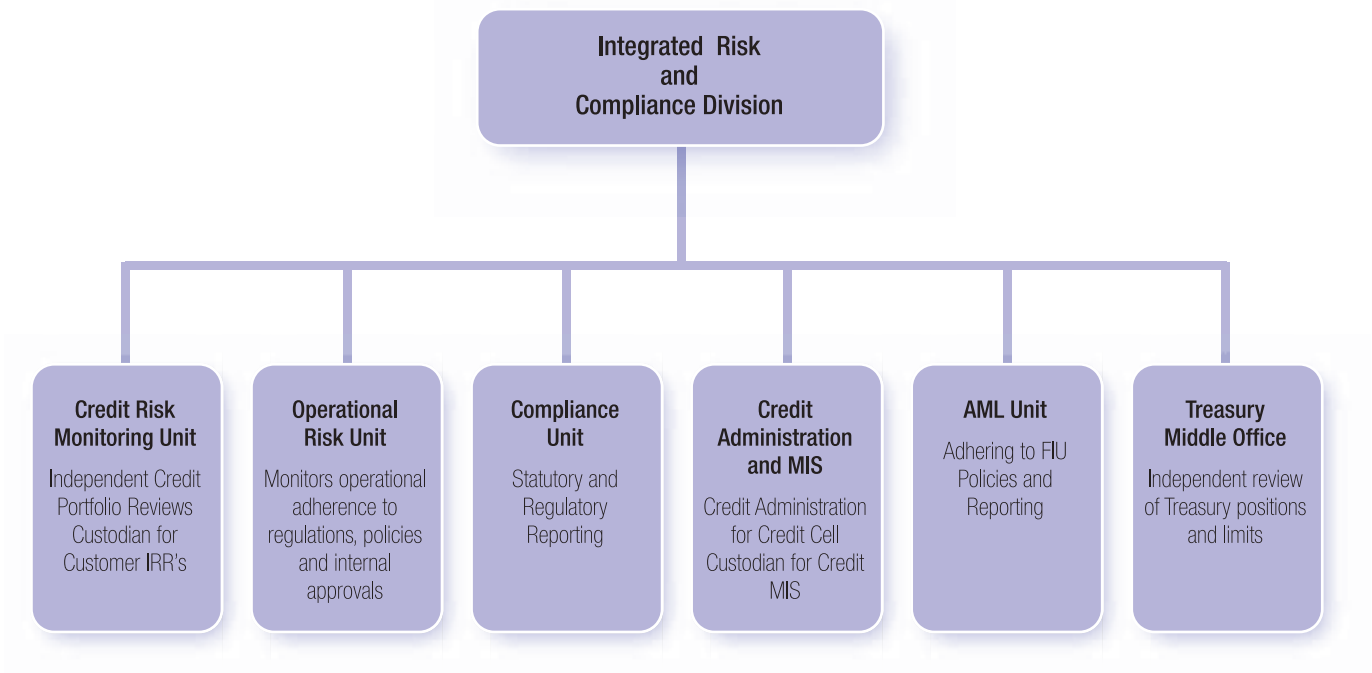
Risk is an integral part of banking business and HNB aims at delivering superior shareholder value by achieving an appropriate trade-off between risk and returns. Our Risk management strategy is based on a clear understanding of various risks, disciplined risk assessment and measurement procedures and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

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

The Board Risk Committee which was established this year, oversees the Bank's risk management policies and controls. On a day-to-day basis, the various risks inherent in HNB's operations are managed by both Risk and Compliance Division and each business unit.

The Bank set up an Integrated Risk and Compliance Division in 2005, directly reporting to Managing Director / CEO. The function has since expanded into a full fledged function encompassing 6 units; whilst retaining its independence effectively integrates with business functions to ensure Risk Management is truly ingrained in the Bank's culture.

The Integrated Risk and Compliance Division provides the Board and Board Risk Committee, the assurance that the performance of the overall risk management framework and Risk Management Initiatives ensure balanced coverage of the Risk Charter.



AML: Anti Money Laundering  
FIU: Financial Intelligence Unit  
IRR: Internal Risk Ratings  
MIS: Management Information Systems

## Organisational Control and Board Governance

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

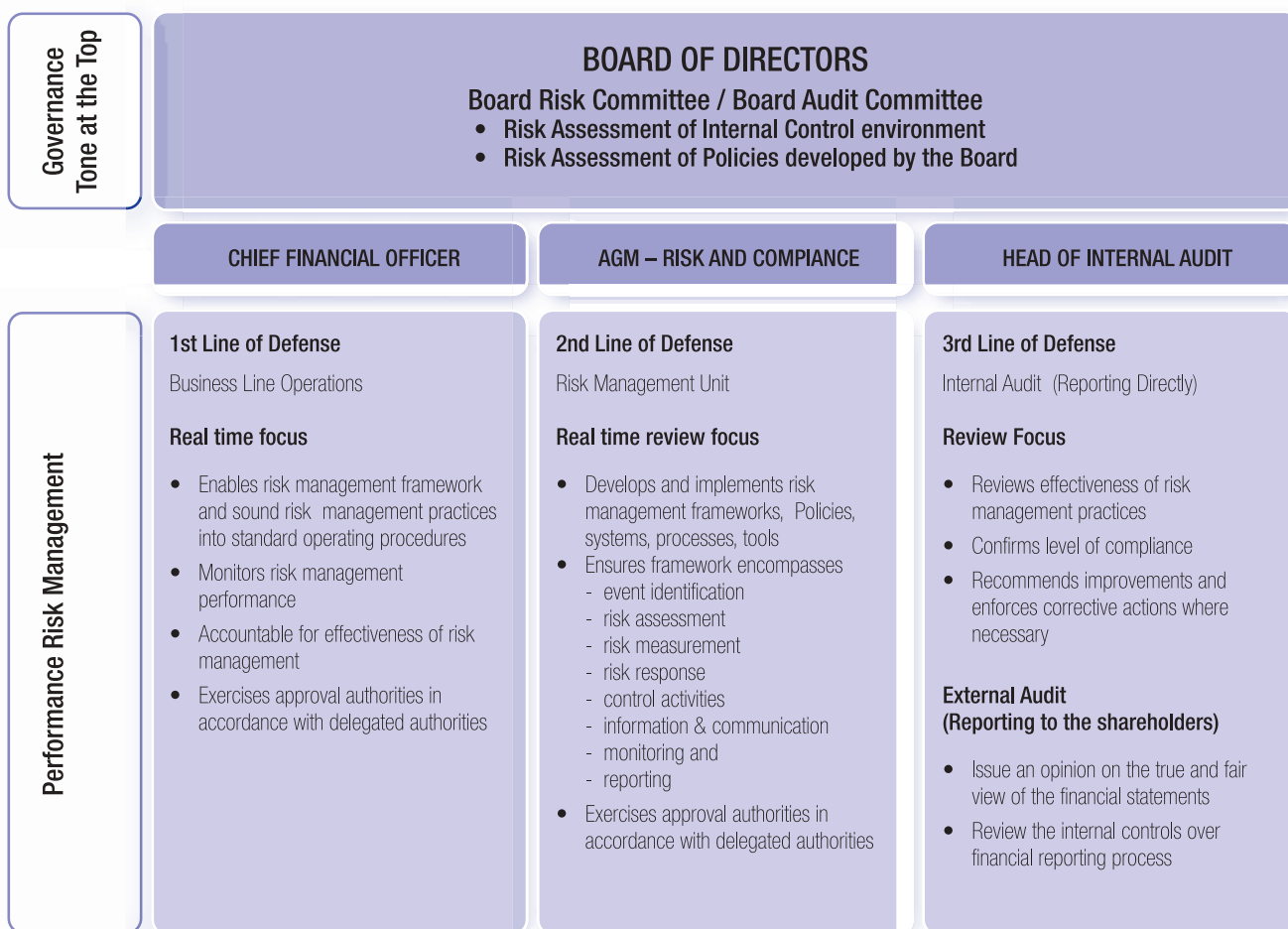
The Audit Committee assists the Board in overseeing internal audit and the adequacy of the Bank's accounting policies and financial reporting.

The Risk Committee assists the Board in fulfilling its responsibilities relating to the oversight of the Bank's risk management strategies, policies and processes that have the

potential to impact significantly on earnings performance, reputation and capital protection, and to approve significant credit transactions and other matters beyond the approval discretion of executive management.

The Asset and Liability Committee (ALCO), Credit Policy, Operational Risk, IT Steering Committee and CSR Subcommittees, each with specialized focus, support the Risk Committee and are responsible for the co-ordination of risk matters for each of the areas of risk management.

## Three Lines of Defense



# Risk Management

## HNB's Approach to Managing Key Risks

### Credit Risk

Credit risk is the risk that a borrower is unable to meet its financial obligations to the lender. We measure, monitor and manage credit risk for each borrower and also at the portfolio level. We have standardised credit approval processes, which include a well-established procedure of comprehensive credit appraisal and rating. We have developed internal credit rating methodologies for Corporate and Small and Medium Enterprises ("SME") customers. The rating factors include quantitative and qualitative issues and credit enhancement features specific to the transaction. The rating serves as an input in the approval as well as post-approval credit processes. Credit rating, as a concept, is being internalised within the Bank.

The rating for every borrower is reviewed at least annually. Industry knowledge is constantly updated through field visits and interactions with clients, regulatory bodies and industry experts.

The framework is top down, being defined by Credit Principles and Policies. The effectiveness of the credit risk management framework is validated through various compliance and monitoring processes.

### Operational Risk

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

The Bank has a comprehensive Loss tracking database analysed by business function and loss incident as per BASEL requirements. An effective feedback loop is in place to ensure that learning from loss incidents is effectively disseminated across the network to prevent / minimise recurrence.

The Risk Management Committee approved Operational Risk Management Guidelines during the year. These guidelines serve as Operational Risk Best Practices and are driven through the network by Regional Operational Managers through regular meetings.

An Operational Risk Policy is being developed comprising risk identification, assessment of controls to mitigate these risks, risks measurement, risks monitoring and mitigation. The Operational Risk Unit will facilitate its implementation.

### Market Risk

Market risk is 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. The Bank's Treasury does very little trading on own account, does not offer derivative products and only carries a small equity trading portfolio, at present. Consequently the relative exposure to market risk from these areas is low. We limit our exposure to exchange rate risk by stipulating position limits. The focus is mainly on Interest rate risk arising from conduct of normal business. Given the criticality of this area in the current environment a key priority is to further improve our infrastructure to ascertain re-pricing gap analysis and duration analysis with a view to ensuring adequate liquidity at all times through systematic funds planning and maintenance of liquid investments. We are extremely fortunate to have a stable funding source in retail deposits over the years.

Market risk policies include the Treasury Policy and the Asset-Liability Management (ALM) Policy. The policies are approved by the Board of Directors.

The Treasury Middle Office monitors the asset-liability position under the supervision of the ALCO. It also oversees treasury activities and adherence to regulatory / internal policy guidelines. The Treasury Middle Office is also responsible for processing treasury transactions, tracking the daily funds position and complying with all treasury-related management and regulatory reporting requirements.

### Compliance Risk

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

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

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

## Impact of Global Economic Crisis

The financial and capital markets fall out in 2008 stemming from the developed markets, has rapidly cascaded to massive negativities even in the smallest markets around the world did not leave Sri Lanka unscathed. However, being a bank that has practiced extremely prudent risk policies stood the Bank in good stead in these trying times. Having a constant eye on global

market events, the Bank foresaw the signs initially and began analysing the effects the fallout would have on the Bank.

Key Risk Management Initiatives undertaken during 2008 to address the impact of global economic crisis are briefly discussed below.

### 1. Top 20 Customer Review

The largest 20 customers of the Bank comprise 26% of our Credit Portfolio. Our focus was to analyse the impact and levels of risk these customers would be exposed to, their vulnerability to the fallout and the mitigating initiatives we may have to take to stem the flow.

The largest 20 customers mainly comprise, leading players in their respective industries or highly diversified conglomerates. Although performance is likely to be impacted in varying levels either due to the softening of demand locally or overseas and reduction in prices due to fallout from global commodity prices, these companies possess adequate reserves and capacity to overcome these challenges in the short to medium term.

### 2. Impact of Global Commodity Prices Slump on Portfolio

A study was conducted on key commodities impacting the Sri Lankan economy – Tea, Rubber, Coconut, Steel, Sugar, Dhal, Palm Oil and Wheat. Price trends and risk management approaches were disseminated to the network to better equip credit decision making.

Tea was one of the industries hardest hit by the crisis. The Bank has exposure at all levels of the supply chain from tea small holders, factory owners, tea brokers to tea exporters. Having always believed that relationships are the foundation to good business practice, we are now walking the talk. We have added up our learning, applying, growing and winning practices to ensure that the rudiments of our years of practical business experience is now shared with our customers in their most trying times. Assistance in the form of specialist knowledge, financial restructuring arrangements are being worked out on a case by case basis. The exposure to tea small holders and bought leaf factories, the most affected segments, is Rs 1.2 Bn (less than 1% of the credit portfolio). This risk exposure whilst inevitable, is certainly manageable.

### 3. Industry Risk Analysis

The Bank conducted a risk review of each industry and developed industry risk ratings based on the outlook over the

next two years. This was followed by a critical review of Current portfolio concentration by industry and medium term exposure targets developed to reflect risk ratings.

### 4. Treasury Placements and Counterparties

A review of Bank Placements, Limits by Counterparty and Correspondent Banks was undertaken and revisions were made where necessary.

## Conclusion

The Bank has a well diversified portfolio comprising Corporate, SME and Retail exposures and has no exposure to subprime or global hedge funds. Its exposure in the form of gold (for the purposes of proprietary book) and local stock market is below 1% of total assets. Given its strong and stable local and foreign currency deposit base built up over the years its reliance on interbank markets is low, which holds the Bank in good stead for the future.

## Conformance against New Regulations Introduced during the Year (Table 1)

Mandatory Regulations	
Obtaining Know Your Customer ("KYC") Data from customers (August 2008 update) <ul style="list-style-type: none"> <li>- New Customers</li> <li>- Existing Customers</li> </ul>	Already Compliant New KYC Document introduced in October 2008, planned to complete by December 2009
Prohibition of acceptance of deposits by non-authorized persons / finance companies from public (September 2008)	All new customer relationships are scrutinised on an ongoing basis All existing customer relationships were verified Fully compliant by December 2008
Develop a 1% General Provision on Total Advances net of cash backed and fully provided accounts by March 2009 (September 2006)	Fully Compliant w.e.f June 2008
New Credit Loss Provisioning Methodology (May 2008)	Compliant with effect from Regulation date
Margin Requirements against Letters of Credit (November 2008) Imports on Documents against Acceptance Terms (November 2008)	
Guidelines	
AML Risk Profiling of all Customers (May 2007)	Process will commence with purchase of AML software during the year, with a view to completion by end 2009
Integrated Risk Management Guidelines (September 2008)	In general, agreement with Best Practice Guidelines and addressed in the Bank's BASEL Advanced Risk Management Roadmap
Guidelines on Outsourcing (October 2008)	Checklist prepared to assess extent of adherence and the Bank's Outsourcing Policy developed.

# Risk Management

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

Having set up an independent Risk and Compliance Division four years back, we have systematically focused our efforts towards BASEL 2 Advanced Risk Management Practices. We completed a diagnostic study with the assistance of external consultants in 2007 followed by a gap analysis of where we are against where we want to be and developed a 5 year implementation roadmap to achieve our goal ahead of the Regulatory deadline of 2013. The Bank views BASEL 2 Risk Management Practices as an opportunity to embrace best in class Risk Management Practices in our continuing quest of Learning, Applying, Growing and developing Winning Strategies to achieve Sustainable Profits.

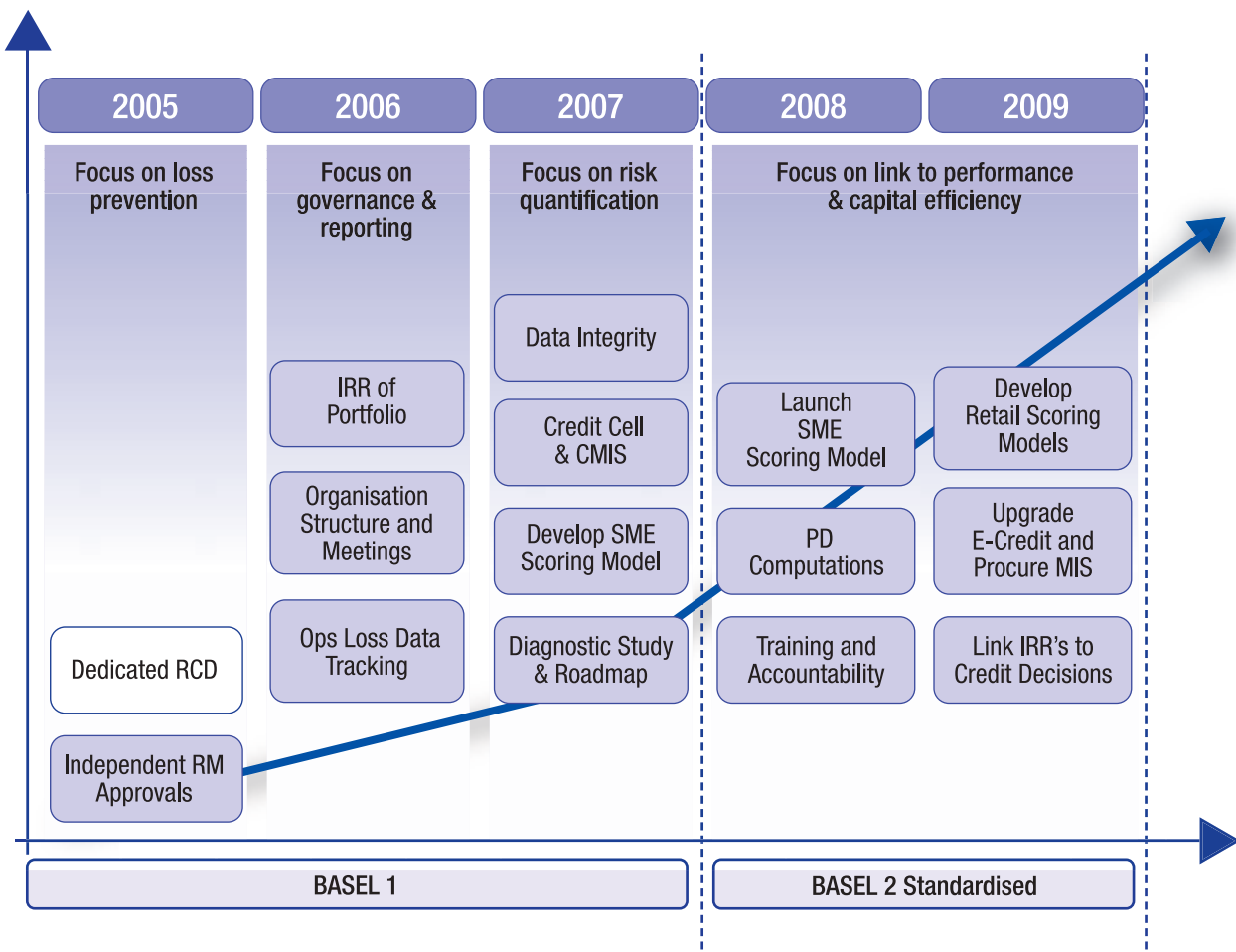
The Bank transitioned from BASEL 1 to BASEL 2 basis of Capital Adequacy from 1st January 2008, after a period of parallel computations as required by the regulator. The progress achieved consequent to our comprehensive preparations in the form of companywide training and data integrity initiatives as per our Risk Management Roadmap ensured the transition was smooth and trouble free. Accordingly, the revised methodology for Capital allocation for Credit Risk is the Standardised Approach, Operational Risk requires a Capital allocation based on the Basic Indicator Approach whilst Market Risk remains unchanged from BASEL 1.

Key Risk Management Initiatives Implemented during 2008	
SME Model	We were successful in supplementing our existing Corporate Banking Internal Ratings Scorecard with a SME Scoring Model this year. The development of a customized model, through a scientific process including back testing sample customer data representing all geographical regions will undoubtedly assist in our efforts in improving our focus in identifying, monitoring and controlling risks of this diverse but promising segment. This model was successfully launched this year with practical interactive training programs conducted across all regions.
PD Computations	Probability of Default (PD) computations were conducted to assess the robustness of our Internal Risk Ratings Model for Corporate and SME Customers. Initial results appear promising.
Training and Accountability	A comprehensive program on Risk Management Techniques and BASEL 2 was conducted for non risk management staff at Senior Management level comprising Finance, IT, HR and Retail Banking facilitated by an international consultant. Successfully completed Credit Risk Modular training for the first batch of Credit Relationship Managers and a second batch have commenced this program. This Program was developed by Omega USA a global leader in Credit Training and was facilitated by the Risk Management Unit. KPI Wizard system an internally developed customised MIS to track risk performance across business units was successfully launched during the year. The benefits of this system include standardization of risk measures, communication of best practices, facilitation of performance benchmarking and accountability for performance across business units. It is significant to mention that KPI Wizard System received public recognition when it was awarded the Bronze at the National Best Quality Software Awards Ceremony this year.



<b>Priorities for 2009</b>	
Develop Retail Scoring Models	Having internalised Corporate and SME Internal Risk Ratings, our priority would be to develop Scoring Models for Retail Banking Segments – Housing, Leasing, Personal Loans and Credit Cards. This process will be facilitated by expert consultants and significantly assist in our Risk Management Capacity building efforts for the future.
Upgrade ECredit and Procure MIS	Existing Credit Approval Infrastructure will be upgraded to improve MIS functionalities and deeper analysis with the new Core Banking system implementation. This will be followed by procurement of BASEL 2 Advanced Risk Management software that facilitates necessary computations such as PD, LGD, EL and RAROC.
Link IRR's to Credit Decisions	Corporate and SME Internal Risk Ratings will be gradually incorporated to Credit Policy to reflect pricing, quality of security and targeting new customers. We are however, deeply mindful of the significant challenges in internalising this process and will give due consideration to business and external regulatory factors.

## Our Journey towards BASEL 2



CMIS : Credit Management Information System  
 EL : Expected Loss  
 IRR : Internal Risk Ratings  
 KPI : Key Performance Indicator  
 LGD : Loss Given Default

PD : Probability of Default  
 RAROC : Risk Adjusted Return on Capital  
 RCD : Risk and Compliance Division  
 RM : Risk Management  
 SME : Small and Medium Enterprises

# Risk Management

## Risk Console

Risk Category	Risk Rating	Mitigating Actions Implemented in 2008	
		Risk Assessment	Risk Mitigating Strategies
<b>Credit Risk</b> <b>Risk of borrower default</b>			
Effectiveness of Credit Policy  Risk arises where Credit Policy amendments does not keep pace with changes in local and global environment	Moderate	Adequacy and Effectiveness of Credit Policies evaluated in monthly meetings.  Regular review of Credit Approval Structure based on feedback from Regional Management / Network.  Miscellaneous Reports developed for policy amendments as necessary. Eg: Impact on portfolio of potential downturn in Tea Industry, Assessment of margin adequacy for lending against quoted shares and foreign currency, Impact of Water's Edge judgement on portfolio.	Credit Policy and discretionary lending limits regularly updated. Risk Evaluation of new products prior to launch.  Reports circulated among relevant business segments, Credit Policy Members and Board as necessary.
Adequacy of Portfolio monitoring  Risk arises where systems and controls are not in place to regularly assess the health of the credit portfolio.	Low	Developed KPI Wizard, a standardised MIS to track performance across business units. This will assist in improving overall management of Credit Risk through greater focus on Key Risk Ratios, improved sharing of best practices through performance benchmarking and improved accountability at all levels.  Independent Credit Reviews to assess effectiveness of monitoring and adherence to covenants. four large customer centres comprising 111 SME clients and 45 Corporates were reviewed.	Risk Managers independently review Regional Performance and provide monthly feedback highlighting areas for improvement to line management.  Responses to our observations from business units obtained and followed through to implementation. General control weaknesses shared across the network.
		Credit Quality Based on Internal Risk Ratings.  Corporate Banking Portfolio Based on Internal Risk Rating	Focusing on High Risk Accounts (Internally Risk Rated B and below) Reviews by Risk Managers.  Quarterly Review of Watch listed accounts to ensure adequate assessment of quality across the network and timely identification of account strategy under Temporary, Maintain and Exit categories.  Quarterly review of new additions to Non performing Advances ("NPA") by action category (i.e. housekeeping issues, legal action, negotiation etc.) for follow up.

Risk Category	Risk Rating	Mitigating Actions Implemented in 2008																					
		Risk Assessment	Risk Mitigating Strategies																				
		<p><b>Non - Performing Loans</b></p> <table border="1"> <caption>Non-Performing Loans Data</caption> <thead> <tr> <th>Year</th> <th>NPA Gross as a % of Loans and Advances</th> <th>NPA Net as a % of Loans and Advances</th> </tr> </thead> <tbody> <tr> <td>2005</td> <td>8.37%</td> <td>2.87%</td> </tr> <tr> <td>2006</td> <td>7.05%</td> <td>1.85%</td> </tr> <tr> <td>2007</td> <td>5.78%</td> <td>1.41%</td> </tr> <tr> <td>2008</td> <td>6.73%</td> <td>2.28%</td> </tr> </tbody> </table>	Year	NPA Gross as a % of Loans and Advances	NPA Net as a % of Loans and Advances	2005	8.37%	2.87%	2006	7.05%	1.85%	2007	5.78%	1.41%	2008	6.73%	2.28%	<p>Observations shared with Business Line Managers for necessary actioning and agreed strategies followed through.</p>					
Year	NPA Gross as a % of Loans and Advances	NPA Net as a % of Loans and Advances																					
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<p><b>Credit Concentration Risk</b> Risk arises where Credit Portfolio is not sufficiently diversified</p>	Low	<p><b>Industry Concentration</b></p> <p>Industrywise Exposure</p> <table border="1"> <caption>Industry Concentration Legend</caption> <thead> <tr> <th>Industry</th> <th>Industry</th> <th>Industry</th> </tr> </thead> <tbody> <tr> <td>Agriculture &amp; Fishing</td> <td>Traders</td> <td>Credit card</td> </tr> <tr> <td>Manufacturing</td> <td>New Economy</td> <td>Pawning</td> </tr> <tr> <td>Tourism</td> <td>Financial and Business Services</td> <td>Other</td> </tr> <tr> <td>Transport</td> <td>Infrastructure</td> <td></td> </tr> <tr> <td>Construction</td> <td>Other Services</td> <td></td> </tr> </tbody> </table>	Industry	Industry	Industry	Agriculture & Fishing	Traders	Credit card	Manufacturing	New Economy	Pawning	Tourism	Financial and Business Services	Other	Transport	Infrastructure		Construction	Other Services		<p>Target Industry Limits developed based on Industry Risk Ratings. Strategies developed to gradually improve penetration of low risk industries and conversely reduce exposure to high risk industries.</p>		
Industry	Industry	Industry																					
Agriculture & Fishing	Traders	Credit card																					
Manufacturing	New Economy	Pawning																					
Tourism	Financial and Business Services	Other																					
Transport	Infrastructure																						
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	High	<p><b>Geographical Concentration</b></p> <p>Geographical Distribution</p> <table border="1"> <caption>Geographical Distribution Data (2008)</caption> <thead> <tr> <th>Region</th> <th>Percentage</th> </tr> </thead> <tbody> <tr> <td>Western</td> <td>73%</td> </tr> <tr> <td>Southern</td> <td>4%</td> </tr> <tr> <td>North Central</td> <td>4%</td> </tr> <tr> <td>Northern</td> <td>4%</td> </tr> <tr> <td>Sabaragamuwa</td> <td>4%</td> </tr> <tr> <td>Uva</td> <td>4%</td> </tr> <tr> <td>Eastern</td> <td>2%</td> </tr> <tr> <td>Central</td> <td>2%</td> </tr> <tr> <td>Overseas</td> <td>2%</td> </tr> </tbody> </table>	Region	Percentage	Western	73%	Southern	4%	North Central	4%	Northern	4%	Sabaragamuwa	4%	Uva	4%	Eastern	2%	Central	2%	Overseas	2%	<p>Largely inevitable, given development efforts have been historically focused in Western Province. With the improvement in infrastructure and recent development efforts in the South and East the Bank is ideally placed with its extensive, ever expanding branch network to leverage on emerging opportunities there by reduce the level of concentration in anyone geographical area over time.</p>
Region	Percentage																						
Western	73%																						
Southern	4%																						
North Central	4%																						
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Risk Category	Risk Rating	Mitigating Actions Implemented in 2008	
		Risk Assessment	Risk Mitigating Strategies
	Low	<p><b>Segmental Concentration</b></p> <p>Exposure by Counterparties</p> <p>Legend:</p> <ul style="list-style-type: none"> <li>Corporates &gt;1 Bn</li> <li>Corporates 100 Mn - 1 Bn</li> <li>Corporates 35 Mn - 100 Mn</li> <li>SME 35 Mn - 10 Mn</li> <li>Personal Loans</li> <li>Micro finance</li> <li>Leasing</li> <li>Housing</li> </ul>	<p>The Bank has a well diversified portfolio comprising Corporate, SME, Retail and Microfinance segments. It is pertinent to mention that the Aggregate of 'Material Exposures' (Lending Exposures above core capital) is below the regulatory guideline of 5 times Tier 2 Capital).</p>
<p><b>Operational Risk</b>  <b>Risk of Losses</b>  <b>arising from faulty control systems, human negligence, internal and external fraud and acts of god</b></p>			
<p>Risks arising from a poor Control Environment</p>	Low	<p>A comprehensive Operational Loss database is in place to track losses by incident type and business line per BASEL 2 Guidelines.</p> <p>Total Operational Losses for Year 2008 as a percentage of Net Income for the Year 2008 is 0.4%. Analyzed as follows.</p> <p>Legend:</p> <ul style="list-style-type: none"> <li>Internal Fraud</li> <li>External Fraud</li> <li>Employment Practices &amp; Workplace Safety</li> <li>Clients, Products &amp; Business Services</li> <li>Damage to Physical Assets</li> <li>Business Disruption &amp; System Failures</li> <li>Execution, Delivery, &amp; Process Management</li> </ul>	<p>Material Losses regularly analysed by cause and actions taken to improve systems and controls to prevent recurrence in the future.</p> <p>Developed Operational Risk Guidelines and mandated Operational Risk Review Meetings across the network.</p> <p>5 new Circulars issued during 2008 to provide guidelines on how to manage recurrent Operational Risk Issues</p>
<p>Technology Risk arising from new Core Banking System implementation and consequent</p>	Moderate	<p>The Bank is in the process of implementing a new Core Banking System. The branch migration plan was preceded by a live simulation of the system. Technical and Security Features were reviewed by the Bank's IT Team supplemented by independent reviews by Internal Audit. Departmental / Branch Operational issues are surfaced for resolution by Departmental liaison officers.</p>	<p>The Project Implementation Plan is administered by the Project Steering Committee chaired by MD.</p>

Risk Category	Risk Rating	Mitigating Actions Implemented in 2008	
		Risk Assessment	Risk Mitigating Strategies
risks arising from system breakdowns and disruptions during the changeover		An Independent review of System Migration was carried out by the External Auditors as a special engagement to assess any potential risks.	Comprehensive 24 hour live offsite backup system in place, minimising impact of data loss.  24 hour Helpdesk tracks all requests and forwards problems after assessing whether Technical or Application related to relevant departments for resolution.
Technology Risk of not keeping abreast of latest technology and delivery channels in banking	Moderate	The emergence of cost efficient alternative delivery channels (ie. Internet, mobile banking) threatens the traditional brick and mortar banking model.	With the implementation of new Core Banking System the Bank would be a front runner in driving technology induced banking.
<b>High Impact Unforeseen Events</b>  Risk arising from lack of preparedness to Natural Disasters and Terrorism		A re-assessment of insurance adequacy of specific segments carried out and insurance cover enhanced. e.g. Exposure to Maldives Tourist resorts requires comprehensive insurance covering Tsunami, Storms, Tempest etc. Pawning and High Rise Buildings Portfolio insurance coverage strengthened.	Specific Circulars issued and followed up for implementation.  A Business Continuity Plan is in place to cover Core Systems and payments and settlements systems.
Risk arising from the Global Economic Crisis to the Bank's portfolio	Moderate	Impact of Global Economic Crisis on HNB's portfolio reviewed and its implications assessed for: Top 20 Accounts Key Industries Key Commodities and Commodity Players Key Correspondent Banks	Improved awareness created across network and key account managers and guidelines / policy reviewed as appropriate.
<b>People Risk</b> Risk arising from inability to attract and retain skilled staff at middle to senior management levels	Moderate	The impact of Brain drain has been considerable in the financial services sector.	Succession Planning for all departments are being developed.  Performance Related Share Options introduced for Management grade staff and upwards.  Preference given to Bank staff for overseas job opportunities within Bank. A batch of Management Trainees recruited this year with a view to filling the critical skill gaps in the future.

# Risk Management

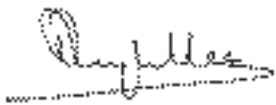
Risk Category	Risk Rating	Mitigating Actions Implemented in 2008	
		Risk Assessment	Risk Mitigating Strategies
<b>Market Risk</b> Risks arising from fluctuations in interest rates, foreign exchange positions and prices of equity investments			
General appetite for Market Risk based on Treasury activity	Low	Treasury Management Focus is on covering Corporate Banking Positions with minimal trading on own account under the guidance of ALCO and Treasury Committee.	Developed Treasury Policy outlining discretionary limits for key management staff and counterparties, operational procedures for Treasury front, back and middle office units.
<b>Foreign Exchange Risk</b> Risk arising from unhedged foreign exchange positions and poor treasury controls	Low	Very little exposure to unhedged positions given internal policy and strengthened supervision by the regulators on minimising open foreign currency positions.	New Treasury Trading System with new functionalities being rolled out with new Core Banking System implementation.
<b>Liquidity Risk</b> Risk arising from inability to meet maturing deposit liabilities as they fall due	Moderate	<p>Regular review of Asset and Liability Yield Analysis by product carried out this year to develop strategies to prevent / minimise deterioration in Net Interest Yields in a high interest rate scenario.</p> <p>The Bank maintains a Loans to Deposit ratio of approx 90%. As a key remittance player in the country, foreign currency deposits of the Bank exceed foreign currency lending by over 100%. Therefore, the reliance on interbank borrowing is low, which is a considerable strength.</p>	<p>Strategies to retain low cost deposit portfolio through value additions to Pathum Vimana Savings Product and New product Capital Savings.</p> <p>Ensuring long-term lending on floating rate basis whilst ensuring regular re-pricing of fixed priced loans.</p>
Interest Rate Risk arising from Maturity Mismatch	Moderate	Maturity Mismatch of Rupee and FCY Earning Assets and Liabilities reviewed and implications identified. The absence of a long term yield curve, results in having to borrow short to lend long for both Rupee and Dollar exposures. This is a key risk in an escalating interest rate scenario further amplified by a lack of liquidity in the Dollar market.	Specific Strategies developed to retain and grow foreign currency deposit base, thereby reduce reliance on interbank market.
<b>Regulatory Risk</b> Risks arising from not conforming to statutory and regulatory requirements.	Low	In a continually changing regulatory environment, the Compliance Unit centrally monitors adherence.	Quarterly checklist confirming adherence to regulatory requirements submitted to Board Audit Committee.

Risk Category	Risk Rating	Mitigating Actions Implemented in 2008	
		Risk Assessment	Risk Mitigating Strategies
Risk arising from non compliance with Anti Money Laundering legislation (AML)	Low	In today's environment AML Risks are an integral element of bank risks and HNB has played a critical role in spearheading industry efforts in this area. The Bank continues to maintain excellent relationships with regulators and law enforcement agencies	The Bank has a dedicated AML Unit which submits reports to FIU per regulations. A training module on AML was posted on the Bank's e-learning which was completed by over 1,000 associates.  Bank account opening forms are AML Compliant as required by legislation.
<b>Legal Risk</b> Risk arising from litigation against the Bank or faulty legal documentation	Low	The Bank runs a full fledged legal department. Specialist legal advice is obtained from external consultants on a need basis.	No significant legislation against the Bank during the year.  Ongoing review of Service delivery provided by the Legal Department is monitored through internal customer surveys etc.
<b>Reputation Risk</b> Risk arising from an event or behaviour that could adversely impact market 'perception' thereby affecting its going concern.			
Risk arising from poor external and internal surveillance to identify strategic risks in a timely manner	Moderate	Corporate Management meets at least annually at 'offsite' strategy meetings, to develop / review medium term goals and strategic priorities in the context of the environment.	Specific action plans with accountabilities and timelines developed to address each Strategic goal / Risk area identified.
Risk to Brand / Reputation arising from lack of / inadequate Corporate Social Responsibility practices	Low	An active Corporate Social Responsibility ("CSR") Committee is in place with cross - functional representation to oversee implementation of CSR Projects	Number of on going and new initiatives have been undertaken by the Bank in areas of affordable drinking water, sanitation, health care, literacy and financial inclusion amongst others. These initiatives are considered imperative as a good Corporate Citizen and ensure sustainability of our business strategies.

# Corporate Governance and Compliance

## Chairman's Introduction

I am pleased to report to you on the activities of the Bank's Board and its Committees over the past 12 months, as the Bank's Chairman. It has been an eventful and busy year but we have continued to apply the high standards of corporate governance that we set both for ourselves as a Board and for the Bank. We report below on how we have adopted in 2008 with the guidelines enshrined in the Code of Best Practice on Corporate Governance issued jointly by the Securities and Exchange Commission of Sri Lanka (SEC) and the Institute of Chartered Accountants of Sri Lanka (ICASL) in 2008, We also report below on how we have complied in 2008 with the Continuing Listing Rule No. 6 of Colombo Stock Exchange (CSE) and the Direction on Corporate Governance for Licensed Commercial Banks issued by the Central Bank of Sri Lanka (CBSL) (Banking Act Direction No 11 of 2007 and subsequent amendments thereto) which became effective 1 January 2008. We are committed to promoting good corporate governance. We seek to be at the forefront of best practices and to respond, in a timely fashion, to corporate governance developments.

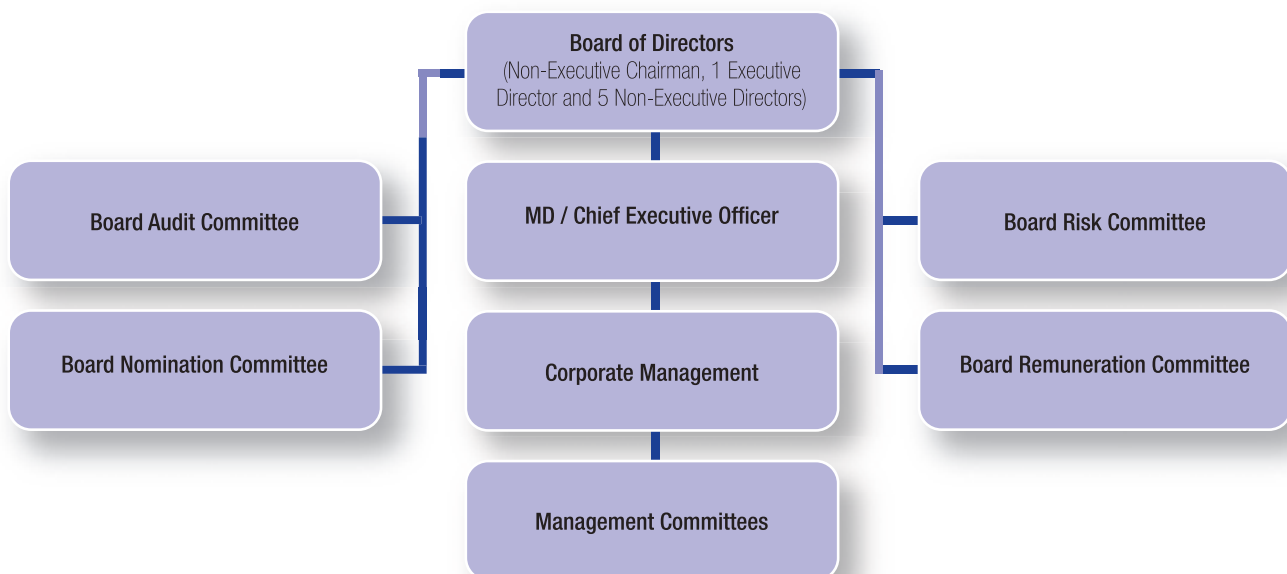


**Rienzie T. Wijetilleke**  
Chairman

Colombo, Sri Lanka.  
13th February 2009

## Corporate Governance Framework

We have adopted a Corporate Governance framework that covers both Corporate Governance and Compliance aspects of the Bank. It encompasses governance structures that are strategically linked with performance management, enabling the Bank to focus on the key areas that drive our business.



The Corporate Governance & Compliance process adopted by the Bank to ensure Conformance is disclosed below.



## Corporate Governance

Corporate Governance is the process by which business operations of the Bank are directed and controlled by the Board of Directors. The Board is responsible to shareholders for creating and delivering sustainable shareholder value through the management of the the Bank's businesses. It therefore determines the goals and policies of the Bank to deliver such long-term value, providing overall strategic direction within a framework of rewards, incentives and controls. The Board aims to ensure that management strikes an appropriate balance between promoting long-term growth and delivering short-term objectives. The Board is also responsible for ensuring that management maintains a system of internal controls that provides assurance of effective and efficient operations, internal financial controls and compliance with laws and regulations. In carrying out this responsibility, the Board has regard to what is appropriate for the Bank's business and reputation, the materiality of the financial and other risks inherent in the business and the relative costs and benefits of implementing specific controls. The Board is also the decision-making body for all other matters of such importance as to be of significance to the Bank as a whole because of their strategic, financial or reputational implications or consequences.

The roles of the Chairman and Chief Executive Officer are separate. The Chairman's main responsibility is to lead and manage the work of the Board to ensure that it operates effectively and fully discharges its legal and regulatory responsibilities. The Board has delegated the responsibility for the day-to-day management of the Bank to the Chief Executive Officer, who is responsible for recommending strategy to the Board, leading the Corporate Management and for making and implementing operational decisions. The Board of Directors has collective responsibility for the success of the Bank. However, the Chief Executive Officer and Corporate Management have responsibility for business operations, whereas non-executive Directors are responsible for bringing independent judgement and scrutiny to decisions taken by the Board, providing objective challenge to management. The Board can draw on the wide range of skills, knowledge and experience they have built up as Directors of other companies as business leaders or leading professionals. It is the intention to have a broad spread of experience represented on the Board.

Corporate Governance is a fundamental part of the culture and business practices of the Bank. At HNB, we have made an attempt to present the actual structures and processes in place in the simplest form possible for the users of this report, so that they could gain an understanding of the adequacy and effectiveness of the process.

## Statement of Compliance

The disclosures below reflect the Bank's level of compliance with the Direction on Corporate Governance for Licensed Commercial Banks issued by the Central Bank of Sri Lanka (CBSL) (Banking Act Direction No 11 of 2007 and subsequent amendments thereto) which came into effect on 1 January 2008, for Banks to be fully complied by 1 January 2009.

The Following disclosures also indicate the level of conformance to the Code of Best Practice on Corporate Governance for Public Companies, issued jointly by the Securities and Exchange Commission of Sri Lanka (SEC) and the Institute of Chartered Accountants of Sri Lanka (ICASL) in 2008.

# Corporate Governance and Compliance

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

**A. Texts in Blue refers to the extent of Adoption to the SEC & ICASL Code of Best Practice on Corporate Governance**

**B. Texts in Pink refers to the level of compliance with the CBSL Direction on Corporate Governance**

**C. Texts in Brown refers to the level of compliance and the extent of Adoption under A and B above**

**D. Texts in Orange refers to Section headings under A and B above**

Corporate Governance Principles	Pronouncement Reference	Adoption / Compliance Status	Level of Compliance / Extent of Adoption
<b>1. The Board of Directors</b>			
1.1 Qualified and suitable Board of Directors	SEC & ICASL– A 1	Adopted	The Board consists of professionals in Banking, Accounting, Management, Law and Business Leaders. They possess the skill and experience and knowledge to set the directions and oversee the operations of the Bank.
	CBSL Rule 3 (2) CBSL Rule 3 (8)	Complied Complied	The profiles of the Directors are given on page 16 to 17 of the Annual Report.
1.2 Meetings	SEC & ICASL – A 1.1	Adopted	During the year 14 Board meetings were held, at approximately monthly intervals, to review the Bank's performance and to determine which strategies and business practices are aligned with stakeholders' expectations. Additional meetings are held whenever necessary.
	CBSL Rule 3 (1)	Complied	The number of meetings of the Board, Board appointed Sub Committees and individual attendance by members are given on page 75 of the Annual Report
1.3 Board Responsibilities	CBSL Rule 3 (1)	Complied	The Bank has a defined set of responsibilities for the Board and the Corporate Management.  The main responsibilities of the Board are;
	SEC & ICASL – A1.2	Adopted	<b>Stakeholders Interests</b> Serving in the interests of long term sustainable return for shareholders with also regard to the interest of the other stakeholders, including customers, regulators, staff and communities, and building trust in the Bank through consistent business performance, transparency and accountability.
	SEC & ICASL – A1.2	Adopted	<b>Strategy</b> Providing strategic directions and formulating corporate strategic initiatives, while reviewing, approving and monitoring the Bank's risk appetite.  The future strategic initiatives taken by the Board have been described in the Management Discussion and Analysis on pages 24 to 42 of this Annual Report.
	SEC & ICASL – A1.2	Adopted	<b>Business Performance</b> Reviewing business results and monitoring budgetary controls.

Corporate Governance Principles	Pronouncement Reference	Adoption / Compliance Status	Level of Compliance / Extent of Adoption
	SEC & ICASL – A1.2	Adopted	<b>Integrity of external reportings</b> Reviewing and monitoring the processes, controls and procedures which are in place to maintain the integrity of the Bank's accounting and financial records and statements; and review and monitor reportings to shareholders and regulators including the provision of objective, comprehensive, factual and timely information to various stakeholders.
	SEC & ICASL – A1.2	Adopted	<b>Relationship with Stock Exchanges, Regulators and Continuous Disclosure</b> Maintaining a direct, ongoing and healthy dialogue and communication with the SEC, CSE and other stock exchanges where the Bank's securities are listed, ensuring that the market and our stakeholders are kept informed of developments.
	SEC & ICASL – A1.2	Adopted	<b>Risk Management and Compliance</b> Monitoring and reviewing the risk management processes, the Bank's risk profile and processes for compliance with prudential regulations and standards and other regulatory requirements.
	SEC & ICASL – A1.2	Adopted	<b>Corporate Governance</b> Monitoring and reviewing corporate governance framework of the Bank.
	SEC & ICASL – A1.2	Adopted	<b>Corporate Social Responsibility</b> Setting standards and monitoring compliance with our social responsibility policies and practices; considering the social, ethical and environmental implications of our business activities.
	SEC & ICASL – A1.2	Adopted	<b>Audit</b> Recommending to shareholders the appointment of the External Auditor based on the review process conducted by the Audit Committee.
	SEC & ICASL – A1.2	Adopted	The <b>Corporate Management</b> has been delegated with the following responsibilities.
	CBSL Rule 3 (4)	Complied	<b>Strategy</b> Developing and implementing corporate strategies and making recommendations to the Board on significant strategic initiatives for approval.  <b>Senior Management Selection</b> Recommending senior management selection and appointments, performance evaluation and succession planning to the Board.  <b>Financial Performance</b> Developing the annual budget and management of day to day operations in line with the Board approved budgetary forecast.  <b>Risk Management</b> Developing and maintaining an effective risk management framework.
1.4 Access to independent professional advice	SEC & ICASL – A1.3 CBSL Rule 3 (1)	Adopted Complied	The procedure for Directors to seek independent professional advice, in furtherance of their duties, at the Bank's expense, is co-coordinated through the Board Secretary

# Corporate Governance and Compliance

Corporate Governance Principles	Pronouncement Reference	Adoption / Compliance Status	Level of Compliance / Extent of Adoption
1.5 Company Secretary	SEC & ICASL – A1.4 CBSL Rule 3 (1)	Adopted Complied	All Directors have access to the Board Secretary who is an Attorney-at-Law by profession. She is responsible for supporting and advising the Chairman and the Board on all Corporate Governance matters, Board procedures and compliance with applicable rules and regulations.
	CBSL Rule 3 (1)	Complied	The Board Secretary maintains minutes of the Board meetings in sufficient details
1.6 Dedication of adequate time and effort by the Board and Board Committees	SEC & ICASL – A1.6 CBSL Rule 3 (6)	Adopted Complied	The Chairman and members of the Board dedicate adequate time for the fulfillment of their duties as Directors of the Bank. In addition to attending Board meetings, they attend sub-committee meetings and make decisions via circular resolutions. The Board sub-committees include; <ul style="list-style-type: none"> <li>- Nomination Committee</li> <li>- Audit Committee</li> <li>- Credit Committee</li> <li>- Procurement Committee</li> <li>- Remuneration Committee</li> <li>- Asset Disposal Committee</li> <li>- Integrated Risk Management Committee</li> </ul>
1.7 Training for new Directors	SEC & ICASL – A1.7 CBSL Rule 3 (1)	Adopted Complied	Directors undertake such professional development as they consider necessary in assisting them to carry out their duties as Directors. Presentations are made to the Board by the senior management of the Bank from time to time on industry related matters.
1.8 Annual self assessment by the Board	CBSL Rule 3 (1)	Complied	The annual self assessment of the Board is carried out by the Chairman against the assessment checklist developed by the Board and is circulated to all the members. Each member of the Board provides his / her comments on this assessment. The completed self assessments are maintained by the Board Secretary.
<b>2. Chairman &amp; CEO</b>			
2.1 Division of Responsibilities of the Chairman & MD / CEO	SEC & ICASL – A 2 CBSL Rule 3 (5)	Adopted Complied	The functions of the Chairman and MD / CEO are clearly separated in order to ensure a balance of power and authority, such that no individual has unfettered powers of decision.
<b>3. Chairman's Role</b>			
3.1 Role of the Chairman	SEC & ICASL – A 3 CBSL Rule 3 (5)	Adopted Complied	The Chairman of the Bank is a Non-Executive Director, elected by the Board. The Chairman's role encompasses: <ul style="list-style-type: none"> <li>- Ensuring that Board members undertake appropriate induction, covering terms of appointment, duties and responsibilities.</li> <li>- Providing effective leadership in formulating Board strategy.</li> <li>- Representing the views of the Board to the public.</li> <li>- Ensuring regular meetings, the minutes of which are accurately recorded and where appropriate included the individual and collective views of the Directors.</li> <li>- Encouraging effective participation of all Directors in the decision making process to optimize contribution.</li> <li>- Approving the agenda prepared by the Board Secretary; and conducting Board meetings.</li> </ul>

Corporate Governance Principles	Pronouncement Reference	Adoption / Compliance Status	Level of Compliance / Extent of Adoption
	CBSL Rule 3 (5)	Complied	There are no material relationships between the Chairman / CEO and other members of the Board which will impair their respective roles
<b>4. Financial Acumen</b>			
4.1 Availability of sufficient financial acumen and knowledge	SEC & ICASL – A 4	Adopted	The MD / CEO is a fellow member of the Institute of Chartered Accountants of Sri Lanka and a fellow member of the Chartered Institute of Management Accountants – UK. In addition, the Board includes a fellow member of the Chartered Institute of Management Accountants – UK, and a director who is a fellow member of the Institute of Chartered Accountants of Sri Lanka & also a fellow member of the Institute of Chartered Accountants in England & Wales. These members of the Board have the ability to offer guidance on matters of finance to the Board.
4.2 Board Performance and Composition	SEC & ICASL – A 5	Adopted	Determining the size and composition of the Board and based on the recommendations of the Nomination Committee, making recommendations to the shareholders on the appointment and removal of directors and monitoring Board processes and performance.
4.3 Executive review, succession planning and culture	CBSL Rule 3 (1)	Complied	Remuneration Committee approves the appointments of executive management and monitors and reviews executive succession planning. Based on the assessment carried out by the Remuneration Committee, the Board reviews and monitors the performance of the CEO. The Board drives the Bank's culture to maintain a high level of reputation and ethical standards.
4.4 Presence of a strong non-executive element on the Board	SEC & ICASL – A 5 CBSL Rule 3 (2)	Adopted Complied	Six of the seven Directors of the Board are non-executives. The MD / CEO is the sole executive director.
4.5 Independence of the Directors	CBSL Rule 3 (2)	Complied	An Independent director must be independent of management and free to exercise unfettered independent judgement.  The Board considers that the following Non-Executive Directors are also Independent as defined by the Direction on Corporate Governance for Licenced Commercial Banks issued by the CBSL; Mr M V Theagarajah Mr Ratneswara Sivaratnam - resigned on 24th April 2008 Ms Pamela C. Cooray Mr Ranjeevan Seevaratnam
	SEC & ICASL – A 5.5	Adopted	Mr M V Theagarajah is considered as an independent Director by taking account of the following circumstances; - He does not represent any of the shareholder groups. - He is not involved in any operational aspects of the Bank. - His long experience in the field of financial management, knowledge and wisdom. in conformity with CSE listing rule no 6.3 (b) on Corporate Governance.

# Corporate Governance and Compliance

Corporate Governance Principles	Pronouncement Reference	Adoption / Compliance Status	Level of Compliance / Extent of Adoption
<b>5 Appointment to the Board</b>			
5.1 Nomination Committee	SEC & ICASL – A 7	Adopted	<p>The Nomination Committee of the Bank is comprised of the following four directors. MD / CEO attends these meetings by invitation.</p> <p>Mr Rienzie T. Wijetilleke – Non-Executive Chairman            Mr D H S Jayawardena - Non-Executive Director            Mr M V Theagarajah - Non-Executive Director            Mr R K Obeyesekere - Non-Executive Director</p> <p>The Nomination Committee carried out continuous review of the composition of the Board, and one of the responsibilities of the Nomination Committee is identifying, evaluating and recommending candidates for suitable positions to ensure succession planning within the Bank for the approval of the Board.</p>
5.2 Directors appointments	CBSL Rule 3 (2) & 3(6)	Complied	All new appointments as well as continuing directorships are reviewed by the Nomination Committee. The Directors are required to report any substantial change in their professional responsibilities, occupation of business associations to the Nomination Committee, which will examine the facts and circumstances and make recommendations to the Board.
5.3 Disclosure of details of new Directors to shareholders	SEC & ICASL – A 7.3	Adopted	Details of new Directors are disclosed to the shareholders on their appointment. Prior notice on appointment of new Directors is given to the Director of Bank Supervision, CBSL.
<b>6 Re - election</b>			
6.1 Re - election of Directors	SEC & ICASL – A 8	Adopted	<p>According to the Articles of Association of the Bank, each director other than the MD / CEO, retires by rotation once every three years and is required to stand for re-election by the shareholders at the Annual General Meeting. The proposed re-election of directors is subject to prior review by the full Board.</p> <p>As required by the Companies Act. No.7 of 2007, any director who has reached the age of 70 years stands for re-election on annual basis.</p> <p>Non-Executive Directors are appointed for a specified term subject to re-election.</p>
<b>7 Appraisal of Board Performance</b>			
7.1 Appraisal of Audit Committee performance	SEC & ICASL – A 9	Adopted	<p>The effectiveness of the Audit Committee is assessed by the following members annually and presented to the Board.</p> <p>Mr Rienzie T. Wijetilleke – Non-Executive Chairman            Mr Rajendra Theagarajah – MD / CEO            Mr Nihal Kekulawala – CFO            Mr M Asokan – Head of Internal Audit            KPMG Ford, Rhodes, Thornton &amp; Co – External Auditor</p> <p>This year the Board took the initiative to include External Auditor, Head of the Internal Audit and the CFO to assess the audit committee and the final report was presented to the Board.</p>

Corporate Governance Principles	Pronouncement Reference	Adoption / Compliance Status	Level of Compliance / Extent of Adoption
7.2 Appraisal of Board Performance	SEC & ICASL – A 9	Adopted	The performance of the Board and its committees is evaluated by the Board annually to ensure that the Board functions effectively and efficiently, and the Board formally documents this evaluation process.
<b>8. Appraisal of the CEO</b>			
8.1 Appraisal of the MD / CEO	SEC & ICASL – A 11	Adopted	The performance of the MD / CEO is reviewed every year by the full Board against financial and non financial targets which are in line with the short, medium and long term objectives of the Bank.
<b>9 DIRECTORS' REMUNERATION</b>			
9.1 Human Resources / Remuneration Committee	SEC & ICASL – B 1 CBSL Rule 3 (6)	Adopted Complied	<p>The Remuneration Committee comprises of the following three Non-Executive Directors.</p> <p>Mr Rienzie T. Wijetilleke – Non-Executive Chairman Mr R K Obeyesekere - Non-Executive Director Ms Pamela C. Cooray – Non-Executive Director Mr Rajendra Theagarajah MD / CEO (By invitation only)</p> <p>The Remuneration Committee is responsible for assisting the Board with regard to remuneration policy for the Executive Director and the Corporate Management, and for making all relevant disclosures.</p> <p>The Committee determines and agrees with the Board, the broad policy framework for the remuneration of the MD / CEO. The MD / CEO participates in such meetings by invitation in deciding the remuneration of the Corporate Management in order to recruit, retain and motivate the Corporate Management.</p>
9.2 Level and make up of the Remuneration	SEC & ICASL – B 2	Adopted	The remuneration package of the MD / CEO is structured to link rewards to corporate and individual performance. Non-executive Directors receive a nominal fee as disclosed in this Annual Report.
9.3 Disclosure of Remuneration	SEC & ICASL – B 3 CBSL Rule 3 (8)	Adopted Complied	The details of the total remuneration of the Directors are disclosed on page 156 of the Annual Report.
<b>10. RELATIONS WITH SHAREHOLDERS</b>			
10.1 Constructive use of the Annual General Meeting (“AGM”)	SEC & ICASL – C 1 CBSL Rule 3 (1)	Adopted Complied	The Board remains mindful of being accountable to the shareholders and the need for transparency at all levels, striving to maintain this value framework in all shareholder dealings and communications. The primary modes of communication between the Bank and the shareholders are the Annual Report and AGM. Information is received by the shareholders prior to the AGM to give them an opportunity to exercise the prerogative to raise any issues relating to the business of the Bank, either verbally or in writing prior to the AGM. The Board which includes the Chairmen of the Audit, Remuneration, Nomination and Integrated Risk Management Committees are present at the AGM to answer any questions.

# Corporate Governance and Compliance

Corporate Governance Principles	Pronouncement Reference	Adoption / Compliance Status	Level of Compliance / Extent of Adoption
10.2 Circularisation of Notice of the AGM	SEC & ICASL – C 1.4 SEC & ICASL – C 1.5	Adopted Adopted	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. The Bank proposes a separate resolution for each item of business, giving shareholders the opportunity to vote on each substantially different issue.
10.3 Major transactions	SEC & ICASL – C 2	Adopted	During 2008 there were no major transactions which materially affected the Bank's net asset base.  Transactions, if any, which materially affect the net assets of HNB, will be disclosed in the quarterly / annual financial statements.
<b>11. ACCOUNTABILITY AND AUDIT</b>			
11.1 Financial Reporting, Statutory and Regulatory Reporting	SEC & ICASL – D 1	Adopted	The Bank has reported a balanced and fair assessment of its position and prospects for the year ended 31st December and at the end of each quarter.
	SEC & ICASL – D 1.1 CBSL Rule 3 (8)	Adopted Complied	In the preparation of quarterly and annual financial statements, the Bank had strictly complied with the requirements of the Companies Act, No. 7 of 2007, the Banking Act, No. 30 of 1988 and amendments thereto, and are prepared and presented in conformity with Sri Lanka Accounting Standards. The Bank has complied with the reporting requirements prescribed by the regulatory authorities such as the, Central Bank and CSE. As the Bank's Global Depository Receipts (GDR's) are listed in the Luxemburg Stock Exchange, the Bank has also complied with all the reporting requirements of the Luxemburg Stock Exchange.
	CBSL Rule 3 (8)	Complied	The financial statements for the year ended 31st December 2008 and for the quarters then ended have been published in all three languages.
11.2 Statement of Solvency and Auditor's report on the Statement of Solvency	SEC & ICASL – D 1.1	Adopted	The Board of Directors was satisfied that the Bank would meet the solvency test in terms of the provisions of the Companies Act No: 7 of 2007 immediately after the interim dividend was paid in December 2008 and the final dividend proposed which will be paid in April 2009. The Board made Statements of Solvency to the Auditor and obtained Certificates of Solvency from the Auditor in respect of each dividend payment conforming to the statutory provision.
11.3 Directors' report in The Annual Report	SEC & ICASL – D 1.2	Adopted	The Directors' Report is given on pages 122 to 126 of the Annual Report.
11.4 Declaration by the Board that the business is a going concern	SEC & ICASL – D 1.2	Adopted	This is given in the Directors' Report on page 122 of the Annual Report.
11.5 Statement of Directors' on their responsibility on the preparation and presentation of financial statements	SEC & ICASL – D 1.3	Adopted	The Statement of Directors' Responsibility for Financial Reporting is given on page 130 of the Annual Report.
11.6 Management report in the Annual Report	SEC & ICASL – D 1.4	Adopted	The Management Discussion and Analysis is given on pages 24 to 42 of the Annual Report.



Corporate Governance Principles	Pronouncement Reference	Adoption / Compliance Status	Level of Compliance / Extent of Adoption
11.7 Summoning an EGM to notify shareholders if net assets fall below one half of the shareholders' funds	SEC & ICASL – D 1.6	N/A	Likelihood of such occurrence is remote. However, should the situation arise, an EGM will be called for and shareholders will be notified.
<b>12 Internal Control</b>			
12.1 Maintaining a sound system of internal control and risk management	SEC & ICASL – D 2	Adopted	<p>The Board is ultimately responsible for the Bank's system of internal controls and for reviewing their effectiveness. These systems support in managing the risk of the Bank's business and ensure that the financial information on which business decisions are made and which is published is reliable, and also ensures that the Bank's assets are safeguarded.</p> <p>The system of internal controls is designed to manage rather than eliminate the risk of failure to achieve business objectives. Internal controls are aimed at providing reasonable and not absolute assurance against material misstatement or loss.</p> <p>The Board of Directors is satisfied with the effectiveness of the system of internal controls.</p> <p>A detailed Risk Management Report is given on pages 50 to 61 of the Annual Report.</p>
12.2 Reviewing the effectiveness of the Internal Control System	SEC & ICASL – D 2.1	Adopted	The Internal Audit Division of the Bank carries out regular reviews on the internal control system. A control self assessment is also being used by the Bank as a means to enhance process discipline and internal control.
	SEC & ICASL – D 2.1 CBSL Rule 3 (8)	Adopted Complied	The Audit Committee monitors and reviews the effectiveness of the Bank's internal audit function and the internal control system. The Audit Committee's report on the effectiveness of the internal control system is reviewed by the Board annually.
<b>13 Audit Committee and Auditor</b>			
13.1. Composition and Terms & Conditions of the Audit Committee	SEC & ICASL – D 3.1	Adopted	The Audit Committee of the Bank is comprised of three Non-Executive Directors, two of them are Independent, and meets regularly throughout the year. The Board Secretary functions as the Secretary to the Audit Committee. The MD / CEO, Head of the Internal Audit and CFO attend meetings on invitation.
13.2 Review of external audit function and relationship with External Auditor	SEC & ICASL – D 3.2	Adopted	The Audit Committee monitors and reviews the External Auditor's independence, objectivity, and the effectiveness of the audit process taking into account relevant professional and regulatory requirements. The Committee also sets out the policy for the engagement of the External Auditor to provide non-audit services, taking into account relevant regulation with regard to the provision of non-audit services and the guidelines issued by the Central Bank of Sri Lanka on "Prohibited Services". The Audit Committee has the primary responsibility for making recommendations on the appointment,

# Corporate Governance and Compliance

Corporate Governance Principles	Pronouncement Reference	Adoption / Compliance Status	Level of Compliance / Extent of Adoption
			<p>re-appointment or removal of the External Auditor in-line with professional standards and regulatory requirements.</p> <p>The Bank follows the practice of ensuring independence of the External Auditor by rotation of Audit Engagement Partner every 5 years.</p> <p>The External Auditor has provided a confirmation on compliance with the "Guidelines for appointment of auditors of listed companies" issued by SEC.</p>
13.3 Review of Internal Audit Function	SEC & ICASL – D 3.3	Adopted	<p>The Internal Audit function is governed by the Internal Audit Charter that spells out the role, rights and responsibilities.</p> <p>The Internal Audit Charter is approved by the Board of Directors. The Audit Committee monitors and reviews the effectiveness of the Bank's Internal Audit function. The Head of Internal Audit reports to the Audit Committee. The Audit Committee is responsible for the appointment of Head of Internal Audit. The Audit Committee reviews and approves the Internal Audit plan and resource requirements. It reviews the important Internal Audit findings and follow-up procedures. The Committee is responsible to ensure that the Corporate Governance requirements as per the SEC-ICASL code in respect of Internal Audit are complied with.</p>
13.4 Conflict of Interest	SEC & ICASL – D.4	Adopted	All Directors exercise their independent and objective judgment on issues of strategy, policy, resources and standards of conduct.
	CBSL Rule 3 (1)	Complied	The Board is conscious of its obligations to ensure that Directors avoid conflicts of interest (both real and apparent) between their duty to the Bank and their other interests. The Board has adopted a procedure to ensure that conflicts and potential conflicts of interest of Directors are disclosed to the Board. Any Director with a material personal interest in a matter being considered by the Board declares his / her interest and unless the Board resolves otherwise, he / she does not participate in discussions or vote on that specific matter. Independent Directors do participate in such meetings.
	CBSL Rule 3 (7)	Complied	<p>All credit evaluations and trading transactions with related parties are approved by all Directors who are present in Sri Lanka, other than the Director who has interest in the said transaction.</p> <p>All Related Party transactions are disclosed on pages 191 to 200 of the Annual Report.</p>
13.5 Code of Business Conduct and Ethics	SEC & ICASL – D 4		Being developed for adoption in 2009.
13.6 Confidential Information	SEC & ICASL – D 4.1 (Schedule G)	Adopted	The Directors regard the confidentiality of customer information as highly important. The Bank has a policy which prevents the disclosure of confidential customer information outside the Bank or the use of that information for the personal financial gains or gains of any other entity. (Including any entity where a Director has an association).

Corporate Governance Principles	Pronouncement Reference	Adoption / Compliance Status	Level of Compliance / Extent of Adoption
<b>14 SHAREHOLDERS</b>			
14.1 Institutional Shareholders	SEC & ICASL – E 2	Adopted	Institutional shareholders are encouraged to make considered use of their votes and their voting intentions.
<b>15 OTHER CORPORATE GOVERNANCE INITIATIVES</b>			
15.1 Corporate Governance Culture	SEC & ICASL – E 2 & D 5	Adopted	The Bank fosters a culture which encourages the highest standards of integrity and professionalism, amongst employees and Directors. Suitable orientation is provided to all new Directors, managers and employees.
15.2 Other Investors	SEC & ICASL – F 1	Adopted	Individual shareholders are encouraged to carry out adequate analysis or seek independent advice on investing or divesting decisions.

# Corporate Governance and Compliance

## Governance Initiatives as per International Best Practices

### 1. Monitoring of Controlled Entities

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

Directors of each of the controlled entities are provided with Corporate Governance guidelines, which have been approved by the Board of the Bank. The Corporate Governance guidelines set out the specific roles, duties and responsibilities of the Directors of controlled entities. Such guidelines set out the key expectations that the Board would have, from the Boards of controlled entities. The guidelines have been specifically tailored to the different entities, depending on the nature of its business and activities.

The Board of the Bank's confidence in the activities of a controlled entity Boards is achieved through high quality controlled entity Boards committed to Group objectives.

There is a standing invitation to all of the Bank's Directors to attend any Board Meeting of a controlled entity through consultation with the Chairman. Such visits are undertaken to develop a broader understanding of the Group's total business operations.

### 2. Human Capital

Disclosure of description of HR policies and practices adopted by the Bank, including the performance evaluation process, career development and work / life balance are disclosed on Page 89 to 97 of this Annual Report.

### 3. Corporate Social Responsibility ("CSR")

In keeping with our core value of serving the community in which we live and work, the Bank has embarked on several ventures. Details of which are discussed on pages 83 to 86 in the Sustainability Report which was compiled based on the Global Reporting Initiative (GRI) guidelines. The Bank has set up a Sustainability Committee, which has three sub-committees addressing the social responsibility issues relating to our key stakeholders, namely

- Customer Service and Investor Group
- Employee Liaison Group
- Environmental and Community Advisory Group

The Bank's CSR Report presented within the Sustainability Reporting Guidelines and included in this Annual Report from pages 83 to 86 has been reviewed by an independent Assurance Provider

## COMPLIANCE

The Bank's compliance monitoring framework, requires that all of the Bank's business functions, establish processes for identifying applicable laws and regulations pertaining to the operations of the Bank.

16 Regulatory Compliance	<p>An independent risk &amp; compliance function is in place to ensure that the Bank complies with applicable laws and regulations.</p> <p>The Compliance Reports signed by the MD / CEO and CFO are reviewed by the Audit Committee prior to publishing interim and year end financial statements. The CFO is required to submit a report on whether the Bank is up to date in the settlement of statutory payments.</p> <p>The MD / CEO and CFO in their Responsibility Statement confirms that the Bank has complied with all applicable laws and regulations and guidelines and that there are no material litigations that are pending against the Bank other than those disclosed in the Notes to the financial statements in the Annual Report. This statement is presented on page 131 of this Annual Report.</p>
17 Risk Management	<p>Risk is a key parameter of the Bank's business. Accordingly, the Board has established a Board Risk Committee to provide Board level monitoring and oversight of all the Bank's risk management. The details of the Risk Management framework of the Bank are given on pages 50 to 61.</p>

## MEETINGS

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

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

Names	Directorship Status	Board Meetings	Audit Committee	Nomination Committee	Remuneration Committee	Integrated Risk Management Committee
Mr Rienzie T. Wijetilleke	Non-Executive Chairman	14/14	-	No meetings were held during the year as there were no nominations made to the Board.	1/1	1/1
Dr V P Vittachi (Note 02)	Non-Executive Director	0/09 (Note 05)	-		-	-
Mr Rajendra Theagarajah	Managing Director / CEO	14/14	-		1/1 (Note 01)	1/1 (Note 01)
Mr D H S Jayawardena	Non-Executive Director	13/14	4/5		-	-
Mr M V Theagarajah	Non-Executive Director	12/14	-		-	1/1
Mr R K Obeyesekere	Non-Executive Director	13/14	-		1/1	1/1
Ms Pamala C. Cooray	Independent Non-Executive Director	13/14	5/5		1/1	-
Mr Ratneswara Sivaratnam (Note 03)	Independent Non-Executive Director	0/05 (Note 05)	-		-	-
Mr Ranjeevan Seevaratnam	Independent Non-Executive Director	14/14	5/5		-	-

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

Names	Credit	Asset Disposal	Procurement Committee
<b>Total No. of papers approved in 2008</b>	<b>286</b>	<b>03</b>	<b>19</b>
Mr Rienzie T. Wijetilleke	245	02	17
Dr V P Vittachi (Note 02)	06	-	-
Mr Rajendra Theagarajah (Note 01)	283	03	18
Mr D H S Jayawardena	33	-	-
Mr M V Theagarajah	139	-	16
Mr R K Obeyesekere	136	03	19
Ms Pamela C. Cooray	201	03	-
Mr Ratneswara Sivaratnam (Note 03)	-	-	-
Mr Ranjeevan Seevaratnam	144	-	8 (Note 04)

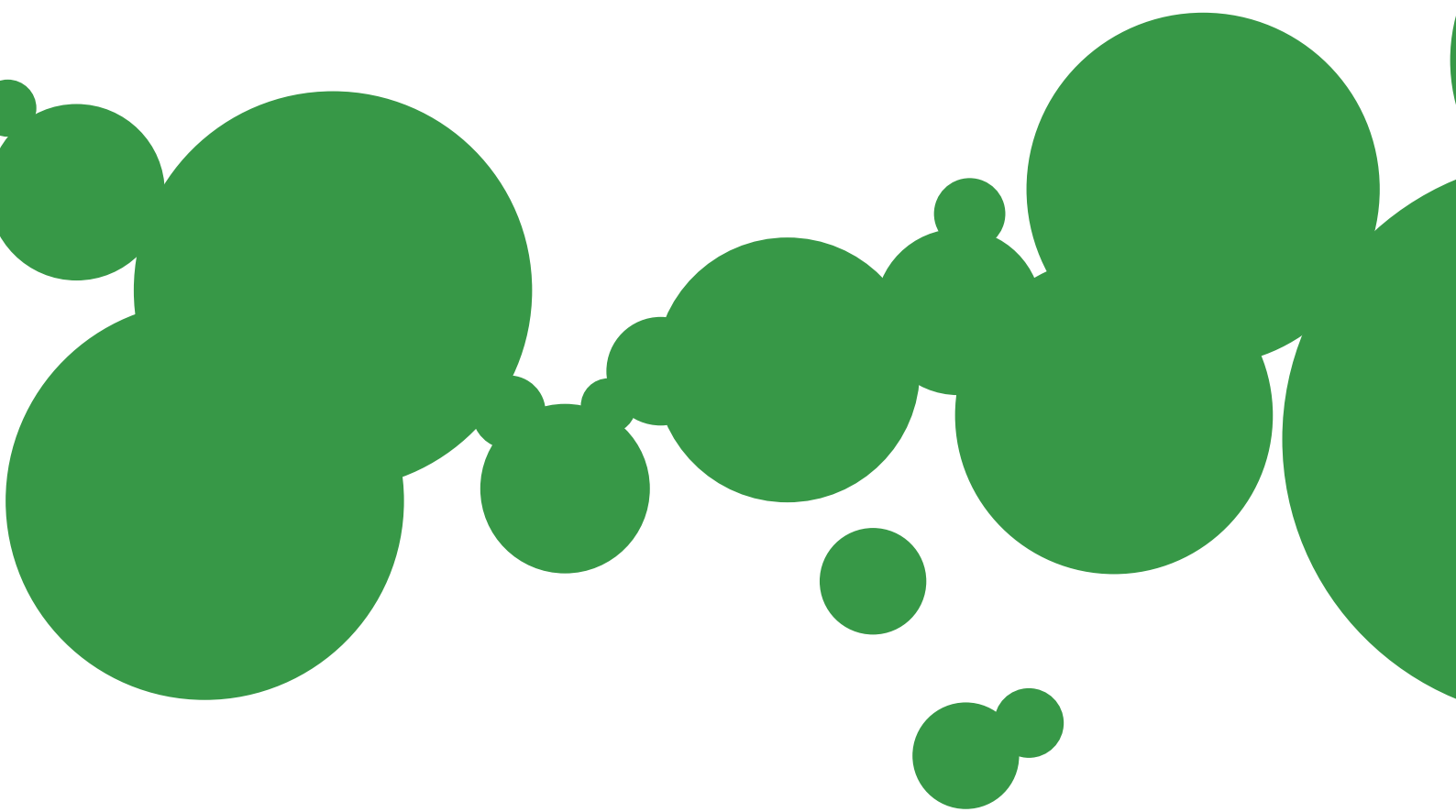
Note 01 - Attended by invitation but is not a member of the sub committee

Note 02 - Resigned on 21st August 2008

Note 03 - Resigned on 24th April 2008

Note 04 - While Mr Ranjeevan Seevaratnam is not a regular member of this Committee, he was co-opted as a member and approved 8 papers during the year when a regular committee member was not available.

Note 05 - Dr V P Vittachi and Mr Ratneswara Sivaratnam did not attend Board meetings in 2008 due to medical reasons.



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# Sustainability Report

Making it **all add up**



# Chief Executive Officer's Message

“The emphasis this year has been not only on enhancing shareholder value and creating wealth but also on ensuring that the correct mix and balance is maintained in the key focus areas of customers, employees and the general community.”

2008 was a difficult year for the financial services both in Sri Lanka and globally. These turbulent times serve to underscore the importance of translating commitment to responsible business practices into business reality. Despite these financially challenging times, we are determined to stay on course and stand by our overall corporate social responsibility objectives. In many ways, this is an opportunity for the Bank, when our commitment to being a responsible, sustainable business is more important than ever. We adopt a stakeholder-based approach to identifying the social and environmental risks and opportunities for our business.

This year too, we are developing our Corporate Social Responsibility (CSR) ambitions under the strap line of 'sustainability'. This is simply the way the Bank does business, and will hold firm whatever market or operational circumstances we face.

Our understanding of sustainability embraces two things. Firstly, we strive for sustainable relationships. That means seeking to ensure that our long-term values of innovation, trust, and putting our customers first are observable in the way we serve our customers and stakeholders. Our focus is to remain profitable for our shareholders and enable our corporate and retail customers to face the challenges of the changing economic conditions.

Secondly, sustainability enshrines the idea of being a responsible corporate citizen. Banks are an indispensable part of a productive national economy and a healthy society. They foster and stimulate risk taking and entrepreneurship - both are fundamental ingredients of sustainable economic growth and progression. Our corporate citizenship should not be confined to the making of mere philanthropic donations. It

must include our obligations as a responsible employer, and our duty to manage the wider social and environmental impact of what we do. The Bank's management of its social and environmental impact is based on the clear rationale that it is ultimately good for business. We feel that 'sustainability' better captures these responsibilities, and applying the term to our activities will keep us mindful of the centrality and durability of these commitments to our business and our brand.

We provide more information on our activity in 2008 on all the issues that matter most to our stakeholders throughout this report and online. We also provide an update on our progress against the priorities we set ourselves on these issues last year, and spell out our plans for the year ahead. This enables us to chart not just where we have come from, but also where we plan to go. I look forward to providing you with an update on our success this time next year.



**Rajendra Theagarajah**  
Managing Director / CEO

Colombo, Sri Lanka  
13th February 2009







## Preamble

What does it take for an organisation that goes back 120 years to have consistently walked the path of a responsible corporate citizen? Collating experience, skills, expertise, knowledge and humanness into a single minded vision of adding value to the lives, lifestyles and ethos of our stakeholders, the Bank has brought together its learning experiences, applied that knowledge to ensure a growing entity that has retained a winning leadership position over the years. It all adds up to a bank that is one with the people; the environment and the nation; a bank to whom sustainability means meeting the needs of the present generation without compromising the ability of future generations to meet their own needs; a bank that builds on a vision, mission, objectives, values and ethics to encompass its final goal of being the truss upon which the future relies on.

Adding up our life's lessons to the basic precept of sustainability, the Bank has beyond doubt been the catalyst of change. Whether it is in creating wealth for our shareholders, or in spearheading socio-economic transformations for communities and the environment, or in ensuring that our valued business partners are prime examples of pragmatic development, or in infusing global best practices in governance, accountability and transparency in our workings or in giving our team the opportunities to become responsible citizens of the world, the Bank's impact on our stakeholders has been on a positive sustainable platform championing a win-win environment for all.

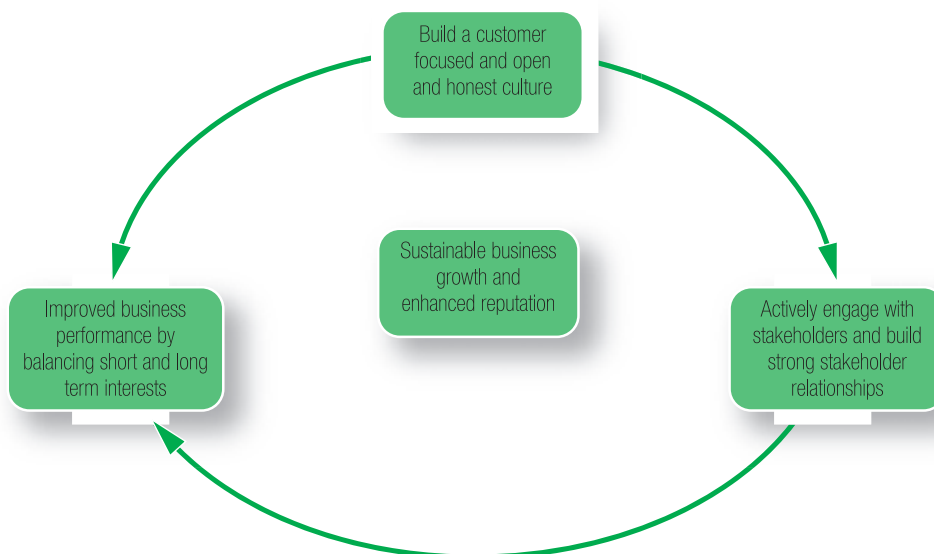
## Our Sustainability Strategy

As reported last year, our sustainability strategy is the foundation on which our overall business strategy is based and provides a framework to develop our priorities and action plans in response to the risks and opportunities that arise due to sustainability trends and challenges.

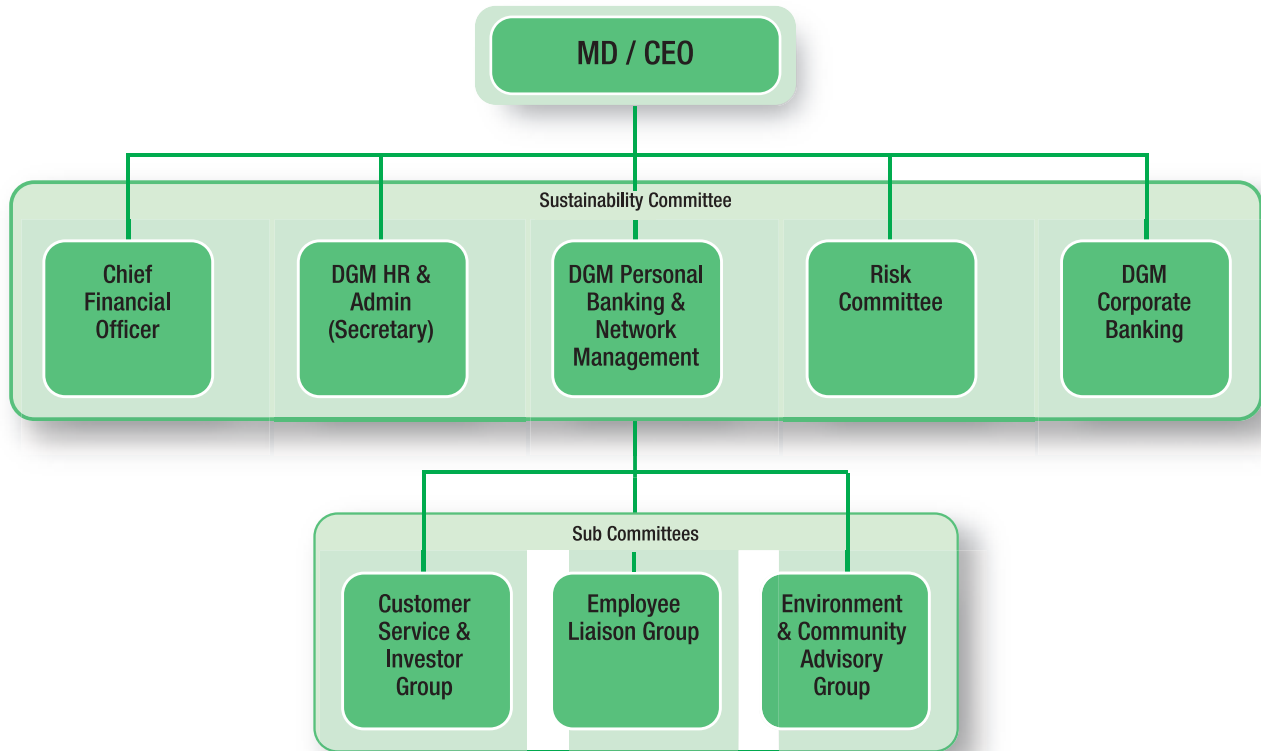
The key elements of our sustainability strategy are to enhance business performance, build an open and honest culture and engage actively with stakeholders. This is achieved by focusing on six areas;

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

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



## Sustainability Stewardship



### Duties of Sustainability Committee:

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

### Sustainability Structure

Driven on a top down approach that demonstrates the Bank's complete commitment to sustainability, the Bank's sustainability structure is headed by the MD / CEO, ensuring that our vision, goals, objectives and processes are integrated and etched into the sustainability framework. The dedicated Sustainability Committee sets goals, direction and framework annually, while three sub committees set out the project focus, investment and approval framework.

In a broad sense, our sustainability focus areas encompass our key stakeholders and include:

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



### Corporate Social Responsibility (CSR) Trust

As reported last year the plans for setting up the CSR Trust are nearly finalised and the work of the Trust is expected to commence during the first quarter of 2009.

### Risk Management and Enterprise Governance

At HNB we firmly believe that strong governance is crucial for our success and we have made significant changes to improve our Risk Management and Corporate Governance systems. Our approaches to Risk Management and Corporate Governance and Compliance have been described in pages 50 to 61 and 62 to 75 respectively in the Annual Report.

### Stakeholder Engagement

We recognise that stakeholder engagement is necessary to create value by contributing to risk management, organisational resilience, learning and innovation and identification of opportunities to create products and improve performance.

### HNB's MD / CEO says:

"By embracing sustainability, we strive to ensure that, in the way that we serve our customers and stakeholders, our long-term values of innovation, trust, and putting our customers first are clearly demonstrated".

### HNB's Contribution to the National Economy

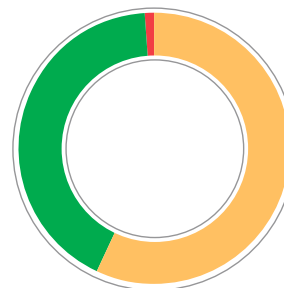
Our industry leadership is now legendary, etched in the annals of corporate Sri Lanka as a bank that has proved beyond doubt its sustainability, built on a solid foundation with overarching governance tenets that ensure strength, stability and an assurance of an upward growth curve that will give fillip to the industry and macro economy. Our contribution to the economy began 120 years ago, having been set up as a Bank to serve the burgeoning plantation industry at that time. With the evolution of not only the financial services industry but also the corporate sector over the decades, the Bank drove its winning formula to the fore, evolving with the times, infusing best practices,

emulating global trends and thus creating a culture of stewardship that has now become the norm.

We are a primary contributor to the national economy. Being a bank with over one million customers, we have taken on the mantle of ensuring that our products, service and the very ethos we build our vision upon will ultimately contribute towards the development of the country. Whether it is in inculcating a savings culture, stimulating industry, encouraging foreign remittances, developing the rural economy through micro entrepreneurs or partnering infrastructure development, the Bank has proven that it has applied the lessons learned for growth and infused a winning formula for sustainable development.

The recognition we have received from our peers in both the local and global spheres gives us added impetus to utilise our leadership tenets, entrepreneurial spirit, community empathy and excellent teamwork to grow the Bank further, where the national economy will benefit completely, with these positives cascading to each and every citizen.

### Government Tax



- >> Bank's total expenditure Rs 30.18 Bn
- >> Of this, amount expended on staff emoluments and benefits Rs 4.35 Bn



## Sustainability Report

# Community Relations

Our community relations are conceptualised and formulated around continued interaction and proactive relationships we have with the communities we work with. Over the years, we have fostered a two way partnership that has given us the impetus to learn from each other, apply those rudiments and ensure that the partnership grows from strength to strength to create a winning combination. Ultimately, it has all added up to creating a sustainable platform of community development and continued community investment.

The focus areas in our community investment strategy are projects that the Bank has worked upon over the years, most of which have continued over the last few years and some newer initiatives we have embarked upon.

In recognition of the Bank's continued and sustained input into community sustainability, the Bank was honoured with two accolades from the Ceylon Chamber of Commerce at its prestigious Best Corporate Citizen Awards 2008:

- **Gami Pubuduwa, the Bank's flagship micro finance scheme won first place in the Special Projects Category**
- **Nana Pubuduwa, the Bank's School Library project was presented a Merit Award in the Special Projects Category**

## Supporting high literacy

**Nana Pubuduwa – School Library Project**  
**Investment for 2008 – Rs 9 Mn**

**Total investment up to 31st December 2008 – Rs 21 Mn**

Aiding high literacy among students country wide became one of our sustainability missions in 2005 and since then, the Bank has been vigorous in its endeavour of establishing libraries in schools, especially in the more underprivileged rural areas of the country. The goal at inception was to create 100 libraries but given the needs that we saw emerge once the library project was well underway, the Bank has established more than its targeted number, with 145 libraries established to date. The initiative was subsequently expanded to computer literacy as well, with the donation of 25 computers to selected schools to facilitate more knowledge gathering among the future generation, equipping them with the tools required to become sustainably employed. The investment includes refurbishment of buildings, donation of books and provision of equipment, furniture and fittings. Now working on a needs-analysis, the Bank continues to add to the project to establish a more wholesome, holistic environment for more knowledge harnessing for students.



This year, the Bank added to its library impetus with the following:

Libraries completed	31
Libraries under construction	5
Libraries equipped with books	145
Libraries equipped with computers	25

We are also in the process of producing a documentary on this project with which we hope to publicise and gain more support for the project so that we will have a more inclusive community approach to this very worthy initiative.

The long term benefits we envisage from the Nana Pubuduwa project, which was accorded a merit commendation at the Best Corporate Citizens' Awards 2008 organised by the Ceylon Chamber of Commerce are to:

- Improve literacy levels
- Stimulate a continuous passion for reading and learning
- Create an Information Technology enabling environment for students who would otherwise not have the opportunity
- Improve English literacy
- Create opportunities for higher education and employment
- Facilitate increased and sustainable income which will uplift the community
- Inculcate savings habits and entrepreneurial skills

**Lowa Dinana Singiththo – Investment Rs 10 Mn**

Developing holistic individuals, we believe, will add significant value to the future path of the nation. While we assist academic high achievers through scholarships, libraries and computer literacy programmes, we also believe that all skills and talents inherent in children must be honoured and used for this development. Together with the Ministry of Education, the Bank organized country wide competitions among



students encouraging achievements in extra curricular aesthetics.

Categorized by age and district and culminating in all island finals, students were encouraged in art, essay, short story writing, speech, singing and drama, showcased in all three languages. An independent panel of judges from the Ministry of Education selected winners at district level and at national level, with winners being awarded cash prizes and certificates. One of the most significant highlights was that each all island individual winner in the A/L classes, was awarded ten points towards his or her university entrance Z score. An added incentive was that the Bank selected the best entries in the art competition for its annual greeting cards for 2008.

**Rewarding Young Achievers**

Given the 4,395 strong team at the Bank, we are very aware of the challenges faced by some members of our Hatna Team in ensuring that their highly talented promising children are given an avenue to pursue higher education and attain the goals they could easily achieve, if the opportunities are granted to them. On an initiative begun last year, and continued this year, the Bank rewarded high achieving team members' children with scholarships, which would aid them in continuing their university studies. Identifying those who have excelled in the competitive state examinations, the Bank granted 5 scholarships during the year to high scoring students who were earmarked for university.

**Contributing towards better health**

**Safe Drinking Water and Sanitation Project – Investment Rs 5 Mn**

Aligned to the Millennium Development goals as per the United Nations Organisation, the Bank took upon itself the task

of assisting the goal of safe drinking water and sanitation. One of the most critical health issues prevailing in Sri Lanka is bowel disease instigated by unsafe drinking water, most prevalent in rural villages with little or no access to safe and hygienic drinking water.

The village of Siruthopu in Mannar was the Bank's pioneering safe drinking water project which has touched the lives of 75 families. The village houses resettled families who were affected by the tsunami and the war and the only source of water to the village previously was a single plastic tank refilled by a bowser periodically, most often unsafe for drinking and the cause of numerous water borne diseases. The Bank constructed a well and a water tank with six taps within the village center for the villagers to have access to safe drinking water.

In October this year, the Bank assisted the area of Mavillaru in Muthur by dredging 125 wells. This area houses about 125 families who have been resettled in their own homes and had a dire necessity for a safe drinking water source. The Bank undertook the speedy clean up and dredging of the wells in just two days ensuring that the families were given a quick solution to their unsafe drinking water problem.

The village of Araly in Chunnakkam houses 750 families, most of them farmers whose demand for fresh safe water is often not met. The danger of salt water intrusion into their only source of drinking water due to over irrigation, a common problem in that part of the country, added to their woes. With the problem highlighted by the ADB two years ago, the Bank in partnership with the National Water Supply and Drainage Board identified another fresh water source and constructed a large well connected to a water tank, to meet the village's needs of water.

Similar projects are underway in Puttalam, Anuradhapura, Vakara and Kataragama.

#### **National Cancer Institute, Maharagama – Investment Rs 2 Mn**

The Cancer Counselling Center in Maharagama which was a project initiated by the Bank in 2007, continues to receive the support of the Bank. The Center, which was fully equipped with modern facilities by the Bank, fulfills the need for trauma counseling, vital for cancer patients and their immediate family members visiting the single largest national cancer institute in Sri Lanka. The project is partnered by the Maharagama Cancer Hospital doctors with support from the Royal Marsden Hospital UK, through short training courses as a value addition for doctors and nurses imparted by the London Counselling Center.

Further, additional assistance will be provided by the Bank to renovate and maintain the entire male Surgical Ward at the Cancer Hospital.

The Bank's proposal to set up a Trust Fund for the benefit of supporting the families whose sole breadwinner is afflicted with cancer is well underway with a trust being setup within the Bank's overall CSR Trust.

#### **Giving Back to Our Elders – Investment Rs 200,000**

The Bank continued its commitment to the Share Foundation, a community nursing initiative that assists in improving the quality of life of the elderly and incapacitated in their own homes. The Bank's investment in this project is continuing to fund the work of two nursing sisters attached to the Colombo - Kotahena and Anuradhapura - Allagollawa Community Centers.

#### **Dengue and Chikungunya Prevention – Investment Rs 160,000**

The Bank continued to partner the Colombo Municipal Council in the current year as well to conduct awareness programmes within Colombo for the prevention of the sometimes fatal Dengue and Chikungunya diseases. The Public Health Department of the Colombo Municipal Council, on a private-public sector partnership project with the Bank, initiated a disease control programme titled 'No to D & C Campaign'. The effectiveness of the awareness campaign was considered extremely successful in its first year with Chikungunya almost eradicated and the incidence of Dengue reduced by 56%.

#### **Training Veterinary Professionals – Investment Rs 75,000**

Having embarked on an animal sterilization and anti-rabies drive last year, the Bank laid a firm foundation to continue its intervention in animal welfare, as it ultimately concerns the health of the community as well. This year, the Bank sponsored a training programme for veterinary professionals in partnership with the Society of Companion Animal Practitioners of Sri Lanka.

#### **Blood Donation Campaigns**

Under the aegis of the Deputy Director of Health Services and the Blood Bank of the General Hospital in Kandy, the Bank's Kandy branch initiated a blood donation campaign to be of assistance to injured servicemen and other patients who are in dire need of blood. 195 donors including team members,



customers and well wishers participated in the campaign, notching the largest donated amount in the Central Province.

This year too, the Bank's Head Office organized a Blood Donation campaign in aid of the Blood Bank of the Cancer Hospital. 184 donors including tenants of HNB Towers participated with great enthusiasm.

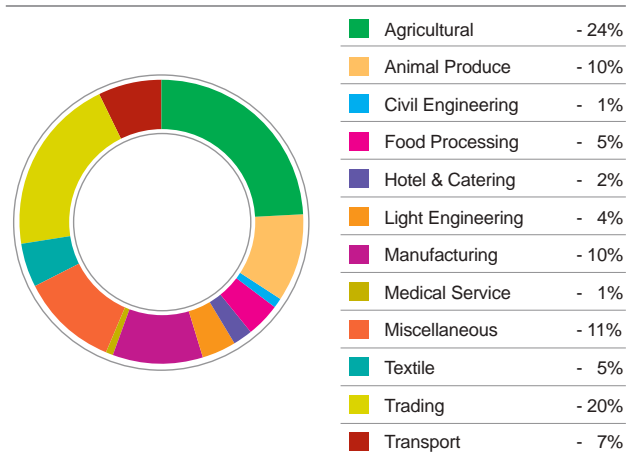
#### Village Empowerment - Gami Pubuduwa

Our award winning sustainable development project that will eventually be a vital cog in the wheel of developing the rural economy, Gami Pubuduwa, completed 19 years of operations in Sri Lanka. Based on the philosophy of developing poverty stricken villagers by recognising and encouraging their inherent talents and skills, Gami Pubuduwa has todate touched the lives of numerous families through over 70,000 projects since its inception in 1989. Recognised via numerous awards for its sustainability flavour in empowering and reawakening communities that are considered non-bankable, including the Winner in the Special Projects category presented by the Ceylon Chamber of Commerce at their Best Corporate Citizen Awards, the fundamental trusses of the programme are to partner villagers with funding, skills and community development, build sustainable relationships between the Bank and the community and contribute towards micro sector sustainability through technical advice and assistance.

Total Number of Projects completed - 75,400  
 Total Financing of projects - Rs 5.1 Bn  
 Existing portfolio caters to - 14,053 Project loans  
 NPA Rate maintained - lower than 5%

GAMI PUBUDUWA REVIEW 2008		
Sector	No of Loans	Portfolio Rs'000
Agricultural	3,388	439,077
Animal produce	1,396	132,185
Civil Engineering	201	52,377
Food Processing	628	108,264
Hotel & Catering	304	62,975
Light Engineering	542	112,448
Manufacturing	1,451	290,452
Medical service	96	24,760
Miscellaneous	1,498	288,227
Textile	725	105,395
Trading	2,812	464,327
Transport	1,012	150,205
<b>Grand Total</b>	<b>14,053</b>	<b>2,230,692</b>

Gami Pubuduwa Review - 2008  
 Sectorwise Distribution of Number of Loans







## Sustainability Report

# Environmental Relations

Our focus on environmental sustainability although slower to get off the ground in the recent past, has now gathered momentum. Having concentrated with vigor on our community development initiatives which we felt was a vital aspect in the empowerment of the rural economy, the Bank is now turning towards bettering its environmental footprint. As a responsible corporate citizen, we are cognizant of the responsibility we must display in being a leader in better environmental practices and conservation.

### Energy Efficient Buildings

The HNB Tower incorporates revolutionary technology which includes variable air volume units to control temperature, a demand controlled ventilation system with an energy saving feature, an intelligent microprocessor that detects necessary levels of illumination and energy efficient exterior features.

### Constructing Green Buildings

Having already constructed the HNB Tower as one of the most energy efficient buildings in Colombo, one of our biggest and most ambitious plans in our eco-framework in the next few years is to initiate our very own 'Green Building' in Nittambuwa.

Having already established a benchmark in energy efficiency for high rise buildings, we aim to add those synergies into our new Green Building as well. We have already sourced the services of two renowned eco-architects to assist us and hope to complete the building by 2010. LEEDS Certification is also envisaged on completion.

We also have plans of working on the construction of two more 'Green' buildings with completion dates set in 2011 and 2012.

### Permeating Eco-practices

#### Garbage Disposal

The recycling project espousing systematic garbage disposal at HNB Tower continues with added impetus with the best practices also permeating our rental clients who have also bought into our recycling tenets. Garbage collected throughout the building is sorted for recycling and dispatched to recycled paper and plastic manufacturers.

#### Paper Waste Management

We also continue our paper waste management initiatives with the best practices now being cascaded across our branch network as well. Printouts and photocopies must be double sided, communication should, as is practically possible, be



done via the intranet or online. The Virtual Branch which has a significant number of customer usages will be revamped next year with more facilities and brought in line with the new Core Banking solution. Further we have introduced more core modules into our E-Learning System thus reducing the paper usage in training materials.

## Combating climate change

While our recycling processes are aimed at combating some negativities that trigger climate change, as reported in our Sustainability Report of 2007, the Bank's response to climate change is four-pronged. Our aim is to ensure that our stakeholders too become a part of this initiative. Issues like climate change require collective responses for successful results.

- With our customers, we wholeheartedly encourage and promote responsible lending practices

- Continuous workshops, programmes and communication with the Hatna Team to increase awareness about climate change, the triggers and the solutions that each person individually and as teams can engage in
- For our suppliers, we plan to introduce a formal mechanism to assess their environmentally friendly practices and also strive to increase their sensitivity to environmental issues.
- Constantly engage in climate change initiatives with our stakeholders to educate ourselves on the issues pertaining to the earth's future and also to permeate the knowledge we have garnered to others.



## Sustainability Report

# Employee Relations

### HNB as a Caring Employer

Caring for our people is a fundamental in our culture and one we strive to espouse because it is our people who harness our strengths to give us the impetus to embark on our journey of winning. One of our guiding principles is to develop the best people in the industry, a process that involves seeking, developing and retaining the best talent in an intensely competitive industry. We thrive on our diversity, on our multi cultural platforms and the dimensions these infuse into meeting our goals. A wide range of learning, development and leadership programmes that holistically encompasses the fundamental tenets of a non-discriminatory environment that promotes dignity, respect, self worth and equality give the Hatna Team an edge over competitors and a definite advantage in creating a winning team.

#### 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

### 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

### HR Objectives

- Ensure fair and lawful treatment of all staff and implementation of non discriminatory work practices
- Create an exciting work environment for our team where rewards are performance-driven and individual potential realized
- Ensure excellence of our HR processes to retain our position as a preferred employer
- Foster creativity and learning to develop a highly skilled, service oriented and efficient team that thrives on new challenges
- Ensure that each and every staff member is embraced into the Hatna Family and inculcate the culture of unity in diversity



## HR Business Model



People power is what the Hatna Team thrives on! A winning team - 4,395 in total are driven by motivation, dynamism, inspiration and a winning formula that collates a host of tenets pertaining to learning, applying and growing an entity with individual ability and skill at its center. Ours is a people based culture that employs equality, meritocracy, a participatory interactive approach and an inspirational milieu that encourages teamwork, entrepreneurial spirit and individual spark. We promote innovation and creativity, out of the box thinking and a knowledge gathering environment which instills a life long learning culture.

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.

During the year the Bank received the Gold Award (Super 10) at the HRM Awards 2007 for the most effective HRM methods and techniques organised by the Association of Human Resources Professionals.

### An Ethical Employer and a Value Driven Employee

We value honesty and integrity in everything that we do. We conduct our business responsibly and in compliance with local laws and regulations and international best practice and stress on the need to uphold the highest standards of ethics and values. An official Code of Ethics is presented to all new entrants together with their letter of appointment, detailing our core values.

Any violation of professional and personal ethics is dealt with seriously by the management and appropriate punishments sometimes culminating in the termination of employment are meted out.

## The Hatna Team Drivers

- Creating a culture and an understanding that emphasizes individual and organizational growth which includes continuous professional development, acquisition of skills and capabilities and managing attitudinal and transformational change.
- Implementing a measurement based performance driven culture with rewards and career progress linked to performance.
- Creating a sense of ownership to inspire individual career aspirations towards alignment with organizational vision with a participatory bottom-up management framework aiding the process. The SEARCH suggestion scheme which acknowledges and enables status reviews of all ideas forwarded with gift incentives for suggestions, Quality Circles, In-

house publications and Cross Functional committees representing the team at all hierarchical levels give impetus to this.

- Continuous learning and development on and off the job assisted by a comprehensive Skills Inventory and regular Performance Appraisals which identify strengths, weaknesses and avenues to bridge gaps.
- Harnessing a cordial relationship through harmonious industrial relations and assisting team members during crisis.
- Identifying the Best Customer Centre region-wise to aid the concepts of leadership, teamwork and high productivity.
- Creating an enabling environment by providing staff quarters to those working in areas where lodging facilities are scarce.

## 2008 e-initiatives in HR

- Hosting of the e-learning system on the internet enabling staff to access the learning modules in the comfort of their homes
- Administered an online examination on the salient features of Anti Money Laundering /

Know Your Customer policies for all staff from Corporate Management to new recruits

- Fully automated interactive payroll system for overtime, claims and other benefits
- Online recruitment at entry level
- Online booking facility for holiday bungalows

## IMPLEMENTATION OF 5S STANDARDS

To promote a philosophy of continuous improvement and empowerment of our staff leading to a more productive and comfortable work life, we are in the process of implementing the principles of 5S - Kaizen in our customer centers. To date the system has been successfully implemented in 60 customer centers and we intend to implement it across our entire network and head office divisions in 2009.

## HR INFORMATION SYSTEM

Harnessing the synergies we possess within the Bank, the Human Resource Division implemented a host of innovations and value additions into our operations and workings to ensure a smooth functioning of the HR function as well as ensuring that our Hatna Team is given the appropriate environment to work as an effective team with clear goals in focus. We have used Information Technology and revamped our processes for added impetus into these initiatives.

Striving to provide the highest level of efficiency with which data on employees and HR activities is compiled and maintained, the bank has automated its HR activities and record-keeping processes. With a view to enhancing speedy solutions as well as quick delivery of HR services, an initiative has been taken to further improve this facility with a revised system that would increase productivity and user friendliness and be a lively and interactive tool. All functions of the HR Division will become predominantly on-line paving the way for speedier and more accurate decision making based on reliable information.

## ENGAGING AND RETAINING THE BEST

Recruitment at the Bank is a concerted process, one that employs much thought to ensure absolute success. Recruiting the right person for the right job and retaining those skills for the future journey of the Bank is a challenge in any HR division,

but given the winning team we have nurtured over the years, our processes have undoubtedly proven that our HR fundamentals are appropriate to meet the challenges of our times.

Recruitment and selection is based on organizational needs and specific recruitment and selection criteria including qualifications, experience, external and internal examinations, assessment interviews and aptitude tests. Personnel are selected from among internal and external candidates depending on specific needs. Recruitment is followed by a comprehensive induction, while placement is determined by the relevant committee appointed for the task of assigning and periodically rotating and transferring staff in accordance with the needs of the Bank.

The process of external recruitment has been improved in 2008 with the introduction of an online system through a homegrown site. The online process has facilitated faster recruitment with technology replacing human intervention for identifying candidates eligible for the positions advertised. It is also proposed in the forthcoming year to introduce an online system of examinations for candidates and exploiting technology in the interview and appraisal process. This improvement will enable the HR Division to address staff requirements in a more efficient manner in 2009.

As one of the founder members of the "Employers network on disability" founded by the Employers Federation of Ceylon, together with the International Labour Organisation (ILO) we are committed to the Code of Good Practice on the employment of differently able people and each year we strive to increase the number of such recruitments.

## LEARNING & DEVELOPMENT

Given our focused emphasis on creating and nurturing a knowledge gathering culture, not only in an academic or theoretical sense, but in developing a holistic individual and



team that will add value to the organization, the Learning and Development culture we have instigated within the Bank drives the Team to constantly imbibe their thirst for knowledge. Through focused training programmes, this knowledge building culture is constantly driven upwards, with the Annual Training Needs Analysis and Annual Training Plan forming the basis of continuous development.

A Continuous Professional Development (CPD) system is infused into the process of learning where those at the clerical and supervisory levels could further acquire knowledge on an on-going basis. Efficiency Bar Examinations provide the opportunity for team members to continuously update their knowledge levels, sit for in-house examinations and acquire CPD points which are linked to their promotions to higher grades.

Our fully-fledged in-house Training Centre equipped with some of the most modern equipment and training facilities is the primary foundation in building our knowledge culture. In addition, overseas training opportunities are availed to those executives and managers with the aspirations of developing further skills, while external and internal training programmes are integral to our HR calendar.

A Training Management System linked to the Performance Management System analyses specific training needs and helps HR to develop a focused facilitative approach to ensure that the right skills are made available to the right people at the right time.

E-learning took on newer dimensions with more value additions, which included the facet of team members being able to access the learning modules from the comfort of their homes.



Multi-skilling is one of the fundamental principles in our training focus and permeates all levels within our team.

Penetrative training programmes that impart appropriate skills in shorter time frames to our new recruits are a relatively new initiative that has seen much success. There has been a marked increase in better service delivery levels through these accelerated programmes which we intend to continue developing as a primary training feature.

30 Managers with potential for progression were identified to follow a focused programme on Management Development at the Post Graduate Institute of Management. This programme is to be continued in 2009 and we hope to include assistant managers as well. Customized management programmes were also implemented for managers and assistant managers.

As a bank, our business can be sustained only through the relationships we build. Firmly committed to a culture of service, we sought to improve our service skills through the implementation of a series of programmes on effective communication and public speaking. In addition to building confidence of the participants, the course helped to instill our values of courteous service as well. In addition we continued our emphasis on building our customer service platforms towards excellence, with customized customer care programmes coordinated by a renowned external trainer. The unique features of this programme were that entire teams from selected customer centres participated at the same time and in most instances the training was carried out at a regional location convenient to the staff.

Small and Medium Enterprises (SME) lending, which now forms a truss in our social responsibility banking segment was given further impetus with comprehensive five day training

Training & Development	2006	2007	2008
Training & Development Cost (Rs Mn)	82.2	87.4	104.4
Training & Development Cost / Employee (Rs '000)	19	20	24
T & D Cost as % of Personnel Expenses	2.9%	2.7%	2.9%

programmes imparted by an international expert for managers and credit officers.

With the support of the International Finance Corporation, a course on Bank Lending was launched. The programme was based on the international Credit Skills Assessment of the Omega Credit Skills programme. During the first year, 12 of our Account Relationship and Customer Centre Managers successfully completed the programme and were awarded internationally recognized certificates. This programme will be continued in 2009.

With a view to promoting responsible health care comprehensive 3-day programmes on Health and First Aid were conducted.

Training in IT was stepped up in 2008 and was twofold. Training on the new core banking solution (details of which appear on page 36 of this report) and improving IT literacy as a step towards encouraging more online communication amongst our team.

### New Modules Incorporated into Mainstream Training in 2008

- Management Development programmes
- Effective communication and public speaking
- Specially customized Customer Care Programmes
- Omega Credit Skills Assessment
- First Aid & Safety

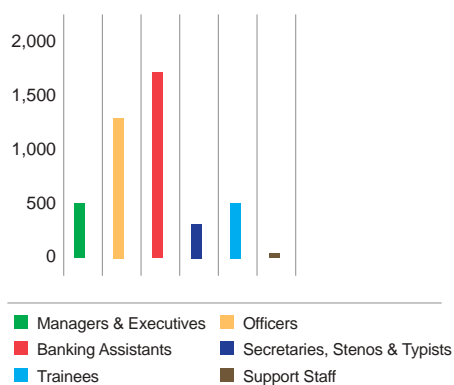
## PERFORMANCE MANAGEMENT

An expressed measure or level of achievement in the context of prescribed aspects including work quality, meeting time schedules, cost effectiveness and achievement of objectives are the broad examples that constitute the performance management initiative of the Bank. Executive and managerial levels work through an online system based on the Balanced Scorecard, quarterly appraisals, performance tracking and final evaluation which ascertains measurable goals achieved during a particular year. Qualitative assessments govern the specified competencies, while performance reviews are accompanied by appraisal interviews, which assess strengths and weaknesses, action plans for improvement, rewards, increments, bonus and promotions. Other levels are appraised through a 180 degree review where self assessment, defining action plans to bridge deficiencies in performance and appraisal interviews make up a transparent performance appraisal process. Trainees' performance is tracked once every two months, while probationers are tracked monthly.

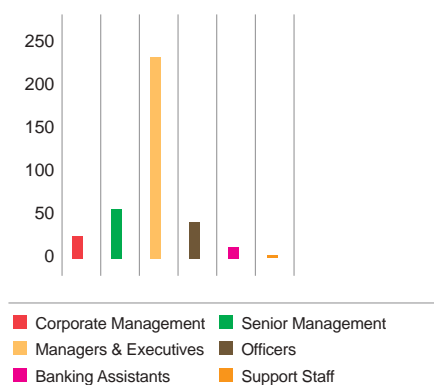
## COMPENSATION, BENEFITS, REWARDS, RECOGNITION

A vital facet in achieving career aspirations, career development at the Bank is a continuous process in a team member's work life and from the Bank's perspective it is a clear path to developing and retaining talent. Through the well integrated Performance Management system, HR is able to align performance with career development and fit it into the annual business planning process. Agreed Performance Statements are used to translate corporate priorities, values and behaviour to the workplace and provide clarity about role and responsibility expectations, as well as the skills required to

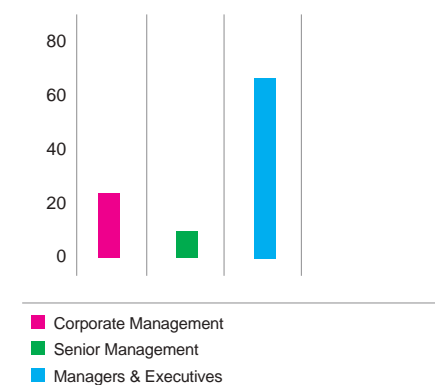
In-house Training



Local Training



Overseas Training





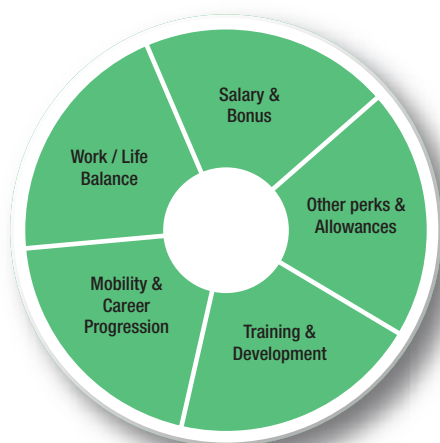
meet those career aspirations. Regular and ongoing feedback is also a key feature of the system.

The formal awards and recognition programme is a central point in rewarding good performance and high achievers. The annual awards ceremony recognizing excellent teamwork in the customer centres, best customer centre performances and other selected areas of performance is a much looked forward event in the Bank's internal calendar. In addition, long serving team members counting over 25 years service are also recognized for their loyalty and total commitment in enriching the Bank's journey over the years.

Succession planning is aligned to the Bank's structure, transformations and business processes, harnessing talent that will add value to the ultimate vision of the Bank.

There is a clear demarcation between compensation and performance driven pay to variable pay. Benefits cover a wide range of perquisites including medical facilities, vehicles, fuel allowances and entertainment. A broad scheme encompassing loans at concessionary rates of interest is also in place for staff members.

In 2008, the entire payroll process went online, with team members now able to view and claim allowances and other benefits through this fully automated process.



Staff Welfare	2006	2007	2008
Staff Welfare Cost (Rs Mn)	73.7	72.6	103.2
Staff Welfare Cost per employee (Rs '000)	17	17	23
Staff Welfare Cost as a % of Personnel Expenses	2.6%	2.2%	2.9%

### Communicating Frankly and Openly

A participatory style of communication pervades the entirety of our employee relations. Small team meetings, review committees on a number of facets like general problem solving, customer service and business development are held periodically, with cross sectional meetings also adding flavour to the subjects at hand. Monthly staff meetings are also mandatory. Our open door management style permeates from the MD / CEO. Always accessible, this is a practice that has been instrumental in giving all team members a platform to air their views with their immediate management superior and subsequently, if the need arises, up the hierarchical chain. Besides this, a formal grievance procedure is also established.

'Search' is a suggestion scheme that encourages team members to give their ideas and suggestions for the improvement of the Bank and also inter-team relations. These are discussed and analysed periodically and implemented according to practicality.

The in-house magazine 'Hatnamag' is issued quarterly with Management and staff contributing towards the content.

The HR Newsletter – Tidings - is also issued quarterly to keep our members abreast of the latest HR news. The newsletter not only informs staff about latest developments in HR but also lists useful information such as details of Circulars issued during the period, information of training programmes and also serves as one of the platforms in which the achievements of our team members are commended.

In an effort to further improve communication within the organisation, from this year, HR managers accompany regional managers on branch visits to gain experience and knowledge of the ground realities first hand. This has created a firm foundation of trust and commitment on all facets as team members now have the opportunity to interact with the Head Office on their personal matters on a one to one basis.

### Industrial Relations

Adhering stringently to the internationally accepted International Labour Organisation (ILO) labour practices and standards as well as other relevant regulations applicable to Sri Lanka, given our service fundamentals, industrial harmony is crucial for the smooth functioning of the Bank. Our learning, applying, growing and winning fundamentals have been implemented into the very ethos of our industrial relations and it is this that has ensured that the Bank has cordial relations with the respective unions and their representatives. The continuous dialogue we have established with the Unions, the





open door discussions, the transparent and accountable processes have all added up to an environment of complete industrial harmony.

### TEAM SPIRIT NURTURED

The Bank has always espoused the advantages of team spirit and togetherness as the winning recipe for success. Team building however, is not simply on knowledge levels but encompasses a variety of holistic features that help build a healthy united cohesive team who will have the camaraderie, friendship and loyalty over and above the call of duty. Extra curricular activities, recreational efforts and talent spotting are all encouraged, with family days, sports meets, festive and religious events as well as excursions organised to nurture and strengthen the bonds. This promotion of extra curricular and recreational activities has in fact given the Bank much prominence in external arenas given the honours that the large number of national and internationally recognised sportsmen and women of the Hatna Team excel in.

The Bank remains acutely attuned to team welfare as well, ensuring that the work environment is ergonomically designed to enhance productivity, a sense of belonging and also high levels of comfort. Ambience, lighting, ventilation, sanitary care, restaurants, drinking water, staff quarters and holiday bungalows are all welfare measures available throughout the year. In fact, while staff quarters were available to team members at a subsidized cost in the past, from this year, accommodation within the quarters is free to any team member requiring it.



Taking the concept of the Hatna family further, the Bank extends financial support for medical care to immediate family members of our team in respect of critical or serious illnesses. The employees' children scholarship scheme initiated last year successfully disbursed 5 scholarships in 2008 for those who have excelled at district level at the GCE A/L examination. Taking care of the children of our deceased staff members, the Bank has awarded scholarships to 13 children. This scheme supports the children until they complete their Secondary Education. The Bank also completed construction of a home for the family of Palitha Rupasinghe, a Member of our Support Staff, who met with a fatal accident.

### The future of HR

The dimensions of HR will transform to become more inclusive, proactive and have more interaction using IT. HR will become a true professional business partner in the formula of learning, applying, growing and winning contributing through strategic thinking, consultancy skills, relationship management, expert networking, business and financial comprehension and change management.



### Our high flyers

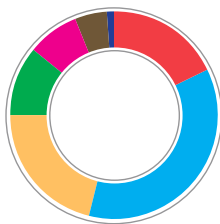
Our emphasis on developing holistic individuals is amply demonstrated with the high flyers mentioned below:

- HNB Toastmasters' Club was awarded the prestigious President's Distinguished Club Award for 2007/8, achieving all ten goals stipulated by Toastmasters International USA
- HNB won the Overall Championship at the Inter Bank Student Quiz competition organized by the Institute of Bankers of Sri Lanka
- Mohan Chandana Gamage of HR was awarded two Sri Lanka Prizes by CIM UK, for the Best Performance in the Professional Certificate in Marketing subjects of Marketing Environment and Marketing in Practice

- W T Ridmika Dep, Legal Officer from the Credit Supervision and Recoveries Department obtained the highest overall marks for Insurance Law at the Post Attorney Diploma in Banking from the Sri Lanka Law College

We also recognise with pride the achievement of our MD / CEO Rajendra Theagarajah who was elected Vice Chairman of the Asian Bankers Association for 2009/10. In addition, he has been featured in an international corporate digest titled, 'Asian Banking CEOs – the Future of Finance in Asia'.

Age-wise Analysis of Employees



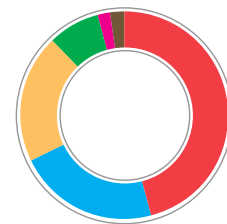
18 - 25	18%	25 - 35	36%
35 - 40	21%	40 - 45	11%
45 - 50	8%	50 - 55	5%
Over 55	1%		

Gender-wise Analysis of Employees



Male	63%
Female	37%

Servicewise Analysis of Employees



upto 5 Yrs	46%	5 - 10 Yrs	22%
10 - 15 Yrs	20%	15 - 20 Yrs	8%
20 - 25 Yrs	2%	Over 25 Yrs	2%



## Achievements in Sports

### Hockey

- Mercantile Hockey League 2008 Champions
- Mercantile Knockout Champions
- Mercantile Annual Seven A Side Hockey Tournament – Runner Up

### Football

- Mercantile League Tournament Champions

### Badminton

- Mercantile Individual Open Badminton Championship – Overall Champions;  
Men's Doubles - Champions  
Mixed Doubles - Champions
- Mercantile Inter - firm Badminton Team Championship – Runner Up;  
Men's 'A' Division - Runner up,  
Women's 'A' Division - Runner up
- 56th National Open Badminton Championship  
- Men's Doubles Champions  
- Women's Doubles Champions

### Athletics

- Mercantile Athletic Championship 2008  
– Women's Overall Champions,  
– Amateur and veteran Champions

### Netball

- Sportsline.com Challenge Trophy – Runner Up
- Western Province Netball Tournament – Runner Up
- Open Club Netball Tournament – Champions
- Super League Netball Tournament – Runner Up

### Basketball – Men

- Mercantile Semi League Tournament – Runner Up (B Division)
- Mercantile Knockout Tournament – Runner Up (B Division)

### Basketball – Women

- HNB Sponsored Mercantile League Tournament – Champions
- Delmege Sponsored Mercantile Knockout Tournament – Runner Up



## Sustainability Report Investor Relations

Our investor relations are not simply about creating wealth for our shareholders but are built on a long term partnership that uses the synergies of both partners to ensure a winning relationship. In our years as a leader in the banking industry, we ensured that our goals have always been met, that our compliance facets are always beyond the norm, that our thrust in business is pragmatic but governed by the principles of governance, ethics and integrity and that our astute management strategies and timely decision making is meant to always instill confidence in our partnerships and lay a sustainable foundation for our business growth.

We are the only Sri Lankan bank to date to have Global Depository Receipts (GDR) listed outside Sri Lanka (on the Luxembourg Stock Exchange) and among our very firsts, we are counted as the first private commercial bank to introduce housing loans, the first to brand a product and the first to introduce pawn broking services, customized credit cards and affinity cards. The fact that we have been honoured by the industry both locally and globally for our efforts speaks for itself. Now considered a Superbrand, the Bank this year too etched further confidence among its stakeholders by winning several awards.

### BUSINESS EXCELLENCE

- Excellence in Retail Financial Services - Asian Banker Awards 2008
- LMD 50 Leaderboard of Top 10 Companies
- Business Today Top 10
- “National Business Excellence Awards 2008” presented by the “National Chamber of Commerce of Sri Lanka”
  - Overall Winner - The National Business Excellence Award 2008 (Gold)
- Winner : Award for the ‘Excellence in Business and Financial Performance’
- Winner : Business Excellence Award - Extra Large Category
- Winner : Business Excellence Award - Banking & Financial Sector
- Runner up : Award for “Excellence in Best Performance Management Practices”
- Most Productive Network of Locations - awarded by Moneygram International Inc.



But over and above the honours and recognition, what is most salient is that the Bank has combined its winning formula with judicious strategies to overcome a very challenging environment that was faced by the entire industry this year. Whether it was the global meltdown that permeated the country or Sri Lanka's milieu of high interest rates, inflation and economic instability, the Bank, using its prudent risk management policies, good decision making and extensive reach, posted a good growth curve and significant results against this unfavourable backdrop. Innovation and creativity also formed a part of this winning platform where customer centric strategies, an extensive product portfolio, adherence to standards and infusion of best practices were further inbred into our everyday operations, instilling unfailing investor confidence in the short and long term.

#### Strategic Review Workshop

The corporate management team led by the MD / CEO worked together to review and revalidate the strategic focus of the Bank taking into consideration the dynamics of our operating environment and global trends. Our Corporate Balance Score Card is constantly revisited and evaluated to identify the appropriate critical success factors relevant to the present environment and this exercise like in the previous years focused essentially on ensuring a sustainable milieu for all our stakeholders.

#### Exchange Houses

Sri Lanka in the recent past has witnessed a growing inflow of remittances into the country from migrant workers. In order to facilitate this income flow, the Bank opened its first exchange house in Oman named Majan Exchange LLC in 2008. Similarly we have just completed regulatory formalities for two more similar operations in the UAE and Canada. These exchange houses will not only concentrate on remittances to Sri Lanka but also to the entire Asian Region.

#### Indian Operations

The Bank signed a Memorandum of Understanding with the City Union Bank of India and now awaits regulatory clearance to commence investment banking operations. The new investment bank operation will mainly concentrate on fee based income. This would give the Bank an opportunity to enter the Indian market with minimum amount of capital and manageable risk.

#### Acuity Partners

Continued pressure on interest income has emphasised the need to increase fee based income sources of the Bank. In light of this HNB and DFCC entered into a joint venture to bring together stock broking, fixed income securities and investment banking capabilities of both banks under a single umbrella. Accordingly Acuity Partners (Pvt) Ltd was incorporated to consolidate the resources and expertise of both the banks.



### KNOWLEDGE MANAGEMENT

- HRM Awards 2007 – Super 10 - Gold Award – for the most effective HRM methods and techniques organised by the Association of Human Resources Professionals
- National Software Quality Awards 2008 – Bronze – for “Research & Development” – for KPI Wizard System
- National Software Quality Awards – Bronze – for design and development of a software solution to facilitate remittances from Sri Lankan migrant workers

### FINANCIAL REPORTING & GOVERNANCE

- 3 Awards at the Annual Report Competition held by the Institute of Chartered Accountants of Sri Lanka

- Banking Sector - Silver
- Corporate Governance Disclosure - Silver
- Corporate Social Responsibility - Bronze
- South Asian Federation of Accounts (SAFA)
  - Banking Sector - Best Presented Accounts - Silver

### COMMUNITY IMPACT

- Ceylon Chamber of Commerce: Best Corporate Citizens Awards 2008, Special Projects category – First Place for Gami Pubuduwa Micro Finance project
- Ceylon Chamber of Commerce: Best Corporate Citizens Awards 2008, Special Projects category – Merit Award for Nana Pubuduwa school library project



Legend's Thangajath  
Managing Director CFO



## RESILIENT BANKER



Sri Lanka's relative economic resilience to global financial turmoil is a plus.

**Q:** How is your company faring under prevailing macroeconomic conditions?

**A:** HNB continued its growth momentum in 2007 despite many obstacles in the operating environment, recording post-tax profits of 46 per cent – an almost identical increase over the past three years.

Continued focus on asset quality, sound liquidity and a disciplined approach to cost management contributed to these results.

**Q:** What expectations do you have of your company's performance this year?

**A:** Our priorities are to ensure that the newly acquired one banking system is effectively implemented across the board, continue to build our resources in risk management and focus, in one people, what has been the backbone of our success. This year will be one of considerable but not excessive growth in the balance sheet on the back of improved asset quality, a stable deposit base and improved capital adequacy ratios.

**Q:** What are your company's future plans, especially in respect of business expansion?

**A:** HNB has demonstrated its business resilience in varying economic conditions in the past, relying on a combination of strategies to ensure sustainable growth momentum.

We will continue to be selective in organic business development, with a preference for lower cost, higher and SMEs, hence drive expansion in the rural and leverage the benefits of infrastructure development projects in the rural.

Internationally, building our institutional banking franchise in emerging economies over the medium term is a key priority. On the back of a strong strategic alliance with India, we are assessing entry into other markets. We also continue to aggressively grow our real estate base with a view to positioning ourselves as a global player.

**Q:** What progress, if any, is the industry of which your company is a part making at present?

**A:** The banking sector is robust and has emerged relatively unscathed despite global credit and capital flows. The flip side of being perceived as a better performing industry has been the high bid-ask spread of around 100 per cent of our price on stock, impacting on price realisation and future capacity building. Industry growth continues to be hampered by a lack of consolidation and requires urgent attention from regulators, as scale is a prerequisite to becoming globally competitive.

**Q:** What CSR activities does your company currently engage in?

**A:** As a pioneer in lending to the micro-finance sector, we have been successful in helping over 70,000 rural entrepreneurs over the last two decades through the 'Nava Patalana' programme.

We are now exploring the possibility of taking this initiative to the next level through an operational strategic alliance.

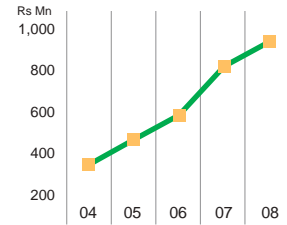
The 'Nava Patalana' scheme, building 100 schools for village schools, is another example of focusing on the social fabric of our country – using the tools of empowerment and infrastructure to build corporate citizenship.

**Q:** How do you view the country situation at present?

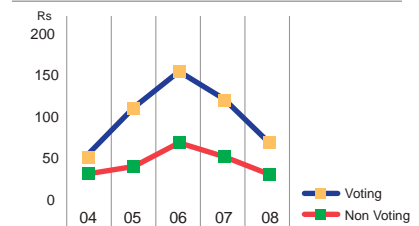
**A:** Sri Lanka's relative economic resilience to global financial turmoil is a plus, while prospects for an early transition to the euro zone are positive. However, considerable pending policies, coupled with strong regulations, will bolster into the financial sector to withstand difficult times.

Among the negatives are the effects on the export industry, such as shortage and inflation rates as well as inflation, which we further exacerbated by a rise in global commodity prices.

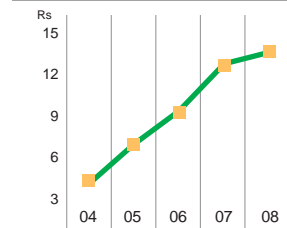
### Gross Dividends



### Share Price

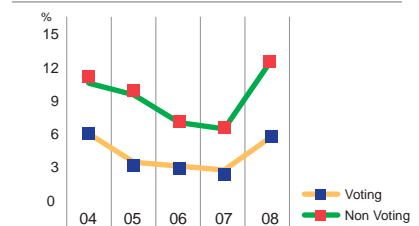


### Earnings Per Share

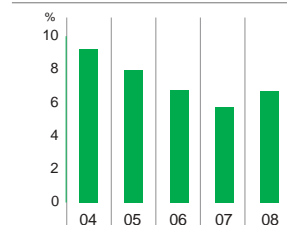


\* Earnings per share has been adjusted for existing number of shares issued

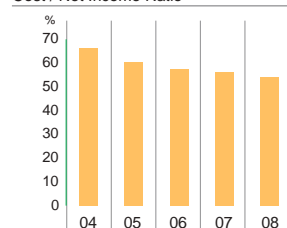
### Dividend Yield



### Gross NPA Ratio



### Cost / Net Income Ratio



### Indicators depicting HNB's sustained growth over the last five years

	2004	2005	2006	2007	2008
Earnings per Share (Diluted) (Rs)	4.15	7.02	9.43	12.83	13.67
Dividend Yield (%) - Voting	6.14	3.56	3.21	2.86	5.73
Dividend Yield (%) - Non Voting	10.69	9.64	7.14	6.57	12.50
Assets Growth (YOY) (%)	14.59	8.66	18.11	18.79	9.60
Holding Period Return - Voting (%)	(10.29)	104.39	42.89	61.80	(39.80)
Holding Period Return - Non Voting (%)	2.18	38.93	80.72	62.14	(32.39)
Operating Cost - Efficiency Ratio (%)	66.21	60.28	57.80	56.21	54.27
Share Price - Voting (Rs)	57.00	112.50	155.75	122.50	69.75
Share Price - Non Voting (Rs)	32.75	41.50	70.00	53.25	32.00
Gross Dividends (Rs Mn)	350.35	471.06	588.82	824.35	942.12



## Sustainability Report

# Customer Relations

The Bank's customer philosophy has always been one of long term partnerships strengthened and nurtured to assure a winning formula. The learning tenets applied to a growth strategy have added up in tangible benefits to our customers, whether in products to suit their lifestyles and aspirations or in service levels that strive towards excellence. It is customers who sustain our business as a fundamental catalyst to our entire vision. Their discerning habits and constant insistence on product innovation and service excellence have seen HNB work judiciously towards meeting the constantly raising bar.

Thus, to add up towards the winning formula, we have always pursued global processes, systems and best practices, giving our customers the best in class from an international banking perspective. Whether it is students or micro entrepreneurs, global trailblazers or blue chip conglomerates, young families or senior citizens, our customer portfolio is pervasive, distinct and embeds the philosophy of strong reliable partnerships for a win-win relationship.

## Towards Service Excellence

Service excellence is fundamental to our winning stance. It is one of the primary challenges we continue to face in ensuring that we are constantly ahead of customer expectations and in getting the right equation for customer retention and new customer attraction. The benchmarks we have set, the best

practices we imbue and the standards we constantly improve upon are meant to strengthen the evolving paradigm of customer service excellence. A number of initiatives continue within the service excellence framework we have established for ourselves.

### The Bank's Service Standards Manual

Implemented last year, the Bank's Service Standards Manual details the minimum service standards required for a winning bank, permeating a service oriented culture that works towards service excellence.

### Customer Interaction

In a bid to reach out to the rural community a customer event was arranged in Hambantota where the HNB team led by the MD / GEO had an opportunity to interact with around 260 customers. As in the past, these events whilst helping to strengthen relationships also provided an opportunity to obtain our customers opinions and better our services.

## Complaints Handling

Ninety written complaints were filed this year for follow up through our rigorous complaint handling process which is most often resolved either at customer centre or regional level and in some extreme cases, require the aegis of the Financial



Ombudsman. The dedicated Complaints Handling Unit which analyses all complaints made via email, telephone or in writing, resolved a majority of the complaints with minimum intervention. However, five complaints did have the intervention of the Financial Ombudsman, whose transparent process gives redress in a just and fair manner.

The corrective measures reported in 2007 arising from the results of a customer survey done two years ago continued to be carried out in 2008 as well. As a further measure customer centres were encouraged to carry out individual customer surveys in their locality as a prelude to a special customer care training programme for entire customer centre teams. More details of this programme are reported under Employee Relations Section of this report.

## Enabling the Differently Aabled

We continued the initiative begun two years ago of making our customer centre network accessible for the differently able. 10 more customer centres were made accessible to the differently able during the year making a total of 41 such customer centres as at end 2008. The customer centres are wheelchair accessible with dedicated counters to serve this segment of the community. We also added 14 ATMs into our existing 22 enabling ATMs, giving those differently able customers easier access to the ATM facilities.

## Visibility and Penetration

Our corporate branding which underwent a transformation a few years ago is unequivocally at top of the mind recall among the people of Sri Lanka. The strong branding is identified by our customers as reflective of our ethics, values and extensive

product and service portfolio. The new look, extended through an ever present branding formula, is being rolled across the entire customer centre network. Signage and exteriors are being transformed to fall in line with our image and values and under the refurbishing plan, ten more locations will have the new branding standards while another ten are earmarked for completion next year.

We opened 10 customer centres throughout the year - and seven relocations. While our Batticaloa customer centre was relocated to a larger premises in anticipation of the development envisaged in the East, our strategic customer centre located at R A de Mel Mawatha was also relocated to Green Path for better accessibility to our customers. A Priority Banking Center will also be established within this customer centre next year.

We surpassed our milestone of having 250 ATMs within the network ensuring that customers now have greater access to our services. In 2008 our second drive through ATM was established at the Green Path customer centre. The SMS banking platform too was extended to include Tigo the mobile service provider, while our Virtual Branch is earmarked for a complete revamp in line with our Core Banking Solution next year for ease of transactions and numerous value additions. Our Internet / SMS Banking / Mobile Banking facilities continue to be the only trilingual banking facilities of this sort in the country, enabling us to serve the convenience of our diverse multicultural customer base. Our Customer Centre Network is presented on pages 44 and 45.





## HNB Receives MoneyGram Award

World renowned service provider in the electronic money transfer services league, MoneyGram International Inc presented the Bank with the prestigious award for the Most Productive Network of Locations at a ceremony in Goa, India. This further engraves our customer service tenets, which have always been to ensure that customers come first and that customer aspirations are exceeded at all times. The Bank, which uses MoneyGram to service the large Sri Lankan community resident around the world, networks through MoneyGram's 150,000 locations in 180 countries and was appointed Super Agent in Sri Lanka in April 2008 for the contribution and growth of large business volumes in Sri Lanka. Prior to this award, in 2007, the Bank received yet another award from MoneyGram for the Best Signage Collaboration Project at the MoneyGram Asia Pacific Agents' Conference in China, signalling the winning position we espouse with our customer service partners.

All the Bank's Customer Centers imbue the global standards that MoneyGram espouses. Plans are underway to expand the value additions and service tenets that the Bank can give MoneyGram customers.

## Overseas Presence Expansion

As a measure of assisting the expatriate diaspora further, the Bank continues to extend its services and presence across the globe. The most significant step in extending our presence beyond Sri Lanka this year was the establishment of Majan Exchange LLC in Oman, in which the Bank has a 40% stake with a view to service those in Pan Asia, including India,



Pakistan, Bangladesh, Nepal and Sri Lanka. The services extended will include web based solutions, a loyalty card and SMS alerts. A second exchange house was established in January 2009, emulating a similar model in Abu Dhabi. More customer centres are planned in these two countries over the next two years, while we are also pursuing opportunities in Canada.

Given the extensive Sri Lankan expatriate base in the Middle East and having nurtured long term relationships with them over the years, the Bank sponsored the Sinhala Avurudu celebrations held in Oman organized by the Sri Lankan Community Social Club. A number of HNB stars entertained over 2,000 Sri Lankans who joined in enjoying a fun filled day.

## Nurturing Student Bankers

One of the most penetrative and interactive initiatives in inculcating a savings culture among the future generation is the nurturing of Student Bankers. Implemented in 2001, the Student Bankers' Association promotes savings among students via Singithi accounts. The Annual Student Bankers' Conferences were held in Jaffna and Trincomalee this year, with the participation of 60 schools and about 234 students. The conference, while instilling banking knowledge among these young leaders, is also a forum where friendships are forged and common goals, expectations and aspirations are addressed and discussed to spearhead a more tolerant responsible society of world citizens.



## Partnering Micro Entrepreneurs as Development Partners

A segment of the community that we feel has immense potential to be vital cogs in the wheel of rural development, micro entrepreneurs are now firmly positioned as a winning segment of our customer profile. Our award winning micro finance programme is now well on the way to establishing an economically sustainable segment of society that is contributing effectively to the rural economy. By empowering rural entrepreneurs, giving them confidence to utilize their skills and talents to further their independence and imparting technical and consultative advice to ensure sustainability of their venture, Gami Pubuduwa today encompasses the true tenets of sustainable development. The programme also gives rural farmers the opportunities of embarking on study tours sponsored by the Bank.

The Bank today has 110 micro financing units disbursing funds to nearly 5,400 micro entrepreneurs who support about 15,000 families. Servicing this large rural community are 124 micro finance field officers and for the first time in Sri Lanka, 40 agricultural graduates also disseminate their knowledge to the farmers.



## Micro Insurance Schemes

The number of entrepreneurs seeking to benefit under this scheme was significant. Recording a 75% growth in the number of policies issued since last year when the product was first launched in collaboration with our subsidiary company HNB Assurance PLC, it bears witness to the increased financial literacy and know-how of our rural entrepreneurs and the Bank's role in their development.

## Introduction of Finacle

During 2008 the Bank started implementing Finacle, a new Core Banking system purchased from Infosys, India. The implementation is scheduled to be completed by mid 2009, which will bring the whole network onto a single platform. The new system will enable the Bank to enhance service standards and provide new services to customers. In addition, Finacle will significantly improve the Management Information System (MIS) of the Bank, which is crucial during turbulent times.



## Sustainability Report

# Supplier Relations

The qualitative platform we espouse in nurturing and strengthening our supplier relationships is firmly embedded in taking the Bank's values, ethics, integrity, transparency and processes into a dimension of a winning relationship. Into this equation, we add the features of equality, best practices, open dialogue and standards to give our suppliers added impetus in learning, applying and growing with us which all add up into our winning formula.

### Process improvements

This year, we focused immensely on managing these supplier relationships on a better scale. While the relationships have always been strong, evolving relationships require us to be more mindful of their goals and align them into what we want from them. Invoice settling was streamlined for a speedier, more efficient payment system that enables suppliers to obtain their payments in a 60% shorter time span than before. Sourcing and distribution was also brought into a framework; distribution of elements like stationery is currently outsourced and plans of outsourcing packing is also envisaged, by early 2009. This will bring in more effective waste management processes and in turn will increase productivity and eliminate time and resource wastage.

### The Supply Process

A stringent albeit transparent registration process is in place for suppliers. While the selection process is transparent and each step documented and available for inspection at any time, a supplier audit on delivery determines the quality of the goods supplied. Supplier management was introduced into our Management Information System this year for a more open registration process. The features within the MIS will detail the supplier's strengths, service category and operational segment. This enables the Bank to identify each supplier with the required service and notify them when tenders need to be forwarded. These features within the MIS will be more inclusive next year, when information pertaining to numbers, relationship periods, areas of business and responses received will be monitored and detailed for future reference.

The standards stipulated by the Bank in respect of supplies must conform to formally laid out guidelines and it is imperative that all suppliers conform to these guidelines. The suppliers are encouraged to rescrutinize their quality and standards to meet the Bank's expectations which also serve as self improvement initiatives for the suppliers. Systems and processes are periodically reviewed and improved upon whenever necessary.



## Micro, Small and Medium Suppliers Promoted

A noteworthy aspect within the Bank's supplier relationships is that it encourages micro, small and medium sized organizations also to register as suppliers. This is a facet of the winning formula we have employed over the years and one which we are sure adds up to maintaining good relationships and buoying the economy in the larger picture.

## Learning from our Suppliers

A team of senior officials from the Bank visited the Infosys Leadership Institute in Mysore under a Finacle Executive Appreciation Programme. The campus which sprawls over hundreds of acres of land was evidence to how environmentally friendly practices could be implemented on a

large scale. This first hand observation of the latest methods of energy conservation, rain water harvesting, recycling of water, waste management techniques, use of solar energy, pollution free transport within the campus by means of bicycles and electric vehicles etc was a useful learning experience.

We intend implementing most of these eco friendly practices as far as meaningfully possible across our customer centre network and in the design of our future customer centres. More information about our green projects is detailed in the Environmental Relations section of this report.

# Key Performance Indicators

## 1. COMMUNITY RELATIONS

Investment in School Library projects - Rs 9 Mn

Number of Libraries completed during the year - 31

Investment in safe drinking water project - Rs 5 Mn

Village Empowerment - Gami Pubuduwa

Number of loans disbursed during the year - 14,053

Total financing of projects upto 2008 - Rs 5.1 Bn

Sector analysis of micro finance loans - Details are given on page 86

## 2. EMPLOYEE RELATIONS

The in-house, local and overseas training data are available on page 93

Agewise, Genderwise and Servicewise analysis of the Bank staff are given on page 96

Employee turnover at Corporate / Senior Management level 1.67%

## 3. INVESTOR RELATIONS

The economic performance indicators of the Bank have been presented on page 100.

## 4. CUSTOMER RELATIONS

90 written customer complaints were received and resolved effectively during the year.

10 customer centers were upgraded during the year to facilitate differently able customers.

ATMs at 14 more customer centres have been rendered wheel chair accessible.

10 new customer centers were opened during the year.



# Independent Assurance Report



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## To The Readers of The Sustainability Report 2008

### Introduction

We have been engaged by Hatton National Bank PLC (Bank) to review the Sustainability Report 2008 (further referred to as The Report). The Report, including the identification of material issues, is the responsibility of the Bank's management. Our responsibility is to issue an assurance report on The Report.

### Context and scope

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

- reasonable assurance on whether:
  - the data on financial performance, as specified on page 100 of The Report are properly derived from financial statements of the Bank for the year ended 31st December 2008;
- limited assurance on whether:
  - the data on Key Performance Indicators for 2008 specified on page 107 are fairly stated ;
  - the other information in The Report is fairly stated.

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

### Standards and criteria

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

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

There are no generally accepted standards for reporting sustainability performance. The Bank applies its own internal sustainability reporting criteria, derived from Sustainability Reporting Guidelines of the Global Reporting Initiative (GRI) and its stakeholder engagement process as detailed on page 82 of The Report.

### Considerations and limitations

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

To obtain a thorough understanding of the financial results and financial position of the Bank, the reader should consult the Bank's audited financial statements for the year ended 31 December 2008, included in the Annual Report from page 134 to 206.

### Work undertaken and conclusions

We reviewed the reliability of the data on Key Performance Indicators for 2008 based on:

- visits to selected project sites and branches to review systems and data;
- And reviews of:
- the systems used to generate, aggregate and report these data.
  - the data reported by the relevant business units to corporate level;
  - the data validation processes at corporate and business level;
  - the data trends in discussions with management

Based on the above, the data for Key Performance Indicators for 2008, specified on page 107 do not appear to be unreliable.

### Financial data

We have reconciled the data on financial performance reported on page 100 of The Report with the audited financial statements of the Bank for the year ended 31st December 2008.

Based on the above, we conclude that the data on financial performance reported on page 100 are properly derived from the financial statements of the Bank for the year ended 31 December 2008 for which the independent auditors issued an unqualified audit opinion dated 13th February, 2009 on page 133 of the Annual Report.

### Other information

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

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

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

*Ford Rhodes Thornton & Co.*

### CHARTERED ACCOUNTANTS

Colombo, Sri Lanka

13th February 2009

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

S. Srikananathan FCA  
Ms. M. P. Parera FCA  
C.P. Jayatileke FCA  
W.W.J.C. Perera FCA

# The Global Reporting Initiatives (GRI) G3

The Global Reporting Initiative (GRI) provides a generally accepted framework for reporting on an organisation's economic, environmental and social performance. Hatton National Bank PLC (Bank) has used the GRI Sustainability Reporting Guidelines (G3) in the development of our 2008 Sustainability Report. This index provides a comprehensive listing of the GRI indicators reported by the Bank. We have also used the financial services sector supplements on social and environmental performance. This Index refers to information in our 2008 Sustainability Report, as well as the other sections of our 2008 Annual Report.

We have self assessed our report as an A

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

## GRI Index

### Profile

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

### Economic

- Economic performance
- Market presence
- Indirect economic impacts

### Environmental

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

### Labour practices and decent work

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

### Human rights

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

### Society

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

### Product responsibility

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

## Profile

1. Strategy and analysis		Reference
1.1 Statement from the CEO and chairperson	<ul style="list-style-type: none"> <li>Chairman's Message</li> <li>CEO's Review</li> </ul>	8-11 12-15
1.2 Description of key impacts, risks and opportunities	<ul style="list-style-type: none"> <li>CEO's Review/CEO's Message</li> <li>Inspiring and engaging our people</li> <li>Supporting high literacy</li> <li>Towards service excellence</li> <li>Corporate responsibility highlights</li> <li>Corporate Governance and Compliance</li> </ul>	12.15, 78 93 83 101 86, 98-100 62-75
2. Organisational Profile		
2.1 Name of the reporting organization	<ul style="list-style-type: none"> <li>Hatton National Bank PLC</li> </ul>	
2.2 Primary brands, products and services	<ul style="list-style-type: none"> <li>Management Discussion &amp; Analysis</li> </ul>	24-44
2.3 Operational structure of the organization	<ul style="list-style-type: none"> <li>Management Discussion &amp; Analysis</li> </ul>	24-44
2.4 Location of organization's headquarters	<ul style="list-style-type: none"> <li>HNB Towers , 479 T B Jayah Mawatha, Colombo 10</li> </ul>	
2.5 Number and name of countries with operations	<ul style="list-style-type: none"> <li>Sri Lanka and Oman (Rep offices in India and Pakistan)</li> </ul>	
2.6 Nature of ownership and legal form	<ul style="list-style-type: none"> <li>Corporate Information</li> </ul>	139
2.7 Markets served	<ul style="list-style-type: none"> <li>Management Discussion &amp; Analysis</li> </ul>	24-44
2.8 Scale of the reporting organization	<ul style="list-style-type: none"> <li>Number of employees</li> <li>Income Statement</li> <li>Ten year summary</li> <li>Twenty largest shareholders</li> <li>Breakdowns of operating income / expenses</li> </ul>	139 134 218 225 156
2.9 Significant changes during the reporting period	<ul style="list-style-type: none"> <li>Changes to the Group structure</li> </ul>	122
2.10 Awards received	<ul style="list-style-type: none"> <li>Recognition</li> </ul>	98-99
3. Report profile		
3.1 Reporting period	<ul style="list-style-type: none"> <li>1 January 2008 to 31 December 2008</li> </ul>	
3.2 Date of most recent previous report	<ul style="list-style-type: none"> <li>December 2007</li> </ul>	
3.3 Reporting cycle	<ul style="list-style-type: none"> <li>Annual</li> </ul>	
3.4 Contact point	<ul style="list-style-type: none"> <li>Contact details</li> </ul>	Back cover
3.5 Report Scope and Boundary	<ul style="list-style-type: none"> <li>GRI 3</li> </ul>	
3.5 Defining report content	<ul style="list-style-type: none"> <li>HNB's 2008 Sustainability Report covers the Bank's operations.</li> </ul>	
3.6 Boundary of report	<ul style="list-style-type: none"> <li>About our Report</li> <li>Key challenges and opportunities</li> </ul>	78-105
3.7 Limitations on scope/boundary	<ul style="list-style-type: none"> <li>The report covers only the Sri Lankan operations of HNB</li> </ul>	
3.8 Data measurement techniques	<ul style="list-style-type: none"> <li>Based on GRI</li> </ul>	
3.10 Restatements	<ul style="list-style-type: none"> <li>None</li> </ul>	
3.11 Significant changes	<ul style="list-style-type: none"> <li>No significant changes.</li> <li>The initiatives taken by the Bank have been reported</li> </ul>	83-105
3.12 Location of content	<ul style="list-style-type: none"> <li>Will be uploaded on the HNB website</li> </ul>	
3.13 External assurance	<ul style="list-style-type: none"> <li>Independent Assurance report</li> </ul>	108
4. Governance, commitments and engagement		
4.1 Governance structure	<ul style="list-style-type: none"> <li>Corporate Governance and Compliance</li> </ul>	62
4.2 Chair of the highest governance body	<ul style="list-style-type: none"> <li>Chairman's message</li> <li>Chairman's introduction</li> </ul>	8-11 62
4.3 Highest governance body	<ul style="list-style-type: none"> <li>Sustainability Stewardship</li> <li>Corporate Governance framework</li> </ul>	81 62
4.4 Mechanisms for employees/share holders to provide recommendations/direction to the board	<ul style="list-style-type: none"> <li>Investor Feedback form</li> <li>Access to directors</li> <li>Stakeholder engagement</li> </ul>	235 AGM 82



4.5 Compensation and performance	<ul style="list-style-type: none"> <li>• Corporate Responsibility Leadership</li> <li>• Performance appraisal based on balance scorecard</li> </ul>	89-97
4.6 Avoidance of conflicts of interest	<ul style="list-style-type: none"> <li>• Conflict of interest</li> <li>• Directors' Disclosure of Interest Policy and Policy for handling conflicts of interest</li> </ul>	72
4.7 Expertise of governance body	<ul style="list-style-type: none"> <li>• Board composition, selection and appointment</li> </ul>	72, 127-128
4.8 Mission and values statements	<ul style="list-style-type: none"> <li>• Sustainability Report</li> </ul>	16, 64
4.9 Management of performance		78, 89, 62
4.10 Evaluating the performance	<ul style="list-style-type: none"> <li>• Performance evaluations</li> <li>• Financial Review</li> </ul>	50, 62
4.11 Precautionary approach	<ul style="list-style-type: none"> <li>• Risk Management Framework</li> </ul>	89
4.12 Externally developed initiatives	<ul style="list-style-type: none"> <li>• Dengue and Chikungunya Prevention</li> </ul>	46
4.13 Membership in associations	<ul style="list-style-type: none"> <li>• None</li> </ul>	50
4.14 List of stakeholder groups	<ul style="list-style-type: none"> <li>• Sustainability Structure</li> </ul>	85
4.15 Identification and selection of stakeholders	<ul style="list-style-type: none"> <li>• Sustainability Structure</li> <li>• GRI 3</li> </ul>	81
4.16 Approaches to stakeholder engagement	<ul style="list-style-type: none"> <li>• Stakeholder Strategy</li> <li>• GRI 3</li> </ul>	81
4.17 Key issues and concerns of stakeholders	<ul style="list-style-type: none"> <li>• Key challenges and opportunities</li> <li>• Stakeholder Relations</li> </ul>	80
		83-105

## Economic

<b>Management approach</b>		
Disclosure of management approach	<ul style="list-style-type: none"> <li>• Management Discussion &amp; Analysis</li> </ul>	23-75
<b>Economic performance</b>		
EC1 Economic value generated and distributed	<ul style="list-style-type: none"> <li>• Value added statement</li> </ul>	216
EC2 Financial implications of climate change	<ul style="list-style-type: none"> <li>• Initiatives are being taken by HNB</li> </ul>	
EC3 Organization's defined benefit pension plan	<ul style="list-style-type: none"> <li>• Description of the Pension Plan</li> </ul>	186
EC4 Financial assistance from government	<ul style="list-style-type: none"> <li>• HNB does not receive any significant assistance from government</li> </ul>	
<b>Market Presence</b>		
EC5 Entry-level wage-local minimum age(additional)	<ul style="list-style-type: none"> <li>• Defined in the Collective agreement and Labour law</li> </ul>	
EC9 Indirect Economic impacts (additional)	<ul style="list-style-type: none"> <li>• Concessions for the community</li> <li>• Improving financial literacy and inclusion.</li> <li>• Taking the next step in responsible lending.</li> <li>• Indigenous employment, mature-aged workers, women in management and disability advocacy</li> <li>• Supporting rural employment and access to financial services</li> </ul>	83-105

## Environment

Management Approach		
Disclosure of management approach	<ul style="list-style-type: none"> <li>Policy/Initiatives</li> </ul>	87
Materials		
EN1 Material used by weight or volume	<ul style="list-style-type: none"> <li>Not available now</li> </ul>	
EN2 Percentage of materials used that are recycled input materials	<ul style="list-style-type: none"> <li>Initiatives taken by HNB have been reported but the data are not available now</li> </ul>	87
EN3 Direct energy consumption by primary energy source	<ul style="list-style-type: none"> <li>Initiatives taken by HNB have been reported but the data are not available now</li> </ul>	87
EN4 Indirect energy consumption by primary source.	<ul style="list-style-type: none"> <li>Initiatives taken by HNB have been reported but the data are not available now</li> </ul>	87
EN5 Energy saved due to conservation and efficiency improvements (Additional).	<ul style="list-style-type: none"> <li>Initiatives taken by HNB have been reported but the data are not available now</li> </ul>	87
EN6 Initiatives to provide energy-efficient or renewable energy based products and services, and reduction in energy requirements as a result of these initiatives (additional).	<ul style="list-style-type: none"> <li>Initiatives taken by HNB have been reported but the data are not available now</li> </ul>	87-88
EN7 Initiatives to reduce indirect energy consumption and reductions achieved (additional)	<ul style="list-style-type: none"> <li>Initiatives taken by HNB have been reported but the data are not available now</li> </ul>	87-88
Water		
EN8 Total water withdrawal by source.	<ul style="list-style-type: none"> <li>Initiatives taken by HNB have been reported but the data are not available now</li> </ul>	87-88
<i>Sections EN9 – EN17, E19 - EN20, EN23 – EN25 are not applicable to HNB. Accordingly references have not been made to these sections in this Table .</i>		
Emissions, Effluents and Waste		
EN18 Initiatives to reduce emissions and reductions achieved (additional)	<ul style="list-style-type: none"> <li>Managing our environmental impact and supply chain</li> </ul>	87-88, 105
EN21 Total water discharge by quality and destination.	<ul style="list-style-type: none"> <li>Initiatives taken by HNB have been reported but the data are not available now</li> </ul>	87-88
EN22 Total weight of waste by type and disposal method	<ul style="list-style-type: none"> <li>Initiatives taken by HNB have been reported but the data are not available now</li> </ul>	87-88
EN23 Total number and volume of significant spills	<ul style="list-style-type: none"> <li>Not applicable to HNB</li> </ul>	
EN24 Weight of transported, imported, exported, or treated waste deemed hazardous under the terms of the Basel Convention Annex I,II,III and VIII and percentage of transported waste shipped internationally (additional)	<ul style="list-style-type: none"> <li>Not applicable to HNB</li> </ul>	
EN25 Identity, size, protected status, and biodiversity value of water bodies and related habitats significantly affected by the reporting organization's discharges of water and runoff (additional).	<ul style="list-style-type: none"> <li>Not applicable to HNB</li> </ul>	
Products and Services		
EN26 Initiatives to mitigate environmental impacts of products and services, and extent of impact mitigation.	<ul style="list-style-type: none"> <li>Environmental Relations</li> </ul>	87
EN27 Percentage of products sold and their packaging materials that are reclaimed by category.	<ul style="list-style-type: none"> <li>Not applicable to HNB</li> </ul>	
Compliance		
EN28 Monetary value of significant fines and total number of non-monetary sanctions for non-compliance with environmental laws and regulations.	<ul style="list-style-type: none"> <li>No fines</li> </ul>	

<b>Transport</b>		
EN29 Significant environmental impacts of transporting products and other goods and materials used for the organization's operations, and transporting members of the workforce (additional).	<ul style="list-style-type: none"> <li>Initiatives taken by HNB have been reported but the data are not available now</li> </ul>	
<b>Overall</b>		
EN30 Total environmental protection expenditures and investments by type (additional)	<ul style="list-style-type: none"> <li>Initiatives taken by HNB have been reported, but the data are not available now</li> </ul>	

## Labour practices and decent work

<b>Labour practices and decent work</b>		
Disclosure of management approach	<ul style="list-style-type: none"> <li>Policy</li> </ul>	89
<b>Employment</b>		
LA1 Breakdown of total workforce.	<ul style="list-style-type: none"> <li>Employee Relations</li> </ul>	96
LA2 Employee turnover	<ul style="list-style-type: none"> <li>Staff turnover is monitored by the HR Division regularly</li> </ul>	
LA3 Minimum benefits (additional)	<ul style="list-style-type: none"> <li>Defined in the Collective Agreement</li> </ul>	
<b>Labour /Management Relations</b>		
LA5 Notice period regarding operational changes	<ul style="list-style-type: none"> <li>Defined by the Collective Agreement, Labour law and appointment letters</li> </ul>	
<b>Occupational Health &amp; Safety</b>		
LA6 Management – Worker health and safety committees (additional)	<ul style="list-style-type: none"> <li>Health, safety and wellbeing</li> </ul>	93, 95
LA7 Lost Time Injury Frequency Rate	<ul style="list-style-type: none"> <li>Health, safety and wellbeing</li> </ul>	93
LA8 Serious communicable diseases	<ul style="list-style-type: none"> <li>Assistance is provided to employees with serious medical ailments, beyond the normal medical scheme.</li> </ul>	
LA9 Health and safety in union agreements (additional)	<ul style="list-style-type: none"> <li>Collective Agreement</li> </ul>	
<b>Training and Education</b>		
LA10 Hours of training	<ul style="list-style-type: none"> <li>Learning and development</li> </ul>	91
LA11 Employability and managing career endings (additional)	<ul style="list-style-type: none"> <li>Learning and development</li> </ul>	91
<b>Diversity and Equal Opportunity</b>		
LA13 Employees according to diversity	<ul style="list-style-type: none"> <li>Diversity</li> <li>Equal opportunity</li> </ul>	96
LA14 Basic salary of men and women	<ul style="list-style-type: none"> <li>No gender pay differential at HNB</li> </ul>	



## Human Rights

Management approach		
Disclosure of management approach	<ul style="list-style-type: none"> <li>• HR Policy</li> </ul>	89
Investment and procurement practices		
HR1 Investments with HR clauses/screening	<ul style="list-style-type: none"> <li>• Engaging and retaining the best</li> </ul>	91
HR2 Suppliers that underwent HR screening	<ul style="list-style-type: none"> <li>• Supply process</li> </ul>	105
HR3 Employee training on human rights (additional)	<ul style="list-style-type: none"> <li>• Learning and Development</li> </ul>	91
Non- Discrimination		
HR4 Incidents of discrimination	<ul style="list-style-type: none"> <li>• None reported</li> </ul>	
Freedom of association and collective bargaining		
HR5 FOA and collective bargaining	<ul style="list-style-type: none"> <li>• Collective Agreement</li> </ul>	
Child Labour		
HR6 Child labour	<ul style="list-style-type: none"> <li>• Governed by Labour law in the country</li> </ul>	
Forced and Compulsory Labour		
HR7 Forced or compulsory labour	<ul style="list-style-type: none"> <li>• Governed by Labour law in the country</li> </ul>	
Security Practices		
HR8 Security personnel trained in human rights (additional)	<ul style="list-style-type: none"> <li>• Security process is outsourced. But the Security Coordinator of HNB is responsible for the overall security arrangement of HNB and the internal security cadre</li> </ul>	
Indigenous Rights		
HR9 Rights of indigenous people (additional)	<ul style="list-style-type: none"> <li>• Not applicable</li> </ul>	

## Society

Management approach		
Disclosure of management approach	<ul style="list-style-type: none"> <li>• Policy</li> <li>• Goals and performance</li> </ul>	83
Community		
SO1 Impacts of operations on communities	<ul style="list-style-type: none"> <li>• Initiatives taken by HNB</li> </ul>	83
Corruption		
SO2 Analysis for risks of corruption	<ul style="list-style-type: none"> <li>• Employees handbook</li> <li>• Internal Training sessions</li> </ul>	90
SO3 Training in anti-corruption	<ul style="list-style-type: none"> <li>• Employees handbook</li> <li>• Internal Training sessions</li> </ul>	91
SO4 Instances of corruption	<ul style="list-style-type: none"> <li>• None reported</li> </ul>	90
Public Policy		
SO5 Public policy development and lobbying	<ul style="list-style-type: none"> <li>• No significant involvement during the year</li> </ul>	
SO6 Contributions to political parties or related institutions (additional)	<ul style="list-style-type: none"> <li>• No contributions to political parties</li> </ul>	
Anti-Competitive Behavior		
SO7 Legal actions for anti-competitive, antitrust and monopoly practices (additional)	<ul style="list-style-type: none"> <li>• None reported during the year</li> </ul>	
Compliance		
SO8 Monetary value of significant fines	<ul style="list-style-type: none"> <li>• None reported during the year</li> </ul>	

## Product Responsibility

Management approach		
Disclosure of management approach	<ul style="list-style-type: none"> <li>• Policy</li> <li>• Goals and performance</li> </ul>	101
Customer Health & safety		
PR2 Non-compliance with regulations/codes (additional)	<ul style="list-style-type: none"> <li>• We are currently determining whether we have any incidences of this nature</li> </ul>	
Product and Service Labelling		
PR3 Information required by procedures	<ul style="list-style-type: none"> <li>• Improving Financial Literacy and Inclusion</li> </ul>	101
PR4 Non-compliance concerning labelling (additional)	<ul style="list-style-type: none"> <li>• We are currently determining whether we have any incidences of this nature</li> </ul>	
PR5 Customer satisfaction (additional)	<ul style="list-style-type: none"> <li>• Customer Relations</li> </ul>	101
Marketing Communications		
PR6 Adherence to laws, standards and codes	<ul style="list-style-type: none"> <li>• Customer Relations</li> </ul>	101
PR7 Non-compliance concerning marketing (additional)	<ul style="list-style-type: none"> <li>• Simple and clear communication</li> </ul>	
Customer Privacy		
PR8 No of breaches of customer privacy (additional)	<ul style="list-style-type: none"> <li>• We are currently determining whether we have any incidences of this nature</li> </ul>	
Compliance		
PR9 Non-Compliance with laws/regulations	<ul style="list-style-type: none"> <li>• None reported during the year</li> <li>• We are currently determining whether we have any incidences of this nature</li> </ul>	

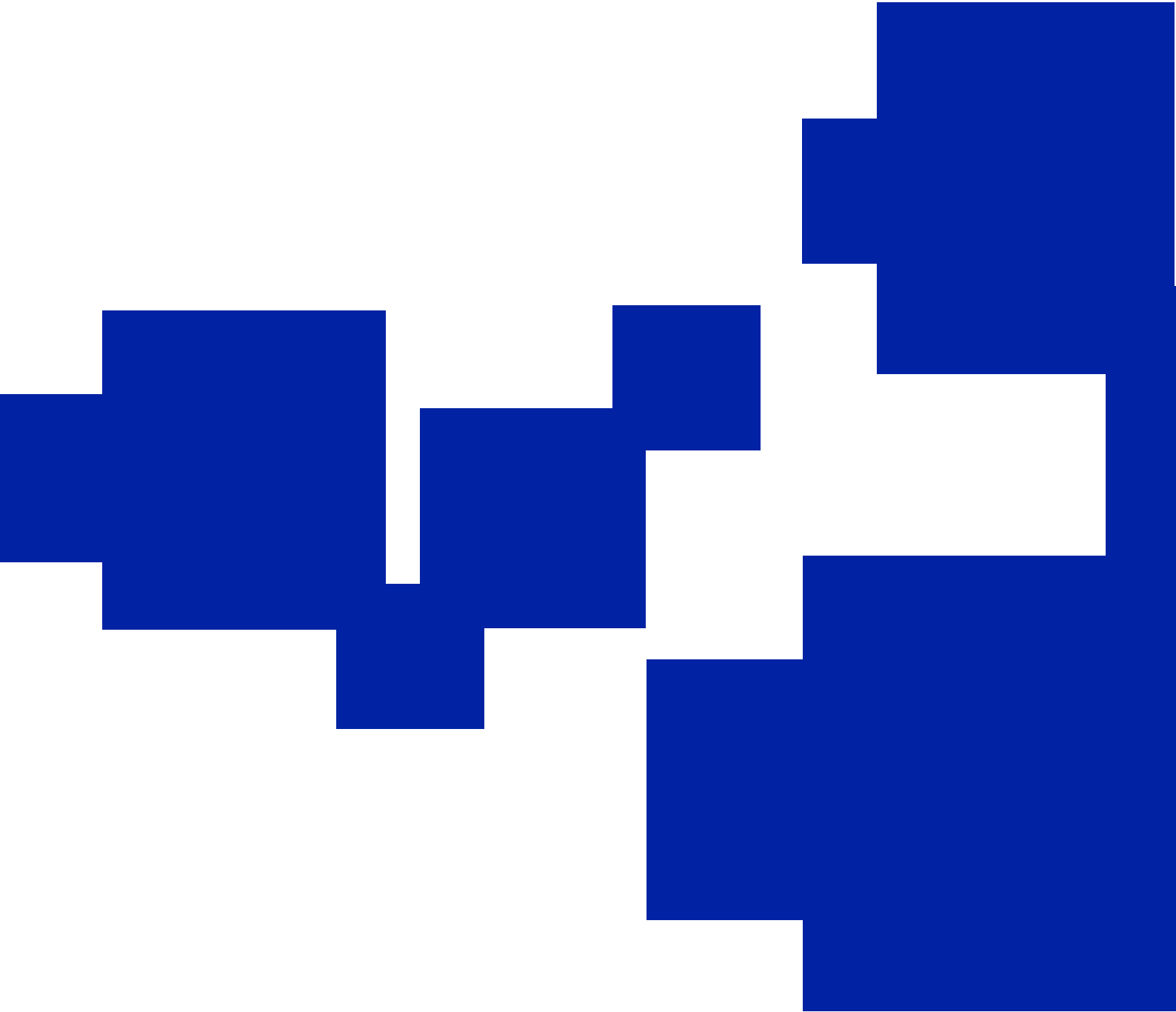


# Financial Services Sector Supplement Social Performance (November 2002)

Corporate Social Responsibility Management		
CSR1 : CSR Policy	<ul style="list-style-type: none"> <li>• CEO's Message</li> <li>• Sustainability Strategy</li> </ul> External standards: <ul style="list-style-type: none"> <li>• Global Reporting Initiative</li> <li>• International Standards on Assurance Engagements (ISAE 3000)</li> <li>• Sri Lanka Auditing Practice Statements (SLAPS 3)</li> </ul>	78 80
CSR2 : CSR organization	<ul style="list-style-type: none"> <li>• Sustainability Strategy</li> <li>• Sustainability Stewardship</li> </ul>	80 81
CSR3 : CSR Audits	Independent Assurance Report	108
CSR4 : Management of sensitive issues	<ul style="list-style-type: none"> <li>• Policies and practice, Human rights</li> <li>• Stakeholder engagement</li> <li>• Key challenges and opportunities</li> <li>• Workplace relations, communication and complaints.</li> <li>• Social and environmental risks in Institutional lending</li> <li>• Issue-specific training</li> </ul>	78-106
CSR5 : Non-compliance with law or code of conducts	We are currently determining whether we have any incidences of this nature	
CSR6 : Stakeholder dialogue	Stakeholder engagement Investor Feedback form	82 235
Internal Social Performance		
INT1 : Internal CSR Policy	<ul style="list-style-type: none"> <li>• Sustainability Strategy</li> </ul>	80
INT2 : Staff turnover and job creations	<ul style="list-style-type: none"> <li>• Employee Relations</li> </ul>	89
INT3 : Employee satisfaction	<ul style="list-style-type: none"> <li>• Employee Relations</li> </ul>	89
INT4 : Senior management remuneration	<ul style="list-style-type: none"> <li>• Performance appraisal based on balance scorecard</li> </ul>	93
INT5 : Bonuses fostering sustainable success (additional)	<ul style="list-style-type: none"> <li>• Performance appraisal based on balance scorecard</li> </ul>	93
INT6 : Female-Male salary Ratio	<ul style="list-style-type: none"> <li>• Based on gender wise employee analysis</li> </ul>	96
INT7 : Employee profile	<ul style="list-style-type: none"> <li>• Age wise and gender wise</li> </ul>	96
SOC1 : Charitable Contributions	<ul style="list-style-type: none"> <li>• Disclosed in the Directors Report</li> </ul>	122
SOC2 : Economic value added	<ul style="list-style-type: none"> <li>• Ten year summary</li> </ul>	218
Performance of Suppliers		
SUP1 :Screening of major suppliers	<ul style="list-style-type: none"> <li>• Supply Process</li> </ul>	105
SUP2 : Supplier satisfaction	<ul style="list-style-type: none"> <li>• Process improvement</li> </ul>	105
Retail Banking		
RB1 : Policy-socially relevant elements	<ul style="list-style-type: none"> <li>• Customer Relations</li> <li>• Personal Banking</li> </ul>	101 26
RB2 : Lending profile	<ul style="list-style-type: none"> <li>• Corporate Banking Lending Profile</li> <li>• Personal Banking Lending Profile</li> </ul>	24 26
RB3 : Lending with high social benefit	<ul style="list-style-type: none"> <li>• Village empowerment</li> <li>• Customer Relations</li> </ul>	86 104

# Financial Services Sector Supplement Environmental Performance (March 2005)

Financial Services Sector Supplement: Environmental Performance		
F1 : Environmental policies	<ul style="list-style-type: none"> <li>• Initiatives taken by the Bank have been disclosed. A structured approach to climate change is to be implemented in 2009</li> </ul>	87
F2 : Assessing/screening environmental risks	<ul style="list-style-type: none"> <li>• Initiatives taken by the Bank have been disclosed. A structured approach to climate change is to be implemented in 2009</li> </ul>	87
F3 : Threshold at which assessments are applied	<ul style="list-style-type: none"> <li>• Date are currently not available</li> </ul>	
F4 : Clients compliance with risk assessment	<ul style="list-style-type: none"> <li>• Customer Relations</li> </ul>	101
F5 : Staff competency	<ul style="list-style-type: none"> <li>• Employee Relations</li> </ul>	89
F6 : Audits that include environmental risk systems	<ul style="list-style-type: none"> <li>• A structured approach is to be implemented in 2009</li> </ul>	
F7 : Interactions regarding risks and opportunities	<ul style="list-style-type: none"> <li>• Customer Relations</li> <li>• Community Relations</li> </ul>	101 83
F8 : Companies that have been engaged	<ul style="list-style-type: none"> <li>• Not currently available</li> </ul>	
F9 : Assets subjected environmental screening	<ul style="list-style-type: none"> <li>• Not currently available</li> </ul>	
F10 : Voting policy on environmental issues	<ul style="list-style-type: none"> <li>• Not currently available</li> </ul>	
F11 : Percentage of assets under management	<ul style="list-style-type: none"> <li>• Not currently available</li> </ul>	
F12 : Environmental products and services	<ul style="list-style-type: none"> <li>• Management Discussion &amp; Analysis</li> </ul>	24-35
Investment Banking		
1B1 : Investment policy-socially relevant elements	<ul style="list-style-type: none"> <li>• Products and services</li> </ul>	35
1B2 : Customer profile: global transaction structure	<ul style="list-style-type: none"> <li>• Management Discussion &amp; Analysis</li> </ul>	24-35

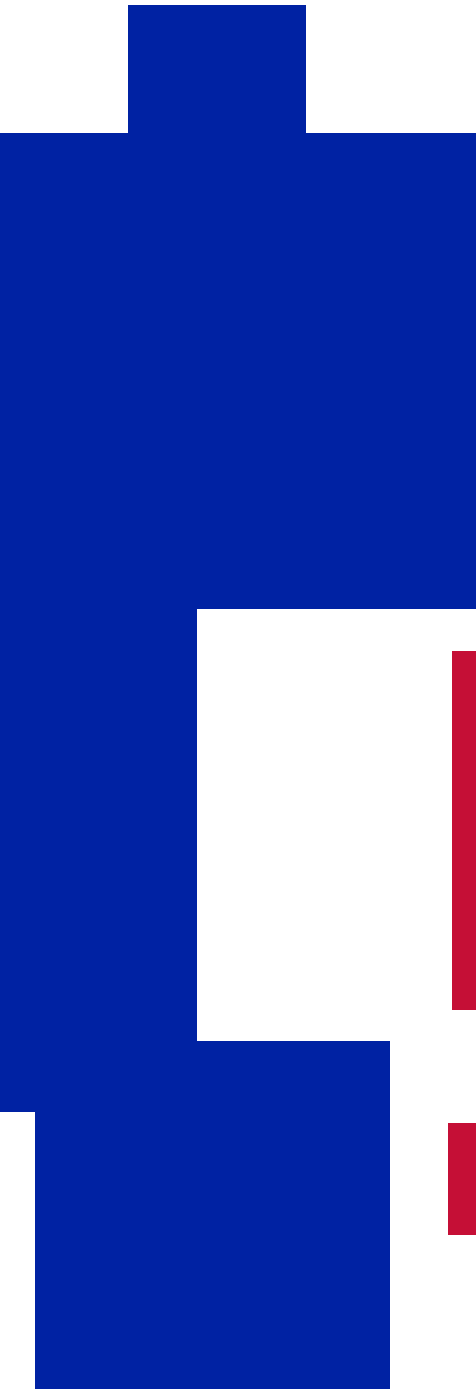


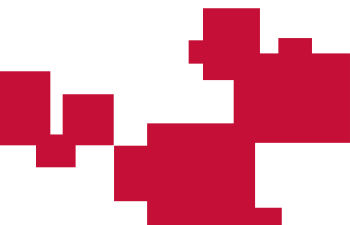




# Financial Information

Numbers that **all add up**





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# Financial Calendar

## FINANCIAL CALENDAR - 2008

Rs. 1.00 per share Interim Dividend for 2008 paid on	15th December 2008
Audited Financial Statements signed on	13th February 2009
40th Annual General Meeting to be held on	31st March 2009
Rs. 3.00 per share Final Dividend for 2008 payable on	7th April 2009

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	26th May 2008
2nd Quarter Interim Results released on	28th August 2008
3rd Quarter Interim Results released on	28th November 2008

## PROPOSED FINANCIAL CALENDAR - 2009

Interim Dividend for 2009 to be payable in **	December 2009
41st Annual General Meeting to be held in	March 2010
Final Dividend for 2009 to be payable in **	April 2010

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 2009
2nd Quarter Interim Results to be released in	August 2009
3rd Quarter Interim Results to be released in	November 2009

\*\* Subject to confirmation by Directors



# Annual Report of the Board of Directors on the Affairs of the Company

The Board of Directors of Hatton National Bank PLC has pleasure in presenting their Annual Report to the members for the financial year ended 31st December 2008, together with the audited consolidated financial statements of the Bank for that year, the Auditors' Report on those financial statements, conforming to the requirements of the Companies Act. The financial statements were accepted and approved by the Board of Directors on 13th February 2009. The Report also includes certain disclosures required to be made under the Listing Rules of the Colombo Stock Exchange as a listed company and are guided by the recommended best practices on Corporate Governance.

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

The ordinary shares and the unsecured subordinated redeemable debentures of the Bank are listed on the Colombo Stock Exchange in Sri Lanka, Global Depository Receipts of the Bank are listed on the Luxemburg Stock Exchange. The Bank's implied long term unsecured senior debt has been assigned AA-(lka) by Fitch Ratings Lanka Ltd.

## PRINCIPAL ACTIVITIES

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

## CHANGES TO THE GROUP STRUCTURE

HNB Stockbrokers (Pvt) Ltd (HNBSB) and HNB Securities Ltd (HNBS) two of the wholly owned subsidiaries of the Bank were engaged in stockbroking, dealing in government securities and corporate finance business. The Bank reached an agreement for a Joint Venture with DFCC Bank to carry on investment banking / corporate financing / capital markets business of both Banks in order to improve efficiency / rationalize costs and to enhance the profitability of both Banks. The Joint Venture Company (JVC) incorporated for this purpose was Acuity Partners (Pvt) Ltd with a capital of Rs 500 Mn shared equally between the two Banks. The Bank's investment was made by transferring 100% ownership in HNBSB (net asset value of Rs 100 Mn) and transferring 50.01% ownership of HNBS (50% of net asset value of Rs 300 Mn) in exchange for the shares in the JVC. This investment in the JVC is reflected in Note 31 to the Financial Statements. Under the new Joint Venture business model, HNBSB and HNBS ceased to be subsidiaries of the Bank.

During the year the Bank invested 40% in the equity of Majan Exchange LLC (Majan), a company incorporated on 9th June 2008

in the Sultanate of Oman, to actively engage in the remittance business and in other related business activities in Oman, on a profit sharing basis. The business operations of Majan are totally managed by the Bank on a management fee. Majan is classified as a subsidiary of the Bank because of its control over the financial and operating policies of the Company.

## REVIEW OF OPERATIONS

A review of the operations of the Bank during the financial year 2008 and results of those operations are contained in the Chairman's Message (pages 8 to 11), the Chief Executive Officer's Review (pages 12 to 15) and Management Discussion and Analysis (pages 24 to 49). These reports form an integral part of the Annual Report.

## FUTURE DEVELOPMENTS

An overview of the future developments of the Bank is given in the Chairman's Message (pages 8 to 11), the Chief Executive Officer's Review (pages 12 to 15) and Management Discussion (pages 24 to 49).

## FINANCIAL STATEMENTS

The financial statements of the Bank and the Group for the year ended 31st December 2008 duly signed by the Chief Financial Officer and two of the Directors of the Bank are given on pages 134 to 206 which form an integral part of the Annual Report of the Board.

## SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies adopted in the preparation of the financial statements and the impact of the changes in Sri Lanka Accounting Standards during the year are given on pages 139 to 154.

## GOING CONCERN

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

## AUDITORS' REPORT

Bank's Auditors, Messrs KPMG Ford, Rhodes, Thornton and Co. carried out the audit on the consolidated financial statements for the year ended 31st December 2008 and their report on those statements which forms an integral part of the Report of the Board of Directors, is given on page 133 of this Annual Report.

## INCOME

The Income of the Group for 2008 was Rs 38,725,404,000/= (2007 - Rs 32,075,889,000/=) while the Bank's income was Rs 37,165,915,000/= (2007 - Rs 29,994,718,000/=). An analysis of the Income is given in Note 9 to the Accounts.

## FINANCIAL RESULTS AND APPROPRIATIONS

The Bank has recorded a profit before tax and profit after tax growth of 10.4% and 6.5% respectively in 2008. The Group's profit after tax for the year was less than that of the Bank's by Rs 333.2 Mn. This was mainly due to the divesture of 100% and 50.01% shareholdings in the Bank's fully owned subsidiaries namely HNB Stockbrokers (Pvt) Ltd and HNB Securities Ltd, to the newly formed joint venture with DFCC Bank which released Rs 475.5 Mn by way of profit on disposal and dividend income.

	2008 Rs '000	2007 Rs '000
The Group Profit for the year ended 31st December 2008 after payment of all expenses of management and providing for depreciation and contingencies	4,485,126	4,564,584
Less: Taxation	<u>(1,599,300)</u>	<u>(1,364,782)</u>
Group Net Profit after taxation	2,885,826	3,199,802
Minority Interest	<u>(55,288)</u>	<u>(49,333)</u>
	2,830,538	3,150,469
Unappropriated Profit brought forward from previous year	<u>2,861,252</u>	<u>1,722,195</u>
Balance available for Appropriation	5,691,790	4,872,664
<b>Appropriations</b>		
Transfer to General Reserve	(1,700,000)	(1,565,000)
Transfer to Reserve Fund	(161,000)	(152,000)
Final Dividend - 2007	(824,353)	(294,412)
Interim Dividend - 2008	(235,530)	-
Disposal of subsidiaries	<u>(154,287)</u>	<u>-</u>
Balance carried forward as at 31st December	<u>2,616,620</u>	<u>2,861,252</u>

## Reserves

The Group Reserves consist of:

	2008 Rs '000	2007 Rs '000
Capital Reserve	5,771,072	5,768,262
Statutory Reserve Fund	982,707	821,707
Repairs & Renovation Reserve	6,700	6,700
Exchange Equalisation Reserve	2,459	-
Revenue Reserve	<u>11,098,973</u>	<u>9,643,605</u>
Total	<u>17,861,911</u>	<u>16,240,274</u>

The movement in these reserves is shown in the Statement of Changes in Equity on page 136 of the Annual Report.

## CORPORATE DONATIONS

During the year the Bank made donations amounting to Rs 19,405,000/= (2007 - Rs 29,451,000/=) in terms of the resolution passed at the last Annual General Meeting. The donations made to Government approved charities from the above sum amount to Rs 225,000/= (2007 - Rs 1,364,310/=).

## TAXATION

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

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

The Bank is also liable for Financial VAT at 20%

## STATUTORY PAYMENTS

The Directors, to the best of their knowledge and belief, are satisfied that all statutory payments in relation to the government and the employees have been made up to date.

## DIVIDENDS

An interim dividend of Rs 1.00 per share (2007 - nil) was paid to the holders of the ordinary shares (both voting and non-voting) for the financial year 2008. The dividend was paid on 15th December 2008. This interim dividend was paid fully out of dividends received and therefore was not subjected to withholding tax. The Directors recommend a Final Dividend of Rs 3.00 per share (2007 - Rs 3.50 per share) for the financial year 2008 and the dividend to be paid on 7th April 2009 to the holders of ordinary shares (voting and non-voting) of the Bank as at the close of business on 31st March 2009, subject to withholding tax.

The Board of Directors was satisfied that the Bank would meet the solvency test in terms of the provisions of the Companies Act, No. 7 of 2007 immediately after the interim dividend was paid in December 2008 and the final dividend proposed which will be paid in April 2009. The Board provided the Statements of Solvency to the Auditors and obtained Certificates of Solvency from the Auditors in respect of each dividend payment conforming to the statutory provision.

## CAPITAL EXPENDITURE

The total capital expenditure on acquisition of Investment Property; Property, Plant and Equipment and Intangible Assets of the Bank and the Group amounted to Rs 1,904,798,000/= and Rs 1,936,352,000/= respectively (2007 Bank - Rs 929,113,000/= and Group - Rs 962,904,000/=). Details of which are given in Notes 33, 34 and 35 to the financial statements. The capital expenditure approved and contracted for, after the year end is given in Note 47 (a) to the financial statements.

## PROPERTY, PLANT AND EQUIPMENT (PPE)

Details of PPE are given in Note 34 to the financial statements.

## MARKET VALUE OF FREEHOLD PROPERTIES

The net book value of freehold properties owned by the Bank and the Group as at 31st December 2008 is included in the accounts at Rs 4,655,057,000/= and Rs 9,748,401,000/= respectively. (2007 Bank - Rs 4,124,693,000/= and Group Rs 9,263,921,000/=). A panel of Chartered Valuers / Licensed Surveyors carried out a revaluation of the Bank's freehold properties in 2007. The details of freehold properties owned by the Bank are given in Note 34 to the financial statements.

# Annual Report of the Board of Directors on the Affairs of the Company

## OUTSTANDING LITIGATION

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

## EVENTS AFTER THE BALANCE SHEET DATE

No circumstances have arisen since the balance sheet date which would require adjustments to, or disclosure in, the accounts, except those disclosed in Note 52 to the accounts.

## STATED CAPITAL AND DEBENTURES

The stated capital of the Bank as at 31st December 2008 was Rs 5,059,390,000/=, consisting of 235,529,400 ordinary shares (189,329,400 - Voting and 46,200,000 - Non-voting).

The Bank had issued debentures to the value of Rs 2,754,851,000/= as at 31st December 2008 (2007 - Rs 4,623,794,000/=).

## SHARE INFORMATION

Information relating to earnings, dividend, net assets and market price per share is given in the Financial Highlights on page 4 of the Annual Report. Information on share trading is given on page 222 of the Annual Report.

## SHAREHOLDINGS

As at 31st December 2008 there were 4,120 and 11,920 registered voting and non-voting shareholders respectively. The distribution is indicated on pages 221 and 222 of the Annual Report. The twenty largest voting shareholders and twenty largest non-voting shareholders of the Bank as at 31st December 2008, together with an analysis are given on page 225 of the Annual Report.

## EQUITABLE TREATMENT TO SHAREHOLDERS

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

## BOARD OF DIRECTORS

The Board of Directors of the Bank consists of seven Directors with wide financial and commercial knowledge and experience. The following Directors held office as at the balance sheet date and their brief profiles are given on pages 16 and 17 of the Annual Report.

Name of the Director	Status
Mr Rienzie T. Wijetilleke (Chairman)	Non-Executive
Mr Rajendra Theagarajah (Managing Director)	Executive
Mr D H S Jayawardena	Non-Executive
Mr M V Theagarajah	Non-Executive
Mr R K Obeyesekere	Non-Executive
Ms Pamela C. Cooray	Non-Executive
Mr Ranjeevan Seevaratnam	Non-Executive

## RESIGNATIONS

Dr V P Vittachi and Mr Ratna Sivaratnam, who were Directors of the Bank resigned from the Board during the year. Dr Vittachi resigned with effect from 21st August 2008 and Mr Sivaratnam resigned with effect from 24th April 2008.

## RE-APPOINTMENT RECOMMENDED

Mr M V Theagarajah, Director, is over the age of 70 years. In terms of the provisions of the Companies Act, a director over 70 years and who continues on the Board, has to be re-appointed by the Membership annually. Accordingly, a resolution will be proposed for re-appointment of Mr M V Theagarajah a Director notwithstanding the age limit of 70 years stipulated by Section 210 of the Companies Act, No. 7 of 2007.

Under the Banking Act Direction No: 11 of 2007 read together with Direction No. 5 of 2008, the Director is permitted to continue in Office for 3 years from 1st January 2009

## BOARD COMMITTEES

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

Audit Committee - Comprises - Mr Ranjeevan Seevaratnam (Chairman)  
Mr D H S Jayawardena  
Ms Pamela C. Cooray

The Report of the Board Audit Committee is given on page 132 which forms part of this Annual Report of the Board.

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

Remuneration Committee - Comprises - Mr Rienzie T. Wijetilleke (Chairman)

Mr R K Obeyesekere  
Ms Pamela C. Cooray

The Report of the Remuneration Committee is given on page 129 which forms part of the Annual Report of the Board.

Integrated Risk Management Committee - Comprises - Mr M V Theagarajah (Chairman)  
Mr Rienzie T. Wijetilleke  
Mr R K Obeyesekere

### DIRECTORS' MEETINGS

The number of Directors' meetings which comprise Board meetings, Audit Committee meetings, Nomination Committee meetings, Remuneration Committee meetings and Integrated Risk Management Committee meetings and the attendance of Directors at these meetings are given on page 75 of the Annual Report.

### DIRECTORS' RESPONSIBILITY FOR FINANCIAL REPORTING

The Directors are responsible for the preparation of the financial statements of the Bank to reflect a true and fair view of the state of its affairs. The Directors are of the view that these financial statements have been prepared in conformity with the requirements of the Sri Lanka Accounting Standards, Companies Act, No. 7 of 2007, Sri Lanka Accounting and Auditing Standards Act, No. 15 of 1995, Banking Act, No. 30 of 1988 and amendments thereto and the Listing Rules of the Colombo Stock Exchange. The Statement of Directors' Responsibility for Financial Reporting is given on page 130 forms an integral part of the Annual Report of the Board of Directors.

### DIRECTORS' INTEREST REGISTER

The Bank maintains Directors' Interest Register conforming to the provisions of the Companies Act. The Directors of the Bank have disclosed their interests in other Companies to the Board and those interests are recorded in the interest register conforming to the provisions of the Companies Act. The particulars of those entries are set out on pages 127 and 128 of the financial statements which form an integral part of the Annual Report of the Board.

### DIRECTORS' INTERESTS IN THE ORDINARY SHARES

The Shareholdings of Directors were as follows :-

	As at 31st December.2008	As at 31st December 2007
Mr Rienzie T. Wijetilleke	7,806	7,806
Mr Rajendra Theagarajah	18,644	18,644
Mr D H S Jayawardena	10,010	10,010
Mr M V Theagarajah	289,948	289,948
Mr R K Obeyesekere	10,010	10,010
Ms Pamela C. Cooray	46,599	25,010
Mr Ranjeevan Seevaratnam	500	500

There has been no change in their interests in shares between 31st December 2008 and 13th February 2009, being the date of this Report.

### RELATED PARTY TRANSACTIONS

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

### DIRECTORS' REMUNERATION

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

### HUMAN RESOURCES

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

### EMPLOYEE SHARE OWNERSHIP PLAN

The Bank established an Employee Share Ownership Plan in the year 2005 for the benefit of the staff members in the grade of Executive and above with the approval of the shareholders. The scheme was formulated to pass certain benefits (dividends / bonus shares, etc.) on the ordinary shares (non-voting) of the Bank to the staff without transferring the ownership. For this purpose, the Bank created a Trust and the Trustees were entrusted to acquire ordinary shares (non-voting) of the Bank in the secondary market or otherwise and to allocate the shares to the staff on a basis determined by the Board. The Trustees were granted a special loan at a commercial rate of interest to acquire the shares. The benefits from the shares are given to the staff members during their employment. On cessation of employment they are paid the market value of the shares allocated. Any part of the loan outstanding, interest and statutory payments are recovered prior to transferring the benefits.

### EMPLOYEE SHARE OPTION PLAN

In the year 2007 with the approval of the shareholders, the Bank formulated an Employee Share Option Plan for the staff in the Management grades, recognising and rewarding them for their contribution. The Scheme was aimed at motivating the Management staff further. This gives an option to the Management staff to acquire ownership in the ordinary shares (both voting and non-voting) of the Bank, provided the Bank has met certain set profit goals. It is operative for 5 years and the Management staff has the option to purchase ordinary shares (voting and non-voting) of the Bank each year up to a limit of 1.25% of the shares issued up to a maximum of 5% of the shares issued. The first option to purchase shares has been offered to the staff, which is exercisable within one year.

# Annual Report of the Board of Directors on the Affairs of the Company

## ENVIRONMENT

The Bank has used its best endeavours to comply with the relevant environmental laws and regulations. The Bank has not engaged in any activity that is harmful or hazardous to the environment.

## RISK & INTERNAL CONTROL

The Board considers that strong internal controls are integral to the sound management of the Bank and it is committed to maintain strict financial, operational and risk management controls over all its activities.

The Directors are ultimately responsible for the Bank's system of internal control and for reviewing its effectiveness. Such a system is designed to manage, rather than eliminate, the risk of failure to achieve business objectives and can provide only reasonable and not absolute assurance against material misstatement or loss. There is an ongoing process for identifying, evaluating and managing the risks that are faced by the Bank, and the Directors have reviewed this process, through the Audit Committee.

The Board of Directors is satisfied with the effectiveness of the system of internal control for the year under review and up to the date of approval of the Annual Report and financial statements.

## CORPORATE GOVERNANCE

In the management of the Bank, the Directors have placed emphasis in conforming to the best corporate governance practices and procedures. Accordingly, systems and structures have been introduced / improved from time to time to enhance risk management measures and to improve accountability and transparency.

## CSE LISTING RULES ON CORPORATE GOVERNANCE

In March 2007, the Colombo Stock Exchange (CSE) introduced mandatory rules on corporate governance for listed companies. The rules mandated the listed companies to conform to those rules relating to the composition of the Board and Board Sub-Committees. Every listed company was required to comply with the rules from the financial year commencing on or after 1st April 2008.

## BANKING ACT DIRECTIONS ON CORPORATE GOVERNANCE

Under the Banking Act, the Monetary Board issued Direction No: 11 of 2007 on Corporate Governance For Licensed Commercial Banks in Sri Lanka, which was amended by Direction No: 5 of 2008. The aforesaid Directions mandated the licensed commercial banks to start conforming to the rules from 1st January 2008 and to be fully compliant by 1st January 2009, except where extended compliance dates have been expressly provided in the rules.

The Bank has adopted the best practices on corporate governance, in addition to conforming to the mandatory requirements, thereby ensuring long term sustainability and

stability of the Bank. A separate report on governance is given on pages 62 to 75.

## COMPLIANCE WITH LAWS AND REGULATIONS

The Bank has at all times ensured that it complied with the applicable laws and regulations including the listing rules of the Colombo Stock Exchange as a listed company. The Management Officers responsible for compliance, table a report on compliance at the quarterly meetings of the Board Audit Committee.

## AUDITORS

The Bank's Auditors during the period under review were Messrs. KPMG Ford, Rhodes, Thornton & Co., Chartered Accountants. A sum of Rs 5,855,000/= (2007 - Rs 4,045,000/=) was paid to them as audit fees and reimbursement of expenses during the year under review and Rs 1,734,000/= (2007 - Rs 380,000/=) was paid for non-audit related work such as reviewing and issuing an assurance report on the Sustainability Report, and review report on the implementation of the core banking system. Based on the declaration from Messrs. KPMG Ford, Rhodes, Thornton & Co., and as far as the Directors are aware, the Auditors do not have any relationship or interest with the Bank other than those disclosed in this paragraph.

The retiring Auditors, KPMG Ford, Rhodes, Thornton & Co., have expressed their willingness to continue in office. A resolution relating to their re-appointment and authorising the Directors to fix their remuneration, will be proposed at the forthcoming Annual General Meeting.

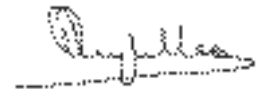
## NOTICE OF MEETING

The 40th Annual General Meeting of the Bank is convened on Tuesday the 31st day of March, 2009, 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 40th Annual General Meeting is on page 230 of the Annual Report.

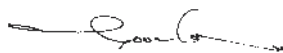
For and on behalf of the Board of Directors.



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



**Rienzie T Wijetilleke**  
Chairman



**Indrani Goonesekera**  
Deputy General Manager (Legal) / Board Secretary

Colombo, Sri Lanka  
13th February 2009



# Directors' Interests in Contracts with the Bank

The Bank carries out transactions in the ordinary course of business at commercial rates with entities in which a Director of the Bank is the Chairman or a Director of such entities. The transactions with entities where a Director of the Bank either has control or exercises significant influence, have been classified as related party transactions and disclosed in Note No. 48 (f) to the Financial Statements.

The transactions with entities where a Directors of the Bank neither have control nor exercise significant influence, but only hold directorships are disclosed below:

## 1. Lending Transactions with Bank

Company	Name of Director (Relationship)	Nature of Transaction	Aggregate Amount of Accommodation as at 31st December 2008		Security
			Limit (Rs Mn.)	Outstanding (Rs Mn.)	
Mahaweli Reach Hotels PLC	Mr Rienzie T. Wijetilleke (Director)	Overdrafts	7.50	7.68	Cash deposit and immovable property.  * Since reduced to Rs 2.68 Mn ** Since reduced to Rs 27.43 Mn *** Since reduced to Rs 39.84 Mn
		Overdrafts	2.56	* 3.01	
		Standby Overdrafts	-	0.02	
		Term Loans	26.37	** 28.56	
		Term Loans	7.78	7.97	
		Term Loans	39.06	*** 40.62	
		<b>Total</b>	<b>83.27</b>	<b>87.86</b>	
Soy Foods (Lanka) Ltd	Subsidiary of Ceylon Biscuits Ltd in which company Mr Rienzie T. Wijetilleke is a Director	Overdraft	20.00	-	Negative pledge over the project assets
		Letters of Credit	60.00	19.43	
		Letters of Guarantee	23.00	20.40	
		Short Term Loan	20.00	-	
		Import Loan	(20.00)	-	
		<b>Total</b>	<b>123.00</b>	<b>39.83</b>	
Watawala Plantations PLC	Subsidiary of Sunshine Holding Ltd in which company Mr Rienzie T. Wijetilleke is the Chairman	Overdraft	100.00	85.26	Immovable property (leasehold), absolute Ownership of the vehicles, machinery, equipment leased etc.
		Letters of Credit	5.00	10.30	
		Letters of Guarantee	15.00	7.15	
		Packing Credit	50.00	26.81	
		E-Friends Loan	53.83	53.83	
		Lease	9.45	9.45	
		<b>Total</b>	<b>233.28</b>	<b>192.80</b>	
Swiss Biogenics Ltd	Subsidiary of Sunshine Holding Ltd in which company Mr Rienzie T. Wijetilleke is the Chairman	Overdraft	(5.00)	-	Corporate Guarantee & inventories
		Letters of Credit	200.00	68.19	
		Import Loan	(100.00)	-	
		Letters of Guarantee	(10.00)	-	
		Forex Forward Contracts	(100.00)	-	
		<b>Total</b>	<b>200.00</b>	<b>68.19</b>	
Sunshine Travels & Tours Ltd	Subsidiary of Sunshine Holding Ltd in which company Mr Rienzie T. Wijetilleke is the Chairman	Overdraft	5.00	4.14	Cash deposit
		Letters of Guarantee	10.00	10.00	
		<b>Total</b>	<b>15.00</b>	<b>14.14</b>	
Sunshine Teas (Pvt) Ltd	Subsidiary of Swiss Biogenics Ltd which is a Subsidiary of Sunshine Holding Ltd in which company Mr Rienzie T. Wijetilleke is the Chairman	Overdraft	(25.00)	8.86	Inventories, mortgage over tea bagging machine
		Letters of Credit	50.00	-	
		Letters of Guarantee	10.00	9.71	
		Term Loan	4.60	4.60	
		Short Term Loan	(25.00)	-	
		<b>Total</b>	<b>64.60</b>	<b>23.17</b>	
		Packing Credit Loan US \$ Mn	1.45	0.96	
		Export Bill Discounting US\$ Mn	(0.75)	-	
		Forex Forward Contracts US \$ Mn	0.60	-	
		<b>Total</b>	<b>2.05</b>	<b>0.96</b>	

## Directors' Interests in Contracts with the Bank

Company	Name of Director (Relationship)	Nature of Transaction	Aggregate Amount of Accommodation as at 31st December 2008		Security	
			Limit (Rs Mn.)	Outstanding (Rs Mn.)		
New Nawaloka Hospitals PLC	Subsidiary of Nawaloka Hospitals PLC in which company Mr Rienzie T. Wijetilleke is a Director	Overdraft	20.00	* 20.64	Immovable property * Since regularised	
		Letter of Credit	10.00	5.78		
		Term Loan	29.98	29.98		
		Term Loan	200.00	200.00		
		Term Loan	25.00	25.00		
		Import LC / Term Loan	50.24	50.24		
		<b>Total</b>	<b>335.22</b>	<b>331.64</b>		
Tea Smallholder Factories PLC	Mr R Seevaratnam (Director)	Overdraft	50.00	-	Immovable property	
Acme Printing and Packaging PLC	Mr R Seevaratnam (Director)	Overdraft	10.00	* 10.64	Board Resolution * Excess temporary since regularised	
		Import Loan	15.00	5.89		
		Term Loan	1.39	1.39		
		<b>Total</b>	<b>26.39</b>	<b>17.92</b>		
Shaw Wallace Marketing PLC	Mr R Seevaratnam (Director)	Overdraft	15.00	14.07	Immovable property and inventories	
		Letter of Credit	270.00	210.90		
		Letter of Credit	40.00	4.54		
		Letter of Guarantee	5.00	0.20		
		Short Term Money Market Loan	300.00	254.00		
		<b>Total</b>	<b>630.00</b>	<b>483.71</b>		
Diesel and Motor Engineering PLC	Mr R Seevaratnam (Director)	Overdraft	(45.00)	17.18	Immovable property	
		Import Letter of Credit	1,750.00	256.84		
		Letter of Guarantee	(150.00)	138.43		
		Import Loan / Short Term Loan	(1,750.00)	532.36		
		Forward Exchange Contract	(100.00)	-		
		Term Loan	(100.00)	97.48		
		Term Loan	(120.00)	-		
		Term Loan	(200.00)	-		
		<b>Total</b>	<b>1,750.00</b>	<b>1,042.29</b>		
		Dipped Products PLC	Mr R Seevaratnam (Director)	Overdraft		20.00
Export Loan	100.00			50.00		
<b>Total</b>	<b>120.00</b>			<b>67.82</b>		
Kelani Valley Plantations PLC	Mr R Seevaratnam (Director)	Overdraft	50.00	48.62	Title to goods imported	
		Letter of Credit	(15.00)	-		
		<b>Total</b>	<b>50.00</b>	<b>48.62</b>		
Hayleys MGT Knitting Mills PLC	Mr R Seevaratnam (Director)	Overdraft	15.00	* 15.12	Immovable property and machinery * Excess temporary, since regularised	
		Term Loan	4.66	6.99		
		Term Loan	9.70	9.70		
		Lease	3.19	3.19		
		<b>Total</b>	<b>32.55</b>	<b>35.00</b>		
		Overdraft US\$ Mn	(0.10)	0.10		
		Import Letter of Credit US\$ Mn	}	0.01		
		Export Bills US\$ Mn		(0.50)		0.01
		Import Bills US\$ Mn		0.07		
		Import Loans US\$ Mn		0.03		
<b>Total US\$ Mn</b>	<b>(0.60)</b>	<b>0.22</b>				

### 2. Trading Transactions with Bank

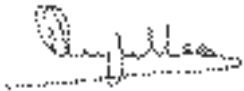
Company	Name of Director	Nature of Transaction	Amount (Rs)
Diesel and Motor Engineering PLC	Mr R Seevaratnam (Director)	Purchase of Motor Vehicle	45.29

# Remuneration Committee Report

The Remuneration Committee, appointed by and responsible to the Board of Directors, comprises three Non-Executive Directors. The Committee is headed by the Non-Executive Chairman Mr Rienzie T Wijetilleke and the members include Mr R K Obeyesekere and Ms Pamela C Cooray. Brief profiles of each member are given on pages 16 to 17. The Managing Director attends all meetings by invitation. The Deputy General Manager Human Resources and Administration assists the Committee by providing information required in its decision making process. The Committee met at once during 2008. In addition, 18 number of papers relating to recruitment, human resource development and remuneration issues were approved by the Committee via circulation. The minutes of the Remuneration Committee and a summary of papers approved by the said Committee are circulated and affirmed by the Board of Directors.

The Committee is responsible for setting the remuneration policy of HNB and determining remuneration package of the Managing Director / Chief Executive Officer (MD / CEO). The Committee also discusses and advises the MD / CEO on structuring of remuneration packages for Corporate Management and other managerial staff . This enables HNB to attract, retain and motivate high calibre individuals with the skills and abilities required to lead the organisation.

The Committee has the authority to seek external independent professional advice on matters within its purview.



**Rienzie T. Wijetilleke**  
Chairman - Remuneration Committee

Colombo, Sri Lanka  
13th February 2009



# Directors' Responsibility for Financial Reporting

The responsibility of the Directors in relation to the Financial Statements of the Bank and its subsidiaries prepared in accordance with the provisions of the Companies Act, No. 7 of 2007 is set out in the following statement. The responsibilities of the External Auditors in relation to the financial statements are set out in the Report of the Auditors given on page 133 of the Annual Report.

As per the provisions of the Companies Act, No. 7 of 2007 the Directors are required to prepare financial statements for each financial year and place them before a general meeting. The financial statements comprise the balance sheet as at 31st December 2008, and the income statement, statement of changes in equity and cash flow for the year then ended and notes thereto.

The financial statements of the Bank and its subsidiaries give a true and fair view of:

1. the state of affairs of the Bank and its subsidiaries as at balance sheet date; and
2. the profit or loss of the Bank and its subsidiaries for the financial year ended on the balance sheet date.

In preparing these financial statements the Directors are required to ensure that:

1. the appropriate accounting policies have been selected and applied in a consistent manner and material departures, if any, have been disclosed and explained;
2. judgements and estimates have been made which are reasonable and prudent; and
3. all applicable Accounting Standards, as relevant, have been followed.

The Directors are also required to ensure that the Bank and its subsidiaries have adequate resources to continue in operation to justify applying the going concern basis in preparing these financial statements.

Further, the Directors have a responsibility to ensure that the companies within the Group maintain sufficient accounting records to disclose, with reasonable accuracy the financial position of the Bank and its subsidiaries.

Financial Statements prepared and presented in the Report are consistent with the underlying books of account and are in conformity with the requirements of Sri Lanka Accounting Standards, Companies Act, No. 7 of 2007, Sri Lanka Accounting and Auditing Standard Act, No. 15 of 1995, Banking Act, No. 30 of 1988 and amendments thereto and the Listing Rules of the Colombo Stock Exchange.

The Directors have also instituted effective and comprehensive systems of Internal Control. This comprises Internal Check, Internal Audit and the whole system of financial and other controls required to carry on the business of banking in an orderly manner, safeguard its assets, prevent and detect frauds and other irregularities and secure as far as practicable the accuracy and reliability of the records.

Directors are required to prepare the financial statements and to provide the Bank's Auditors, KPMG Ford, Rhodes, Thornton & Co., 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, 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 3.00 per share for this year, to be paid on 7th April 2009.

The Directors to the best of their knowledge and belief, are satisfied that all statutory payments in relation to all relevant regulatory and statutory authorities which were due and payable by the Bank and its subsidiaries as at the Balance Sheet date have been paid or where relevant provided for.

The Directors are of the view that they have discharged their responsibilities as set out in this statement.

By Order of the Board



**Indrani Goonesekera**

Deputy General Manager (Legal) / Board Secretary

Colombo, Sri Lanka  
13th February 2009

# Chief Executive Officer's and Chief Financial Officer's Responsibility Statement

The financial statements of the Hatton National Bank Group are prepared in compliance with the Sri Lanka Accounting Standards issued by the Institute of Chartered Accountants of Sri Lanka, Companies Act, No. 7 of 2007, Sri Lanka Accounting and Auditing Standards Act, No. 15 of 1995, the Banking Act, No. 30 of 1988 and amendments thereto and the Listing Rules of the Colombo Stock Exchange. The Accounting Policies used in the preparation of the financial statements are appropriate and are consistently applied by the Group (material departures, if any, have been disclosed and explained in the notes to the financial statements). There are no departures from the prescribed Accounting Standards in their adoption. Comparative information has been reclassified wherever necessary to comply with the current presentation.

The significant accounting policies and estimates that involve a high degree of judgement and complexity were discussed with our external auditors and the Audit Committee.

The Board of Directors and the Management of the Bank accept responsibility for the integrity and objectivity of these financial statements. The estimates and judgements relating to the financial statements were made on a prudent and reasonable basis, in order that the financial statements reflect in a true and fair manner, the form and substance of transactions and that the Bank's state of affairs is reasonably presented. To ensure this, the Bank has taken proper and sufficient care in installing a system of internal control and accounting records, for safeguarding assets and for preventing and detecting frauds as well as other irregularities, which is reviewed, evaluated and updated on an ongoing basis. Our internal auditors have conducted periodic audits to provide reasonable assurance that the established policies and procedures of the Bank were consistently followed. However, there are inherent limitations that should be recognised in weighing the assurances provided by any system of internal controls and accounting.

The financial statements of the Group were audited by Messrs KPMG Ford, Rhodes, Thornton & Co., Chartered Accountants, ("KPMG") and their report is given on page 133 of the Annual Report.

The Audit Committee of the Bank meets periodically with the internal audit team and the external auditors to review their audit plans, assess the manner in which these auditors are performing their responsibilities and to discuss their reports on, internal controls and financial reporting issues. To ensure complete independence, the external auditors and the internal auditor have full and free access to the members of the Audit Committee to discuss any matter of substance.

The Audit Committee pre-approves the audit and non audit services provided by our external auditors, KPMG, in order to ensure that the provision of such services does not impair KPMG's independence.

We confirm that the Bank and all its subsidiaries have complied with all applicable laws and regulations and guidelines and that there are no material litigations that are pending against the Group other than those disclosed in the Notes 47 to the Financial Statements in the Annual Report.



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



**J D N Kekulawala**  
Chief Financial Officer

Colombo, Sri Lanka  
13th February 2009



# Audit Committee Report

## COMMITTEE COMPOSITION

The Audit Committee comprises of three Non Executive Directors, a majority of whom are independent. The Committee is chaired by Mr Ranjeevan Seevaratnam, who is a fellow member of the Institute of Chartered Accountants of Sri Lanka and the Institute of Chartered Accountants in England & Wales.

The members of the Board appointed Audit Committee are,

Mr Ranjeevan Seevaratnam

Mr D H S Jayawardena

Ms P C Cooray

The Company Secretary functions as the Secretary to the Audit Committee.

## MEETINGS

The Audit Committee met five times during the year. Attendance by the Committee members at each of these meetings is given in the table on page 75 of the Annual Report. The MD/CEO, CFO, External Auditor and the Head of Internal Audit also attended these meetings by invitation.

## FINANCIAL REPORTING

The Committee, as part of its responsibility to oversee the Bank's financial reporting process on behalf of the Board of Directors, has reviewed and discussed with the Management, the annual and the quarterly financial statements prior to their release, including the extent of compliance with the Sri Lanka Accounting Standards, the Companies Act, No. 7 of 2007, the Banking Act No. 30 of 1988 and subsequent amendments thereto. Matters of special interest in the current environment and the processes that support certifications of the financial statements by the Bank's MD / CEO and CFO were also brought up for discussion.

The Committee also confirmed with the CFO that financial reporting requirements relating to the GDR listing have been complied with.

## RISKS AND CONTROLS

During the year, the Committee reviewed the effectiveness of the Bank's internal control system and has reviewed quarterly reports on losses resulting from frauds or operational failures.

The Committee has reviewed the processes for identification, evaluation and management of all significant risks throughout the Bank and other Group entities. The Committee received and reviewed reports on all significant matters discussed by the Risk Committee.

During the year under review Integrated Risk Management Committee was formed in compliance with the Mandatory Code of Corporate Governance issued by the Central Bank of Sri Lanka, for Licensed Banks in Sri Lanka.

## EXTERNAL AUDIT

The Audit Committee undertook the annual evaluation of the independence and objectivity of the External Auditor and the effectiveness of the audit process.

The Committee met with the External Auditor during the year to discuss their audit approach and procedures, including matters

relating to the scope of the audit and Auditor's independence. The Lead Audit Partner is rotated every five years, in order to ensure the independence of the Auditor.

The Committee reviewed the Management Letter issued by the External Auditor together with the management responses thereto.

The Audit Committee reviewed the Non-Audit Services provided by the External Auditor and was of the view that such services were not within the category of services identified as restricted under;

- (i). 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 subsequent amendments thereto.
- (ii). The Guidelines for Listed Companies on Audit and Audit Committees issued by the Securities and Exchange Commission of Sri Lanka.

The Letter of Representation issued to the External Auditor was tabled at the Audit Committee Meeting.

The Audit Committee has recommended to the Board of Directors the re-appointment of the External Auditor, KPMG Ford, Rhodes, Thornton & Co. and fixed the Auditor's remuneration, for approval by the shareholders at the Annual General Meeting.

## INTERNAL AUDIT

During the year, the Audit Committee reviewed the performance of the internal audit function, the findings of the audits completed and the Department's resource requirements including succession planning and also approved the internal audit plan.

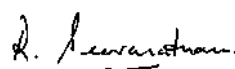
## REGULATORY COMPLIANCE

The Committee reviewed the procedures established by Management for compliance with the requirements of regulatory bodies. Assistant General Manager – Risk & Compliance submitted to the Audit Committee on a quarterly basis, a report on the extent to which the Bank was in compliance with mandatory banking & statutory requirements.

## COMMITTEE EVALUATION

The annual evaluation of the Committee was conducted by the Non-Executive Chairman, the Managing Director, the Chief Financial Officer, the Head of Internal Audit and the External Auditor in accordance with International best practices and was deemed to be satisfactory.

On behalf of the Audit Committee;



**R Seevaratnam**  
Chairman

Colombo, Sri Lanka  
13th February 2009

# Independent Auditors' Report



KPMG Ford, Rhodes, Thurston & Co.  
 Chartered Accountants  
 32A, Sir Michael Marston Mawatha,  
 P. O. Box 198,  
 Colombo 08303,  
 Sri Lanka.

Tel : +94 - 11 242 8428  
 +94 - 11 542 8426  
 Fax : +94 - 11 244 8872  
 +94 - 11 244 8088  
 +94 - 11 254 1248  
 +94 - 11 250 7526  
 Website : www.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, and the consolidated financial statements of the Company and its subsidiaries as at 31st December, 2008, which comprise the balance sheet as at that date, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes as set out on pages 134 to 206 of this Annual Report

### Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Sri Lanka Accounting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

### Scope of Audit and Basis of Opinion

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Sri Lanka Auditing Standards. Those standards require that we plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

We have obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purposes of our audit. We therefore believe that our audit provides a reasonable basis for our opinion.

### Opinion

In our opinion, so far as appears from our examination, the Company maintained proper accounting records for the year ended 31st December 2008 and the financial statements give a true and fair view of the Company's state of affairs as at 31st December 2008 and its profit and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs as at 31st December 2008 and the profit and cash flows for the year then ended, in accordance with Sri Lanka Accounting Standards, of the Company and its subsidiaries dealt with thereby, so far as concerns the members of the Company.

### Report on Other Legal and Regulatory Requirements

1. These financial statements also comply with the requirements of Sections 153(2) to 153(7) of the Companies Act No. 07 of 2007.
2. These financial statements present the information required by the Banking Act, No. 30 of 1988.

*Ford Rhodes Thurston & Co.*

CHARTERED ACCOUNTANTS  
 13th February 2009  
 Colombo, Sri Lanka

KPMG Ford, Rhodes, Thurston & Co. is a Sri Lanka Partnership  
 incorporated under the Companies Act No. 07 of 2007.  
 The firm is a member of the International Federation of Accountants (IFAC) and is a member of the Institute of Chartered Accountants of Sri Lanka (ICASA).

M. J. Jayasinghe FCA  
 M. S. Fernando FCA  
 P. V. S. Perera FCA  
 T. J. S. Manasinghe FCA  
 M. J. Jayasinghe FCA

S. S. Jayasinghe FCA  
 M. A. P. Perera FCA  
 C. P. Jayasinghe FCA  
 M. S. Jayasinghe FCA

# Income Statement

For the year ended 31st December	Note	Bank		Group	
		2008 Rs 000	2007 Rs 000	2008 Rs 000	2007 Rs 000
<b>INCOME</b>	9	<b>37,165,915</b>	29,994,718	<b>38,725,404</b>	32,075,889
Interest income	10	<b>32,431,158</b>	26,250,038	<b>32,829,516</b>	27,126,554
Less: Interest expenses	11	<b>19,751,667</b>	15,189,698	<b>20,287,224</b>	16,130,086
<b>Net interest income</b>		<b>12,679,491</b>	11,060,340	<b>12,542,292</b>	10,996,468
Foreign exchange profit		<b>1,166,979</b>	1,114,313	<b>1,169,084</b>	1,115,496
Fee and commission income	12	<b>2,364,434</b>	2,081,569	<b>2,434,503</b>	2,121,624
Dividend income	13	<b>538,321</b>	125,142	<b>216,512</b>	92,346
Other income	14	<b>665,023</b>	423,656	<b>2,075,789</b>	1,619,869
<b>Operating Income</b>		<b>17,414,248</b>	14,805,020	<b>18,438,180</b>	15,945,803
Less:					
<b>OPERATING EXPENSES</b>	15				
Personnel expenses	16	<b>3,561,562</b>	3,205,284	<b>3,831,233</b>	3,430,068
Premises, equipment and establishment expenses		<b>2,421,673</b>	2,124,829	<b>2,184,135</b>	1,858,684
Fee and commission expenses		<b>52,990</b>	78,212	<b>49,859</b>	79,268
Provision for employee retirement benefits	17	<b>787,128</b>	451,828	<b>795,495</b>	457,330
Provision for loan losses	18	<b>1,159,238</b>	907,913	<b>1,159,238</b>	907,913
Provision for fall in value of investments		<b>253,840</b>	-	<b>259,535</b>	2,006
Other expenses		<b>4,393,169</b>	3,702,200	<b>5,667,158</b>	4,660,267
		<b>12,629,600</b>	10,470,266	<b>13,946,653</b>	11,395,536
<b>PROFIT FROM OPERATIONS</b>		<b>4,784,648</b>	4,334,754	<b>4,491,527</b>	4,550,267
Share of profit / (loss) of associates (net of income tax)	19	-	-	<b>(6,401)</b>	14,317
<b>PROFIT BEFORE INCOME TAX</b>		<b>4,784,648</b>	4,334,754	<b>4,485,126</b>	4,564,584
Less: Income tax expense	20	<b>1,565,668</b>	1,312,298	<b>1,599,300</b>	1,364,782
<b>PROFIT FOR THE YEAR</b>		<b>3,218,980</b>	3,022,456	<b>2,885,826</b>	3,199,802
<b>Attributable to:</b>					
<b>Equity holders of the Bank</b>				<b>2,830,538</b>	3,150,469
<b>Minority interest</b>				<b>55,288</b>	49,333
<b>PROFIT FOR THE YEAR</b>		<b>3,218,980</b>	3,022,456	<b>2,885,826</b>	3,199,802
<b>BASIC EARNINGS PER SHARE (Rs)</b>	21	<b>13.67</b>	12.83	<b>12.02</b>	13.38
<b>DIVIDEND PER SHARE (Rs)</b>		<b>*4.00</b>	3.50	<b>*4.00</b>	3.50

The Notes to the Financial Statements from pages 139 to 206 form an integral part of these financial statements.

\*Calculated on Interim dividend paid and final proposed, which is to be approved at the Annual General Meeting.



# Balance Sheet

As at 31st December	Note	Bank		Group	
		2008 Rs 000	2007 Rs 000	2008 Rs 000	2007 Rs 000
<b>ASSETS</b>					
Cash and cash equivalents	22	23,301,952	19,158,706	23,559,937	19,275,322
Statutory deposit with Central Banks	23	11,847,323	13,405,856	11,861,998	13,405,856
Government treasury bills		-	-	759,137	1,156,357
Commercial papers		225,908	236,411	235,793	236,411
Securities purchased under re-sale agreements		1,400,000	3,450,000	2,539,256	5,859,205
Dealing securities	24	71,868	589,584	81,419	712,489
Investment securities	25	25,915,717	20,296,769	26,970,786	20,977,676
Bills of exchange	26	1,958,505	2,069,450	1,958,505	2,069,450
Loans and advances	27	161,301,826	144,985,264	159,461,752	143,414,872
Lease rentals receivable within one year	28	4,392,233	4,395,864	4,392,233	4,395,864
Lease rentals receivable after one year	28	7,096,976	8,893,584	7,096,976	8,893,584
Non-current assets held for sale	29	1,455	1,455	1,455	1,455
Investments in associates	30	132,326	132,326	143,700	165,093
Investment in joint venture	31	250,000	-	-	-
Investments in subsidiaries	32	2,179,086	2,293,663	-	-
Investment properties	33	187,467	188,661	176,313	180,628
Property, plant and equipment	34	6,865,648	6,082,558	13,901,017	13,181,575
Intangible assets	35	727,598	183,864	753,384	210,410
Other assets	36	7,414,284	6,542,333	8,096,318	6,866,302
<b>Total Assets</b>		<b>255,270,172</b>	<b>232,906,348</b>	<b>261,989,979</b>	<b>241,002,549</b>
<b>LIABILITIES</b>					
Deposits from customers	37	186,769,862	175,659,573	186,614,541	175,566,618
Dividends payable	38	127,303	30,321	127,303	30,321
Borrowings	39	15,401,290	9,897,731	15,401,078	9,904,451
Securities sold under re-purchase agreements		8,799,953	6,036,514	9,649,138	8,352,882
Bills payable		1,047,930	1,198,237	1,047,930	1,198,237
Current tax liabilities		2,380,633	1,539,288	2,416,260	1,605,160
Insurance provision - Life	40	-	-	1,360,505	880,674
Insurance provision - Non life	41	-	-	470,206	340,562
Subordinated debentures	42	2,754,851	4,623,794	3,734,851	5,588,794
Deferred tax liabilities	43	872,402	605,693	872,664	607,618
Other liabilities	44	16,535,011	14,896,167	17,026,386	15,407,909
<b>Total Liabilities</b>		<b>234,689,235</b>	<b>214,487,318</b>	<b>238,720,862</b>	<b>219,483,226</b>
<b>EQUITY</b>					
Stated capital	46	5,059,390	5,059,390	5,059,390	5,059,390
Statutory reserve fund		982,707	821,707	982,707	821,707
Retained earnings		3,045,537	2,747,440	2,616,620	2,861,252
Other reserves		11,493,303	9,790,493	14,262,584	12,557,315
<b>Total Equity attributable to equity holders of the Bank</b>		<b>20,580,937</b>	<b>18,419,030</b>	<b>22,921,301</b>	<b>21,299,664</b>
<b>Minority interest</b>		<b>-</b>	<b>-</b>	<b>347,816</b>	<b>219,659</b>
<b>Total Equity</b>		<b>20,580,937</b>	<b>18,419,030</b>	<b>23,269,117</b>	<b>21,519,323</b>
<b>Total Liabilities and Equity</b>		<b>255,270,172</b>	<b>232,906,348</b>	<b>261,989,979</b>	<b>241,002,549</b>
Commitments and Contingencies	47	68,065,957	57,963,574	68,065,957	57,963,574


The Notes to the Financial Statements from pages 139 to 206 form an integral part of these financial statements.

These Financial Statements are in compliance with the requirements of Companies Act, No. 7 of 2007.

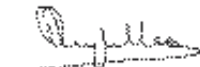


**Nihal Kekulawala**  
Chief Financial Officer

For and on behalf of the Board



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



**Rienzie T. Wijetilleke**  
Chairman



**Indrani Goonesekera**  
Deputy General Manager Legal /  
Board Secretary

Colombo, Sri Lanka  
13th February 2009

# Statement of Changes in Equity

Bank	Attributable to Equity Holders of the Bank									Minority Interest	Total
	Stated Capital			Statutory Reserve Fund	Other Reserves				Retained Earnings		
	Voting Shares	Non-Voting Shares	Share Premium		Capital Reserve	General Reserve	Repairs & Renovation Reserve	Exchange Equalisation Reserve			
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000		
Balance as at 31.12.2006	946,647	231,000	2,704,096	669,707	240,262	6,395,000	6,700	-	1,736,396	-	12,929,808
Bonus issue	946,647	231,000	-	-	-	(1,177,647)	-	-	-	-	-
Final dividend for 2006	-	-	-	-	-	-	-	-	(294,412)	-	(294,412)
Revaluation surplus [Note 34]	-	-	-	-	2,778,725	-	-	-	-	-	2,778,725
Deferred tax liability on Revaluation Reserve [Note 43 (a)]	-	-	-	-	(17,547)	-	-	-	-	-	(17,547)
Profit for the year 2007	-	-	-	-	-	-	-	-	3,022,456	-	3,022,456
Transfers during the year 2007	-	-	-	152,000	-	1,565,000	-	-	(1,717,000)	-	-
<b>Balance as at 31.12.2007</b>	<b>1,893,294</b>	<b>462,000</b>	<b>2,704,096</b>	<b>821,707</b>	<b>3,001,440</b>	<b>6,782,353</b>	<b>6,700</b>	<b>-</b>	<b>2,747,440</b>	<b>-</b>	<b>18,419,030</b>
Final dividend for 2007	-	-	-	-	-	-	-	-	(824,353)	-	(824,353)
Deferred tax liability for Revaluation Reserve [Note 43 (a)]	-	-	-	-	2,810	-	-	-	-	-	2,810
Profit for the year 2008	-	-	-	-	-	-	-	-	3,218,980	-	3,218,980
Interim dividend 2008	-	-	-	-	-	-	-	-	(235,530)	-	(235,530)
Transfers during the year 2008	-	-	-	161,000	-	1,700,000	-	-	(1,861,000)	-	-
<b>Balance as at 31.12.2008</b>	<b>1,893,294</b>	<b>462,000</b>	<b>2,704,096</b>	<b>982,707</b>	<b>3,004,250</b>	<b>8,482,353</b>	<b>6,700</b>	<b>-</b>	<b>3,045,537</b>	<b>-</b>	<b>20,580,937</b>

Group	Attributable to Equity Holders of the Bank									Minority Interest	Total
	Stated Capital			Statutory Reserve Fund	Other Reserves				Retained Earnings		
	Voting Shares	Non-Voting Shares	Share Premium		Capital Reserve	General Reserve	Repairs & Renovation Reserve	Exchange Equalisation Reserve			
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000		
Balance as at 31.12.2006	946,647	231,000	2,704,096	669,707	240,262	6,395,000	6,700	-	1,722,195	180,326	13,095,933
Bonus issue	946,647	231,000	-	-	-	(1,177,647)	-	-	-	-	-
Final dividend for 2006	-	-	-	-	-	-	-	-	(294,412)	(10,000)	(304,412)
Revaluation surplus [Note 34]	-	-	-	-	5,545,547	-	-	-	-	-	5,545,547
Deferred tax liability on Revaluation Reserve [Note 43 (a)]	-	-	-	-	(17,547)	-	-	-	-	-	(17,547)
Profit for the year 2007	-	-	-	-	-	-	-	-	3,150,469	49,333	3,199,802
Transfers during the year 2007	-	-	-	152,000	-	1,565,000	-	-	(1,717,000)	-	-
<b>Balance as at 31.12.2007</b>	<b>1,893,294</b>	<b>462,000</b>	<b>2,704,096</b>	<b>821,707</b>	<b>5,768,262</b>	<b>6,782,353</b>	<b>6,700</b>	<b>-</b>	<b>2,861,252</b>	<b>219,659</b>	<b>21,519,323</b>
Final dividend for 2007	-	-	-	-	-	-	-	-	(824,353)	(15,002)	(839,355)
Deferred tax liability for Revaluation Reserve [Note 43 (a)]	-	-	-	-	2,810	-	-	-	-	-	2,810
Disposal of subsidiaries	-	-	-	-	-	-	-	-	(154,287)	-	(154,287)
Investment in foreign subsidiary	-	-	-	-	-	-	-	2,459	-	87,871	90,330
Profit for the year 2008	-	-	-	-	-	-	-	-	2,830,538	55,288	2,885,826
Interim dividend for 2008	-	-	-	-	-	-	-	-	(235,530)	-	(235,530)
Transfers during the year 2008	-	-	-	161,000	-	1,700,000	-	-	(1,861,000)	-	-
<b>Balance as at 31.12.2008</b>	<b>1,893,294</b>	<b>462,000</b>	<b>2,704,096</b>	<b>982,707</b>	<b>5,771,072</b>	<b>8,482,353</b>	<b>6,700</b>	<b>2,459</b>	<b>2,616,620</b>	<b>347,816</b>	<b>23,269,117</b>

The Notes to the financial statements from page 139 to 206 form an integral part of these financial statements.

In accordance with Section 58 of Companies Act, No. 7 of 2007, share capital and share premium have been classified as stated capital.

Statutory Reserve Fund represents the statutory requirement in terms of Section 20 (1) and (2) of the Banking Act No. 30 of 1988.

Capital Reserve relates to revaluation of Freehold Land & Buildings carried out in 1989, 1993 & 2007 and includes the surplus on revaluation of those assets.

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

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

# Cash Flow Statement

For the year ended 31st December	Bank		Group	
	2008 Rs 000	2007 Rs 000	2008 Rs 000	2007 Rs 000
<b>Cash flows from operating activities</b>				
Interest and commission receipts	34,795,592	28,331,607	35,264,019	29,248,178
Interest payments	(19,710,316)	(15,152,499)	(20,245,872)	(16,092,887)
Receipts from other operating activities	1,373,716	1,233,745	2,863,710	2,430,774
Cash payments to employees	(4,058,190)	(3,657,112)	(4,327,861)	(3,881,896)
Cash payments to suppliers	(1,849,311)	(1,637,594)	(1,463,871)	(1,233,152)
Payments for other operating activities	(4,385,041)	(3,362,226)	(5,046,422)	(3,927,372)
<b>Operating profit before changes in operating assets and liabilities [Note (a)]</b>	<b>6,166,450</b>	<b>5,755,921</b>	<b>7,043,703</b>	<b>6,543,645</b>
<b>(Increase) / Decrease in operating assets:</b>				
Treasury bills / commercial papers	2,060,503	(3,395,747)	2,996,267	(1,411,668)
Deposits held for regulatory or monetary control purposes	1,558,533	(1,389,324)	1,543,858	(1,389,324)
Loans and advances	(15,379,923)	(27,383,184)	(15,069,852)	(26,248,127)
Other short term assets	(1,077,960)	(1,852,899)	(918,504)	(2,035,602)
<b>Increase / (Decrease) in operating liabilities:</b>				
Deposits from customers	10,861,341	27,429,789	10,798,976	27,431,053
Negotiable certificates of deposit	248,947	672,329	248,947	672,329
Other liabilities	1,203,400	4,939,081	952,519	4,996,495
<b>Net cash generated from / (used in) operating activities before income tax</b>	<b>5,641,291</b>	<b>4,775,966</b>	<b>7,595,914</b>	<b>8,558,801</b>
Income taxes paid	(457,614)	(260,349)	(525,964)	(263,138)
<b>Net cash generated from operating activities</b>	<b>5,183,677</b>	<b>4,515,617</b>	<b>7,069,950</b>	<b>8,295,663</b>
<b>Cash flows from investing activities</b>				
Dividend income	538,321	125,142	216,512	92,346
Income from investment securities	-	5,528	-	5,528
Net proceeds from sale of securities	254,281	182,348	(1,988,052)	112,144
Net proceeds from sale of investment securities	(5,280,699)	149,392	(5,756,318)	2,453,119
Purchase of Property, Plant & Equipment	(1,353,672)	(912,300)	(1,373,369)	(940,125)
Purchase of Intangible assets	(551,126)	(16,813)	(562,895)	(22,779)
Improvements to Investment properties	-	-	(88)	-
Proceeds from sale of Property, Plant & Equipment	14,782	31,132	14,941	32,122
Investments in Subsidiaries	(56,121)	-	-	-
Net cash effect on disposal of Subsidiary companies [Note (b)]	-	-	(32,599)	-
Net cash effect on investment in joint venture [Note (c)]	-	-	98,127	-
<b>Net cash generated from / (used in) investing activities</b>	<b>(6,434,234)</b>	<b>(435,571)</b>	<b>(9,383,741)</b>	<b>1,732,355</b>
<b>Cash flows from financing activities</b>				
Increase / (Decrease) in Debentures	(1,910,294)	(533,405)	(1,895,295)	(1,557,598)
Increase / (Decrease) of borrowings	8,266,998	(2,269,163)	9,471,610	(7,102,040)
Dividends paid	(962,901)	(302,194)	(977,909)	(312,194)
<b>Net cash generated from / (used in) financing activities</b>	<b>5,393,803</b>	<b>(3,104,762)</b>	<b>6,598,406</b>	<b>(8,971,832)</b>
Net increase in cash and cash equivalents	4,143,246	975,284	4,284,615	1,056,186
Cash and cash equivalents at beginning of the year	19,158,706	18,183,422	19,275,322	18,219,136
<b>Cash and cash equivalents at end of the year [Note (22)]</b>	<b>23,301,952</b>	<b>19,158,706</b>	<b>23,559,937</b>	<b>19,275,322</b>

# Cash Flow Statement

For the year ended 31st December	Bank		Group	
	2008 Rs 000	2007 Rs 000	2008 Rs 000	2007 Rs 000
<b>Note (a) Reconciliation of operating profit</b>				
Profit before taxation	4,784,648	4,334,754	4,485,126	4,564,584
Dividend income	(538,321)	(125,142)	(216,512)	(92,346)
Income from investment securities	-	(5,528)	-	(5,528)
(Profit)/loss on sale of Property, Plant and Equipment	(7,979)	(18,653)	(8,030)	(19,201)
Bad debts recovered	(296,019)	(280,042)	(296,019)	(280,042)
Loss on FCBU revaluation	46,290	13,796	46,290	13,796
Depreciation of Property, Plant and Equipment	479,721	420,970	613,845	548,881
Depreciation of Investment Properties	1,194	1,194	4,403	4,397
Amortization of Intangible Assets	91,446	65,070	102,017	72,254
Provision for loan losses	1,159,238	907,913	1,159,238	907,913
Loss on marked to market valuation of dealing securities	14,674	30,037	14,674	30,037
Unclaimed VAT written off	-	200,310	-	200,310
Provision for Employees Retirement Benefits	290,500	-	298,867	5,502
Impairment loss on fixed assets	-	87,764	-	87,764
Loss from sale of dealing securities	154	86,279	154	86,279
Provision for non-life and life insurance fund	-	-	609,476	393,977
Provision for fall in value in investments	253,840	-	259,535	2,006
Profit from sale of Subsidiaries	(154,287)	-	(77,113)	-
Share of Associates (profit) / loss (net of Income Tax)	-	-	6,401	(14,137)
Interest capitalised on debentures	41,351	37,199	41,351	37,199
	<b>6,166,450</b>	<b>5,755,921</b>	<b>7,043,703</b>	<b>6,543,645</b>

<b>Note (b) Net Identifiable assets / liabilities of disposed subsidiaries as at the date of disposal</b>	<b>Rs 000</b>
Property, Plant & Equipment	12,630
Intangible Assets	6,971
Reverse repurchase agreements	486,533
Investment Securities	3,468,341
Trade & Other Receivable	183,767
Cash & cash equivalents	32,599
Employee retirement benefits	(3,563)
Payable under repurchase agreements	(3,571,635)
Trade & Other payable	(150,935)
Current & Deferred Taxation	(64,708)
Net identifiable assets and liabilities	400,000
Share of net assets of HNB Securities Ltd since classified as long term investment	(150,000)
	250,000

<b>Note (c) Bank's share of net Identifiable assets / liabilities of investment in joint venture as at the date of investment</b>	
Property, Plant & Equipment	12,231
Intangible Assets	2,735
Investment Securities	887,269
Reverse repurchase agreements	162,233
Trade & Other Receivables	383,596
Cash & cash equivalents	98,127
Employee retirement benefits	(2,518)
Payable under repurchase agreements	(892,909)
Trade & Other payables	(377,104)
Current & Deferred Taxation	(14,968)
Net identifiable assets and liabilities	250,000

The Notes to the Financial Statements from pages 139 to 206 form an integral part of these financial statements

# Notes to the Financial Statements

## 1. REPORTING ENTITY

Hatton National Bank PLC ("Bank") is a public quoted company incorporated on 5th March 1970 with limited liability and domiciled in Sri Lanka. The registered office of the Bank is situated at No. 479, T B Jayah Mawatha, Colombo 10. The shares of the Bank have a primary listing on the Colombo Stock Exchange, while the Global Depository Receipts (GDR's) issued by the Bank have a primary listing on the Luxemburg Stock Exchange.

The staff strength of the Bank as at 31st December 2008 is 4,395 (2007 – 4,334).

The consolidated financial statements of the Bank for the year ended 31st December 2008 include the Bank and its Subsidiaries (together referred to as the "Group" and individually as "Group entities") and the Group's interest in its Associates and Joint venture.

The Bank does not have an identifiable parent of its own.

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

### 1.1 Principal Activities

#### 1.1.1 Bank

The principal activities of the Bank continued to be banking and related activities such as accepting deposits, corporate and retail banking, personal financial services, off shore banking, foreign currency operations, trade services, investment banking, development banking, rural finance, project finance, dealing in government securities etc.

#### 1.1.2 Subsidiaries

The Subsidiaries of the Bank are HNB Assurance PLC, Sithma Development (Pvt) Limited and Majan Exchange LLC and the principal activities of these subsidiaries are insurance services, property development & provision of remittances and foreign currency related services respectively.

#### 1.1.3 Associate

The Associate of the Bank is M/s Lanka Ventures PLC and the principal activities of the associate is providing venture capital services.

#### 1.1.4 Joint Venture

The joint venture of the Bank is Acuity Partners (Pvt) Ltd and its principal activities are operating as an investment company & providing financial services.

## 2. BASIS OF PREPARATION

### 2.1 Statement of Compliance

The Balance Sheet, Income Statement, Statement of Changes in Equity and Cash Flow Statement have been prepared in accordance with the Sri Lanka Accounting Standards laid down by the Institute of Chartered Accountants of Sri Lanka, and comply with the requirements of Companies Act No. 7 of 2007 and Banking Act No. 30 of 1988 and amendments thereto.

### 2.2 Approval of Financial Statements by Directors

The financial statements were authorised for issue by the Board of Directors on 13th February 2009.

### 2.3 Basis of Measurement

The financial statements have been prepared on the historical cost basis and applied consistently with no adjustments being made for inflationary factors affecting the financial statements, except for the following;

- Land and buildings are measured at cost at the time of acquisition and subsequently at revalued amounts, which are the fair values at the date of revaluation less accumulated depreciation and impairment losses, if any.
- Dealing securities are measured at market value.

### 2.4 Functional and Presentation Currency

The financial statements are presented in Sri Lankan Rupees, which is the Bank's functional currency. Except as indicated, financial information presented in Sri Lankan Rupees has been rounded to the nearest thousand.

### 2.5 Use of Estimates and Judgements

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

Information about significant areas of estimation and uncertainty that have the most significant effect on the amounts recognised in the financial statements are described in Note No. 2.5.1 to 2.5.4.

## 2.5.1 Provision for Loan Losses

In addition to the specific provisions for possible loan losses made on the basis of a continuous review of all loans and advances to customers in accordance with the Sri Lanka Accounting Standard 23, "Revenue Recognition and Disclosures in the Financial Statements of Banks" and the directions issued by the Central Bank of Sri Lanka, the Bank evaluates the need for additional provisions for loans and advances based upon management's best estimate of recoverability. In estimating the recoverability the management makes judgments about the borrower's financial situation, the workout strategy and the net realisable value of any underlying collateral.

The general provisions cover loan losses inherent in portfolios with similar credit risk characteristics (portfolios of Pawning, Lease receivables and Shanthi housing loans) when there is objective evidence to suggest that they contain impaired loans, but the individual impaired loans cannot yet be identified. In assessing the need for general provision for loan losses, management considers factors such as credit quality, portfolio size, concentrations, and economic factors. In order to estimate the required provisions, assumptions are made to define the way inherent losses are determined based on historical experience.

## 2.5.2 Classification of Dealing (Trading) and Investment Securities

In classifying securities as "Dealing" (Trading), the Bank has determined that it meets the description set out in Note No. 4.6.1

In classifying securities as "Investment", the Bank has determined that it has both the positive intention and ability to hold the securities until their maturity date as required by Note No. 4.6.2

## 2.5.3 Assessment of Impairment

The Bank assesses at each Balance Sheet date whether there is objective evidence that an asset or a portfolio of assets is impaired. The recoverable amount of an asset or a cash generating unit is the greater of its value in use and its fair value less cost to sell. In assessing value in use, the estimated future cash flows are discounted to present value using appropriate discount rates that reflects the current market assessments of the time value of money and risks specific to the asset.

## 2.5.4 Employee Retirement Benefits

The liability as at Balance Sheet date was actuarially valued based on the assumptions set out in Note No. 45 (a) v.

## 3. MATERIALITY AND AGGREGATION

Each material class of similar items is presented separately in the financial statements. Items of a dissimilar nature or function are presented separately unless they are immaterial.

## 4. SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below have been applied consistently to all periods presented in these financial statements. The accounting policies of the Bank have been consistently applied by Group entities where applicable and deviations if any, have been disclosed accordingly.

### 4.1 Basis of Consolidation

#### 4.1.1 Subsidiaries

Subsidiaries are entities that are controlled by the Bank. Control exists when the Bank has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights, that presently are exercisable are taken into account. The financial statements of Subsidiaries are included in the consolidated financial statements from the date that control effectively commences until the date that control effectively ceases.

The Minority Interests are presented in the consolidated Balance Sheet within Equity, separately from the equity attributable to the Equity Holders of the Bank. Minority Interests in the profit or loss of the Group are disclosed separately in the consolidated Income Statement.

The consolidated financial statements are prepared to a common financial year end of 31st December. The accounting policies of subsidiaries have been changed where ever necessary to align them with the policies adopted by the Group.

A list of Subsidiaries within the Group is provided in Note No. 32.

#### 4.1.2 Associates

Associates are entities in which the Bank has significant influence, but no control over the financial and operating policies. Significant influence is presumed to exist when the Bank holds between 20 and 50 percent of the voting power of another entity. The Associates are accounted for using the equity method and are recognised initially at cost. The Bank's investments include goodwill identified on acquisition, net of any accumulated impairment losses. The consolidated financial statements include the Bank's share of the income and expenses and equity movements of the Associate, after adjustments being made to align the accounting policies with those of the

Group from the date that significant influence effectively commences until the date that significant influence effectively ceases.

When the Bank's share of losses exceeds its interest in the Associate, the carrying amount of that interest is reduced to nil and the recognition of further losses is discontinued except to the extent that Bank has an obligation or made payments on behalf of the Associate. If the associate subsequently reports profits, the Bank resumes recognising its share of those profits only after its share of the profits equals the share of losses not recognised.

The Bank discontinues the use of the equity method from the date that it ceases to have significant influence over an Associate and re classifies the investment as "Investment securities" in accordance with Sri Lanka Accounting Standard 22 "Accounting for Investments".

A list of Associates within the Group is provided in Note No. 30.

#### **4.1.3 Joint Venture**

Joint venture is an entity over whose activities the Bank has joint control, established by contractual arrangement and requiring unanimous consent for strategic, financial and operating decisions. The Bank recognises its interest in the Joint Venture using the line by line reporting format for proportionate consolidation method and is recognised initially at cost.

The Bank combines its share of each of the assets, liabilities, income and expense of the Joint Venture with similar items, line by line in the consolidated financial statements from the date that joint control commences, until the date joint control ceases.

Details of the Joint Venture are provided in Note No. 31

#### **4.1.4 Transactions Eliminated On Consolidation**

Intra-group balances and transactions and any unrealised gains arising from intra-group transactions, are eliminated in preparing the consolidated financial statements. Unrealised gains arising from transactions with Associates/Joint Venture are eliminated to the extent of the Group's interest in the Associates / Joint Venture against the investment in the Associate/ Joint Venture. Unrealised losses are eliminated in the same way as unrealised gains except that they are only eliminated to the extent that there is no evidence of impairment.

## **4.2 Foreign Currency Translation**

Transactions in foreign currencies are translated to Sri Lankan Rupees at the middle rate of exchange ruling at the dates of the transactions.

Monetary assets and liabilities denominated in foreign currencies at the Balance Sheet date are translated to Sri Lankan Rupees at the middle rate of exchange ruling at that date. Foreign exchange differences arising on the settlement or reporting of the Bank's monetary items at rates different from those which were initially recorded are dealt with in the Income Statement.

Non-monetary assets and liabilities denominated in foreign currency that are stated at historical cost at the Balance Sheet date are translated to Sri Lankan Rupees at the foreign exchange rates ruling at the date of the initial transaction.

The financial statements of foreign entities within the Group whose functional currency is different to presentation currency, (Sri Lankan Rupees) are translated to Sri Lankan Rupees using the following procedures.

Assets and liabilities are translated at the middle rate of exchange at the date of Balance sheet.

Income and expenses are translated at the middle rate of exchange ruling during the period under consideration.

All resulting foreign exchange differences are recognised directly in equity.

The Income Statement and the Balance Sheet of the Foreign Currency Banking Unit is translated to Sri Lankan Rupees at the middle rate of exchange ruling at the balance sheet date.

Forward Exchange Contracts are valued at the forward market rates ruling on the date of the Balance Sheet. Resulting net unrealised gains and losses are dealt with through the Income Statement.

## **ASSETS AND BASES OF THEIR VALUATION**

### **4.3 Cash and Cash Equivalents**

Cash and cash equivalents include cash in hand, balances with banks, placements with banks, money at call and short notice and money market funds. They are brought to account at the face value or the gross value where appropriate.

#### 4.4 Statutory Deposit with Central Banks

The Monetary Law Act requires that all commercial banks operating in Sri Lanka maintain reserves against all deposit liabilities denominated in Sri Lankan Rupees. The licensing regulations for Exchange Houses issued by the Central Bank of Oman require that all Exchange Houses maintain a deposit with the Central Bank of Oman.

The details of reserve requirements are given in Note No. 23.

#### 4.5 Government of Sri Lanka Treasury Bills and Bonds

##### 4.5.1 Investment in Treasury Bills and Bonds held for dealing

Investments in Treasury Bills and Treasury Bonds in dealing portfolio are those investments that the Group acquires or incurs principally for the purpose of selling, or holds as part of a portfolio that is managed for short term profit. These investments are initially recognised and subsequently measured at market value in the Balance Sheet. Gains and losses on marked to market valuation are dealt with through the Income Statement.

##### 4.5.2 Securities Purchased Under Re-sale Agreements

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

#### 4.6 Investments

##### 4.6.1 Dealing (Trading) Securities

Dealing (Trading) securities are those investments that are acquired or incurred principally for the purpose of selling or holding as part of a portfolio that is managed for short term profit. These investments are initially recognised at cost and subsequently measured at market value. Gains and losses on marked to market valuations are dealt with through the Income Statement.

##### 4.6.2 Investment Securities

These are securities which are acquired and held for yield or capital growth in the medium/long term with the positive intent and ability to hold until maturity. Such securities are recorded at cost. Interest and dividend income are accrued. Changes in market values of these securities are not taken into account, unless there is considered to be a diminution in value which is other than temporary.

Investments in Treasury bills/bonds in the investment portfolio are initially measured at market value of bills/bonds purchased and the discount/premium accrued thereon.

##### 4.6.3 Investments in Subsidiaries

Investments in Subsidiaries are stated at cost in the Bank's financial statements.

##### 4.6.4 Investments in Associates

Investments in Associates are accounted for at cost in the Bank's financial statements and under the Equity method in the consolidated financial statements.

Under the Equity method, the Investments in Associates are initially accounted for at cost and the carrying amount is adjusted for post acquisition changes in the Bank's share of net assets of the Associates, less any impairment in the Bank's net Investments in Associates.

##### 4.6.5 Investment in Joint Venture

Investment in Joint Ventures are accounted for at cost in the Bank's financial statements and under the proportionate consolidation method in the consolidated financial statements.

#### 4.7 Non-Current Assets Held For Sale

Non-current assets that are expected to be recovered primarily through sale rather than through continuing use are classified as "held for sale" once identified that the carrying amount will be recovered principally through a sale transaction rather than through continuing use. These are assets which are available for immediate sale in their present condition, subject to only the terms that are usual and customary for sale of such assets and their sale is highly probable.

"Non-Current Assets Held For Sale" are presented separately on the face of the balance sheet at the lower of its carrying amount and fair value less costs to sell.

Assets classified as "Non-Current Assets Held For Sale" are neither amortised nor depreciated.

Impairment losses on initial classification as held for sale and subsequent gains and losses on re measurement are recognised in the Income Statement.

#### 4.8 Loans and Advances to Customers

Loans and advances to customers are stated in the Balance Sheet at the recoverable amount represented by the gross value of the outstanding balance adjusted for provision of loan losses and interest in suspense (interest which is not accrued to revenue).



#### 4.8.1 Non-Performing Loans and Advances

The loans and advances are classified as Non Performing Advances (NPA) based on the criteria set out in Direction No. 3 of 2008 dated 8th May 2008, issued by the Central Bank of Sri Lanka on "Classification of Loans and Advances, Income Recognition and Provisioning". Details of the criteria referred to above are given in Note No. 27 (c).

Up to the date of issue of amended Direction referred to above, the loans and advances which were 90 days or more in arrears of due capital and / or interest were classified as non-performing.

Provision for possible loan losses are made on the basis of a continuous review of all loans and advances to customers in accordance with the Sri Lanka Accounting Standard 23, "Revenue Recognition and Disclosures in the Financial Statements of the Banks" and the Directions issued by the Central Bank of Sri Lanka and disclosed in the Financial Statements of the Bank.

#### 4.8.2 Foreclosed Properties

Foreclosed properties represent properties acquired in full or partial settlement of loans and advances up to 2001 and are yet to be disposed. From 2001 onwards this practice was discontinued where by loans and advances in satisfaction of which properties are acquired, continue to be classified as non-performing loans and advances. These are accounted for at the lower of cost or market value on an individual property basis. The shortfall between the prevailing market value of the property and the related loan outstanding is recognised as a provision for loan losses in the Income Statement during the year of acquiring the said property in satisfaction of the loan. Any shortfall between the carrying amount of these properties and their respective market values identified subsequently is charged as a provision for loan losses in the Income Statement. Subsequent gains and losses on the disposal of the said properties are treated as provisions written back or charged to the Income Statement respectively. These properties are recorded under loans and advances until those are disposed off.

#### 4.8.3 Provision for Loan Losses

##### 4.8.3 (a) Specific provisions for loan losses are made as follows:

In accordance with the Direction issued by the Central Bank of Sri Lanka on 08th May 2008, Direction No 3 of 2008 "Classification of Loans & Advances, Income Recognition & Provisioning" specific provisions on NPA are made as follows.

Category of NPA credit quality	Minimum specific provision requirement
Substandard	
Credit cards	25%
Other advances	20%
Doubtful	50%
Loss	100%

The provision made relates to all categories of loans and advances including pawning and leasing identified as substandard, doubtful and loss.

Where necessary, specific provisions have been made over and above the minimum percentages stipulated above, on a case by case basis.

##### 4.8.3 (b) General Provision

The amount of potential losses not specifically identified but which experience indicates are present in the portfolio of Pawning, Lease receivables and Shanthi housing loans are recognised as a general provision in the Income Statement. Accordingly, a general provision of 0.1% of the total portfolio of Pawning facilities, 2% of the Lease receivables (net of specific provision) and 0.2% of the total portfolio of Shanthi housing loans is made in the Income Statement.

The Direction issued by the Monetary Board of the Central Bank of Sri Lanka on 5th December 2006, in terms of Section 46 of the Banking Act No 30 of 1988, as amended, in "Requirements to Maintain a General Provision for Advances" requires all licensed commercial banks to maintain a general provision of 1% of the total on balance sheet performing loans and advances and on balance sheet overdue loans and advances, net of interest in suspense and credit facilities secured by cash deposits, gold or Government securities with the same bank. The general provision was commenced with a minimum of 0.1% provision as at 31st December 2006 and thereafter incremental provisions are being made on the same basis till 31st March 2009, with the view of meeting the total provision requirement of 1% not later than 31st March 2009.

The Direction referred to above was revoked and replaced by the Direction issued on 8th May 2008 on "Classification of Loans and Advances, Income Recognition and Provisioning" which reiterated the above basis for general provisioning.

#### **4.8.4 Revenue Recognition on Non-performing Loans**

When an advance is classified as non-performing based on criteria set out in Direction No. 3 of 2008 dated 8th May 2008 issued by the Central Bank of Sri Lanka on "Classification of Loans and Advances, Income Recognition and Provisioning" as explained in Note No. 27 (c), interest ceases to be recognised and is taken to income thereafter on cash basis.

Upto the date of issue of the amended Direction referred to above, interest ceased to be recognised on Loans and Advances when due capital and / or interest were in arrears for more than 90 days. Interest was taken to Income on cash basis thereafter.

#### **4.9 Finance Leases**

Assets leased to customers which transfer substantially all the risks and rewards associated with ownership other than legal title, are classified as finance leases. Amounts receivable under finance leases are included under 'Lease Rentals Receivable'. Leasing balances are stated in the Balance Sheet after deduction of initial rentals received, unearned lease income and the provisions for rentals doubtful of recovery.

##### **4.9.1 Provision for Lease Receivables**

Specific provision has been made in relation to identified non performing leases as stated above in Note No 4.8.3 (a). In addition, a general provision has been made as stated above in Note No. 4.8.3 (b).

#### **4.10 Intangible Assets**

##### **4.10.1 Basis of Recognition**

An intangible asset is recognised if it is probable that the future economic benefits that are attributable to the asset will flow to the entity and the cost of the assets can be measured reliably.

##### **4.10.1 (a) Goodwill**

Goodwill arising on the acquisition represents the excess of the cost of acquisition over the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities at the date of acquisition. Upon transition to revised Sri Lanka Accounting Standard 25 "Business Combinations", goodwill is no longer amortised. Instead, goodwill is tested for impairment annually and assessed for any indication of impairment at each reporting date to ensure that its carrying amount does not exceed its recoverable amount. If an impairment loss is identified, it will be recognised immediately in the Income Statement.

The negative goodwill is recognised immediately in the Income Statement.

##### **4.10.1 (b) Software**

All computer software costs incurred, licensed for use by the Group, which are not integrally related to associated hardware, which can be clearly identified, reliably measured and it's probable that they will lead to future economic benefits, are included in the Balance Sheet under the category intangible assets and carried at cost less accumulated amortisation and any accumulated impairment losses.

##### **4.10.2 Subsequent Expenditure**

Expenditure incurred on software is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

##### **4.10.3 Amortisation**

Intangible assets, except for goodwill, are amortised on a straight line basis in the Income Statement from the date when the asset is available for use, over the best estimate of its useful economic life. The estimated useful life of software is six years.

#### **4.11 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 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, - "Investment Property" (Revised 2005). Accordingly, land classified as investment properties are stated at cost and buildings classified as investment properties are stated at cost less any accumulated depreciation and any accumulated impairment losses.

#### 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	
Freehold buildings	2.5% per annum
[Refer Note No. 33 (a)]	
Sithma Development (Pvt) Ltd*	
Freehold buildings	2.5% per annum
(Smart building)	
[Refer Note No. 33 (b)]	
Plant, machinery & equipment	
integral to freehold buildings	20% per annum
referred to above	

\* Sithma Development (Pvt) Limited

The HNB Towers which is owned by Sithma Development (Pvt) Ltd ("Sithma"), is leased to occupants including the Bank. However, the ancillary services provided by Sithma Development (Pvt) Ltd to the occupants of HNB Towers, is a significant component of the arrangement as a whole. Therefore, HNB Towers is not classified as Investment Property in the financial statements of Sithma, but has been classified under Property, Plant and Equipment in accordance with Sri Lanka Accounting Standard 40 "Investment Property" (Revised 2005).

#### 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 property only when there is a change in use.

### 4.12 Property, Plant & Equipment

Property, Plant & Equipment are tangible items that are held for servicing, or for administrative purposes and are expected to be used during more than one period.

#### 4.12.1 Basis of Recognition

Property, Plant & 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 & 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 & Equipment except freehold land & buildings and records at cost of purchase or construction together with any incidental expenses thereon less accumulated depreciation and any accumulated impairment losses.

#### 4.12.4 Revaluation Model

The Group applies the revaluation model for the entire class of freehold land and buildings. Such properties are carried at a revalued amount, being their fair value at the date of revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Freehold land & buildings of the Group are revalued every seven years on a roll over basis to ensure that the carrying amounts do not differ materially from the fair values at the Balance Sheet date. On revaluation of an asset, any increase in the carrying amount is credited directly to equity, under capital reserve or used to reverse a previous revaluation decrease relating to the same asset, which was debited to the Income Statement. In this circumstance, the increase is recognised as income to the extent of the previous write down. Any decrease in the carrying amount is recognised as an expense in the Income Statement or debited directly to equity under revaluation reserve to the extent of any credit balance existing in the capital reserve in respect of that asset.

#### 4.12.5 Subsequent Costs

The cost of replacing part of an item of Property, Plant & Equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within that part will flow to the Group and its cost can be reliably measured. The costs of day to day servicing of Property, Plant & Equipment are charged to the Income Statement as incurred.

#### 4.12.6 Derecognition

The carrying amount of an item of Property, Plant & Equipment is derecognised on disposal or when no

future economic benefits are expected from its use or disposal. The gain or loss arising from the derecognition of an item of Property, Plant & Equipment is included in Income Statement when the item is derecognised.

When replacement costs are recognised in the carrying amount of an item of Property, Plant and Equipment, the remaining carrying amount of the replaced part is derecognised. Major inspection costs are capitalised. At each such capitalisation, the remaining carrying amount of the previous cost of inspections is derecognised.

#### 4.12.7 Depreciation

The Group provides depreciation from the date the assets are available for use up to the date of disposal, at the following rates on a straight line basis over the periods appropriate to the estimated useful lives of the different types of assets, except for which are disclosed separately.

#### HNB and subsidiary companies (except for Sithma Development (Pvt) Ltd.)

	% per annum
Freehold buildings	2.5
Motor vehicles	25
Computer equipment	16.7
Office equipment	20
Furniture and fittings	10
Fixtures	10
Civil works (Majan Exchange LLC)	10
Improvements to leasehold buildings	over the lease period

Depreciation is not provided for freehold land.

#### Sithma Development (Pvt) Ltd.

	% per annum
Freehold buildings - Sithma building	1
Generators, generator panels and associated power cables	2
Chillers, cooling towers and associated equipment	4
Lifts and escalator	4
Building management systems	4
Plant and machinery	20
Equipment	20
Motor vehicles	25

#### 4.12.8 Capital Work-in-Progress

Capital work-in-progress is stated at cost. These are expenses of a capital nature directly incurred in the construction of buildings, major plant and machinery and system development, awaiting capitalisation.

#### 4.12.9 Borrowing Costs

Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset have been capitalised as part of the cost of the asset in accordance with Sri Lanka Accounting Standard 20, "Borrowing Costs". Capitalisation of borrowing costs ceases when substantially all the activities necessary to prepare the qualifying asset for its intended use are completed.

#### 4.13 Work in progress - Residential Apartment Complex

Sithma Development (Pvt) Ltd. commenced a project to develop a residential apartment complex. The expenses related to this project is accounted for as work-in-progress until the completion of the project.

On completion, the value of apartments are transferred to Inventories - Residential Apartment Complex. Both work in progress and Inventories are shown under Other Assets in the Balance Sheet.

#### 4.14 Impairment

##### 4.14.1 Financial Assets

The Bank assesses at each Balance Sheet date whether there is objective evidence that a financial asset or a portfolio of financial assets is impaired. A financial asset or portfolio of financial assets is impaired and impairment losses are incurred if and only if, there is objective evidence of impairment as a result of one or more loss events that occurred after the initial recognition of the asset and prior to the Balance Sheet date ("a loss event"), and that loss event or events have had an impact on the estimated future cash flows of the financial asset (or the portfolio), that can be reliably estimated.

The Bank first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant and collectively for financial assets that are not individually significant (except for loans and advance explained below). Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

For loans and advances, impairment loss is measured individually and collectively as explained in Note No

4.8.3. When a loan is uncollectible, it is written off against the related provision. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of the amounts previously written off are included under "Other Income" in the Income Statement.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed by adjusting the impairment provision account. The amount of the reversal is recognised in the Income Statement.

#### **4.14.2 Non Financial Assets**

Tangible and intangible assets (excluding deferred tax assets which are explained in Note No. 43) are written down to recoverable amount where their carrying value exceeds recoverable amounts.

The carrying values of Property, Plant & Equipment are reviewed for impairment annually or when events or changes in circumstances indicate that the carrying value may not be recoverable. If such indications exist and where the carrying values exceed the estimated recoverable amount, the assets are written down to their recoverable amount. Impairment losses are recognised in the Income Statement unless it reverses a previous revaluation surplus for the same asset.

Assets with an indefinite useful life, including goodwill, are not subject to amortisation and are tested on an annual basis for impairment and additionally whenever an indication of impairment exists. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

The recoverable amount of an asset is the higher of its fair value less cost to sell or its value in use. Any decrease in the carrying value is recognised as an expense in the Income Statement in the reporting period in which the impairment loss occurs.

For assets that do not generate largely independent cash inflows, the recoverable amount is determined for the cash generating unit to which that asset belongs. Management judgement is applied to establish cash generating units. Each of these cash generating units is represented by an individual primary reporting segment, or a subdivision of a primary segment.

An impairment loss in respect of goodwill is not reversed. In respect of other assets impairment losses recognised in prior periods, are assessed at each balance sheet date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

## **LIABILITIES AND PROVISIONS**

### **4.15 Deposits from Customers**

Deposits include non interest bearing deposits, savings deposits, term deposits, deposits redeemable at call and certificates of deposit. They are brought to account at the gross value of the outstanding balance. Interest paid is charged to the Income Statement.

### **4.16 Dividends Payable**

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

### **4.17 Borrowings**

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

### **4.18 Securities Sold under Re-purchase Agreement**

Securities sold under agreements to re-purchase are recorded separately in the financial statements. The difference between the sale and the purchase price represents interest expense, which is recognised in the Income Statement over the period of the re-purchase agreement.

### **4.19 Bills Payable and Other Liabilities**

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

### **4.20 Employee Retirement Benefits**

#### **4.20.1 Defined Benefit Plan**

A defined benefit plan is a post employment benefit plan other than a defined contribution plan.

### 4.20.1 (a) Pension Fund

The Bank operates an approved Pension Fund to facilitate the following payments for permanent staff of the Bank:

- a) Pensions to retiring staff
- b) Benefits to staff who opted for the Optional Scheme for Pension introduced in 2005
- c) Gratuity  
If the employee leaves the Bank before the age of 55 and satisfy the criteria as per Gratuity Act.

The Bank's obligation in respect of defined benefit pension plans is calculated by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods and discounting that benefit to determine its present value, then deducting the fair value of any plan assets. The discount rate is the yield at the reporting date on Government bonds that have maturity dates approximating to the terms of the Bank's obligations. The calculation is performed by a qualified actuary using the projected unit credit method which is the method recommended by Sri Lanka Accounting Standard 16 (revised 2006) "Employee Benefits" (SLAS 16).

When the benefits of a plan are improved, the portion of the increased benefit relating to past service by employees is recognised in the Income Statement on a straight-line basis over the average period until the benefits become vested. To the extent that the benefits vest immediately, the expense is recognised immediately in Income Statement.

In respect of actuarial gains and losses that arise in calculating the Bank's obligation in respect of a plan, to the extent that any cumulative unrecognised actuarial gain or loss exceeds 10 percent of the greater of the present value of the defined benefit obligation and the fair value of plan assets, that portion is recognised in Income Statement over the expected average remaining working lives of the employees participating in the plan. Otherwise, the actuarial gain or loss is not recognised.

Monthly provision is made by the Bank to the Pension Fund, based on a percentage of the gross salary of employees. The percentage of contributions are determined by the same actuary and retirement benefits are provided to all permanent staff. The Bank carries out an actuarial valuation of the Pension Fund in December each year to ascertain the full liability of the Fund. The valuation method used by the actuary to

value the Fund is the "Projected Unit Credit Method", the method recommended by SLAS 16.

The demographic assumptions underlying the valuation are retirement age (55 yrs.), early withdrawals from service and retirement on medical grounds, death before and after retirement etc

The Subsidiaries do not operate Pension Funds.

### 4.20.1 (b) Widows, Widowers and Orphans Pension Fund

The Bank operates a separate Widows, Widowers and Orphans Pension Scheme (WW & OP) which was established with effect from 1st September 1995.

The actuarial valuation of the Widows, Widowers and Orphans Pension Scheme is carried out by the same actuary who carried out the actuarial valuation of the Pension Fund using the same method and same assumptions detailed in Note No. 4.20.1 (a) above.

### 4.20.1 (c) Majan Exchange LLC

The Company's obligation in respect of non-Omani terminal benefits which is an unfunded defined benefit retirement plan, is made in accordance with Omani Labour Laws and is calculated by estimating the amount of future benefit that such employees have earned in return for their service in the current and prior periods. The obligation is calculated using the projected unit credit method and is discounted to its present value.

### 4.20.2 Defined Contribution Plans

A defined contribution plan is a post employment plan under which an entity pays fixed contributions into a separate entity and will have no legal or constructive obligation to pay a further amount. Obligations for contributions to defined contribution plans are recognised as expense in the Income Statement as and when they are due.

#### 4.20.2 (a) Employees' Provident Fund

The Bank and employees contribute 12% and 8% respectively on the salary of each employee to the approved private Provident Fund while the Group entities and their employees contribute the same percentages to Employees' Provident Fund.

#### 4.20.2 (b) Employees' Trust Fund

The Bank / Group contributes 3% of the salary of each employee to the Employees' Trust Fund.

#### **4.20.2 (c) Majan Exchange LLC**

In respect of Majan Exchange LLC, contributions to a defined contribution retirement plan for Omani employees in accordance with the Omani Social Insurance Scheme are recognised as expense in the Income Statement as and when they are due.

#### **4.20.3 Gratuities**

No provision has been made in the financial statements of the Bank for gratuities to employees who have completed five or more years of service, payable under the Payment of Gratuity Act No. 12 of 1983, as the Bank contributes for all permanent employees through its own non-contributory pension scheme which is in force.

Up to 31 December 2007, provisions had been made for retirement gratuities in the financial statements of the Subsidiaries from the first year of service for all employees in conformity with Sri Lanka Accounting Standards 16 - Retirement Benefit Costs which was effective till 1 July 2007. However, under the Payment of Gratuity Act No. 12 of 1983, the liability to an employee arises only on completion of five years of continual service. The gratuity liabilities were not externally funded.

Based on the Sri Lanka Accounting Standards 16 (Revised 2006) – Employee Benefits (“SLAS 16”) which became effective from the financial year commencing after 1 July 2007, the Subsidiaries other than HNB Assurance PLC have adopted the Gratuity Formula method while HNB Assurance PLC continues to apply actuarial valuation method.

Accordingly the Subsidiaries have adopted the Revised SLAS 16 from 1st January 2008 and have made provisions based on the above methods.

The gratuity liabilities are not externally funded.

#### **4.20.4 Employee Share Ownership Plan**

The Employee Share Ownership Plan introduced in 2005 offered share options to executive and high rank officers of the Bank. The shares allotted to the respective employee under the plan would remain within the plan while the beneficial interest will be with the employee. At the time the employee leaves the Bank the difference between the issue price and the market price is paid to the employee. Therefore the said Employee Share Ownership Plan has no potential dilutive effect on the earnings per share of the Bank.

#### **4.20.5 Employee Share Option Plan**

At the Annual General Meeting held on 28th March 2008 a resolution was passed to formulate an Employee Share Option Plan (ESOP) apart from the existing Employee Share Option Scheme enabling the management staff in the rank of the Manager 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 of the Bank.

Details of allocations are given in Note No. 46.

#### **4.21 Provisions**

A provision is recognised if, as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation.

A provision for onerous contracts is recognised when the expected benefits to be derived by the Group from a contract are lower than the unavoidable cost of meeting its obligations under the contract. The provision is measured at the present value of the lower of the expected cost of terminating the contract and the expected net cost of continuing with the contract. Before a provision is established, the Group recognises any impairment loss on the assets associated with that contract.

Provisions for non-performing loans and advances are made as set out in Note No. 4.8.3.

#### **4.22 Operational Risk Events**

Provisions for operational risk events are recognised for losses incurred by the Bank which do not relate directly to amounts of principal outstanding for loans and advances.

The amount recognised as a provision is the best estimate of the expenditure required to settle the present obligation as at the Balance Sheet date, taking into account the risks and uncertainties that surround the events and circumstances that affect the provision.

#### **4.23 Commitments and Contingencies**

All discernible risks are accounted for in determining the amount of all known liabilities. The Bank's share of any contingencies and capital commitments of a Subsidiary or an Associate for which the Bank is also liable severally or otherwise are also included with appropriate disclosures.

Contingent liabilities are possible obligations whose existence will be confirmed only by uncertain future events or present obligations where the transfer of economic benefit is not probable or cannot be reliably measured. Contingent liabilities are not recognised in the Balance Sheet but are disclosed unless they are remote.

#### **4.24 Event After the Balance Sheet Date**

All material and important events which occur after the Balance Sheet date have been considered and disclosed in Note No. 52.

#### **4.25 Revenue Recognition**

##### **4.25.1 Interest Income**

Interest receivable is recognised on an accrual basis. Interest from loans and advances ceases to be accrued when they are classified as non performing as explained in Note No. 4.8.4. Interest on non-performing loans and advances is accounted for on a cash basis. Interest on non-performing loans and advances is credited to the 'Interest in Suspense account' which is netted in the Balance Sheet against the relevant loans and advances.

Interest income from investments is recognised on an accrual basis.

##### **4.25.2 Dividend Income**

Dividend income is recognised in the Income Statement on an accrual basis when the Bank's right to receive the dividend is established.

##### **4.25.3 Lease Income**

The excess of aggregate lease rentals receivable over the cost of the leased assets constitutes the total unearned lease income at the commencement of a lease. The unearned lease income is taken into income over the term of the lease commencing with the month

in which the lease is executed in proportion to the declining receivable balance.

Gross earnings under finance leases in respect of lease rentals due, cease to be taken to revenue when they are in arrears for ninety days. Thereafter, such income is recognised on a cash basis.

##### **4.25.4 Discount on Bills of Exchange**

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

##### **4.25.5 Trading Income**

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

##### **4.25.6 Fee and Commission Income**

Fees and commission income, including account servicing fees, investment management fees, sales commission, placement fees and syndication fees, are recognised as the related services are performed.

##### **4.25.7 Profit/loss from Sale of Property, Plant & Equipment**

Profit/loss from sale of Property, Plant & Equipment is recognised in the period in which the sale occurs and is classified as other income.

##### **4.25.8 Profit/loss from Sale of Investment Properties**

Any gains or losses on retirement or disposal of investment properties are recognised in the month of retirement or disposal.

##### **4.25.9 Rental Income**

Rental income is recognised on an accrual basis.

#### **4.26 Expenses**

##### **4.26.1 Interest Expenses and Other Expenses**

Interest payable and other expenses are recognised on an accrual basis.

##### **4.26.2 Lease Payments made**

Payments made under operating leases are recognised in the Income Statement on a straight-line basis over the term of the lease.

The future monthly commitments on operating leases are shown in Note No. 47 (b).



Minimum lease payments made under finance leases are apportioned between the finance expense and the reduction of the outstanding liability. The finance expense is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability. Contingent lease payments are accounted for by revising the minimum lease payments over the remaining term of the lease when the lease adjustment is confirmed.

#### **4.26.3 Fee and Commission Expenses**

Fee and commission expenses are recognised on an accrual basis.

### **4.27 Income Tax Expense**

Income tax expense comprises of current and deferred tax. Income tax expense is recognised in the Income Statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

#### **4.27.1 Current Tax**

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted on the balance sheet date, and any adjustment to tax payable in respect of previous years.

Provision for taxation is based on the profit for the year adjusted for taxation purposes in accordance with the provisions of the Inland Revenue Act No. 10 of 2006 and the amendments thereto at the rates specified in Note No. 20.

#### **4.27.2 Deferred Tax**

Deferred taxation is provided using the liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the tax base of assets and liabilities, which is the amount attributed to those assets and liabilities for tax purposes. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted by the reporting date.

Deferred tax liabilities are not recognised for the following temporary differences: the initial recognition of goodwill, the initial recognition of assets and liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit and differences relating to investments in Subsidiaries to the extent that they probably will not reverse in the foreseeable future.

Deferred tax assets, including those related to temporary tax effects of income tax losses and credits available to be carried forward, are recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

#### **4.27.3 Withholding Tax on Dividends**

Dividend distributed out of taxable profit of the Subsidiaries and Associate Company attracts a 10% deduction at source and is not available for set off against the tax liability of the Bank. Thus, the withholding tax deducted at source is added to the tax expense of the Subsidiaries and Associates in the consolidated financial statements as a consolidation adjustment.

Withholding tax that arise from the distribution of dividends by the Bank are recognised at the same time as the liability to pay the related dividend is recognised.

#### **4.27.4 Value Added Tax on Financial Services**

The base for the computation of Value Added Tax on Financial Services is the accounting profit before income tax adjusted for the economic depreciation and emoluments of employees computed on prescribed rates.

### **4.28 Earnings Per Share**

The Group presents Basic and Diluted Earnings Per Share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the Bank by the weighted average number of ordinary shares outstanding during the period. Diluted EPS is determined by adjusting the profit or loss attributable to the ordinary shareholders and the weighted average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares, which comprise share options granted to employees. .

### **4.29 Segment Reporting**

A segment is a distinguishable component of the Group that is engaged either in providing related products or services (business segment) , or in providing products and services within a particular economic environment (geographical segment), which is subject to risks and returns different from those of other business segments. For the purposes of segment reporting disclosures, the information is

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

Inter-segment pricing is determined on an arms length basis.

Measurement of segment assets, liabilities, segment revenue and results is based on the accounting policies set out above. Segment revenue results, assets and liabilities include items directly attributable to segments as well as those that can be allocated on a reasonable basis.

Unallocated items include depreciation and amortisation costs.

#### 4.30 Cash Flow Statement

The Cash Flow Statement has been prepared using the "Direct Method" of preparing Cash Flows in accordance with the Sri Lanka Accounting Standard 9, "Cash Flow Statements". Cash and cash equivalents comprise short term, highly liquid investments that are readily convertible to known amounts of cash and are subject to an insignificant risk of changes in value. The cash and cash equivalent include cash in-hand, balances with banks, placements with banks, money at call and short notice and money market funds.

### 5. SIGNIFICANT ACCOUNTING POLICIES THAT ARE SPECIFIC TO THE BUSINESS OF THE SUBSIDIARY – HNB ASSURANCE PLC

#### 5.1 Non-life Insurance Business

##### 5.1.1 Gross Written Premium

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

##### Reinsurance Premium

Premiums ceded to reinsurers are recognised as an expense in accordance with the pattern of reinsurance services received. Reinsurance premiums are decided based on rates agreed with reinsurers.

##### Unearned Premium

The unearned premium reserve represents the portion of the premiums and outward reinsurance premiums

written in the current year in respect of risks related to subsequent periods. Unearned premiums are calculated on the 1/24th basis in accordance with the Regulation of Insurance Industry Act No. 43 of 2000.

##### Unexpired Risk

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

##### Net Deferred Acquisition Expenses

Acquisition expenses, representing commissions, which vary with and directly related to the production of business, are deferred and amortised over the period in which the related written premiums are earned. Reinsurance commission is also treated in the same manner within deferred acquisition costs. .

##### Premiums Receivables

According to the Premium Payment Warranty (PPW) ruling by the Insurance Board of Sri Lanka (IBSL), all policies issued and not recovered over 60 days are cancelled.

##### Reinsurance Receivable

Reinsurance assets include the balances due from both insurance and reinsurance companies for paid and unpaid losses and loss adjustment expenses. Amounts recoverable from reinsurers are estimated in a manner consistent with the claim liability associated with the reinsured policy. Reinsurance is recorded gross in the Balance Sheet unless a right to offset exists.

If a reinsurance asset is impaired, the company reduces the carrying amount accordingly and recognises a loss in the statement of income. A reinsurance asset is impaired if there is objective evidence, as a result of an event that occurred after the initial recognition of the reinsurance asset, that the company may not receive amounts due to it under the terms of the contract, and the event has a reliably measurable impact on the amount that the company will receive from the reinsurer.

##### Claims

Claims incurred include provisions for the estimated cost of claims and related handling expenses in respect of Incidents up to the year end, including those which had not been notified, net of salvage, anticipated reinsurance and other recoveries. Claims outstanding are assessed by review of individual claim files and estimating changes in the ultimate cost of

settling claims. The provision in respect of Claims Incurred But Not Reported (IBNR) is actuarially valued to ensure a more realistic estimation of the future liability based on the past experience and trends. Actuarial valuations are performed on an annual basis.

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

### 5.1.2 Life Insurance Business

#### Gross Written Premiums

Premiums from traditional life insurance contracts, including participating contracts and annuity policies with life contingencies, are recognised as revenue when cash is received from the policyholder. Benefits and expenses are provided against such revenue to recognise profits over the estimated life of the policies.

#### Reinsurance Premium

Outward reinsurance premiums are recognised when payable. Reinsurance recoveries are credited to match the relevant gross claims.

#### Benefits, Losses and Expenses

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

Claims by death and maturity are charged against revenue on notification of death or on expiry of the term.

The interim payments and surrenders are accounted for only at the time of settlement.

#### Actuarial Valuation for Long Term Insurance Provision

The directors agree to the long term insurance provision for the company at the year end on the recommendations of the 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 Consultant Actuary.

## 6 COMPARATIVE INFORMATION

The comparative information is re-classified wherever necessary to conform with the current year's presentation in

order to provide a better presentation. The details of such re-classifications have been provided in Note No. 50.

## 7 FIRST TIME ADOPTION OF SRI LANKA ACCOUNTING STANDARD 16 – (REVISED 2006) “EMPLOYEE BENEFITS”

Sri Lanka Accounting Standard 16 - (Revised 2006) “Employee Benefits”, (SLAS 16 (Revised 2006)), which is applicable to financial statements covering annual periods beginning on or after 1st July 2007, became effective for the Bank / Group from 1st January 2008 and has been applied in preparing these financial statements. The comparative information has not been restated as the Standard has been applied prospectively from 1st January 2008.

### 7.1 The Nature of main Adjustments made To The Consolidated Financial Statements

#### 7.1.1 Measurement of Post Employment Benefit Obligations

The previous SLAS 16 – Retirement Benefit Costs, while retaining the actuarial valuation method as the Bench mark treatment, also recommended the calculation of the gratuity liability based on the Gratuities Act method as an allowed alternative. Accordingly, the Subsidiaries of the Bank except for HNB Assurance PLC had been providing for retirement gratuities in the financial statements based on a minimum of half month salary for each completed year of service commencing from the first year of service. However, the SLAS 16 (Revised 2006) recommends only the actuarial valuation method.

Accordingly all the subsidiaries, except for HNB Assurance PLC have applied the Gratuity formula method as explained in Appendix E of the SLAS 16 (Revised 2006) and have computed the post employment benefit obligations internally. HNB Assurance PLC involved a qualified Actuary as in the case of the Bank, in the measurement of post employment benefit obligations.

#### 7.1.2 Recognition of Actuarial Gains and Losses

According to the previous SLAS 16, the Bank was required to disclose the actuarial gains or losses and in the case of deficit, to set out the method of amortisation of the said deficit.

The SLAS 16 (Revised 2006) requires that the actuarial gains and losses that arise in calculating the entity's obligation in respect of a plan, to the extent that any cumulative unrecognised actuarial gain or loss exceeds 10 percent of the greater of the present value of the defined benefit obligation and the fair value of plan assets, that portion is recognised in Income

Statement over the expected average remaining working lives of the employees participating in the plan. Otherwise, the actuarial gain or loss is not recognised.

### 7.1.3 Transitional Provisions

On first adopting the Standard, the Bank has determined its transitional liability for defined benefit plans as at 1st January 2008. Where the transitional liability was more than the liability that would have been recognised on 1st January 2008 under the respective entity's previous accounting policy, the Bank has made an irrevocable choice to recognise that increase in its defined benefit liability, as an expense on a straight line basis over a period of five years from 1st January 2008.

## 8 DIRECTIONS ISSUED BUT NOT EFFECTIVE / APPLIED AS AT BALANCE SHEET DATE

The Central Bank of Sri Lanka issued Banking Act, Direction No. 9 of 2008 on 30th December 2008 on "Amendments to Directions on Classification of Loans Income Recognition and Provisioning". This Direction addresses the following two areas.

### 8.1 Classification of NPA based on aggregated exposure

According to Section 1 of the above Direction, with effect from 1st January 2010 all credit facilities extended to a borrower should be classified as NPA when one or more of the credit facilities has/have been classified as NPA and if the aggregate amount of the outstanding of such NPA (excluding interest in suspense) exceeds 30% of the total credit facilities extended to such borrower (excluding interest in suspense).

### 8.2 Classification of NPA based on arrears

According to Section 2 of the above Direction the Banks shall reclassify NPA as performing loans and advances in the manner as set out in the said Direction which will be effective till 31st December 2009.

As the above Direction was issued on 30th December 2008, Section 2 of the said Direction was not applied by the Bank during the year and as at balance sheet date.

In the event the Bank had applied Section 2 of the Direction referred to above, the NPA ratio would have been 6.24% as at Balance Sheet date, compared to the NPA ratio of 6.72% reported now as at Balance Sheet date.

For the year ended 31st December	Bank		Group	
	2008 Rs 000	2007 Rs 000	2008 Rs 000	2007 Rs 000
<b>9 INCOME</b>				
Interest income (Note 10)	32,431,158	26,250,038	32,829,516	27,126,554
Foreign exchange profit	1,166,979	1,114,313	1,169,084	1,115,496
Fee and commission income (Note 12)	2,364,434	2,081,569	2,434,503	2,121,624
Dividend income (Note 13)	538,321	125,142	216,512	92,346
Other income (Note 14)	665,023	423,656	2,075,789	1,619,869
	<b>37,165,915</b>	<b>29,994,718</b>	<b>38,725,404</b>	<b>32,075,889</b>

#### 10 INTEREST INCOME

Government securities	2,165,876	1,519,678	2,427,225	2,460,368
Placements with Banks	679,692	724,011	757,713	724,011
Loans and advances to customers	28,565,742	23,389,008	28,565,791	23,297,015
Other interest income	1,019,848	617,341	1,078,787	645,160
	<b>32,431,158</b>	<b>26,250,038</b>	<b>32,829,516</b>	<b>27,126,554</b>

#### Notional Credit for Withholding Tax on Government Securities on Secondary Market Transactions

Section 137 of the Inland Revenue Act No 10 of 2006 provides that a company which derives interest income from the secondary market transactions in Government Securities be entitled to a notional 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 amounts to Rs 32.6 Mn (2007 - Nil) for Bank and Rs 51.85 Mn (2007 - Rs 28.6 Mn) for Group.

For the year ended 31st December	Bank		Group	
	2008 Rs 000	2007 Rs 000	2008 Rs 000	2007 Rs 000
<b>11 INTEREST EXPENSES</b>				
Short term borrowings	2,266,358	2,033,449	2,298,605	2,692,548
Refinance borrowings	474,145	287,974	474,145	287,974
Deposits from customers	16,129,821	11,859,924	16,129,821	11,840,520
Subordinated debentures	578,197	706,416	783,061	1,006,695
Other interest expenses	303,146	301,935	601,592	302,349
	<b>19,751,667</b>	<b>15,189,698</b>	<b>20,287,224</b>	<b>16,130,086</b>

#### 12 FEE AND COMMISSION INCOME

Fee income	6,213	16,747	25,066	35,393
Commission income	2,358,221	2,064,822	2,409,437	2,086,231
	<b>2,364,434</b>	<b>2,081,569</b>	<b>2,434,503</b>	<b>2,121,624</b>

#### 13 DIVIDEND INCOME

Dealing securities	216	6,290	895	6,290
Investment securities - quoted	124,184	92,236	89,800	65,740
Investment securities - unquoted	413,921	26,616	125,817	20,316
	<b>538,321</b>	<b>125,142</b>	<b>216,512</b>	<b>92,346</b>

# Notes to the Financial Statements

For the year ended 31st December	Bank		Group	
	2008 Rs 000	2007 Rs 000	2008 Rs 000	2007 Rs 000
<b>14 OTHER INCOME</b>				
Rent received	43,064	69,504	127,852	74,885
Rent received from Investment Properties	17,457	16,773	35,606	34,923
Insurance premium income	-	-	1,347,875	1,144,932
Income from investment securities	-	5,528	-	5,528
Bad debts recovered [Note 27 (a) and 28 (c)]	296,019	280,042	296,019	280,042
Recovery of loans written off in previous years	7,224	9,233	7,224	9,223
Profit from Sale of property plant & equipment	7,979	18,653	8,030	19,201
Income received on sale of Foreclosed properties	505	15,419	505	15,419
Gain on sale of Government Securities	7,971	4,419	38,476	24,207
Profit on gold and silver trading	4,210	867	4,210	867
Profit from Sale of Subsidiaries	154,287	-	77,113	-
Profit share from Visa Worldwide (Pvt) Ltd	123,489	-	123,489	-
Miscellaneous	2,818	3,218	9,390	10,642
	<b>665,023</b>	<b>423,656</b>	<b>2,075,789</b>	<b>1,619,869</b>
<b>15 OPERATING EXPENSES</b>				
Operating expenses, among others, include the following:				
Legal expenses & professional fees	52,910	47,251	55,246	51,657
Depreciation of Property, Plant and Equipment	479,721	420,970	613,845	548,881
Amortisation of Intangible Assets	91,446	65,070	102,017	72,254
Depreciation of Investment Property	1,194	1,194	4,403	4,397
Provision for operational risk event losses	14,180	13,756	14,180	13,756
Directors' emoluments	45,063	24,755	58,991	35,872
Auditors' remuneration [Note 15 (a)]	7,589	4,425	9,607	6,138
Advertising / Product expenses	622,459	438,819	649,988	460,450
Donations	19,405	29,451	19,665	29,701
Impairment losses recognised on Property, Plant & Equipment	-	87,764	-	87,764
Loss on marked to market valuation of dealing securities	14,674	30,037	14,674	30,037
Loss on FCBU revaluation	46,290	13,796	46,290	13,796
Loss from sale of dealing securities	154	86,279	154	86,279
<b>15 (a) Auditors' Remuneration</b>				
Audit fees and expenses	4,715	4,005	6,104	5,253
Audit related fee and expenses	1,140	40	1,694	307
Non-audit services	1,734	380	1,809	578
	<b>7,589</b>	<b>4,425</b>	<b>9,607</b>	<b>6,138</b>
<b>16 PERSONNEL EXPENSES</b>				
In addition to salaries personnel expenses include the following :				
Contribution to Employees Provident Fund	260,842	233,930	278,078	246,700
Contribution to Employees Trust Fund	65,223	59,030	69,473	62,200

\* Provision for Employee Retirement Benefits is shown separately in Note No. 17.

For the year ended 31st December	Bank		Group	
	2008 Rs 000	2007 Rs 000	2008 Rs 000	2007 Rs 000
<b>17 PROVISION FOR EMPLOYEE RETIREMENT BENEFITS</b>				
Contribution made to Pension Fund	496,628	451,828	496,628	451,828
Amortisation of transitional liability as at 1st January 2008	283,475	-	283,475	-
Amortisation of increase in deficit during the year	7,025	-	7,025	-
Provision made for Gratuities	-	-	8,367	5,502
	<b>787,128</b>	451,828	<b>795,495</b>	457,330

\*On first time adoption of Sri Lanka Accounting Standard (Revised 16) "Employee Benefits" (SLAS 16), the transitional liability of the Bank as at 1st January 2008 was Rs 1,417.37 Mn. According to the transitional provisions provided in SLAS 16, the said deficit is amortised on a straight line basis over a period of 5 years, beginning from 2008. The charge for the year was Rs 283.47 Mn. The subsidiaries did not have transitional liabilities as at 1st January 2008.

#### 18 PROVISION FOR LOAN LOSSES

Specific provision for loans and advances	596,034	559,690	596,034	559,690
General provision for pawning advances	4,346	311	4,346	311
General provision for housing advances	3,824	6,130	3,824	6,130
Statutory general provision for performing and overdue loans and advances	512,042	239,750	512,042	239,750
Total provision for loans and advances [Note 27 (a)]	1,116,246	805,881	1,116,246	805,881
Specific provision for Bills of Exchange [Note 26 (a)]	5,040	9,095	5,040	9,095
General provision for leases [Note 28 (c)]	(36,535)	35,448	(36,535)	35,448
Specific provision for leases [Note 28 (c)]	74,487	57,489	74,487	57,489
Total provision made during the year	1,159,238	907,913	1,159,238	907,913

#### 19 SHARE OF PROFIT / (LOSS) OF ASSOCIATES (NET OF INCOME TAX)

Share of Profit / (Loss) of Associates before Income Tax			18,907	16,195
Recognition of negative goodwill on Splendor Media			3,416	-
Income Tax expense on share of Profit of Associates			(28,724)	(1,878)
Share of Profit / (Loss) of Associates after Income Tax			(6,401)	14,317

#### 20 INCOME TAX EXPENSE

##### Recognised in the Income Statement

##### 20 (a) Current tax expense

Income tax on profits for the year [Note 20 (e)]	1,296,148	1,037,908	1,343,930	1,093,928
Over provision during prior years	-	-	(14,077)	(1,543)
	1,296,148	1,037,908	1,329,853	1,092,385

##### 20 (b) Deferred tax expense

Net opening balance adjustment [Note 43 (c)]	-	(81,933)	-	(81,933)
Deferred tax asset reversed during the year [Note 43 (b)]	241,331	537,955	241,331	537,955
Charge / (Reversal) from deferred tax liability [Note 43 (a)]	28,189	(181,632)	28,116	(183,625)
	269,520	274,390	269,447	272,397
Total income tax expense	1,565,668	1,312,298	1,599,300	1,364,782

# Notes to the Financial Statements

For the year ended 31st December	Bank		Group	
	2008 Rs 000	2007 Rs 000	2008 Rs 000	2007 Rs 000
<b>20 (c) Income tax on profits of Subsidiaries</b>				
HNB Assurance PLC	-	-	19,477	20,485
HNB Stockbrokers (Pvt) Ltd.	-	-	3,179	9,147
HNB Securities Ltd.	-	-	16,879	26,388
<b>20 (d) Income tax on profits of Joint Venture</b>				
Acuity Partners (Pvt) Ltd.	-	-	8,247	-
Total	-	-	47,782	56,020
<b>20 (e) Reconciliation of Accounting Profit and Taxable Income</b>				
Profit before taxation	4,784,648	4,334,754	5,023,059	4,550,267
Disallowable expenses	10,190,445	8,849,489	10,253,221	8,932,254
Allowable expenses	(4,798,641)	(4,430,151)	(4,830,705)	(4,460,612)
Tax exempt income	(5,365,835)	(4,044,733)	(5,470,141)	(4,112,904)
Tax losses brought forward and utilised [Note 20 (f)]	(989,870)	(1,648,276)	(1,019,392)	(1,689,450)
Taxable Income	3,820,747	3,061,083	3,956,042	3,219,555
Of which,				
Taxable income at 35%	3,410,065	2,769,433	3,545,359	2,927,905
Taxable income at 20%	410,682	291,650	410,682	291,650
	3,820,747	3,061,083	3,956,041	3,219,555
Income tax provision for the year is made up of the following:				
Income tax at 35%	1,193,522	969,301	1,240,875	1,024,767
Income tax at 20%	82,136	58,330	82,136	58,330
	1,275,658	1,027,631	1,323,011	1,083,097
Social Responsibility levy at 1.5%	20,490	10,277	20,919	10,831
Income tax on profits for the year	1,296,148	1,037,908	1,343,930	1,093,928
Effective tax rate	27.09%	23.94%	26.76%	24.04%
<b>20 (f) Tax losses brought forward and utilised during the year</b>				
Tax losses brought forward	728,332	2,376,608	1,048,934	2,738,384
Adjustments for brought forward tax losses	261,538	-	261,538	-
Tax losses utilised during the year	(989,870)	(1,648,276)	(1,019,392)	(1,689,450)
Tax losses not utilised and carried forward	-	728,332	291,080	1,048,934

## 20 (g) Hatton National Bank PLC

The Bank's Domestic Banking Unit (DBU) is liable for taxation on its income from banking operations at the rate of 35% (2007 - 35%) for the year. The taxable income of On Shore Operations of the Foreign Currency Banking Unit (FCBU) is liable for taxation at the rate of 35% for the year (2007 - 35%). The taxable income from Off Shore Operations of FCBU is liable for taxation at the rate of 20% (2007 - 20%).

The Bank has recorded a taxable income of Rs 3,820 Mn. during the year 2008. The cumulative tax losses, which were available for setting off against future taxable income, (after set off during the year) amounted to Rs 728.332 Mn as at 31st December 2007. This figure was provisional and subsequently the brought forward tax loss was increased by Rs 261.538 Mn and the total figure was fully utilised during the year.

## 20 (h) HNB Assurance PLC

HNB Assurance PLC, is liable for income tax at the rate of 35% (2007 - 35%) on its taxable income. Provision has been made in the financial statements accordingly.



## 20 INCOME TAX EXPENSE (Contd.)

### 20 (i) Sithma Development (Pvt) Ltd

In accordance with the BOI agreement dated 28th December 1994, the profits and income of Sithma Development (Pvt) Ltd are exempt from taxation until year of assessment 2014/15. After the expiration of the said tax exempt period, the following options are available for the company for another 15 years;

- (a) Income tax payable for the year of assessment shall be computed at 2% of the turnover of the Company, or
- (b) The provisions of the Inland Revenue laws for the time being in force shall apply to the Company.

In the event of the Company elects option (a), no deferred tax liability will arise even after the expiration of the tax exempt period. The Company needs to make the election only 90 days prior to the expiration of the said tax exemption period after evaluating all tax implications prevailing at that time. Therefore, no provision has been made in the Financial Statements by the Company for deferred tax liability which could arise after the tax exempt period in the event the Company elects option (b).

### 20 (j) Acuity Partners (Pvt) Ltd

Acuity partners (Pvt) Ltd, is liable for income tax at the rate of 35% on its taxable income. Provision has been made in the financial statements accordingly.

## 21 EARNINGS PER SHARE

### 21 (a) Basic Earnings per Share

Basic Earnings per Share has been calculated by dividing the profit for the year attributable to Equity Holders of the Bank by the number of ordinary shares on issue (both Voting and Non-Voting) during the year ended 31st December 2008, as per the requirements of the Sri Lanka Accounting Standard 34 - "Earnings per Share".

### 21 (b) Diluted Earnings per Share

The calculation of Diluted Earnings per Share as at Balance Sheet date was based on the profit attributable to Equity Holders of the Bank by the number of ordinary shares on issue as at Balance Sheet date, after adjusting for the effects of all dilutive potential ordinary shares.

Allocations were made under the new Employee Share Option Plan, the details of which are given in Note No 46 (b).

However, the share options received at a particular grant can be exercised only after one year from the grant date. Since one year has not lapsed from the date of allotment as at Balance Sheet date the options did not result in a dilution of the earnings due to which Diluted Earnings per Share is not calculated as at 31st December 2008.

For the year ended 31st December	Bank		Group	
	2008	2007	2008	2007
Profit attributable to Equity Holders of the Bank (Rs 000)	3,218,980	3,022,456	2,830,538	3,150,469
Number of ordinary shares used as the denominator ('000)	235,529	235,529	235,529	235,529
Basic Earnings per Share (Rs)	13.67	12.83	12.02	13.38
As at 31st December	2008	2007	2008	2007
	Rs 000	Rs 000	Rs 000	Rs 000

22 CASH AND CASH EQUIVALENTS				
Local currency in hand	3,183,291	2,543,573	3,184,139	2,544,295
Foreign currency in hand	336,766	369,173	344,142	369,173
Balances with local banks	50,964	28,430	217,050	144,324
Balances / placements with banks in foreign currency	12,542,554	11,710,540	12,542,554	11,710,540
Money at call and short notice	2,590,000	-	2,673,676	-
Placements with banks by FCBU	4,598,377	4,506,990	4,598,376	4,506,990
	23,301,952	19,158,706	23,559,937	19,275,322

# Notes to the Financial Statements

## 23 STATUTORY DEPOSIT WITH CENTRAL BANKS

As at 31st December	Bank		Group	
	2008 Rs 000	2007 Rs 000	2008 Rs 000	2007 Rs 000
Statutory deposit with Central Bank of Sri Lanka	11,847,323	13,405,856	11,847,323	13,405,856
Statutory deposit with Central Bank of Oman	-	-	14,675	-
	11,847,323	13,405,856	11,861,998	13,405,856

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 No. 4.4. The minimum cash reserve requirement on rupee deposit liabilities was reduced to 9.25% with effect from 17th October 2008 and further reduced to 7.75% on 28th November 2008 which was in effect as at 31st December 2008, (2007- 10%). There are no reserve requirement for deposit liabilities of the Foreign Currency Banking Unit and foreign currency deposits liabilities in the Domestic Banking Unit.

Majan Exchange LLC is required to maintain a deposit of Omani Riyal 50,000 with the Central Bank of Oman (CB Oman) in accordance with its licensing regulations for Exchange Houses issued by the CB Oman. Interest is earned at the rate of 2% per annum.

## 24 DEALING SECURITIES

### Quoted Shares

#### 24 (a) Quoted Shares held by the Bank

As at 31st December	2008				2007		
	No of Ordinary Shares	Cost of Investment Rs 000	% of Total Cost	Market Value Rs 000	No of Ordinary Shares	Cost of Investment Rs 000	Market Value Rs 000
<b>Beverage Food and Tobacco</b>							
Distilleries Company of Sri Lanka PLC	-	-	-	-	386,700	35,201	38,863
<b>Construction and Engineering</b>							
Colombo Dockyard PLC	-	-	-	-	55	2	3
<b>Diversified Holdings</b>							
Hayleys PLC	-	-	-	-	238,600	26,620	25,710
Hemas Holdings PLC	-	-	-	-	175,200	20,558	16,644
John Keells Holdings PLC	-	-	-	-	4,323	716	550
	-	-	-	-		47,894	42,904
<b>Health Care</b>							
Lanka Hospitals PLC	2,078,142	52,265	99.73	24,938	1,454,700	42,914	24,731
<b>Telecommunications</b>							
Dialog Telekom PLC	50	1	-	-	174,350	4,199	3,487
Sri Lanka Telecom PLC	-	-	-	-	1,501,900	36,111	47,310
						40,310	50,797
<b>Trading</b>							
Odd lots & delisted shares		139	0.27	1	-	135	-
<b>Total</b>		52,405	100.00	24,939		166,456	157,298
Marked to market valuation gain/(loss)		(27,466)				(9,158)	
<b>Total Quoted Shares - Bank</b>		24,939		24,939		157,298	157,298

#### 24 (b) Quoted shares held by the subsidiaries

Hemas Holdings PLC	4,200	447	3.59	232	-	-	-
John Keells Holdings PLC	39,593	5,221	42.02	1,979	-	-	-
Dialog Telecom PLC	247,500	5,866	47.22	1,485	-	-	-
Asian Hotels & Properties PLC	19,500	890	7.17	483	-	-	-
Total		12,424	100.00	4,179	-	-	-
Marked to market valuation		(8,245)					
Total Quoted Shares -Subsidiaries		4,179		4,179	-	-	-
Total Quoted Shares - Group		29,118		29,118			

	2008		2007				
	Cost of Investment Rs 000	Market Value Rs 000	Cost of Investment Rs 000	Market Value Rs 000			
<b>24 (c) Government of Sri Lanka Treasury Bills held by the Bank</b>							
Discounted value	-	-	145,211	145,022			
Marked to market valuation loss	-	-	(189)	-			
<b>Total Treasury Bills - Bank</b>	-	-	145,022	145,022			
<b>Bonds</b>							
<b>24 (d) Bonds held by the Bank</b>							
<b>Government of Sri Lanka Treasury Bonds</b>	<b>Face Value</b>	<b>Year of Maturity</b>	<b>Discounted Value (Rs 000)</b>				
Rs 50 Mn.		2009	49,830	<b>49,830</b>	<b>46,929</b>	49,537	43,192
Marked to market valuation loss				<b>(2,901)</b>	-	(6,345)	-
				<b>46,929</b>	<b>46,929</b>	43,192	43,192
<b>24 (e) Foreign Currency Bonds held by the Bank</b>							
<b>Face Value</b>	<b>Year of Maturity</b>	<b>Discounted Value (Rs 000)</b>					
US\$ 5 Mn.	2010	US\$ 2,246,372		<b>253,840</b>	-	244,072	244,072
Provision for diminution in value		-		<b>(253,840)</b>	-	-	-
				-	-	244,072	244,072
<b>Total Bonds - Bank</b>				<b>46,929</b>	<b>46,929</b>	287,264	287,264
<b>Total Dealing Securities - Bank [Note 24 (a), (c), (d), (e)]</b>				<b>71,868</b>	<b>71,868</b>	589,584	589,584
<b>24 (f) Bonds held by the Subsidiaries</b>							
<b>Government of Sri Lanka Treasury Bonds</b>	<b>Face Value</b>	<b>Year of Maturity</b>	<b>Discounted Value (Rs 000)</b>				
Rs 4 Mn.		2009	3,902				
Rs 1.4 Mn.		2010	1,250				
Rs 1 Mn.		2011	448				
Rs 0.09 Mn.		2012	66	<b>5,666</b>	<b>5,666</b>	125,436	125,364
Marked to market valuation loss				-	-	(72)	-
<b>Total Bonds - Subsidiaries</b>				<b>5,666</b>	<b>5,666</b>	125,364	125,364
Intercompany adjustment				<b>(294)</b>	<b>(294)</b>	(2,459)	(2,459)
<b>Total Dealing Securities - Group</b>				<b>81,419</b>	<b>81,419</b>	712,489	712,489

## 25 INVESTMENT SECURITIES

### Quoted shares

#### 25 (a) Quoted shares held by the Bank

As at 31st December

	No of Ordinary Shares	2008		Market Value Rs 000	No of Ordinary Shares	2007	
		Cost of Investment Rs 000	Market Value Rs 000			Cost of Investment Rs 000	Market Value Rs 000
Ceylinco Insurance PLC	50,000	8,750	7,250	-	-	-	-
Commercial Bank of Ceylon PLC	1,430,574	95,813	95,848	1,430,574	95,813	210,294	
DFCC Bank PLC	16,054,570	911,399	838,851	16,054,570	911,399	2,038,930	
Distilleries Company of Sri Lanka PLC	1,481,500	11,158	74,816	1,481,500	11,158	148,891	
Magpek Exports PLC	359,000	14,360	*	359,000	14,360	*	
Metal Recyclers Colombo PLC	69	3	*	69	3	*	
		<b>1,041,483</b>	<b>1,016,765</b>		1,032,733	2,398,115	
Provision for diminution in market value b/f		<b>(14,363)</b>			<b>(14,363)</b>		
<b>Total Quoted Shares - Bank</b>		<b>1,027,120</b>	<b>1,016,765</b>		1,018,370	2,398,115	

\* As shares of Magpek Exports PLC and Metal Recyclers Colombo PLC have been de-listed, the Market values are shown as nil. Provision of Rs 14.4 Mn for diminution in market value has been made in the financial statements

Based on the assessment carried out by the Board of Directors as at 31st December 2008 there was no permanent diminution in market value of investment securities except as explained above. Accordingly no further provisions have been made in the Financial Statement for Investment Securities.

# Notes to the Financial Statements

## 25 INVESTMENT SECURITIES (Contd.)

### 25 (b) Quoted shares held by the Subsidiaries

As at 31st December

	2008			2007		
	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
<b>Subsidiaries</b>						
Commercial Bank of Ceylon PLC						
cumulative redeemable preference shares	-	-	-	725,000	7,250	6,525
Hemas Holdings PLC	-	-	-	4,200	447	399
John Keells Holdings PLC	4,680	22	234	41,856	5,521	5,326
Dialog Telekom PLC	-	-	-	247,500	5,865	4,950
Sri Lanka Telecom PLC	-	-	-	155,000	4,265	4,883
Asian Hotels & Properties PLC	-	-	-	19,500	890	780
Hayleys PLC	7,491	558	644	-	-	-
		580	878		24,238	22,863
Provision for diminution in value of investment		-	-		(2,550)	-
<b>Total Quoted Shares - Subsidiaries</b>		<b>580</b>	<b>878</b>		<b>21,688</b>	<b>22,863</b>
<b>Total Quoted Shares - Group</b>		<b>1,027,700</b>	<b>1,017,643</b>		<b>1,040,058</b>	<b>2,420,978</b>

### Unquoted shares

### 25 (c) Unquoted shares held by the Bank

As at 31st December

	2008			2007		
	No. of Ordinary Shares	Cost Rs 000	Directors' Valuation Rs 000	No. of Ordinary Shares	Cost Rs 000	Directors' Valuation Rs 000
Browns' Group Motels Ltd	50,000	500	500	50,000	500	500
Credit Information Bureau of Sri Lanka	5,300	530	530	5,300	530	530
Fitch Rating Lanka Ltd	62,500	625	625	62,500	625	625
Lanka Clear (Pvt) Ltd	2,200,000	22,000	22,000	2,200,000	22,000	22,000
Lanka Financial Services Bureau	225,000	2,250	2,250	500,000	5,000	5,000
S.W.I.F.T.	21	2,051	2,051	21	2,051	2,051
Dialog Telekom PLC						
Rated cumulative redeemable preference shares	648,000,000	648,000	648,000	720,000,000	720,000	720,000
HNB Securities Ltd	7,498,500	74,985	74,985	-	-	-
<b>Total Unquoted Shares - Bank</b>		<b>750,941</b>	<b>750,941</b>		<b>750,706</b>	<b>750,706</b>

### 25 (d) Unquoted shares held by the Subsidiaries

Splendor Media (Pvt) Ltd	-	-	-	25,000	250	250
<b>Total unquoted Shares - Subsidiaries</b>	-	-	-	<b>25,000</b>	<b>250</b>	<b>250</b>
<b>Net asset value adjustment on HNB Securities *</b>		<b>74,985</b>	<b>74,985</b>			
<b>Total unquoted Shares - Group</b>		<b>825,926</b>	<b>825,926</b>		<b>750,956</b>	<b>750,956</b>

### 25 (e) Unit trusts held by the Subsidiaries

Namal Optima	1,000,000	10,000	10,000	-	-	-
Cey Bank	1,500,000	15,000	15,000	-	-	-
<b>Total unit trusts Subsidiaries</b>		<b>25,000</b>	<b>25,000</b>			
<b>Total unquoted shares &amp; unit trusts Group</b>		<b>850,926</b>	<b>850,926</b>		<b>750,956</b>	<b>750,956</b>

\* Bank's holding of HNB Securities Ltd after the share transfer to Acuity Partners (Pvt) Ltd is accounted for at cost in Bank's books while accounted for at net assets value at the date of share transfer in Group.

Based on the internal assessment carried out by the Board of Directors as at 31st December 2008, no provisions have been made for permanent diminution in value of unquoted shares of the Bank/Group in the Financial Statements.

## 25 INVESTMENT SECURITIES (Contd.)

As at 31st December		2008		2007		
Bonds		Cost	Directors' Valuation	Cost	Directors' Valuation	
		Rs 000	Rs 000	Rs 000	Rs 000	
<b>25 (f) Long Term Investments held by the Bank</b>						
Long Term Non-negotiable Bonds						
maturing on 14.11.2016						
		489,000	489,000	489,000	489,000	
	People's Leasing Co. Ltd. - Securitised Notes Trust 10	-	-	33,333	33,333	
	People's Leasing Co. Ltd. - Securitised Notes Trust 14	-	-	57,291	57,291	
	People's Leasing Co. Ltd. - Securitised Notes Trust 20	22,917	22,917	47,917	47,917	
	People's Leasing Co. Ltd. - Securitised Notes Trust 29	52,302	52,302	110,985	110,985	
	Sampath Leasing Securitised Notes	45,000	45,000	90,000	90,000	
	Sri Lanka Development Bonds maturing in 2009	5,198,000	5,198,000	4,246,717	4,246,717	
	Sri Lanka Development Bonds maturing in 2010	5,650,000	5,650,000	4,996,138	4,996,138	
	<b>Total</b>	<b>11,457,219</b>	<b>11,457,219</b>	<b>10,071,381</b>	<b>10,071,381</b>	
<b>25 (g) Government of Sri Lanka Treasury Bonds held by the Bank</b>						
Face Value	Year of Maturity	Discounted Value (Rs 000)				
Rs 3,189.00 Mn	2009	3,155,519				
Rs 251.00 Mn	2013	255,399		3,410,918	3,244,451	
				6,778,216	6,655,887	
	<b>Total - Bonds &amp; Debentures</b>			<b>14,868,137</b>	<b>14,701,670</b>	
				16,849,597	16,727,268	
<b>25 (h) Government of Sri Lanka Treasury Bills held by the Bank</b>						
As at 31st December Face Value	Year of Maturity	Discounted Value (Rs 000)	Cost of Investment Rs 000	2008 Market Value Rs 000	Cost of Investment Rs 000	2007 Directors Valuation Rs 000
Rs 10,170 Mn	2009	9,269,519	9,269,519	9,304,510	1,678,096	1,674,090
<b>Total Bonds, Bills &amp; Debentures - Bank [Note 25 (g), (h)]</b>			<b>24,137,656</b>	<b>24,006,180</b>	18,527,693	18,401,358
<b>Total Investment Securities - Bank</b>			<b>25,915,717</b>	<b>25,773,886</b>	20,296,769	21,550,179
<b>As at 31st December</b>						
			2008 No. of Debentures	Cost of Investment Rs 000	2007 No. of Debentures	Cost of Investment Rs 000
<b>25 (i) Quoted Debentures held by the Subsidiaries</b>						
Commercial Bank of Ceylon PLC - Debentures (Rs 1000/- each)						
		-	-	-	7,250	7,250
	DFCC Bank (Rs 1000/- each)	10,000	10,000	10,000	10,000	10,000
	Seylan Bank PLC (Rs 100/- each)	100,000	10,000	250,000	250,000	25,000
	Sampath Bank PLC	250,000	25,000	250,000	250,000	25,000
	Singer (Sri Lanka) PLC (Rs 100/- each)	240,000	24,000	50,000	50,000	5,000
	Bank of Ceylon	200,000	20,000	-	-	-
	<b>Total Quoted Debentures - Subsidiaries</b>			<b>89,000</b>	<b>72,250</b>	
<b>25 (j) Unquoted Debentures held by the Subsidiaries</b>						
	Singer (Sri Lanka) PLC (Rs 100/- each)	50,000	5,000	-	-	-
	Seylan Bank PLC (Rs 100/- each)	150,000	15,000	-	-	-
	<b>Total unquoted Debentures - Subsidiaries</b>			<b>20,000</b>	<b>-</b>	

# Notes to the Financial Statements

## 25 INVESTMENT SECURITIES (Contd.)

As at 31st December

	2008		2007	
	Cost of Investment Rs 000	Market Value Rs 000	Cost of Investment Rs 000	Market Value Rs 000
<b>25 (k) Government of Sri Lanka Treasury Bonds held by the Subsidiaries</b>				
<b>Face Value</b>	<b>Year of Maturity</b>	<b>Discounted Value (Rs 000)</b>		
Rs 158.44 Mn.	2009	157,160		
Rs 461.70 Mn.	2010	430,317		
Rs 35.00 Mn.	2011	31,870		
Rs 155 Mn.	2012	119,766		
Rs 150 Mn	2013	845,504	824,413	586,719 493,485
<b>Total Bonds and Debentures - Subsidiaries</b>		<b>954,504</b>	<b>933,413</b>	658,969 565,735
<b>Total Bonds and Debentures - Group</b>		<b>25,092,160</b>	<b>24,939,593</b>	19,186,662 18,967,093
<b>Total Investments Securities - Group</b>		<b>26,970,786</b>	<b>26,808,162</b>	20,977,676 22,139,027

### 25 (l) Assets pledged as security

Out of the Treasury Bills and Bonds classified as dealing and investment securities the following amount is pledged as security for repurchase agreements entered into by the Bank / Group.

	Bank		Group	
	2008 Rs 000	2007 Rs 000	2008 Rs 000	2007 Rs 000
Treasury bills	6,845,339	395,000	8,214,165	1,705,728
Treasury bonds	2,060,713	5,641,514	4,121,600	6,736,531
	<b>8,906,052</b>	6,036,514	<b>12,335,765</b>	8,442,259

## 26 BILLS OF EXCHANGE

Inland bills	564,654	560,313	564,654	560,313
Import bills	440,225	285,653	440,225	285,653
Export bills	814,817	1,120,777	814,817	1,120,777
	<b>1,819,696</b>	1,966,743	<b>1,819,696</b>	1,966,743
Foreign Currency Banking Unit bills	436,355	403,674	436,355	403,674
	<b>2,256,051</b>	2,370,417	<b>2,256,051</b>	2,370,417
Less: Specific provision [Note 26 (a)]	(297,546)	(300,967)	(297,546)	(300,967)
	<b>1,958,505</b>	2,069,450	<b>1,958,505</b>	2,069,450

### 26 (a) Movement in provision for Bills of Exchange

Balance brought forward	300,967	291,171	300,967	291,171
Exchange rate variance on foreign currency provision	2,554	701	2,554	701
Specific provision made during the year (Note 18)	5,040	9,095	5,040	9,095
Transfer to loan loss provision*	(7,960)	-	(7,960)	-
Bills written off against provision	(3,055)	-	(3,055)	-
	<b>297,546</b>	300,967	<b>297,546</b>	300,967

\* Specific provisions in excess of the Bills outstanding of the respective customers as at 31st December 2008 are transferred to loan loss provisions made against the other exposures relating to those customers.

As at 31st December	Bank		Group	
	2008 Rs 000	2007 Rs 000	2008 Rs 000	2007 Rs 000
<b>27 LOANS AND ADVANCES</b>				
Sri Lanka Rupee loans and advances				
Overdrafts	35,393,588	33,776,672	34,553,514	33,202,042
Short term loans	7,074,630	5,129,706	7,074,630	5,129,706
Trust receipts	7,882,525	7,097,272	7,882,525	7,097,272
Packing credit loans	849,408	763,188	849,408	763,188
Staff loans	6,760,072	5,744,015	6,760,072	5,748,253
Term loans	50,035,175	48,064,735	49,035,175	47,064,735
Housing loans	18,352,255	16,062,341	18,352,255	16,062,341
Pawning advances	21,129,938	16,783,984	21,129,938	16,783,984
Foreclosed properties [Note 27 (g)]	29,076	37,359	29,076	37,359
	<b>147,506,667</b>	<b>133,459,272</b>	<b>145,666,593</b>	<b>131,888,880</b>
Foreign currency loans and advances				
Overdrafts	2,937,308	2,058,947	2,937,308	2,058,947
Short term loans	582,207	71,034	582,207	71,034
Trust receipts	949,399	1,389,521	949,399	1,389,521
Packing credit loans	4,288,699	3,387,234	4,288,699	3,387,234
Term loans	12,903,391	11,263,612	12,903,391	11,263,612
Housing Loans	291,085	390,022	291,085	390,022
Foreclosed properties [Note 27 (g)]	445,112	427,977	445,112	427,977
	<b>22,397,201</b>	<b>18,988,347</b>	<b>22,397,201</b>	<b>18,988,347</b>
Sri Lanka Rupee and Foreign currency loans and advances	<b>169,903,868</b>	<b>152,447,619</b>	<b>168,063,794</b>	<b>150,877,227</b>
Less:				
Specific provision for loans and advances	5,788,256	5,507,607	5,788,256	5,507,607
Specific provision for Foreclosed properties [Note 27 (h)]	459,046	446,362	459,046	446,362
General provision for pawning advances	21,130	16,784	21,130	16,784
General provision for housing loans	36,729	32,905	36,729	32,905
Statutory general provision for performing and overdue / special mention loans and advances [Note 27 (b) ii]	1,046,156	534,114	1,046,156	534,114
Total provision for loan losses [Note 27 (a)]	<b>7,351,317</b>	<b>6,537,772</b>	<b>7,351,317</b>	<b>6,537,772</b>
Loans and advances after provision	<b>162,552,551</b>	<b>145,909,847</b>	<b>160,712,477</b>	<b>144,339,455</b>
Less: Interest in suspense [Note 27 (f)]	<b>(1,250,725)</b>	<b>(924,583)</b>	<b>(1,250,725)</b>	<b>(924,583)</b>
Net loans and advances	<b>161,301,826</b>	<b>144,985,264</b>	<b>159,461,752</b>	<b>143,414,872</b>
<b>27 (a) Movement in provision for loan losses</b>				
Balance brought forward	6,537,772	6,161,937	6,537,772	6,161,937
Exchange rate variance on foreign currency provision	142,538	39,360	142,538	39,360
Provision made during the year (Note 18)	1,116,246	805,881	1,116,246	805,881
Fully provided loans written off	(183,296)	(203,844)	(183,296)	(203,844)
Recoveries made during the year	(269,903)	(265,562)	(269,903)	(265,562)
Transfer from bills provision [Note 26 (a)]	7,960	-	7,960	-
	<b>7,351,317</b>	<b>6,537,772</b>	<b>7,351,317</b>	<b>6,537,772</b>

# Notes to the Financial Statements

As at 31st December

	2008 Rs 000	2008 Rs 000	2007 Rs 000	2007 Rs 000
<b>27 (b) Total provision for loan losses</b>				
<b>27 (b) i Specific provision</b>				
Bills of Exchange [Note 26 (a)]	297,546		300,967	
Loans and advances	6,247,302		5,953,969	
Lease rentals receivable within one year [Note 28 (c)]	256,965	6,801,813	211,699	6,466,635
<b>27 (b) ii General provision</b>				
Loans and advances	57,859		49,689	
Lease rentals receivable within one year	89,431		89,712	
Lease rentals receivable after one year	145,248		181,502	
Statutory general provision for performing and overdue loans and advances	1,046,156	1,338,694	534,114	855,017
<b>Total provision [Note 26 (a), 27 (a) and 28 (c)]</b>		<b>8,140,507</b>		<b>7,321,652</b>

As explained in Note no 4.8.3 (b), the Bank makes general provision for potential losses not specifically identified but which experience indicates are present in the portfolio of Pawning, Lease Receivable and Shanthi Housing Loans. A further provision of Rs 512 Mn (2007: Rs 239.7 Mn.) was made to meet the regulatory requirement. The total general provision of Rs 1,338.70 Mn (2007 - Rs 855.02 Mn) is 1% (2007 - 0.69%) of the total performing and overdue loans and advances, net of interest in suspense as at the Balance Sheet date and is above the regulatory requirement of 0.9% as at 31st December 2008 (2007 - 0.5%).

## 27 (c) Non-performing lending portfolio

Loans, advances and finance leases are classified as non-performing as explained in Note no 4.8.1. The criteria used for the classification of lending portfolio of the Bank as non performing is set out below. This is in accordance with the Direction issued by the Central Bank of Sri Lanka on 8th May 2008 on " Classification of Loans and Advances, Income recognition & Provisioning".

### 27 (c) i Categorisation of Non-performing lending portfolio

Type of facility	Point of classification
Overdrafts	Outstanding balance in excess of sanctioned limit continuously for a period of 90 days or more
Credit facilities repayable in monthly installments	Three consecutive installments, principal and/or interest have not been paid
Credit facilities payable in quarterly/half yearly installments	An installment is not paid within 90 days from the due date
Credit facilities repayable in one installment at the end of a specified period or on a due date (bullet payments)	Payment is not made within 90 days from the end of the agreed period or the due date
Credit cards	Minimum payment is in arrears for 90 days from the due date



## 27 LOANS AND ADVANCES (Contd.)

### 27 (c) Non-performing lending portfolio (Contd.)

#### 27 (c) i Categorisation of Non-performing lending portfolio (Contd.)

##### Categorisation of NPA

Type of facility	Determinant	Overdue/ special mention	Sub standard	Doubtful	Loss
Overdrafts	Period that the outstanding is in excess of the sanctioned limit continuously	Equal to or more than 90 days but less than 180 days	Equal to 180 days or more but less than 360 days	Equal to or more than 360 days but less than 540 days	Equal to 540 days or more
Credit facilities repayable in monthly installments	No. of installments, principal and/or interest due and unpaid	3 installments or more but less than 6 installments	6 installments or more but less than 12 installments	12 installments or more but less than 18 installments	Equal to 18 installments or more
Credit cards	No of days minimum payment is in arrears for from due date	90 days or more but less than 120 days	120 days or more but less than 180 days	180 days or more but less than 240 days	Equal to 240 days or more
Other credit facilities	No of days payments are in arrears from the due date	90 days or more but less than 180 days	180 days or more but less than 360 days	360 days or more but less than 540 days	Equal to 540 days or more

Provision for possible loan losses are made on the basis of a continuous review of all advances to customers, in accordance with the Sri Lanka Accounting Standard 23, "Revenue Recognition and Disclosures in Financial Statements of Banks" and the directions issued by the Central Bank of Sri Lanka and disclosed in the financial statements of the Bank, after considering the values of the collateral obtained against the respective non performing loans, and advances.

Valuation of collateral is performed based on Direction issued by Central Bank of Sri Lanka as explained in Note. 27 (c) ii.

#### 27 (c) ii Valuation of Securities for Provisioning Purposes

As per an amendment to the directions issued by the Central Bank of Sri Lanka on 15th August 2003 (effective from 1st January 2004) under section 46 (A) of the Banking Act No. 30 of 1988, as amended by Banking (Amendment) Act No. 33 of 1995, the initial and progressive discounts that need to be applied to the forced sale value of immovable properties held as collateral are as follows:

At the time of first provisioning for a loan, only 75% of the forced sale value (FSV) of the property based on a current professional valuation report is considered as the value of collateral (i.e. an initial haircut of 25% will be applied);

When an advance is transferred to the 'Loss' category, the following progressive discounts apply to the forced sale value of immovable property held as collateral, based on a current professional valuation report, depending on the time period for which it remains in the 'Loss' category:

No. of years in loss category	% of FSV of immovable property that can be considered as the value of collateral
1 - 2 years	60%
2 - 3 years	50%
3 - 4 years	40%

All immovable property held as collateral, relating to loans in the 'Loss' category for more than four years, are reviewed on a regular basis and discounted further at the discretion of management.

## 27 LOANS AND ADVANCES (Contd.)

### 27 (d) Asset quality - Bank

As at 31st December	2008		2007	
	Rs 000		Rs 000	
Bills of Exchange	106,906		334,635	
Loans and advances	12,318,928		9,251,910	
Foreclosed properties	474,188		465,336	
Lease rental receivable	656,074		566,538	
	<b>13,556,096</b>		<b>10,618,419</b>	
Less: Specific provisions				
Bills of Exchange	297,546		300,967	
Loans and advances	5,788,256		5,507,607	
Foreclosed properties	459,046		446,362	
Lease rental receivable	256,965	6,801,813	211,699	6,466,635
		<b>6,754,283</b>		<b>4,151,784</b>
Less: Interest in suspense [Note 27 (f)]		<b>(1,250,725)</b>		<b>(924,583)</b>
Net non-performing lending portfolio		<b>5,503,558</b>		<b>3,227,201</b>

Net non-performing lending portfolio of Rs 5,503 Mn. (2007: Rs 3,227 Mn.) is secured by immovable assets, movable assets and other registered securities, approved by the Central Bank of Sri Lanka for provisioning purposes. The values of the immovable properties are discounted for provisioning purposes as explained in Note No. 27 (c) ii.

### 27 (e) Credit risk - Bank

#### 27 (e) i Collateral wise analysis of gross non-performing lending portfolio

The Bank holds collateral against its lending portfolio in the form of mortgage interest over property, other registered securities and assets. Estimation of fair value/realisable value are based on the value of collateral assessed at the time of lending and generally are not updated except when a loan is individually assessed as non-performing.

As at 31st December	2008		2007	
	Rs 000	%	Rs 000	%
Secured by immovable assets	7,538,668	56	4,276,985	41
Secured by movable assets	807,714	6	1,624,176	15
Secured by cash/shares	269,238	2	202,679	2
Other securities	1,480,810	11	1,666,107	16
Clean	3,332,377	24	2,820,463	26
Pawning	127,289	1	28,009	-
	<b>13,556,096</b>	<b>100</b>	<b>10,618,419</b>	<b>100</b>

## 27 LOANS AND ADVANCES (Contd.)

### 27 (e) Credit risk - Bank (Contd.)

#### 27 (e) ii Sector / Productwise analysis of gross lending portfolio

The Bank monitors concentration of credit risk by sectors. An analysis of concentration of credit risk as at the Balance Sheet date is shown below:

Sector / Type of Loan	Overdrafts Rs 000	Short Term Loans Rs 000	Medium Term Loans Rs 000	Long Term Loans Rs 000	Pawning Rs 000	Total Rs 000	%
<b>Bank - 2008</b>							
Food, beverages and tobacco	2,206,369	2,003,888	2,653,322	2,183,704	-	9,047,283	4.97
Agriculture, agro business and fisheries	3,989,494	3,094,402	3,814,467	2,758,908	-	13,657,271	7.51
Textiles and wearing apparel	3,115,127	1,779,689	2,620,249	2,849,080	-	10,364,145	5.70
Wood and paper products	1,344,956	720,830	1,016,925	759,392	-	3,842,103	2.11
Rubber and leather products	1,175,312	1,245,639	717,224	485,546	-	3,623,721	1.99
Metals, chemicals and engineering	2,813,335	1,109,385	1,529,092	4,743,451	-	10,195,263	5.61
Hotels	1,976,412	244,717	1,964,243	1,467,829	-	5,653,201	3.11
Services	3,740,992	3,780,494	5,774,248	5,898,346	-	19,194,080	10.55
Foreclosed properties	-	-	-	474,184	-	474,184	0.26
Others	17,968,898	14,898,681	24,879,304	26,956,649	21,129,938	105,833,470	58.19
<b>Total</b>	<b>38,330,895</b>	<b>28,877,725</b>	<b>44,969,074</b>	<b>48,577,089</b>	<b>21,129,938</b>	<b>181,884,721</b>	<b>100</b>
Gross Loans and Advances (Note 27)						169,903,868	93.41
Lease Rentals Receivable						11,980,853	6.59
						<b>181,884,721</b>	<b>100</b>
<b>The "others" category comprises the following advances:</b>							
Exports	725,227	1,654,001	1,696,477	482,381	-	4,558,086	4.31
Imports	1,799,195	4,045,359	1,920,580	802,840	-	8,567,974	8.08
Trading	4,368,381	1,518,119	3,490,995	1,853,149	-	11,230,644	10.61
Financial	3,297,392	847,209	2,085,186	1,101,541	-	7,331,328	6.93
Housing	-	261,075	3,210,563	15,171,703	-	18,643,341	17.62
Consumption	2,385,080	2,215,469	3,354,457	2,570,977	-	10,525,983	9.95
Miscellaneous	5,393,623	4,357,449	9,121,046	4,974,058	21,129,938	44,976,114	42.50
<b>Total</b>	<b>17,968,898</b>	<b>14,898,681</b>	<b>24,879,304</b>	<b>26,956,649</b>	<b>21,129,938</b>	<b>105,833,470</b>	<b>100</b>

# Notes to the Financial Statements

## 27 LOANS AND ADVANCES (Contd.)

### 27 (e) Credit risk - Bank (Contd.)

#### 27 (e) ii Sector / Productwise analysis of gross lending portfolio

Sector / Type of Loan	Overdrafts	Short Term Loans	Medium Term Loans	Long Term Loans	Pawning	Total	
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	%
<b>Bank - 2007</b>							
Food, beverages and tobacco	1,905,792	2,409,621	2,489,557	1,944,913	-	8,749,883	5.26
Agriculture, agro business and fisheries	3,547,059	3,238,206	3,309,842	2,361,495	-	12,456,602	7.49
Textiles and wearing apparel	2,924,330	2,281,741	2,635,567	2,718,701	-	10,560,339	6.35
Wood and paper products	1,150,216	1,182,441	929,115	633,441	-	3,895,213	2.34
Rubber and leather products	964,642	1,734,252	629,295	407,556	-	3,735,745	2.25
Metals, chemicals and engineering	2,687,515	1,458,178	1,328,106	4,478,662	-	9,952,461	5.99
Hotels	1,703,959	665,913	1,745,608	1,233,504	-	5,348,984	3.22
Services	3,659,537	3,091,361	4,272,560	4,529,580	-	15,553,038	9.36
Foreclosed properties	-	-	-	465,337	-	465,337	0.28
Others	17,307,569	13,587,393	22,763,260	25,060,172	16,783,984	95,502,378	57.46
<b>Total</b>	<b>35,850,619</b>	<b>29,649,106</b>	<b>40,102,910</b>	<b>43,833,361</b>	<b>16,783,984</b>	<b>166,219,980</b>	<b>100.00</b>
Gross Loans and Advances (Note 27)						152,447,619	91.45
Lease Rentals Receivable						13,772,361	8.55
						<b>166,219,980</b>	<b>100.00</b>
The "others" category comprises the following advances:							
Exports	693,748	1,493,286	1,333,895	143,021	-	3,663,950	3.83
Imports	1,631,596	3,772,129	1,674,144	463,742	-	7,541,611	7.90
Trading	4,051,932	1,238,216	3,129,833	1,597,670	-	10,017,651	10.49
Financial	3,176,281	587,028	1,749,150	861,599	-	6,374,058	6.67
Housing	-	193,811	2,282,731	13,975,821	-	16,452,363	17.23
Consumption	2,237,657	2,044,125	3,263,202	2,700,097	-	10,245,081	10.73
Miscellaneous	5,516,355	4,258,798	9,330,305	5,318,222	16,783,984	41,207,664	43.15
<b>Total</b>	<b>17,307,569</b>	<b>13,587,393</b>	<b>22,763,260</b>	<b>25,060,172</b>	<b>16,783,984</b>	<b>95,502,378</b>	<b>100.00</b>

## 27 LOANS AND ADVANCES (Contd.)

### 27 (e) Credit risk - Bank (Contd.)

#### 27 (e) ii Sector / Product wise analysis of gross lending portfolio (Contd.)

Sector / Type of Loan	Overdrafts	Short Term	Medium Term	Long Term	Pawning	Total	
	Rs 000	Loans Rs 000	Loans Rs 000	Loans Rs 000	Rs 000	Rs 000	%
<b>Group - 2008</b>							
Food, beverages and tobacco	2,206,369	2,003,888	2,653,322	2,183,704	-	9,047,283	5.03
Agriculture, agro business and fisheries	3,989,494	3,094,402	3,814,467	2,758,908	-	13,657,271	7.59
Textile and wearing apparel	3,115,127	1,779,689	2,620,249	2,849,080	-	10,364,145	5.76
Wood and paper products	1,344,956	720,830	1,016,925	759,392	-	3,842,103	2.13
Rubber and leather products	1,175,312	1,245,639	717,224	485,546	-	3,623,721	2.01
Metals, chemicals and engineering	2,813,335	1,109,385	1,529,092	4,743,451	-	10,195,263	5.66
Hotels	1,976,412	244,717	1,964,243	1,467,829	-	5,653,201	3.14
Services	3,740,992	3,780,494	5,774,248	5,898,346	-	19,194,080	10.66
Foreclosed properties	-	-	-	474,184	-	474,184	0.26
Others	17,128,824	14,898,681	24,879,304	25,956,649	21,129,938	103,993,396	57.76
<b>Total</b>	<b>37,490,821</b>	<b>28,877,725</b>	<b>44,969,074</b>	<b>47,577,089</b>	<b>21,129,938</b>	<b>180,044,647</b>	<b>100.00</b>
Gross Loans and Advances (Note 27)						168,063,794	93.35
Lease Rentals Receivable						11,980,853	6.65
						<b>180,044,647</b>	<b>100.00</b>
The "others" category comprises the following advances:							
Exports	725,227	1,654,001	1,696,477	482,381	-	4,558,086	4.38
Imports	1,799,195	4,045,359	1,920,580	802,840	-	8,567,974	8.24
Trading	4,368,381	1,518,119	3,490,995	1,853,149	-	11,230,644	10.80
Financial	3,297,392	847,209	2,085,186	1,101,541	-	7,331,328	7.05
Housing	-	261,075	3,210,563	15,171,703	-	18,643,341	17.93
Consumption	2,385,080	2,215,469	3,354,457	2,570,977	-	10,525,983	10.12
Miscellaneous	4,553,549	4,357,449	9,121,046	3,974,058	21,129,938	43,136,040	41.48
<b>Total</b>	<b>17,128,824</b>	<b>14,898,681</b>	<b>24,879,304</b>	<b>25,956,649</b>	<b>21,129,938</b>	<b>103,993,396</b>	<b>100.00</b>
<b>Group - 2007</b>							
Food, beverages and tobacco	1,905,792	2,409,621	2,489,557	1,944,913	-	8,749,883	5.31
Agriculture, agro business and fisheries	3,547,059	3,238,206	3,309,842	2,361,495	-	12,456,602	7.57
Textiles and wearing apparel	2,924,330	2,281,741	2,635,567	2,718,701	-	10,560,339	6.41
Wood and paper products	1,150,216	1,182,441	929,115	633,441	-	3,895,213	2.37
Rubber and leather products	964,642	1,734,252	629,295	407,556	-	3,735,745	2.27
Metals, chemicals and engineering	2,687,515	1,458,178	1,328,106	4,478,663	-	9,952,462	6.04
Hotels	1,703,959	665,913	1,745,608	1,233,504	-	5,348,984	3.25
Services	3,659,537	3,091,361	4,272,560	4,529,580	-	15,553,038	9.45
Foreclosed properties	-	-	-	465,336	-	465,336	0.28
Others	16,732,939	13,591,631	22,763,260	24,060,173	16,783,984	93,931,986	57.05
<b>Total</b>	<b>35,275,989</b>	<b>29,653,344</b>	<b>40,102,910</b>	<b>42,833,362</b>	<b>16,783,984</b>	<b>164,649,588</b>	<b>100.00</b>
Gross Loans and Advances (Note 27)						150,877,227	91.64
Lease Rentals Receivable						13,772,361	8.36
						<b>164,649,588</b>	<b>100.00</b>
The "others" category comprises the following advances:							
Exports	693,748	1,493,286	1,333,895	143,021	-	3,663,950	3.90
Imports	1,631,596	3,772,129	1,674,144	463,742	-	7,541,611	8.03
Trading	4,051,933	1,238,216	3,129,833	1,597,670	-	10,017,651	10.66
Financial	3,176,281	587,028	1,749,150	861,599	-	6,374,058	6.79
Housing	-	193,811	2,282,731	13,975,821	-	16,452,363	17.52
Consumption	2,237,657	2,044,125	3,263,202	2,700,097	-	10,245,081	10.90
Miscellaneous	4,941,724	4,263,036	9,330,305	4,318,223	16,783,984	39,637,272	42.20
<b>Total</b>	<b>16,732,939</b>	<b>13,591,631</b>	<b>22,763,260</b>	<b>24,060,173</b>	<b>16,783,984</b>	<b>93,931,986</b>	<b>100.00</b>

## 27 LOANS AND ADVANCES (Contd.)

As at 31st December

	2008 Rs 000	2007 Rs 000
<b>27 (f) Movement in Interest in Suspense - Bank</b>		
Balance brought forward	924,583	850,746
Interest suspended	1,230,402	835,788
Amounts recovered	(846,689)	(732,277)
Interest written off	(57,571)	(29,674)
Balance as at 31st December	1,250,725	924,583

As a policy, the Bank seals off interest on non-performing loans and advances after one year of classification in to the loss category. However, at the time of recovery, further interest on such advances is calculated from the date on which interest was sealed off.

### 27 (g) Movement in Foreclosed properties

Balance brought forward	18,974	24,452
Disposals during the year	(8,282)	(32,061)
Exchange translation	568	157
Reclassified to provision for loan losses	-	(10,847)
Provision recoveries during the year	3,882	37,273
Balance as at 31st December	15,142	18,974

The total of Foreclosed properties and related provisions have been classified under loans and advances

Sri Lanka Rupee loans and advances	29,076	37,359
Foreign currency loans and advances	445,112	427,977
Specific provision for foreclosed properties [Note 27 (h)]	(459,046)	(446,362)
Balance as at 31st December	15,142	18,974

### 27 (h) Movement in provision for Foreclosed properties

Balance brought forward	446,362	468,218
Reclassified to provision for loan losses	-	10,847
Exchange rate variance in foreign currency provision	16,566	4,570
Recoveries made during the year	(3,882)	(37,273)
Balance as at 31st December	459,046	446,362

### 27 (i) Provision for Kabool Lanka (Pvt) Ltd.

The bank has made a total provision of Rs 2.6 Bn. as at 31st December 2006 against the exposure to Kabool Lanka (Pvt) Ltd. of approximately Rs 2.8 Bn. as a measure of prudence, despite the fact that land and building has a value adequate to cover the un-provided exposure.

The assets jointly owned by Hatton National Bank PLC and Bank of Ceylon, acquired through the legal process was subsequently acquired by the Government under the Provisions of the Land Acquisition Act and the Banks have lodged their claim for compensation.

As at 31st December	Bank		Group	
	2008 Rs 000	2007 Rs 000	2008 Rs 000	2007 Rs 000
<b>28 TOTAL LEASE RENTALS RECEIVABLE</b>				
Gross lease rentals receivable	30,802,644	30,411,111	30,802,644	30,411,111
Initial rentals received	(110,774)	(123,589)	(110,774)	(123,589)
Lease rentals received	(15,577,672)	(12,724,249)	(15,577,672)	(12,724,249)
<b>Total Lease rentals receivable</b>	<b>15,114,198</b>	<b>17,563,273</b>	<b>15,114,198</b>	<b>17,563,273</b>

#### 28 (a) Lease rentals receivable within one year

Lease rentals receivable within one year from				
Balance Sheet date	6,448,192	6,606,245	6,448,192	6,606,245
Unearned lease income	(1,709,563)	(1,908,970)	(1,709,563)	(1,908,970)
Provision for lease receivable				
Specific [Note 28 (c)]	(256,965)	(211,699)	(256,965)	(211,699)
General	(89,431)	(89,712)	(89,431)	(89,712)
<b>Balance as at 31st December</b>	<b>4,392,233</b>	<b>4,395,864</b>	<b>4,392,233</b>	<b>4,395,864</b>

#### 28 (b) Lease rentals receivable after one year

Lease rentals receivable after one year from				
Balance Sheet date	8,666,004	10,957,028	8,666,004	10,957,028
Unearned lease income	(1,423,780)	(1,881,942)	(1,423,780)	(1,881,942)
Provision for lease receivable				
General	(145,248)	(181,502)	(145,248)	(181,502)
<b>Balance as at 31st December</b>	<b>7,096,976</b>	<b>8,893,584</b>	<b>7,096,976</b>	<b>8,893,584</b>

There were no lease rentals receivable beyond five years.

#### 28 (c) Movement in provision for lease rentals receivable

As at 31st December	2008 Rs 000 Specific	2007 Rs 000 Specific	2008 Rs 000 General	2007 Rs 000 General
<b>Bank</b>				
Balance brought forward	211,699	248,227	271,214	235,765
Exchange rate variance on foreign currency provision	-	-	-	1
	211,699	248,227	271,214	235,766
Additional provision made (Note 18)	74,487	57,489	(36,535)	35,448
Recoveries made during the year	(26,116)	(14,480)	-	-
Fully provided debts written off	(3,105)	(79,537)	-	-
	256,965	211,699	234,679	271,214
<b>Group</b>				
Balance brought forward	211,699	248,227	271,214	235,765
Exchange rate variance on foreign currency provision	-	-	-	1
	211,699	248,227	271,214	235,766
Additional provision made (Note 18)	74,487	57,489	(36,535)	35,448
Recoveries made during the year	(26,116)	(14,480)	-	-
Fully provided debts written off	(3,105)	(79,537)	-	-
	256,965	211,699	234,679	271,214

## 29 NON CURRENT ASSETS HELD FOR SALE

As at 31st December	Bank		Group	
	2008 Carrying amount Rs 000	2007 Carrying amount Rs 000	2008 Carrying amount Rs 000	2007 Carrying amount Rs 000
Balance as at 1st January	1,455	6,556	1,455	6,556
Less : Disposals	-	(5,101)	-	(5,101)
Balance as at 31st December	1,455	1,455	1,455	1,455

### 29 (a) Non-current assets held for sale

Freehold land [Note 29 (b)]	1,455	1,455	1,455	1,455
	1,455	1,455	1,455	1,455

### 29 (b) Freehold land

	2008		2007	
	Extent (perches)	Cost of land Rs 000	Extent (perches)	Cost of land Rs 000
Land at No. 118A, Negombo Road, Narammala	-	-	Disposed	-
Land at No. 67/11, Kumaradola Road, Monaragala	20	1,455	20	1,455
		1,455		1,455

Freehold land referred to above is presented as "Non Current Assets Held for Sale", following the commitment of the Bank's management in 2007 to a plan to sell. Efforts to sell this property has commenced.

## 30 INVESTMENTS IN ASSOCIATES

As at 31st December	Principal Activity	% Holding	2008		% Holding	2007		
			Balance Rs 000	Market Value Rs 000		Balance Rs 000	Market Value Rs 000	
<b>30 (a) Bank</b>								
<b>Quoted</b>								
<b>Lanka Ventures PLC</b>	Venture Capital	20.07	132,326	60,218	20.07	132,326	110,399	
(10,036,250 shares)								
			132,326	60,218		132,326	110,399	
<b>Unquoted</b>								
Browns Engineering (Pvt) Ltd.	Engineering	32.63	20,560		32.63	20,560		
(2,056,000 ordinary shares)								
Provision for diminution in value			(20,560)			(20,560)		
Total for the Bank			132,326			132,326		

### Lanka Ventures PLC

The Market Value of Lanka Ventures PLC has fallen below the cost of the investment as at Balance Sheet date. However, since the Bank's share of net assets of Lanka Ventures PLC exceeds the cost of investment as at Balance Sheet date, the Board of Directors was of the opinion that there was no impairment.

### Browns Engineering (Pvt) Ltd

Browns Engineering (Pvt) Ltd is under liquidation and the Bank's investment in the Company has been fully provided for.



### 30 INVESTMENTS IN ASSOCIATES (Contd.)

As at 31st December	Quoted Investments		Unquoted Investments		Total	
	2008 Rs 000	2007 Rs 000	2008 Rs 000	2007 Rs 000	2008 Rs 000	2007 Rs 000
<b>30 (b) Group</b>						
Investment in Associate Companies (at cost)	132,326	132,326	250	-	132,576	132,326
Negative goodwill on acquisition recognised in Income Statement	5,830	5,830	3,416	-	9,246	5,830
Group share of Associate Company retained profits						
Balance as at 1st January	26,937	26,713	-	-	26,937	26,713
Current year's share of profits after tax	(10,961)	14,317	1,144	-	(9,817)	14,317
Dividends received during the year	(15,054)	(14,093)	(188)	-	(15,242)	(14,093)
Group share of Associate Company net assets	139,078	165,093	4,622	-	143,700	165,093
Group investment in Associate Companies (equity basis)	139,078	165,093	4,622	-	143,700	165,093

#### Splendor Media (Pvt) Ltd

Investment in Splendor Media (Pvt) Ltd which was presented as a long term investment in 2007, has been classified as an investment in associate in 2008. The Board of Directors carried out an internal assessment as at 31st December 2008 and concluded that there was no impairment.

#### 30 (c) Summarised Financial Information of Associates

	Lanka Ventures PLC		Splendor Media (Pvt) Ltd.
	2008 Rs 000	2007 Rs 000	2008 Rs 000
Revenue	128,817	122,445	211,965
Expenses	(43,481)	(29,515)	(204,556)
Profit / (Loss)	85,336	92,930	7,409
Current assets	329,256	281,930	88,479
Non current assets	497,476	553,248	630,018
Total assets	826,732	835,178	718,497
Current liabilities	131,735	10,560	70,575
Non current liabilities	2,031	2,031	45
Total liabilities	133,766	12,591	70,620

# Notes to the Financial Statements

## 31 INVESTMENTS IN JOINT VENTURE

### Bank

As at 31st December

	Principal Activity	% Holding	2008		2007		Directors' Valuation Rs 000	
			Balance Rs 000	Directors' Valuation Rs 000	Balance Rs 000	Directors' Valuation Rs 000		
<b>Unquoted</b>								
Acuity Partners (Pvt) Ltd	Financial services	50	250,000	250,000	-	-	-	
			<b>250,000</b>	<b>250,000</b>	-	-	-	

Bank's Interest in Acuity Partners (Pvt) Ltd include:

	2008 Rs 000
Assets	1,181,066
Liabilities	928,590
Income	133,196
Expenses	123,791
Tax	6,941

## 32 INVESTMENTS IN SUBSIDIARIES

### Bank

#### 32 (a) Quoted

As at 31st December

	Principal Activity	% Holding	2008		2007		Market Value Rs 000
			Balance Rs 000	Market Value Rs 000	Balance Rs 000	Market Value Rs 000	
HNB Assurance PLC (22,494,750 shares)	Insurance	60	149,965	416,153	60	149,965	551,121

#### 32 (b) Unquoted

	Principal Activity	% Holding	2008		2007		Directors' Valuation Rs 000
			Balance Rs 000	Directors' Valuation Rs 000	Balance Rs 000	Directors' Valuation Rs 000	
Sithma Development (Pvt) Ltd (206,000,000 ordinary shares)	Property Development	100	1,973,000	1,973,000	100	1,973,000	1,973,000
HNB Securities Ltd (15,000,000 ordinary shares)	Primary Dealer in Government Securities	-	-	-	100	150,000	150,000
HNB Stockbrokers (Pvt) Ltd (3,600,000 ordinary shares)	Share Broking	-	-	-	100	20,698	20,698
Majan Exchange LLC (200,000 shares)	Dealing in foreign exchange	40	56,121	56,121	-	-	-
			<b>2,029,121</b>	<b>2,029,121</b>		2,143,698	2,143,698
Total for Bank			<b>2,179,086</b>			2,293,663	

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.

On 1st July 2008 Hatton National Bank PLC & DFCC Bank entered into an agreement to form an investment banking joint venture. Accordingly, 100% share holding of the Bank in HNB Stockbrokers (Pvt) Ltd, and 50.01% holding in HNB Securities Ltd were transferred to Acuity Partners (Pvt) Ltd on that day. Therefore, from 1st of July 2008 onwards HNB Stockbrokers (Pvt) Ltd & HNB Securities Ltd ceased to be subsidiaries of the Bank. The Bank continues to hold 49.99% of HNB Securities Ltd, which is classified as Investments Securities in view that Bank can not exercise significant influence on the activities of Acuity Partners (Pvt) Ltd, which being a joint venture would require unanimous consent for strategic, financial and operating decisions.

### 33 INVESTMENT PROPERTIES

	Bank		Group	
	2008 Rs 000	2007 Rs 000	2008 Rs 000	2007 Rs 000
<b>Cost</b>				
Balance as at 1st January	195,505	195,505	242,499	242,499
Improvements	-	-	88	-
Balance as at 31st December [Note 33 (a) and 33 (b)]	195,505	195,505	242,587	242,499
<b>Accumulated depreciation</b>				
Balance as at 1st January	6,844	5,650	61,871	57,474
Charge for the year	1,194	1,194	4,403	4,397
Balance as at 31st December	8,038	6,844	66,274	61,871
<b>Net book value as at 31st December 2008</b>	<b>187,467</b>		<b>176,313</b>	
Net book value as at 31st December 2007		188,661		180,628

Land situated at No.479, T B Jayah Mw., Colombo 10 on which HNB Towers is built, and No. 21, 21A, 23 and 25 Janadhipathi Mawatha, Colombo 01 are leased to Sithma Development (Pvt) Ltd by the Bank and the Bank receives ground rent. Accordingly, these lands have been classified as Investment property in the Balance Sheet of the Bank. However, according to SLAS 40, the said lands are treated as Property, Plant & Equipment in the Group Balance Sheet, since these are leased to a Group entity. Accordingly, the revaluation impact of such property is not adjusted for in the Group since the classification is a consolidation adjustment.

#### 33 (a) Valuation of Investment Properties - Bank

As at 31st December 2008	Cost/Carrying amount			Fair Value				
	Building sq.ft	Extent perches	Land Rs 000	Building Rs 000	Total Rs 000	Land Rs 000	Building Rs 000	Total Rs 000
23 & 23 1/1, Independence Avenue, Colombo 7.	9,975	60.40	37,081	47,754	84,835	472,500	42,500	515,000
479 T B Jayah Mawatha, Colombo 10.	Land	100	75,781	-	75,781	508,320	-	508,320
21, 21A, 23 & 25, Janadhipathi Mawatha, Colombo 1.	Land	26.62	34,889	-	34,889	39,930	-	39,930
			147,751	47,754	195,505			1,063,250

#### 33 (b) Valuation of Investment Properties - Group

As at 31st December 2008	Cost/Carrying amount			Fair Value				
	Building sq.ft	Extent perches	Land Rs 000	Building Rs 000	Total Rs 000	Land Rs 000	Building Rs 000	Total Rs 000
23 & 23 1/1, Independence Avenue, Colombo 7.	9,975	60.40	37,081	47,754	84,835	472,500	42,500	515,000
Smart building, 21, 21A, 23 & 25, Janadhipathi Mawatha, Colombo 1.	42,765	-	-	157,752	157,752	-	197,050	197,050
			37,081	205,506	242,587			712,050

The fair value of the investment properties are based on market valuations carried out as at 31st December 2006 by Messrs J.M.T. Fernando, F.I.V. D.I.V. (Sri Lanka), K.C.B. Condegama, A.I.V. (Sri Lanka), members of the Institute of Valuers of Sri Lanka, who are independent valuers not connected with the Bank. The Directors have carried out an internal valuation as at 31st December 2008 based on the market conditions of similar properties situated within close proximity. Based on the above valuation, the Directors of the Bank confirmed that the estimated market value of investment properties as at 31st December 2008 was Rs 779 Mn for the Bank and Rs 541 Mn for the Group. Although the estimated market values as at 31st December 2008 was lower than the market value as at 31st December 2006 shown in the above note, in the opinion of the Board of Directors there is no impairment since the investment properties are presented at cost in the Financial Statements.

# Notes to the Financial Statements

## 34 PROPERTY, PLANT & EQUIPMENT

Bank	Leasehold Buildings	Freehold Land and Buildings	Computer Equipment	Equipment Furniture and Fixtures	Motor Vehicles	Capital Work-in Progress	2008 Total	2007 Total
	Note 34 (b) Rs 000	Rs 000	Note 34 (a) Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
<b>Cost/Valuation</b>								
<b>as at 31/12/2007</b>	792,386	4,159,121	1,449,516	2,169,324	151,732	458,333	<b>9,180,412</b>	5,776,480
Revaluation adjustment on accumulated depreciation	-	-	-	-	-	-	-	(148,421)
Revaluation surplus	-	-	-	-	-	-	-	2,778,725
Impairment*	-	-	-	-	-	-	-	(87,764)
Transfers to intangible assets	-	-	-	-	-	-	-	(146)
Sub category transfers	306	50	(721)	365	-	-	-	-
Additions and improvements	108,715	268,881	340,069	190,215	59,987	385,805	<b>1,353,672</b>	912,300
Disposals during the year	(310)	-	(48,130)	(63,677)	(9,969)	-	<b>(122,086)</b>	(50,762)
Transfers from capital work-in-progress	51,004	296,044	149,159	41,722	-	(621,983)	<b>(84,054)</b>	-
<b>Cost/Valuation</b>								
<b>as at 31/12/2008</b>	952,101	4,724,096	1,889,893	2,337,949	201,750	222,155	<b>10,327,944</b>	9,180,412
Accumulated depreciation as at 31/12/2007	415,756	34,428	995,278	1,571,727	80,665	-	<b>3,097,854</b>	2,868,691
Revaluation adjustment on accumulated depreciation	-	-	-	-	-	-	-	(148,421)
Sub category transfers	(291)	44	672	(427)	2	-	-	-
Charge for the year	85,854	34,567	143,963	188,667	26,670	-	<b>479,721</b>	420,970
Disposals during the year	(308)	-	(46,756)	(58,247)	(9,968)	-	<b>(115,279)</b>	(43,386)
<b>Accumulated depreciation</b>								
<b>as at 31/12/2008</b>	501,011	69,039	1,093,157	1,701,720	97,369	-	<b>3,462,296</b>	3,097,854
<b>Net book value</b>								
<b>as at 31/12/2008</b>	451,090	4,655,057	796,736	636,229	104,381	222,155	<b>6,865,648</b>	
Net book value as at 31/12/2007	376,630	4,124,693	454,238	597,597	71,067	458,333		6,082,558

### 34 PROPERTY, PLANT & EQUIPMENT (Contd.)

Group	Leasehold Buildings	Freehold Land and Buildings	Computer Equipment	Equipment Furniture and Fixtures	Civil Works	Motor Vehicles	Capital Work-in- Progress	2008 Total	2007 Total
	Note 34 (b) Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
<b>Cost/Valuation</b>									
<b>as at 31/12/2007</b>	792,386	9,396,676	1,519,626	4,312,517	-	150,167	714,885	<b>16,886,257</b>	10,597,540
Revaluation adjustment on accumulated depreciation	-	-	-	-	-	-	-	-	(256,935)
Revaluation surplus	-	-	-	-	-	-	-	-	5,545,548
Impairment*	-	-	-	-	-	-	-	-	(87,764)
Transfers to intangible assets	-	-	-	-	-	-	-	-	(146)
Sub category transfers	306	50	(721)	365	-	-	-	-	-
Additions and improvements	111,777	268,881	370,463	220,876	2,269	73,475	737,603	<b>1,785,344</b>	1,147,630
Disposals	(6,432)	-	(68,772)	(71,693)	-	(13,272)	-	<b>(160,169)</b>	(59,616)
Re-classified to other assets	-	-	-	-	-	-	(604,682)	<b>(604,682)</b>	(256,229)
Transfers from capital work-in-progress	51,004	296,044	149,159	41,722	-	-	(621,983)	<b>(84,054)</b>	-
<b>Cost/Valuation</b>									
<b>as at 31/12/2008</b>	949,041	9,961,651	1,969,755	4,503,787	2,269	210,370	225,823	<b>17,822,696</b>	16,630,028
<b>Accumulated Depreciation</b>									
<b>as at 31/12/2007</b>	415,756	132,755	1,029,895	1,784,797	-	85,250	-	<b>3,448,453</b>	3,211,967
Revaluation adjustment on accumulated depreciation	-	-	-	-	-	-	-	-	(260,599)
Sub category transfers	(291)	44	672	(427)	-	2	-	-	-
Charge for the year	88,915	80,451	163,137	251,605	41	29,696	-	<b>613,845</b>	548,881
Disposals during the year	(6,429)	-	(59,671)	(63,798)	-	(10,721)	-	<b>(140,619)</b>	(51,796)
<b>Accumulated Depreciation</b>									
<b>as at 31/12/2008</b>	497,951	213,250	1,134,033	1,972,177	41	104,227	-	<b>3,921,679</b>	3,448,453
<b>Net book value</b>									
<b>as at 31/12/2008</b>	451,090	9,748,401	835,722	2,531,610	2,228	106,143	225,823	<b>13,901,017</b>	-
Net book value as at 31/12/2007	376,630	9,263,921	489,731	2,527,720	-	64,917	458,656		13,181,575

\* As set out in Note No.4.12.4, the Bank/Group had revalued its freehold land & buildings as at 1st January 2007, by professionally qualified independent valuers. The revaluation was carried out by taking into account the observable prices in active market or recent market transactions on arm's length term. The revaluation surplus, amounting to Rs 2,778.7 Mn./Rs 5,545.5 Mn. had been credited to the Revaluation Reserve Account in respect of Bank/Group respectively in 2007. An impairment loss of Rs 87.76 Mn. had been recognised during that year in respect of Freehold land & buildings which was identified during the process of revaluation of such properties.

Based on the assessment of potential impairment carried out internally by the Board of Directors as at 31st December 2008, no provision was required to be made in the financial statements as at Balance Sheet date.

\*\* Work-in-progress - Residential Apartment Complex of Sithma Development (Pvt) Ltd which was included under capital work in progress in 2007 has been re-classified under Other Assets as explained in Note No. 4.13.

## 34 PROPERTY, PLANT & EQUIPMENT (Contd.)

### 34 (a) Computer Equipment - Bank

	Additions Prior to 1.7.2000 Rs 000	Additions After 1.7.2000 Rs 000	2008 Total Rs 000	2007 Total Rs 000
Rate of depreciation	25%	16.67%		
Cost/valuation as at 01.01.2008	576,822	872,694	1,449,516	1,240,454
Additions and improvements	-	340,069	340,069	184,379
Transfers from capital work-in-progress	-	149,159	149,159	33,878
Sub category transfers	-	(721)	(721)	9,615
Disposals during the year	-	(48,130)	(48,130)	(18,810)
Cost/Valuation as at 31.12.2008	576,822	1,313,071	1,889,893	1,449,516

During the year 2008, Finacle Core Banking Solution was available for use and was implemented in selected branches and the cost of hardware of Rs 215.9 Mn was fully capitalised as at 31st December 2008.

### 34 (b) Leasehold Buildings

As at 31st December	Bank 2008			Group 2008			Bank 2007		Group 2007	
	Cost of Buildings Rs 000	Accumulated Depreciation Rs 000	Net Book Value Rs 000	Cost of Buildings Rs 000	Accumulated Depreciation Rs 000	Net Book Value Rs 000	Net Book Value Rs 000	Net Book Value Rs 000		
Up to 1 year	130,102	72,996	57,106	130,102	72,996	57,106	4,816	4,816		
01 - 05 years	264,890	178,112	86,778	261,830	175,052	86,778	60,959	60,959		
05 - 10 years	201,152	71,932	129,220	201,152	71,932	129,220	80,373	80,373		
10 - 15 years	13,750	6,664	7,086	13,750	6,664	7,086	6,431	6,431		
15 - 20 years	-	-	-	-	-	-	3,133	3,133		
Above 20 years	342,207	171,307	170,900	342,207	171,307	170,900	220,918	220,918		
	952,101	501,011	451,090	949,041	497,951	451,090	376,630	376,630		

### 34 (c) Fully Depreciated Property

The initial cost of fully depreciated plant, machinery and equipment as at 31st December 2008, which are still in use as at Balance Sheet date.

	2008 Rs 000
Motor vehicles	53,685
Leasehold Building	188,308
Computer equipment	757,156
Equipment, furniture and fixtures	688,787
Intangible Assets	291,293

### 34 (d) Temporarily Idle Property, Plant & Equipment

There were no temporarily idle property, plant & equipment as at 31st December 2008.

### 34 (e) Retired from Active Use

The carrying amount of property, plant & equipment which are retired from active use and not classified as held for sale as at 31st December 2008 is Rs 0.2 Mn (2007 - Rs 1.6 Mn).

	2008 Rs 000	2007 Rs 000
Computer equipment	-	242
Equipment, furniture and fixtures	199	1,393

### 35 INTANGIBLE ASSETS

As at 31st December	Bank		Group	
	2008 Rs 000	2007 Rs 000	2008 Rs 000	2007 Rs 000
Cost as at 1st January	649,581	632,622	700,575	677,651
Additions and improvements during the year	551,126	16,813	567,912	22,779
Transfer from property plant & equipment	-	146	-	145
Transfer from capital work in progress	84,054	-	84,054	-
Disposal of Subsidiaries	-	-	(14,650)	-
<b>Cost as at 31st December</b>	<b>1,284,761</b>	<b>649,581</b>	<b>1,337,891</b>	<b>700,575</b>
Accumulated amortisation as at 1st January	465,717	400,647	490,165	417,911
Amortisation for the year	91,446	65,070	102,017	72,254
Disposal of Subsidiaries	-	-	(7,675)	-
<b>Accumulated amortisation as at 31st December</b>	<b>557,163</b>	<b>465,717</b>	<b>584,507</b>	<b>490,165</b>
<b>Net book value as at 31st December</b>	<b>727,598</b>	<b>183,864</b>	<b>753,384</b>	<b>210,410</b>

As stated in Note No.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.

\*\* During the year 2008, Finacle Core Banking Solution was available for use and was implemented in selected branches and the cost of software of Rs 540.3 Mn has been capitalised under Intangible assets.

### 36 OTHER ASSETS

As at 31st December	Bank		Group	
	2008 Rs 000	2007 Rs 000	2008 Rs 000	2007 Rs 000
Deposits and prepayments	4,364,369	3,478,854	3,911,928	2,963,406
Items in transit	749,012	490,266	749,012	532,760
Claims receivable	538,602	67,961	625,077	100,744
VAT recoverable	419,575	583,454	424,032	585,217
Inventory items held for use	677,233	154,683	678,690	156,464
WIP - Residential Apartment Complex*	-	-	604,682	280,196
Other debtors	665,493	1,767,115	1,102,897	2,247,515
	<b>7,414,284</b>	<b>6,542,333</b>	<b>8,096,318</b>	<b>6,866,302</b>

\* WIP relating to residential apartment complex of Sithma Development (Pvt) Ltd. was reclassified during the year from capital work in progress under Property, Plant and Equipment to "Other Assets". As explained in Note no 4.13 the WIP - residential apartment complex is classified under Other Assets. However, since the project is in progress no balance was presented under Inventory - Residential Apartment Complex.

### 37 DEPOSITS FROM CUSTOMERS

<b>Local Currency Deposits</b>				
Current Account Deposits	12,748,863	12,482,701	12,688,239	12,454,599
Savings deposits	54,544,453	53,565,590	54,543,448	53,563,068
Time Deposits	75,828,902	66,836,282	75,801,652	66,834,032
Certificates of Deposit	4,269,993	4,021,045	4,269,992	4,021,045
	<b>147,392,211</b>	<b>136,905,618</b>	<b>147,303,331</b>	<b>136,872,744</b>
<b>Foreign Currency Deposits</b>				
Current Account Deposits	1,522,500	1,348,574	1,522,500	1,348,573
Savings Deposits	14,178,854	15,784,655	14,174,831	15,773,454
Time Deposits	23,676,297	21,620,726	23,613,879	21,571,847
	<b>39,377,651</b>	<b>38,753,955</b>	<b>39,311,210</b>	<b>38,693,874</b>
Total deposits	<b>186,769,862</b>	<b>175,659,573</b>	<b>186,614,541</b>	<b>175,566,618</b>
Deposits from Non-Bank Customers	<b>185,006,660</b>	<b>174,322,238</b>	<b>184,851,339</b>	<b>174,322,238</b>
Deposits from Banks	<b>371,570</b>	<b>591</b>	<b>371,570</b>	<b>591</b>
Deposits from Finance Companies	<b>1,391,632</b>	<b>1,336,744</b>	<b>1,391,632</b>	<b>1,243,789</b>
	<b>186,769,862</b>	<b>175,659,573</b>	<b>186,614,541</b>	<b>175,566,618</b>

## Notes to the Financial Statements

As at 31st December	Bank		Group	
	2008 Rs 000	2007 Rs 000	2008 Rs 000	2007 Rs 000
<b>38 DIVIDENDS PAYABLE</b>				
Balance as at 1st January	30,321	38,103	30,321	38,103
Final dividends declared in the prior year	824,353	294,412	824,353	294,412
Interim dividends declared during the year	235,530	-	235,530	-
Dividends paid	(962,901)	(302,194)	(962,901)	(302,194)
Balance as at 31st December	127,303	30,321	127,303	30,321

### 38 (a) Proposed final dividend

Board of Directors have recommended the payment of a final dividend of Rs 3.00 per share for the year ended 31st December 2008 (2007 first and final - Rs 3.50 per share), which is to be approved at the Annual General Meeting to be held on 31st March 2009. In accordance with Sri Lanka Accounting Standard No. 12 (Revised), "Events After the Balance Sheet Date", this proposed final dividend has not been recognised as a liability as at 31st December 2008. 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 1.00 per share (2007 - Nil) was paid for the shareholders on 15th December 2008. Final dividends for the year 2008 amounts to Rs. 706.588 Mn.

### 38 (b) Compliance with Section 56 and 57 of Companies Act No. 7 of 2007

As required by Section 56 of the Companies Act No. 07 of 2007, the Board of Directors of the Bank satisfied the solvency test in accordance with the section 57, prior to recommending the first and final dividend. A statement of solvency completed and duly signed by the directors on 13th February 2009 has been audited by M/s KPMG Ford Rhodes Thornton & Co.

As at 31st December	Bank		Group	
	2008 Rs 000	2007 Rs 000	2008 Rs 000	2007 Rs 000
<b>39 BORROWINGS</b>				
Call and time deposits from banks	7,142,474	2,913,002	7,142,474	2,913,002
Refinance borrowings	6,424,054	5,749,624	6,424,054	5,749,624
Borrowings from foreign banks	1,834,762	1,212,900	1,834,762	1,212,900
Borrowings from local banks	-	22,205	(212)	28,925
	15,401,290	9,897,731	15,401,078	9,904,451

### 40 INSURANCE PROVISION - LIFE

The Insurance Provision - Life balance represents the Life Fund of the Subsidiary HNB Assurance PLC., which is carrying out life and non-life insurance business. This balance represents the amounts attributable to life policy holders included in the Group's net assets. The valuation of the The Insurance Provision - Life as at 31st December 2008 was made by Mr M Poopalanathan, AIA, of M/s Actuarial and Management Consultants (Pvt) Ltd. for and on behalf of HNB Assurance PLC. The life fund stands at Rs 1,360.5 Mn. as at 31st December 2008 (2007 - Rs 880.67 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 30th January 2009.



#### 41 INSURANCE PROVISION - NON-LIFE

Insurance provision non-life represents the following which are included in the financial statements of HNB Assurance PLC., subsidiary of the Bank, as required by the Statement of Recommended Practice of the Institute of Chartered Accountants of Sri Lanka (ICASL) and in accordance with the regulation of Insurance Industry Act, No. 43 of 2000:

As at 31st December	Group			
	2008 Rs 000	2008 Rs 000	2007 Rs 000	2007 Rs 000
Unearned premium				
Gross		502,351		357,344
Reinsurance		(171,203)		(99,230)
Net		331,148		258,114
Deferred acquisition expenses		(6,735)		(4,137)
Unexpired Risk Reserve		7,470		6,135
		331,883		260,112
Claims outstanding - Gross	124,678		70,022	
Claims incurred but not reported - Gross	13,645	138,323	10,428	80,450
Total		470,206		340,562

#### 42 SUBORDINATED DEBENTURES

As at 31st December	Bank		Group	
	2008 Rs 000	2007 Rs 000	2008 Rs 000	2007 Rs 000
Balance as at 1st January	4,560,852	5,120,000	5,525,852	7,083,450
Debentures issued	89,705	1,200,000	89,705	1,200,000
Interest capitalised *	104,294	62,942	104,294	62,942
Debentures redeemed	(2,000,000)	(1,759,148)	(1,985,000)	(2,757,598)
Balance as at 31st December	2,754,851	4,623,794	3,734,851	5,588,794

\* Interest payable on zero coupon bonds have been added to the Debenture value.

#### 42 (a) Terms and Conditions of Unsecured, Subordinated, Redeemable Debentures issued are as follows

##### 42(a) i Year of issuance 2002

Number of debentures of Rs 100 each 2,408,520

Six types of debentures were included in the above issue, with fixed or floating interest rate options as follows.

Redemption period	7 Years	10 Years
Fixed p.a.	14.00%	14.20%
Effective Annual Yield p.a.	14.49%	14.70%
Floating p.a.	TB+1.10%	TB+1.25%
Redeemable on	10 September 2009	10 September 2012

The floating rate is based on the six month treasury bill rate with a cap of 17% p.a. and a floor of 12% p.a. These debentures are listed on the Colombo Stock Exchange.

##### 42(a) ii Year of issuance 2006

Number of debentures of Rs 100 each 11,200,000

Five types of debentures were included in the above issue, with fixed or floating interest rate options as follows.

Redemption Period	6 Year	7 Year	8 Year	15 Year	18 Year
Fixed p.a.				11.00%	11.25%
Effective annual yield p.a.				11.00%	11.00%
Floating p.a.	TB + 2.25%	TB + 2.25%	TB + 2.25%		
Redeemable on	31 March 2012	31 March 2013	31 March 2014	31 March 2021	31 March 2024

The above floating rate is based on the six month treasury bill rate with a cap of 16% p.a. and a floor of 8 % p.a. These debentures are listed on the Colombo Stock Exchange.

## 42 SUBORDINATED DEBENTURES (Contd.)

### 42 (a) Terms and Conditions of Unsecured, Subordinated, Redeemable Debentures issued are as follows (Contd.)

42 (a) iii Year of issuance		2007				
Number of debentures of Rs 100 each		12,000,000				
Two types of debentures were included in the above issue with fixed rates.						
Redemption Period		10 years		15 years		
Fixed p.a.		16.00%		16.25%		
Redeemable on		31 July 2017		31 July 2022		
These debentures are listed on the Colombo Stock Exchange.						
42 (a) iv Year of issuance		2008				
Number of debentures of Rs 100 each		897,040				
Five types of debentures were included in the above issue with fixed or floating interest rate options as follows.						
Redemption period		5 year	7 year	10 year	10 year	15 year
Fixed p.a.					16%	16.75%
Effective annual yield p.a.					16%	16.75%
Floating p.a.		TB + 1.00%	TB + 1.25%	TB + 1.50%		
Redeemable on		04 June 2013	04 June 2015	04 June 2018	04 June 2018	04 June 2023
These debentures are pending listing on the Colombo Stock Exchange.						

42 (a) v The above debentures will, in the event of the winding of the Bank, be subordinated to the claims of depositors and all other creditors of the Bank.

The Bank has not had any defaults of principal, interest or other breaches with respect to its subordinated liabilities during 2008 and 2007.

## 43 DEFERRED TAX LIABILITIES

As at 31st December	Bank		Group	
	2008 Rs 000	2007 Rs 000	2008 Rs 000	2007 Rs 000
Deferred tax liabilities [Note 43 (a)]	903,942	878,564	904,204	880,489
Deferred tax assets [Note 43 (b)]	(31,540)	(272,871)	(31,540)	(272,871)
	872,402	605,693	872,664	607,618

### 43 (a) Deferred Tax Liabilities

	Bank				Group			
	2008		2007		2008		2007	
	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 Originating/(Reversal)	2,510,184	878,563	2,341,459	819,510	2,516,904	880,489	2,353,876	823,428
during the year	80,538	28,189	(518,949)	(181,632)	80,331	28,116	(524,646)	(183,625)
Deferred tax liabilities attributable to revaluation surplus charged to equity	(8,029)	(2,810)	50,134	17,547	(8,029)	(2,810)	50,134	17,547
Adjustment for deferred tax on disposal of subsidiaries and investment in joint venture	-	-	-	-	(4,546)	(1,591)	-	-
Opening balance adjustment as per transitional provision	-	-	637,540	223,139	-	-	637,540	223,139
	2,582,693	903,942	2,510,184	878,564	2,584,660	904,204	2,516,904	880,489

#### Deferred Tax liability charged directly to Equity

According to Sri Lanka Accounting Standard 14 (Revised 2005) "Income Taxes", deferred tax shall be charged or credited directly to equity if the tax relates to items that are credited or charged, in the same or in a different period, directly to equity.

Accordingly, the deferred tax liability arising on revaluation of property, plant & equipment of Rs 17,547 Mn. was charged directly to Revaluation Reserve in the Statement of Changes in Equity in 2007. A reversal of Rs 2.810 Mn has been made to the revaluation reserve in the Statement of Changes in Equity from deferred tax liability in 2008. The reversal of deferred tax liability to revaluation reserve results from the excess depreciation resulting from the revaluation of property, plant & equipment that took place in 2007.

Deferred tax liability has not been recognised for Sithma Development (Pvt) Ltd., in view of the tax holiday enjoyed by the company. The details have been given in note No. 20 (i).

#### 43 DEFERRED TAX LIABILITY (Contd.)

##### 43 (b) Deferred Tax asset

	Bank				Group			
	2008		2007		2008		2007	
	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	779,631	272,871	1,445,011	505,754	779,631	272,871	1,445,011	505,754
Opening balance adjustment as per transitional provision, - Amount recognised in the year [Note 43 (c)]	-	-	871,634	305,072	-	-	871,634	305,072
Deferred tax asset recognised / (reversed) on general provisions	38,814	13,585	(522,077)	(182,727)	38,814	13,585	(522,077)	(182,727)
Deferred tax asset recognised on adjustment for opening tax losses	261,539	91,539	-	-	261,539	91,539	-	-
Reversal of deferred tax asset during the year	(989,870)	(346,455)	(1,014,937)	(355,228)	(989,870)	(346,455)	(1,014,937)	(355,228)
	90,114	31,540	779,631	272,871	90,114	31,540	779,631	272,871

##### 43 (b) i Deductible temporary difference - General provision

Recognition of deferred tax asset arising from general provisions at balance sheet date was limited to 6.72% (2007-6%) of the temporary difference. In management's view the Bank's NPA ratio of 6.72% as at Balance sheet date is an indicator of deferred tax asset which could be recovered in the future periods in respect of the deductible temporary difference arising from general provision.

##### 43 (b) ii Unused tax losses

Unused tax losses amounting to Rs 728,332 Mn outstanding as at 31st December 2007 was further increased by Rs 261.539 Mn. at the time of submitting the income tax return. The full amount was utilised during the year. As such no deferred tax asset was recognised for unutilised tax losses as at 31st December 2008.

##### 43 (c) Application of transitional provision

As per the transitional provision in Sri Lanka Accounting Standard 14 - "Income Taxes", (SLAS 14), the Bank has made an irrevocable choice to recognise the opening balance increase on a straight line basis over two years from 1st January 2006, the date of adoption of this standard. Accordingly the opening balance increase has been fully accounted for as at 31st December 2007.

##### i) The amount recognised in the current year

	Bank		Group	
	2008 Rs 000	2007 Rs 000	2008 Rs 000	2007 Rs 000
Deferred tax asset	-	305,072	-	305,072
Deferred tax liabilities	-	(223,139)	-	(223,139)
Income tax expense [Note 20 (b)]	-	81,933	-	81,933
The net amount of increase to be recognised next year	-	-	-	-

## 44 OTHER LIABILITIES

As at 31st December	Bank		Group	
	2008 Rs 000	2007 Rs 000	2008 Rs 000	2007 Rs 000
Cheques sent on clearing	1,050,638	2,723,138	1,050,638	2,723,138
Accrued expenditure and interest	11,138,493	7,463,695	11,207,687	7,587,136
Claims payable	152,249	70,585	152,249	70,585
Margins	1,563,113	1,359,923	1,563,113	1,359,923
Refundable deposits*	-	-	527,623	61,601
Balance held o/a of Pension fund	1,204,378	1,683,510	1,204,378	1,684,033
Balance held o/a of Widows'/widowers' & orphans' pension fund (WW&OP)	371,027	288,528	371,027	288,528
Balance held o/a of Employees Provident Fund (EPF)	57,194	135,229	59,005	135,492
Provision for Retiring Benefits	-	-	16,851	11,146
Payable to vendors for Lease equipments	120,476	217,874	121,464	219,297
Other creditors	877,443	953,685	752,351	1,267,030
	<b>16,535,011</b>	<b>14,896,167</b>	<b>17,026,386</b>	<b>15,407,909</b>

\*Refundable deposits represents the deposits taken from customers on account of the apartments in the Residential Apartments Complex which is under construction by Sithma Development (Pvt) Ltd.

## 45 EMPLOYEE RETIREMENT BENEFITS

### 45 (a) Pension Fund

An actuarial valuation of the pension fund was carried out as at 31st December 2008 by Mr M Poopalanathan, AIA, M/s Actuarial and Management Consultants (Pvt) Ltd., a firm of professional actuaries. The valuation method used by the actuaries to value the Fund is the "Projected Unit Credit Method", the method recommended by the Sri Lanka Accounting Standard No. 16 (Revised 2006) "Employee Benefits".

Accordingly, the Bank contributes on the following basis for the employees to the Pension Fund:

Pensionable Employees - 24.34%

Employees who opted for the Optional Scheme - 23%

The assets of the fund, which are independently administered by the Trustees as per the provision of the Trust Deed are held separately from those of the Bank.

No additional provision has been made in the financial statements of the Bank for gratuities to employees who have completed five or more years of service payable under the payment of Gratuity Act, No. 12 of 1983 as the Bank contributes for all permanent employees to its own non-contributory pension scheme, which is in force.

### 45 (a) i Amount recognised in the balance sheet are as follows

	2008 Rs 000
Present value of unfunded obligation	-
present value of funded obligation	6,496,902
Total present value of obligations	6,496,902
Fair value of plan assets	(4,338,509)
Present value of net obligations	2,158,393
Amortisation of transitional liability	(283,475)
Amortisation of increase in deficit from previous year	(7,025)
Less: Unrecognised actuarial (gains) / losses	(1,867,893)
Recognised liability for defined benefit obligations	-
Unrecognised actuarial (gains) / losses	
Unrecognised transitional liability as at 1st January 2008	1,133,899
Unrecognised liability for increase in deficit during the year	733,994
	<b>1,867,893</b>

#### 45 EMPLOYEE RETIREMENT BENEFITS (Contd.)

##### 45 (a) Pension Fund (Contd.)

##### 45 (a) ii Plan assets consists of the following

	2008 Rs 000
Equity securities and debentures	1,370,952
Government bond	1,860,316
Balance with HNB PLC	812,687
Other investments	229,225
Interest receivable	72,952
Tax (payable) / receivable	(7,623)
	<b>4,338,509</b>

##### 45 (a) iii Movement in the present value of defined benefit obligations

	2008 Rs 000
Liability for defined benefit obligations brought forward	5,275,079
Actuarial (gains) / losses	595,537
Benefits paid by the plan in 2008	(305,922)
Current service cost & interest cost	932,208
Liability for defined benefit obligations carried forward	<b>6,496,902</b>

##### 45 (a) iv Movement in plan assets

	2008 Rs 000
Fair value of plan assets brought forward	3,857,705
Contributions paid into plan	481,234
Benefits paid by the plan	(305,922)
Actuarial gains / (losses)	(595,537)
Expected return on plan assets	901,029
Fair value of plan assets carried forward	<b>4,338,509</b>

##### 45 (a) v Actuarial assumptions

	2008
Discount rate as at 31st December	11.5%
Expected return on plan assets as at 1st January	15%
Future salary increases	11.12%
Future pension increases	Nil
Increase in cost of living allowance	15%

Assumptions regarding future mortality are based on 1967 - 70 mortality table and a (90) annuitants table (Males and Females) issued by the Institute of Actuaries.

The overall expected long term rate of return on assets is 15%

The demographic assumptions underlying the valuation are retirement age (55 yrs.), early withdrawals from service and retirement on medical grounds, death before and after retirement, etc.

## 45 EMPLOYEE RETIREMENT BENEFITS (Contd.)

### 45 (a) Pension Fund (Contd.)

#### 45 (a) vi Historical information

	2007
Present value of the defined benefit obligation	5,275,079
Fair value of plan assets	(3,857,705)
Deficit in the plan	1,417,374

Sri Lanka Accounting Standard 16 (Revised 2006) "Employee Benefits" is applied prospectively for financial years beginning on or after 1st July 2007. As such no comparative figures are presented.

### 45 (b) Widows', Widowers' and Orphans' Pension Fund

The results of the actuarial valuation of the Widows, Widowers and Orphans Pension Scheme indicates that the actuarial present value of the promised benefit is Rs 154.73 Mn. and that the fair value of the fund assets is Rs 353.79 Mn. resulting in a past service surplus of Rs 199.02 Mn. (2007 - surplus of 161.12 Mn.) in the Widows, Widowers and Orphans Pension Scheme as at 31st December 2008.

No contribution is made by the Bank and the members contribution during the period amounted to Rs 30.87 Mn.

## 46 STATED CAPITAL

In accordance with Section 58 of Companies Act No 7 of 2007, which became effective from 3rd May 2007, share capital and share premium have been classified as stated capital.

As at 31st December	2008		2007	
	Rs 000	Rs 000	Rs 000	Rs 000
<b>VOTING ORDINARY SHARES</b>				
As at 1st January				
189,329,400 (2007 - 94.7 Mn.) voting ordinary shares	1,893,294		946,647	
Bonus issue on 29th March 2007				
94,664,700 voting ordinary shares	-		946,647	
As at 31st December				
189,329,400 voting ordinary shares		1,893,294		1,893,294
<b>NON-VOTING ORDINARY SHARES</b>				
As at 1st January				
46,200,000 (2007 - 23.1 Mn) non-voting ordinary shares	462,000		231,000	
Bonus issue 29th March 2007				
23,100,000 non-voting ordinary shares	-		231,000	
As at 31st December				
46,200,000 non-voting ordinary shares		462,000		462,000
		2,355,294		2,355,294
<b>SHARE PREMIUM</b>		<b>2,704,096</b>		<b>2,704,096</b>
<b>STATED CAPITAL AS AT 31ST DECEMBER</b>		<b>5,059,390</b>		<b>5,059,390</b>

The Non-Voting shares rank pari passu in respect of all rights with the ordinary shares of the Bank except voting rights on resolutions passed at general meetings. If the Bank fails to pay dividends for three consecutive years, these shares will automatically be converted into voting ordinary shares.

#### 46 STATED CAPITAL (Contd.)

##### 46 (a) Employee Share Ownership Plan

Employee Share Ownership Plan was introduced in 2005 where shares were offered to the executive employees of the Bank.

1,249,192 shares were allotted to the Employee Share Ownership Plan in 2008 and the loan outstanding as at 31st December 2008 amounts to Rs 149,978,494.21. The amount released to the employees who left the service in 2008 is Rs 24.52 Mn.

##### 46 (b) Employee Share Option Plan

The number of shares allotted during 2008 are as follows.

Type of share	Date of allotment	Number of Options offered	Allotment price Rs	Market price as at the date of allotment Rs
Voting	28 March 2008	2,366,592	115.54	123.50
Non voting	28 March 2008	577,488	52.51	55.50

No financial assistance is granted to the employees in order to purchase shares.

The share options received at a particular grant can be exercised only after one year from the grant date. However an employee retiring during this period who has been granted options may exercise options prior to retirement.

Since one year has not lapsed from the grant date (28th March 2008) no employee has exercised options as at balance sheet date. In respect of retiring employees since the share price had been less than allotment price during the year no options have been exercised.

#### 47 COMMITMENTS AND CONTINGENCIES - BANK AND GROUP

In the normal course of business, the Bank makes various commitments and incurs certain contingent liabilities with legal recourse to its customers and would be party to litigation due to its operations. No material losses are anticipated as a result of these transactions

##### 47 (a) Capital commitments

Capital expenditure approved by the Board of Directors for which provision has not been made in the accounts amount to approximately Rs 532 Mn.

As at 31st December	Bank		Group	
	2008 Rs 000	2007 Rs 000	2008 Rs 000	2007 Rs 000
Approved and contracted for	532,167	1,016,493	590,257	1,021,102
Approved and not contracted for	-	61,023	14,186	61,023
	532,167	1,077,516	604,443	1,082,125

## 47 (b) Future monthly commitments on operating leases - Bank

As at 31st December		2008 Rs 000	2007 Rs 000
1	- 5 years	10,254	8,030
6	- 10 years	5,550	2,729
11	- 15 years	1,231	285
16	- 20 years	-	143
		17,035	11,187

## 47 (c) Irrevocable Commitments - Bank

Commitments as at Balance Sheet date that cannot be revoked at the discretion of the Bank without the risk of incurring significant penalty or expense amounted to Rs 28.765 Mn. (2006 - Rs 32.388 Mn).

## 47 (d) Contingent Liabilities

As at 31st December		2008 Rs 000	2007 Rs 000
Acceptances		11,304,696	4,272,048
Documentary credits		8,933,960	12,145,882
Guarantees		19,831,166	20,242,394
Bills for collection		8,145,443	7,342,126
Interest rate swap		4,391	547
		48,219,656	44,002,997
Forward Exchange Contracts		19,846,301	13,960,577
Total Contingencies Group and Bank		68,065,957	57,963,574

## 47 (e) Litigation against the Bank

1. HC (Civil) Case No. 132/2001 (i), a depositor's claim for damages against Habib Bank AG Zurich Sri Lanka Branch (HBZ) for setting off a customer liability with a deposit - the Bank substituted with acquisition of HBZ business.
2. HC (Civil) Case No. 277/2007 MR a claim for damages for dishonour of Bank Draft due to a technical issue and for closure of current account.
3. Labour Tribunal Cases Nos. 03/148/99, 08/2114/2002, 08/2115/2002, 8/2176/2002, 23/7957/2002, 26/02/2004, 26/122/2004, 26/06/2005, 9/11/2005, 3/149/2005, 27/1725/2007, 126/2007, 83/2007, 18/2008, and LT Appeal Cases Nos. HCLT 06/2007 and SC HCCA LA 170/2008.
4. L.T. Appeal Case No: 6/2007 vs S.P.R. Sunil Indrajith before High Court No: 6, Colombo.
5. L.T. Appeal Case No: 82/2008 filed by Mr. S. Ramakumar before the High Court Badulla.
6. Supreme Court Leave to Appeal Application No: 170/2008 vs K.M.Mohan.

Based on the above information and current status of the above cases, the Bank is not in a position to quantify the potential financial impact if any, as at the Balance Sheet date. Further, the Bank confirms that there is no case which is not disclosed above which would have a material impact on the financial position of the Bank.



## 47 COMMITMENTS AND CONTINGENCIES - GROUP AND BANK (Contd.)

### 47 (f) Tax assessments against the Bank

The following tax assessments are outstanding, against which the Bank has duly appealed.

- (i) VAT on financial services for 2003 and 2004, amounting to Rs 247 Mn., on Assessment Nos. VATFS/06/0312/06, VATFS/U6/0401/01, VATFS/J6/0402/02, VATFS/U6/0403/03, VATFS/U6/0404/04 and VATFS/U6/0405/05 (appealed to the Board of Review)
- (ii) VAT for the year 2002 taxes amounting to Rs 111.9 Mn. on Assessment Nos. 8340174, 8340175, 8340176, 8340177 and 8340178.
- (iii) VAT for the year 2003, taxes amounting to Rs 324.4 Mn. on Assessment Nos. 8290566, 8290567, 8290568, 8290569, 8290570, 8290571, 8290572, 8290573, 8290574, 8290575, 8290576, 8290577.
- (iv) VAT for the year 2004, taxes amounting to Rs 74.6 Mn. on Assessment Nos. 8325523, 8325524, 8325525, 8325526, 8325527, 8325528, 8325533 and 8325534.
- (v) VAT for the year 2005, taxes amounting to Rs 142.9 Mn. on Assessment Nos. 8334997, 8334998, 8334999, 8335000, 8335001, 8335002, 8335003, 8335006, 8335007 and 8335008.
- (vi) VAT for the year 2006, taxes amounting to Rs 36.2 Mn. on Assessment Nos. 8341405, 8341406, 8341407.
- (vii) PAYE Taxes amounting to Rs 407 Mn. on Assessment Nos. 8018210, 8202714 & 8364152 for the years 2003, 2004 & 2005 respectively.
- (viii) Income Tax for the Year of Assessment 2003/04 amounting to Rs 641.1 Mn on Assessment Nos. 8036192 & 8398969.
- (ix) Income Tax for the Year of Assessment 2005/06 amounting to Rs 542.6 Mn on Assessment Nos. 8412214 & 8734153.
- (x) Income Tax for the Year of Assessment 2006/07 amounting to Rs 939.1 Mn on Assessment Nos. 8534896 & 8728091.

The Bank is of the view that the above assessments will not have any material impact on the financial statements.

## 48 RELATED PARTY DISCLOSURES

The Bank carries out transactions in the ordinary course of its business with parties who are defined as related parties in Sri Lanka Accounting Standard 30 "Related Party Disclosures (revised 2005)", the details of which are reported below. The pricing applicable to such transactions is based on the assessment of risk and pricing model of the Bank and is comparable with what is applied to transactions between the Bank and its unrelated customers.

### 48 (a) Parent and Ultimate Controlling Party

The Bank does not have an identifiable parent of its own.

### 48 (b) Transactions with Key Management Personnel (KMP)

According to Sri Lanka Accounting Standard 30 (Revised 2005) "Related Party Disclosures", Key Management Personnel are those having authority and responsibility for planning, directing and controlling the activities of the entity. Accordingly, the Directors of the Bank (including executive and non-executive Directors) and their immediate family members have been classified as KMP of the Bank.

Immediate family member is defined as spouse or dependent. Dependent is defined as anyone who depends on the respective Director for more than 50% of his/her financial needs.

As the Bank is the ultimate parent of its subsidiaries listed out in Note No. 32, and the Board of Directors of the Bank have the authority and responsibility for planning, directing and controlling the activities of the Group, the Directors of the Bank and their immediate family members have been identified as the KMP of the Group.

Therefore, officers who are only directors of the subsidiaries and not of the Bank have been classified as KMP of that respective subsidiary only.

# Notes to the Financial Statements

## 48(b) i Compensation to KMP

	Bank	Group
Short term employment benefits (Rs Mn)	40,342	53,527
Post employment benefits (Rs Mn)	4,721	5,464
	45,063	58,991
Benefits under Employee Share Option Plan		
Voting (No of shares)	38,083	38,083
Non-voting (No of shares)	9,293	9,293
Benefits under Employee Share Ownership Plan		
Non-voting (No of shares)	46,815	46,815

In addition to their salaries, Bank also provides non cash benefits to KMP and contributes to a post employment defined benefit plan on behalf of Executive Director.

## 48(b) ii Credit Card facilities to KMP

	As at 31st December 2008	
	Limit Rs 000	Outstanding Balance Rs 000
Mr Rienzie T. Wijetilleke (Chairman)	500	426
Mr Rajendra Theagarajah (Managing Director)	400	-
Mr D H S Jayawardena	* 12,500	3,979
Mr M V Theagarajah	500	7
Mr R K Obeyesekere	500	3
Ms Pamela C. Cooray	500	8
Mr Ranjeevan Seevaratnam	310	186

\* Rs 500,000/= clean and the balance is secured by cash deposits.

## 48(b) iii Facilities Granted to KMP

Name of Director	As at 31st December 2008		Security
	Aggregate Amount of Accommodation Limit Rs 000	Outstanding as at Rs 000	
Mr Rienzie T. Wijetilleke (Chairman)	1,510	1,326	Cash deposit
Mr Rajendra Theagarajah (Managing Director)	8,365	8,365	Immovable property
Mr M V Theagarajah	4,600	-	Cash deposit
Mr R K Obeyesekere	9,488	9,488	Cash deposit, absolute ownership of the motor vehicle
Mr Ranjeevan Seevaratnam	1,500	1,266	Cash deposit

No losses have been recorded against loan balances outstanding during the period with KMP and no specific provisions have been made for loan losses on balances with KMP and their immediate family members as at the Balance Sheet Date.

## 48(b) iv Deposits held by KMP with the Bank

As at Balance Sheet date the aggregate deposits (including Treasury Bills and Repos) held by the KMP with the Bank are as follows:

SLRs '000	51,846
USD '000	154
GBP '000	472
Euro '000	140

## 48(b) v Transactions of KMP with Group entities

Name of Director	Transaction Type	Rs 000
Mr Rajendra Theagarajah (Managing Director)	Purchase of apartment from Sithma Development (Pvt) Ltd.	17,050

#### 48 (c) Transactions with / between Subsidiaries

Details of the subsidiaries are given in Note 32. Details on the disposal of HNB Securities Ltd and HNB Stockbrokers (Pvt.) Ltd. during the year are also given in Note 32.

##### 48 (c) i 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 31/12/08		Security
		Limit Rs 000	Outstanding Rs 000	
Overdraft	2% above the one year *WATB. to be reviewed every 6 months.	1,000,000	830,799	Registered primary floating mortgage for Rs 1,800 Mn. over land and building at No. 479, T B Jayah Mw., Colombo 10.
Term Loan	1.5% above the 6 month treasury bill rate (gross). to be reviewed every 6 months	2,000,000	1,000,000	A primary Mortgage bond over immovable property at No 479, T B Jayah Mw., Colombo 10. (Standing concurrent to existing primary concurrent mortgage bond)
Letter of Guarantee Commission		9,000	9,000	Cash Margin of Rs 9 Mn

\*WATB - Weighted Average Treasury Bill Rate

(b) A summary of other transactions of Sithma with HNB and other group companies are given below:

Transaction Type	HNB Rs 000	HNB ASSURANCE Rs 000	HNB SECURITIES Rs 000	HNB STOCKBROKERS Rs 000
Rent income received	554,390	-	6,538	7,763
Rent advance received (as at 31.12.2007)	29,714	-	409	485
Refundable deposit received	500,000	-	3,000	3,000
Insurance premium paid	-	398	-	-
Overdraft Interest paid	130,522	-	-	-
Term Loan Interest paid	226,070	-	-	-
Ground rent paid	3,753	-	-	-

##### 48 (c) ii HNB Assurance PLC

HNB Assurance PLC ("Assurance"), is a subsidiary of Hatton National Bank PLC

(a) Assurance held deposits with the Bank amounting to Rs 140.26 Mn. (2007 - Rs 77.2 Mn.) as at 31st December 2008. The Company also held debentures of the Bank amounting to Rs 20.0 Mn (2007 - Rs 36.6 Mn) as at 31st December 2008.

(b) A summary of transactions of Assurance with HNB and other group companies are given below:

Transaction Type	HNB Rs 000	SITHMA Rs 000	HNB SECURITIES Rs 000	HNB STOCKBROKERS Rs 000
Premium received	30,437	398	190	445
Claims Incurred	6,616	-	176	242
Interest received	9,038	-	11,939	-
Interest paid	154	-	-	-
Rent paid	13,451	-	-	-
Commission paid	48,064	-	-	-
Dividend paid	22,495	-	-	-

##### 48 (c) iii HNB Securities Ltd

HNB Securities Ltd. ("Securities") was a fully owned subsidiary of the Bank up to 30th June 2008. The Bank sold 50.01% of its equity stake in Securities to Acuity Partners (Pvt) Ltd which became a 50% owned joint venture of Hatton National Bank PLC from 1st July 2008. Accordingly as explained in Note 32, Securities ceased to be a subsidiary of the Bank and became a subsidiary of Acuity Partners (Pvt) Ltd.

(a) Securities maintains a current account with HNB and the balance as at 31st December 2008 amounts to Rs 6.8 Mn (2007 - Rs 10.3 Mn).

# Notes to the Financial Statements

(b) A summary of transactions of Securities with HNB and other group companies are given below:

Transaction Type	HNB Rs 000	SITHMA Rs 000	HNB ASSURANCE Rs 000	HNB STOCKBROKERS Rs 000
Interest received	7,969	-	-	-
Insurance premium paid	-	-	190	-
Insurance claims received	-	-	176	412
Interest paid	-	-	11,939	-
Rent paid	-	6,538	-	-
Rent advance paid (as at 31.12.2008)	-	409	-	-
Refundable deposit paid	-	3,000	-	-
Commission paid	29	-	-	-

#### 48(c)iv HNB Stockbrokers (Pvt) Ltd

HNB Stockbrokers (Pvt) Ltd ("Stockbrokers") was a fully owned subsidiary of the Bank up to 30th June 2008. The Bank sold 100% of its equity stake in Stockbrokers to Acuity Partners (Pvt) Ltd which became a 50% owned Joint Venture of Hatton National Bank PLC on 1st July 2008.

(a) Stockbrokers held deposits with the Bank amounting to Rs 11.7 Mn (2007 – Rs 10.1 Mn) as at 31st December 2008.

(b) A summary of transactions of Stockbrokers with HNB and other group companies are given below:

Transaction Type	HNB Rs 000	SITHMA Rs 000	HNB ASSURANCE Rs 000	HNB SECURITIES Rs 000
Interest received	296	-	-	412
Insurance premium paid	-	-	445	-
Insurance claims received	-	-	242	-
Interest paid	114	-	-	-
Rent paid	-	7,763	-	-
Rent advance paid (as at 31.12.2008)	-	485	-	-
Refundable deposit paid	-	3,000	-	-
Commission paid	7,428	-	-	-

#### 48 (d) Transactions with Associates

##### 48(d) i Lanka Ventures PLC

Lanka Ventures PLC has term deposits of Rs 20.0 Mn (2007 – Rs 51.5 Mn) placed with the Bank as at 31st December 2008, in respect of which interest amounting to Rs 6.8 Mn (2007 – Rs 7.6 Mn) has been paid by the Bank for the financial year 2008.

Lanka Ventures PLC has invested in Treasury Bills and Repurchase transactions through HNB Securities Ltd totalling Rs 103.8 Mn and received interest amounting to Rs 40.5 from HNB Securities Ltd (2007 – Rs 48.1 Mn & Rs 9.1 Mn respectively).

##### 48(d) ii Splendor Media (Pvt) Ltd

Splendor Media (Pvt) Ltd is an associate of Sithma, which is a fully owned subsidiary of the Bank.

The Bank and HNB Stockbrokers have paid Rs 27.95 Mn and Rs 0.02 Mn respectively net of rebate received to Splendor Media (Pvt) Ltd as commission against advertising channelled through that company.

##### 48 (e) Transactions with Joint Venture - Acuity Partners (Pvt) Ltd

Acuity Partners (Pvt) Ltd has a current account with the balance of Rs 7,770 with the Bank and has paid bank charges of Rs 6,000.

##### 48 (f) Transactions with Other Related Entities

Other Related Entities are those which are controlled or significantly influenced, directly or indirectly by KMP of the Bank. Significant influence is presumed to be established if a KMP of the Bank has more than 20% shareholding in an entity, unless otherwise rebutted by the respective KMP. Further, significant influence is also established if in the view of a KMP, he / she has the ability to influence the operating and financial policies of an entity even in the absence of 20% shareholding.

#### 48 RELATED PARTY TRANSACTIONS (Contd.)

##### 48 (f) i Lending transactions with Other Related Entities by the Bank

Company	Name of Director / Relationship	Nature of Transaction	Aggregate Amount of Accommodation as at 31st December 2008		Security
			Limit (Rs Mn)	Outstanding (Rs Mn)	
Stassen Exports Ltd.	Mr D H S Jayawardena (Chairman / Shareholder)	Overdraft I	2,253.50	2,016.41	Cash Deposits Quoted company shares and inventories
		Overdraft II	695.00	-	
	Mr R K Obeyesekere (Director / Shareholder)	Letters of Credit	15.00	2.45	
		Letters of Guarantee	100.00	54.09	
	<b>Total</b>		<b>3,063.50</b>	<b>2,072.95</b>	
Stassen International Ltd	Mr D H S Jayawardena (Managing Director)	Overdraft	34.00	6.06	Cash Deposits Quoted company shares and inventories
		Letters of Credit	70.00	27.70	
	Mr R K Obeyesekere (Director)	Letters of Guarantee	125.00	61.00	
		<b>Total</b>	<b>229.00</b>	<b>94.76</b>	
Milford Exports (Ceylon) Ltd	Mr D H S Jayawardena (Managing Director / Shareholder)	Overdraft	0.50	-	Quoted company shares and inventories
		Letters of Credit	2.00	-	
	Mr R K Obeyesekere (Director / Shareholder)	Letters of Guarantee	40.00	23.76	
		<b>Total</b>	<b>42.50</b>	<b>23.76</b>	
Madulsima Plantations PLC	Mr D H S Jayawardena (Chairman)	Overdraft	120.00	60.82	Quoted company shares, Mortgage over leasehold property and inventories
		Standby Overdraft	33.00	-	
	Mr R K Obeyesekere (Director)	Letters of Guarantee	3.90	2.90	
		<b>Total</b>	<b>156.90</b>	<b>63.72</b>	
Stassen Natural Food (Pvt) Ltd	Mr D H S Jayawardena (Managing Director)	Letters of Credit	6.00	1.75	Quoted company shares
		Letter of Guarantee	15.00	15.00	
	Mr R K Obeyesekere (Director)	<b>Total</b>	<b>21.00</b>	<b>16.75</b>	
CBD Exports Ltd	Mr. R K Obeyesekere (Managing Director / Shareholder)	Letters of Guarantee	10.00	-	Quoted Company shares
			-	-	
Browns Beach Hotels PLC	Mr D H S Jayawardena (Chairman) Mr. M V Theagarajah (Director)	Letters of Guarantee	0.26	0.26	Cash Deposits
Sri Lanka Insurance Corporation Ltd	Mr D H S Jayawardena (Chairman) Mr. R K Obeyesekere (Deputy Chairman)	Letters of Guarantee	3.50	3.50	Cash Deposits
Lanka Milk Foods (CWE) PLC	Mr D H S Jayawardena (Chairman)	Overdraft	300.00	65.04	Quoted company shares Immovable property (leasehold) and plant and machinery
		Letters of Credit	131.00	-	
	Mr R K Obeyesekere (Director)	Letters of Guarantee	30.00	0.10	
		<b>Total</b>	<b>461.00</b>	<b>65.14</b>	
Lanka Dairies (Pvt) Ltd	Mr D H S Jayawardena (Chairman)	Overdraft	200.00	183.02	Quoted company shares
		Letters of Credit	22.00	-	
	Mr R K Obeyesekere (Director)	<b>Total</b>	<b>222.00</b>	<b>183.02</b>	
Ambewela Products (Pvt) Ltd	Mr D H S Jayawardena (Chairman)	Overdraft	10.00	7.05	Quoted company shares Immovable property (leasehold) and plant and machinery
		Letters of Credit	15.00	10.72	
	Mr R K Obeyesekere (Director)	<b>Total</b>	<b>25.00</b>	<b>17.77</b>	

# Notes to the Financial Statements

## 48 RELATED PARTY TRANSACTIONS (Contd.)

### 48 (f) i Lending transactions with Other Related Entities by the Bank (Contd.)

Company	Name of Director / Relationship	Nature of Transaction	Aggregate Amount of Accommodation as at 31st December 2008		Security
			Limit (Rs Mn)	Outstanding (Rs Mn)	
Ambewela Livestock Company Ltd	Mr D H S Jayawardena (Chairman)	Overdraft	30.00	0.32	Quoted company shares immovable property (leasehold) and plant and machinery
		Letters of Credit	10.00	0.64	
	Mr R K Obeyesekere (Director)	<b>Total</b>	<b>40.00</b>	<b>0.96</b>	
Pattipola Livestock Company Ltd	Mr D H S Jayawardena (Chairman)	Overdraft	30.00	0.63	Quoted company shares Immoveable property (leasehold) and plant and machinery
		Letters of Credit	10.00	4.19	
	Mr R K Obeyesekere (Director)	<b>Total</b>	<b>40.00</b>	<b>4.82</b>	
Distilleries Company of Sri Lanka PLC	Mr D H S Jayawardena (Chairman)	Standby Overdraft	30.00	-	Quoted company shares and cash deposits
		Letters of Credit	188.00	139.50	
	Mr R K Obeyesekere (Director)	Letters of Guarantee	3.07	3.07	
		<b>Total</b>	<b>221.07</b>	<b>142.57</b>	
Periceyl (Pvt) Ltd	Mr D H S Jayawardena (Chairman)	Standby Overdraft	(25.00)	-	Quoted company shares and cash deposits
		Letters of Credit	25.00	4.90	
	Mr R K Obeyesekere (Director)	Letters of Guarantee	11.53	11.53	
		<b>Total</b>	<b>36.53</b>	<b>16.43</b>	
The Lanka Hospital Corporation PLC	Mr D H S Jayawardena (Director)	Overdraft	220.00	-	Mortgage over movable and immovable assets
		Letters of Credit	80.00	0.80	
		Import Loan	(80.00)	-	
		Term Loan	27.50	27.50	
		<b>Total</b>	<b>327.50</b>	<b>28.30</b>	
Balangoda Plantations PLC	Mr D H S Jayawardena (Chairman)	Overdraft	45.00	-	Immovable Property (leasehold)
		Development Loan	5.02	5.02	
	Mr R K Obeyesekere (Director)	<b>Total</b>	<b>50.02</b>	<b>5.02</b>	
Texpro Industries Ltd	Mr D H S Jayawardena (Chairman)	Overdraft	13.41	*14.20	Immovable Property/ Machinery Cash deposits and Inventories *Excess Temporary Since regularised
		Letters of Guarantee	0.22	0.22	
		<b>Total</b>	<b>13.63</b>	<b>14.42</b>	
		Overdraft US\$ Mn	0.15	0.13	
		Letter of Credit US\$ Mn	1.60	0.99	
		Export Loans US\$ Mn	(1.60)	0.12	
		Bill Purchase US\$ Mn	(0.30)	0.12	
		Term Loans US\$ Mn	0.05	0.05	
		Term Loans US\$ Mn	0.11	0.11	
		Term Loans US\$ Mn	0.06	0.06	
		<b>Total US\$ Mn</b>	<b>1.97</b>	<b>1.58</b>	



# Notes to the Financial Statements

## 48 RELATED PARTY TRANSACTIONS (Contd.)

### 48 (f) i Lending transactions with Other Related Entities by the Bank (Contd.)

Company	Name of Director / Relationship	Nature of Transaction	Aggregate Amount of Accommodation as at 31st December 2008		Security
			Limit (Rs Mn)	Outstanding (Rs Mn)	
Ace Containers (Pvt) Ltd	Subsidiary of Aitken	Interchangeable Limit			
Ace Distriparks (Pvt) Ltd	Spence PLC in which	within 5 companies Overdraft	60.00	19.47	Corporate Guarantee
Ace Container Repair (Pvt) Ltd	Mr. D H S Jayawardena is the Chairman	Letter of Credit	(60.00)	24.28	
Ace Freight Management (Pvt) Ltd		Letter of Guarantee	(60.00)	1.79	
Ace Haulage (Pvt) Ltd		<b>Total</b>	<b>60.00</b>	<b>45.54</b>	
Aitken Spence Garments Ltd	Subsidiary of Aitken Spence PLC in which	Overdrafts	(25.00)	-	Immovable property Quoted Company Shares and Inventories
	Mr. D H S Jayawardena is the Chairman	Letter of Guarantee	0.42	1.73	
		<b>Total</b>	<b>0.42</b>	<b>1.73</b>	
		Overdrafts US\$ Mn	0.25	0.21	
		Letters of Credit US\$ Mn	1.50	0.49	
		Short Term Export Loan US\$ Mn	(1.50)	1.12	
		<b>Total US\$ Mn</b>	<b>1.75</b>	<b>1.82</b>	
Cowie Investments (Pvt) Ltd	Subsidiary of Aitken Spence Hotel Holdings PLC which is a Subsidiary of Aitken Spence PLC in which	Overdrafts US\$ Mn	2.00	1.95	Immovable property (leasehold)
	Mr. D H S Jayawardena is the Chairman	Term Loan US\$ Mn	2.07	2.07	
		<b>Total US\$</b>	<b>4.07</b>	<b>4.02</b>	
Ace Power Generation Embilipitiya (Pvt) Ltd	Subsidiary of Aitken Spence PLC in which	Overdraft	100.00	0.02	Immovable property and Machinery
	Mr. D H S Jayawardena is the Chairman	Letter of Guarantee	33.50	33.50	
		Letter of Guarantee	100.00	100.00	
		<b>Total</b>	<b>233.50</b>	<b>133.52</b>	
		Overdrafts US\$ Mn	0.62		
		Overdrafts US\$ Mn	2.13	2.78	
		Standby Letter of Credit US\$ Mn	0.13	0.13	
		Term Loan US\$ Mn	0.22	0.22	
		Term Loan US\$ Mn	0.95	0.95	
		<b>Total US\$ Mn</b>	<b>4.05</b>	<b>4.08</b>	
Elpitiya Lifestyle Solutions (Pvt) Ltd	Subsidiary of Elpitiya Plantation PLC	Overdraft	1.00	* 2.74	Immovable Property (leasehold) and Plant & Machinery
		Standby Overdraft	1.50	-	
		<b>Total</b>	<b>2.50</b>	<b>2.74</b>	
		Term Loan US\$ Mn	0.12	0.12	* Excess temporary, since reduced to Rs 2.68 Mn
		<b>Total US\$ Mn</b>	<b>0.12</b>	<b>0.12</b>	
ADS Resorts (Pvt) Ltd	Subsidiary of Aitken Spence Hotel International Ltd	Term Loan US\$ Mn	3.12	3.12	Immovable Property
Unique Resorts (Pvt) Ltd	Subsidiary of Aitken Spence Hotel International Ltd	Term Loan US\$ Mn	14.00	14.00	Immovable Property



#### 48 RELATED PARTY TRANSACTIONS (Contd.)

##### 48 (f) ii Other Business Transactions with Other Related Entities by the Bank

Company	Name of Director	Nature of Transaction	Amount (Rs Mn)
Madulsima Plantation PLC	Mr D H S Jayawardena (Chairman) Mr R K Obeyesekere (Director)	Lease of holiday bungalow at Bogawantalawa	1.16
Lanka Bell (Pvt) Ltd	Mr D H S Jayawardena (Chairman)	Telecommunication Charges	24.5
Sri Lanka Insurance Corporation Ltd	Mr D H S Jayawardena (Chairman) Mr R K Obeyesekere (Deputy Chairman)	Insurance Premiums	38.49
Hatton National Bank Retirement Pension Fund	Mr Rajendra Theagarajah (Trustee)	Investment in Term Deposits Investment in HNB Debentures Balance held by the Bank on behalf of the fund Interest paid Contribution made in 2008	219.23 22.37 1,204.38 232.48 787.11
Hatton National Bank Employee Provident Fund	Mr Rajendra Theagarajah (Trustee)	Investment in Term Deposits Investment in Repos Balance held by the Bank on behalf of the fund Investment in HNB Shares - Voting - Non-voting Interest paid	2,072.73 457.71 57.19 57.19 2.08 8.73 533.49
Widows, Widowers and Orphans Pension Fund	Mr Rajendra Theagarajah (Trustee)	Balance held by the Bank on behalf of the fund Interest paid	371.03 63.34

##### 48 (f) iii Business Transactions with Other Related Entities by the Group

Company	Name of Director	Nature of Transaction	Amount (Rs Mn)
<b>Sithma Development (Pvt) Ltd</b>			
Sri Lanka Insurance Corporation Ltd	Mr D H S Jayawardena (Chairman) Mr R K Obeyesekere (Deputy Chairman)	Insurance Premium Paid Debenture Interest Paid (Rs 2 Bn debenture)	13.10 204.86
<b>HNB Assurance PLC</b>			
Stassen Exports Ltd	Mr D H S Jayawardena (Chairman / Shareholder) Mr R K Obeyesekere (Director / Shareholder)	Non-life Insurance Premium Received Claims Incurred	15.84 4.36
Stassen International Ltd	Mr D H S Jayawardena (Managing Director) Mr R K Obeyesekere (Director)	Non-life Insurance Premium Received	1.26
Stassen Natural Foods (Pvt) Ltd	Mr D H S Jayawardena (Managing Director) Mr R K Obeyesekere (Director)	Non-life Insurance Business	0.34

# Notes to the Financial Statements

## 48 RELATED PARTY TRANSACTIONS (Contd.)

### 48 (f) iii Business Transactions with Other Related Entities by the Group (Contd.)

Company	Name of Director	Nature of Transaction	Amount (Rs Mn)
Sri Lanka Insurance Corporation Ltd	Mr D H S Jayawardena (Chairman)	Non-life Insurance Premium Received	0.03
	Mr R K Obeyesekere (Deputy Chairman)	Co-insurance	0.23
Ceylon Garden Coir (Pvt) Ltd	Mr D H S Jayawardena (Managing Director)	Non-life Insurance Premium Received	0.13
	Mr R K Obeyesekere (Director)		
Milford Exports (Ceylon) Ltd	Mr D H S Jayawardena (Managing Director / Shareholder)	Non-life Insurance Premium Received	0.62
	Mr R K Obeyesekere (Director / Shareholder)		
Aitken Spence Garments Ltd	Subsidiary of Aitken Spence PLC in which company Mr D H S Jayawardena is the Chairman	Non-life Insurance Premium Received	0.52
Elpitiya Plantations PLC	Subsidiary of Aitken Spence Plantation Management Ltd	Non-life Insurance Premium Received	0.30
		Claims Incurred	0.01
<b>HNB Stockbrokers (Pvt) Ltd</b>			
Sri Lanka Insurance Corporation Ltd	Mr D H S Jayawardena (Chairman) Mr R K Obeyesekere (Deputy Chairman)	Brokerage Income - General	0.44
		Brokerage Income - Life	5.95
Distilleries Company of Sri Lanka PLC	Mr D H S Jayawardena (Chairman) Mr R K Obeyesekere (Director)	Brokerage Income	0.05
<b>HNB Securities Ltd</b>			
Lanka Ventures PLC	Mr J M J Perera (Director) Mr J D N Kekulawala (Director)	Repurchase Agreement of Treasury Bonds / Bills	103.8

## 49 MATURITY ANALYSIS

### 49 (a) Bank

An analysis of the total assets and liabilities of the Bank as at 31st December, based on the remaining period at the balance sheet date to the respective contractual maturity dates, is given below:

	Up to 3 Months Rs 000	3 to 12 Months Rs 000	1 to 3 Years Rs 000	3 to 5 Years Rs 000	More Than 5 Years Rs 000	Total 2008 Rs 000
<b>Interest earning assets</b>						
Cash and Short term Funds	2,640,964	-	-	-	-	2,640,964
Balances with foreign banks which are interest bearing	17,140,931	-	-	-	-	17,140,931
Securities purchased under resale agreements	1,400,000	-	-	-	-	1,400,000
Commercial papers	225,908	-	-	-	-	225,908
Dealing Securities-Bonds	-	46,929	-	-	-	46,929
Investment Securities-Bonds & Debentures	4,368,847	13,366,805	5,661,994	251,010	489,000	24,137,656
Bills of Exchange	1,901,355	57,150	-	-	-	1,958,505
Loans & Advances	83,203,627	8,860,574	18,172,842	24,469,530	26,595,253	161,301,826
Lease Rentals Receivable	1,682,904	2,709,329	4,752,885	2,344,091	-	11,489,209
	112,564,536	25,040,787	28,587,721	27,064,631	27,084,253	220,341,928
<b>Non interest earning assets</b>						
Cash and Short term Funds	3,520,057	-	-	-	-	3,520,057
Statutory deposit with CBSL	11,847,323	-	-	-	-	11,847,323
Dealing Securities	24,939	-	-	-	-	24,939
Quoted - Shares	-	-	-	-	1,027,120	1,027,120
Unquoted - Shares	-	-	-	-	750,941	750,941
Investment in associate companies	-	-	-	-	132,326	132,326
Investment in joint venture companies	-	-	-	-	250,000	250,000
Investment in subsidiary companies	-	-	-	-	2,179,086	2,179,086
Intangible Assets	-	-	-	-	727,598	727,598
Investment Properties	-	-	-	-	187,467	187,467
Property, Plant & Equipment	-	-	-	-	6,865,648	6,865,648
Non-current Assets held for sale	1,455	-	-	-	-	1,455
Other Assets	-	7,414,284	-	-	-	7,414,284
	15,393,774	7,414,284	-	-	12,120,186	34,928,244
Total assets	127,958,310	32,455,071	28,587,721	27,064,631	39,204,439	255,270,172
Percentage - 31/12/2008	50.13	12.71	11.20	10.60	15.36	100
Percentage - 31/12/2007	46.47	14.27	12.85	11.78	14.63	100

# Notes to the Financial Statements

## 49 MATURITY ANALYSIS (Contd.)

### 49 (a) Bank (Contd.)

	Up to 3 Months Rs 000	3 to 12 Months Rs 000	1 to 3 Years Rs 000	3 to 5 Years Rs 000	More Than 5 Years Rs 000	Total 2008 Rs 000
<b>Interest bearing liabilities</b>						
Deposits from customers	121,301,982	36,337,341	4,675,528	4,312,243	5,871,405	172,498,499
Borrowings - Money at call	7,142,474	-	-	-	-	7,142,474
Borrowings - Refinance	158,479	628,648	1,733,932	1,195,491	2,707,504	6,424,054
Borrowings - Local Banks	-	-	-	-	-	-
Borrowings - Foreign Banks	1,834,762	-	-	-	-	1,834,762
Repo agreements	6,653,584	2,146,369	-	-	-	8,799,953
Subordinated debentures	-	127,628	-	715,328	1,911,895	2,754,851
	137,091,281	39,239,986	6,409,460	6,223,062	10,490,804	199,454,593
<b>Non Interest bearing liabilities</b>						
Deposits from customers	14,271,363	-	-	-	-	14,271,363
Dividend payable	127,303	-	-	-	-	127,303
Bills payable	1,047,930	-	-	-	-	1,047,930
Current tax liability	-	2,380,633	-	-	-	2,380,633
Deferred tax Liability	-	-	-	-	872,402	872,402
Other liabilities	-	16,535,011	-	-	-	16,535,011
Equity	-	-	-	-	20,580,937	20,580,937
	15,446,596	18,915,644	-	-	21,453,339	55,815,579
<b>Total Liabilities &amp; Shareholders' Funds</b>	<b>152,537,877</b>	<b>58,155,630</b>	<b>6,409,460</b>	<b>6,223,062</b>	<b>31,944,143</b>	<b>255,270,172</b>
Percentage - 31/12/2008	59.76	22.78	2.51	2.44	12.51	100.00
Percentage - 31/12/2007	63.75	20.66	2.17	2.04	11.38	100.00

"Up to 3 months" deposits include the Bank's Savings Deposit Base of Rs 68.7 Bn (2007 - Rs 69.3 Bn).

### 49 (b) Group

	Up to 3 Months Rs 000	3 to 12 Months Rs 000	1 to 3 Years Rs 000	3 to 5 Years Rs 000	More Than 5 Years Rs 000	Total 2008 Rs 000
<b>Interest earning assets</b>						
Cash and Short term Funds	2,726,765	29,045	-	-	-	2,755,810
Balances with foreign banks which are interest bearing	17,200,675	-	-	-	-	17,200,675
Securities purchased under resale agreements	1,819,286	688,189	-	-	-	2,507,475
Govt of Sri Lanka Treasury Bills	-	-	-	-	-	-
Commercial papers	225,908	9,885	-	-	-	235,793
Dealing Securities	196,555	262,930	-	122,000	-	581,485
Investment Securities-Bonds & Debentures	4,463,660	13,429,721	6,150,927	568,667	501,500	25,114,475
Bills of exchange	1,901,355	57,150	-	-	-	1,958,505
Loans & Advances	83,203,627	8,861,250	18,174,283	24,469,530	26,595,253	161,303,943
Lease rentals Receivable	1,682,904	2,709,329	4,752,885	2,344,091	-	11,489,209
	113,420,735	26,047,499	29,078,095	27,504,288	27,096,753	223,147,370
<b>Non interest earning assets</b>						
Cash and Short term Funds	3,591,926	-	-	-	-	3,591,926
Statutory deposit with cbsl	11,847,323	-	-	-	-	11,847,323
Dealing Securities	24,939	326,627	-	-	-	351,566
Quoted - Shares	-	4,179	-	-	1,027,120	1,031,299
Unquoted - Shares	-	-	250	25,000	750,941	776,191

#### 49 MATURITY ANALYSIS (Contd.)

##### 49 (b) Group (Contd.)

	Up to 3 Months Rs 000	3 to 12 Months Rs 000	1 to 3 Years Rs 000	3 to 5 Years Rs 000	More Than 5 Years Rs 000	Total 2008 Rs 000
Investment in associate companies	-	-	-	-	132,326	132,326
Investments in Joint Venture Companies	-	-	-	-	250,000	250,000
Investment in subsidiary companies	-	-	-	-	2,354,086	2,354,086
Intangible assets	-	-	-	1,760	768,838	770,598
Investment properties	-	-	-	-	286,983	286,983
Property Plant & equipment	-	-	1,060	3,750	14,802,586	14,807,396
Non current assets held for sale	1,455	-	-	-	-	1,455
Other assets	386,325	7,579,667	100,180	22,884	28,879	8,117,935
	15,851,968	7,910,473	101,490	53,394	20,401,759	44,319,084
Inter company Adjustments						(5,476,475)
Total assets	129,272,703	33,957,972	29,179,585	27,557,682	47,498,512	261,989,979
Percentage - 31/12/2008	48.33	12.70	10.91	10.30	17.76	100
Percentage - 31/12/2007	44.11	14.81	12.26	11.19	17.63	100
Interest bearing liabilities						
Deposits from customers	121,301,982	36,337,341	4,675,528	4,312,243	5,871,405	172,498,499
Borrowings - Money at call	7,142,474	-	-	-	-	7,142,474
Borrowings - Refinance	158,479	628,648	1,733,932	1,195,491	2,707,504	6,424,054
Borrowings - Local Banks	1,754	-	1,048,381	414,724	375,000	1,839,859
Borrowings - Foreign Banks	1,834,762	-	-	-	-	1,834,762
Repo agreements	7,404,656	2,252,726	-	-	-	9,657,382
Subordinated debentures	-	1,127,628	-	715,328	1,911,895	3,754,851
	137,844,107	40,346,343	7,457,841	6,637,786	10,865,804	203,151,881
Non- interest bearing liabilities						
Deposits from customers	14,271,363	-	-	-	-	14,271,363
Dividend payable	127,303	-	-	-	-	127,303
Bills payable	1,047,930	-	-	-	-	1,047,930
Long Term Insurance Fund	-	-	-	-	1,360,505	1,360,505
Non-Life Insurance Reserves	-	-	-	470,206	-	470,206
Current tax liability	-	2,416,775	-	-	-	2,416,775
Deferred tax Liability	-	252	484	-	871,928	872,664
Other liabilities	296,360	16,729,216	22,930	-	523,868	17,572,374
Shareholders' funds	-	-	-	-	22,924,990	22,924,990
	15,742,956	19,146,243	23,414	470,206	25,681,291	61,064,110
Inter company Adjustments						(2,226,012)
Total Liabilities & shareholders' funds	153,587,063	59,492,586	7,481,255	7,107,992	36,547,095	261,989,979
Percentage - 31/12/2008	58.13	22.52	2.83	2.69	13.83	100.00
Percentage - 31/12/2007	61.10	20.42	2.46	2.12	13.90	100.00

# Notes to the Financial Statements

## 50 COMPARATIVE INFORMATION

The following comparative figures have been reclassified in the 2008 financial statements to maintain comparability of financial statements in order to provide a better presentation.

### 50 (a)

	Bank			Group	
	As disclosed Rs 000	Reclassified Rs 000	Adjustment Rs 000	As disclosed Rs 000	Reclassified Rs 000
Income	29,864,606	29,994,718	(130,112)	31,945,777	32,075,889
Interest income	26,137,648	26,250,038	(112,390)	27,014,164	27,127,554
Other income	405,934	423,656	(17,722)	1,602,147	1,619,869
Other expenses	3,570,670	3,700,782	(130,112)	4,528,737	4,658,849

**50 (a) i** Negative figures included in Other Income loss on mark to market of dealing securities of Rs 30.037 Mn & FCBU loss revaluation of Rs 13.796 Mn and loss from sale of dealing securities of Rs 86.279 Mn have been classified as Other Expenses.

**50 (a) ii** Interest income on investment securities classified as Other Income amounting to Rs 112.39 Mn have been reclassified as Interest Income.

### 50 (b)

	Bank			Group	
	As disclosed Rs 000	Reclassified Rs 000	Adjustment Rs 000	As disclosed Rs 000	Reclassified Rs 000
Cash and cash equivalents	24,359,446	19,158,706	5,200,740	24,476,062	19,275,322
Loans and advances	139,784,524	144,985,264	(5,200,740)	138,214,132	143,414,872

Short term money market loans included under cash and cash equivalents have been reclassified as Loans and Advances.

### 50 (c)

	Bank			Group	
	As disclosed Rs 000	Reclassified Rs 000	Adjustment Rs 000	As disclosed Rs 000	Reclassified Rs 000
Subordinated debentures	4,560,852	4,623,794	(62,942)	5,525,852	5,588,794
Other liabilities	14,959,109	14,896,167	62,942	15,470,851	15,407,909

Interest payable on zero coupon debentures classified under other liabilities amounting to Rs 62.942 Mn has been reclassified as Subordinated Debentures.

### 50 (d)

	2007		Group
	As disclosed Rs 000s	Reclassified Rs 000s	Adjustment Rs 000s
Share of Associate Companies' profit after taxation		16,195	14,317 (1,878)
Profit before income tax		4,566,462	4,564,584 (1,878)
Income tax expense		1,366,660	1,364,782 (1,878)

Share of profit of Associates was shown before income tax which is now adjusted to show the share of profit of Associates after tax in accordance with SLAS 3.

### 50 (e)

	2007		Group
	As disclosed Rs 000s	Reclassified Rs 000s	Adjustment Rs 000s
Property, plant & equipment		13,437,804	13,181,575 (256,229)
Other assets		6,610,073	6,866,302 256,229

Work-in-Progress (WIP) relating to residential apartment complex which is under construction by Sithma Development (Pvt) Ltd included under Property, Plant & Equipment has been reclassified as WIP residential apartment complex under Other Assets.

## 51 SEGMENT REPORTING

Segment information is presented in respect of the Group's business segments. The Group's primary format for segment reporting is based on business segments.

The business segments are determined based on the Group's management and internal reporting structure.

### Business segments - Group

	Banking		Leasing		**Dealing		Property		Insurance		Eliminations		Consolidated /Unallocated	
	2008 Rs 000	2007 Rs 000	2008 Rs 000	2007 Rs 000	2008 Rs 000	2007 Rs 000	2008 Rs 000	2007 Rs 000	2008 Rs 000	2007 Rs 000	2008 Rs 000	2007 Rs 000	2008 Rs 000	2007 Rs 000
Revenue from external customers :														
Interest	29,818,922	24,017,657	-	-	430,976	795,933	-	-	325,870	172,576	2,311,122	2,140,198	32,886,890	27,126,364
Exchange/Premium	1,166,979	1,114,313	-	-	132	-	-	-	1,355,360	1,149,795	-	-	2,522,471	2,264,108
Lease/Brokerage	-	-	2,311,122	2,140,198	51,331	69,118	-	-	-	-	(2,311,122)	(2,140,198)	51,331	69,118
Commissions/Rent	2,364,319	2,034,119	-	-	854	387	138,165	62,514	-	-	-	-	2,503,338	2,097,020
Other	1,186,116	529,968	-	-	31,616	24,801	169	-	1,629	1,144	-	-	1,219,530	555,913
Total revenue from external customers	34,536,336	27,696,057	2,311,122	2,140,198	514,909	890,239	138,334	62,514	1,682,859	1,323,515	-	-	39,183,560	32,112,523
Inter-segment revenue	317,528	158,273	929	190	16,140	13,262	564,299	547,713	44,496	47,117	(1,401,548)	(803,189)	(458,156)	(36,634)
Total revenue	34,853,864	27,854,330	2,312,051	2,140,388	531,049	903,501	702,633	610,227	1,727,355	1,370,632	(1,401,548)	(803,189)	38,725,404	32,075,889
Segment result	3,698,253	3,391,117	1,658,755	1,430,871	62,171	115,592	87,319	120,616	196,852	164,753	(491,559)	(47,150)	5,211,791	5,175,799
Unallocated expenses													720,264	625,532
Profit from operations													4,491,527	4,550,267
Income from associates													(6,401)	14,317
Income tax expense													(1,599,300)	(1,364,782)
Profit for the period													2,885,826	3,199,802
Minority interests													(55,288)	(49,333)
Profit for the Equity Holders of the Bank													2,830,538	3,150,469
Segment assets	198,409,606	179,619,276	11,489,209	13,289,448	1,312,520	3,343,590	8,032,850	7,804,904	2,799,471	2,008,881	(3,007,323)	(2,800,278)	219,036,333	203,265,821
Investment in associates													143,700	165,093
Unallocated assets													42,809,946	37,571,635
Total Assets													261,989,979	241,002,549
Segment liabilities	184,080,606	168,406,639	11,489,209	13,289,448	931,094	2,647,569	3,541,914	3,291,346	2,123,356	1,459,738	(2,564,735)	(2,402,745)	199,601,444	186,691,995
Unallocated liabilities													39,119,418	32,791,231
Total liabilities													238,720,862	219,483,226
Cash flows from operating activities	6,975,181	2,360,684	(1,791,504)	2,154,933	(73,279)	65,681	102,708	94,945	650,645	488,182	1,206,199	3,131,238	7,069,950	8,295,663
Cash flows from investing activities	(6,434,234)	(435,570)	-	-	6,881	(33,599)	(386,246)	(214,889)	(572,745)	(475,267)	(1,997,397)	2,891,680	(9,383,741)	1,732,355
Cash flows from financing activities	5,393,803	(3,104,762)	-	-	210,807	(7,000)	-	-	(38,089)	(610)	(1,031,885)	(5,859,460)	6,598,406	(8,971,832)
Capital Expenditure	1,904,580	928,819	221	294	47,723	4,383	3,464	748	48,903	37,761	-	(8,876)	2,004,891	963,129
Depreciation	479,193	421,004	1,722	1,160	20,841	5,622	109,860	109,581	20,123	15,911	(13,491)	-	618,248	553,278
Amortization	90,300	63,297	1,145	1,773	3,637	1,641	79	33	6,856	5,510	-	-	102,017	72,254

\*\*Stock Broking , Securities Dealings, Remittances and Foreign Currency related services

### **52 EVENTS OCCURRING AFTER THE BALANCE SHEET DATE**

There are no events occurring after the Balance Sheet date which require adjustments to or disclosure in the financial statements, other than those disclosed below:

#### **52 (a) Proposed dividends**

Refer Note No. 38 (a)

#### **52 (b) Delma Exchange**

The Bank has invested Rs 58.62 Mn in Delma Exchange, a newly incorporated exchange house in UAE. Delma Exchange obtained its trading licence on 27th January 2009 after which date it became a legal entity. The funds advanced prior to obtaining the trading licence up to Balance Sheet Date have been included in Other Assets.

### **53 DIRECTORS' RESPONSIBILITY STATEMENT**

The Board of Directors of the Bank is responsible for the preparation and presentation of these financial statements. Please refer to page 130 for the statement of the Directors' Responsibility for Financial Reporting.



# Capital Adequacy

Capital Adequacy is a measure of a commercial bank's ability to withstand the associated risks of its business. Regulators find it necessary that every bank holds adequate capital to absorb unexpected losses as a going concern, while they price their products and services to take care of expected losses. Capital Adequacy Ratio (CAR) was measured on the basis of Credit and Market risk under the Basel I accord and under Basel II it takes into account the Credit, Market and Operational risks. Keeping with the international standards of Basel Committee on Banking Regulations and Supervisory Practices, Sri Lanka has been following Basel II CAR calculation from January 2008 after conducting parallel calculations in 2007.

## AVAILABLE CAPITAL

Basel I and Basel II accords recognise three capital elements, namely Tier I, Tier II and Tier III capital.

Tier 1 capital includes paid up ordinary share capital, paid up non cumulative, non redeemable preference shares, share premium, statutory reserve fund, published retained earnings, general and other reserves less goodwill.

Tier II capital includes 50% of asset revaluation reserves (created by revaluations carried out in every seven years) general provision for advances, hybrid debt / equity instruments and approved subordinated term debts. Tier II capital cannot exceed Tier I capital and subordinated debt cannot exceed 50% of the Tier I capital.

Tier III capital will consist only of short term debt instruments and will be used for calculation of Market risk only. Tier III is subject to a maximum of 250% of Tier I capital after meeting the credit and operational risk.

Equity investments in unconsolidated banking and financial subsidiaries and investments in capital of other banks / financial associates are deducted from capital in arriving at the capital base. Sri Lankan banks are required to maintain a minimum total risk weighted capital ratio of 10% in respect of Domestic Banking Unit (DBU) and Foreign Currency Banking Unit (FCBU) operations.

## RISK ASSESSMENT

In order to determine the credit risk applicable for capital adequacy ratio, all assets are risk weighted in order to provide a broad indication of credit risk. According to Basel II guidelines the advances portfolio is segregated for credit risk computation mainly on the type of counterparty. Total portfolio is classified as claims on Banks, Corporates, Financial Institutions and Retail. Off balance sheet transactions are converted to credit equivalents, using a credit conversion factor, before being allocated a risk weighting.

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

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

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

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

# Capital Adequacy

## Capital Base as at 31 st December,

	2007 (Basel I) (Rs Mn)	2008 (Basel II) (Rs Mn)
<b>TIER 1</b>		
Voting ordinary shares	1,893	1,893
Non-Voting ordinary shares	462	462
Share premium	2,704	2,704
Statutory reserve fund	822	983
Published retained profits	2,747	3,046
General & other reserves	6,789	8,489
Less: Deductions from Tier 1 capital (1)	-	(1,345)
<b>Total Tier 1 Capital</b>	<b>15,417</b>	<b>16,232</b>
<b>TIER 2</b>		
Approved asset revaluation reserves (2)	1,042	1,042
General provisions	855	1,339
Debentures	2,958	2,577
<b>Total Tier 2 Capital</b>	<b>4,855</b>	<b>4,958</b>
<b>Total Tier 1 &amp; Tier 2 Capital</b>	<b>20,272</b>	<b>21,190</b>
Less: Deductions from Tier 2 capital (1)	(2,230)	(1,195)
<b>Capital Base</b>	<b>18,042</b>	<b>19,995</b>
Risk Adjusted Capital Ratios		
Tier 1 (Tier 1 capital / Total risk adjusted balance) *	10.32	9.25
Total (Capital base / Total risk adjusted balance) **	12.08	11.40

\* Statutory minimum 5%

\*\* Statutory minimum 10%

## ADJUSTED ASSETS AND OFF-BALANCE SHEET EXPOSURE - 2008 (BASEL II)

As at 31st December	Balance (Rs Mn)	Risk Weights %	Risk Adjusted Balance (Rs Mn)
ASSETS - exposures			
- To Central Government and CBSL	37,067	-	-
- To Banks	19,843	20 - 150	4,907
- To Financial Institutions	6,263	20 - 150	3,876
- To Corporates	65,523	20 - 150	64,925
- To Retail sector (excluding claims secured by residential properties)	39,703	75 - 100	31,306
- Secured on Residential property mortgages	20,748	50 - 100	11,324
- Classified as non performing advances	5,432	50 - 150	6,413
- Other Exposures	1,213	20 - 150	1,213
- Cash Items	4,571	-	210
- Other Assets	13,884	100	13,884
<b>Total assets</b>	<b>214,247</b>		<b>138,058</b>

## OFF -BALANCE SHEET EXPOSURE

As At 31st December	Amount of Off-Balance Sheet Items (Rs Mn)	Credit Conversion Factor %	Credit Equivalent Amount (Rs Mn)	Risk Weights %	Risk Adjusted Balance (Rs Mn)
Financial guarantees, Bank acceptances and other guarantees	5,720	100	5,720	0 - 100	5,720
Performance related guarantees and warranties, stand by credit lines	8,922	50	4,461	0 - 100	4,461
Shipping guarantees, Documentary Letter of Credit	21,113	20	4,223	0 - 100	4,223
Undrawn term and overdraft facilities < 1 year	13,683	0 - 20	36	0 - 100	36
> 1 year	63	50	31	0 - 100	31
Foreign Exchange Contracts	19,846	2	397	0 - 100	397
Foreign Interest Rate Contracts	2,779	7	195	0 - 100	195
<b>Total off- balance sheet exposures</b>	<b>72,126</b>		<b>15,063</b>		<b>15,063</b>

## CAPITAL CHARGE FOR MARKET RISK - 2008

As At 31st December	Capital charge (Rs Mn)	Risk Adjusted Balance (Rs Mn)
Interest rate	0.5	5
Equity	5.0	50
Foreign Exchange & Gold	55.5	555
<b>Total risk adjusted balance for market risk</b>	<b>61.0</b>	<b>610</b>

## CAPITAL CHARGE FOR OPERATIONAL RISK - 2008

As At 31st December	Capital charge (Rs Mn)	Risk Adjusted Balance (Rs Mn)
Average Gross income	14,437.7	
15% of Average Gross income	2,165.7	
<b>Total risk adjusted balance for operational risk</b>	<b>2,165.7</b>	<b>21,657</b>

## Total risk adjusted balances (credit risk, market risk, operational risk and off - balance sheet exposure)

175,388

### NOTES:

(1) Deductions	Tier 1 (Rs Mn)	Tier 2 (Rs Mn)
Additional investment in Sithma Development (Pvt) Ltd	450	450
Employee Share Ownership Plan	150	-
Others	745	745
	<b>1,345</b>	<b>1,195</b>

(2) Revaluation reserves approved by CBSL is Rs million 2,084.

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

(4) Due to basic differences in Basel I and Basel II in computing risk adjusted balances, comparative figures for 2007 are not given.

# Income Statement in US Dollars

For the year ended 31st December	Bank		Group	
	2008 US\$. 000	2007 US\$. 000	2008 US\$. 000	2007 US\$. 000
<b>INCOME</b>	<b>328,902</b>	276,067	<b>342,703</b>	295,222
Interest income	287,001	241,602	290,527	249,669
Less: Interest expenses	174,793	139,804	179,533	148,459
<b>Net interest income</b>	<b>112,208</b>	101,798	<b>110,994</b>	101,210
Foreign exchange profit	10,327	10,256	10,346	10,267
Fee and commission income	20,924	19,158	21,544	19,527
Dividend income	4,764	1,152	1,916	850
Other income	5,885	3,899	18,370	14,909
<b>OPERATING INCOME</b>	<b>154,108</b>	136,263	<b>163,170</b>	146,763
Less:	-	-	-	-
<b>OPERATING EXPENSES</b>	-	-	-	-
Personnel costs	31,518	29,501	33,904	31,570
Premises, equipment and establishment expenses	21,430	19,557	19,329	17,107
Fee and commission expenses	469	720	441	730
Provision for employee retirement benefits	6,966	4,158	7,040	4,209
Provision for loan losses	10,259	8,356	10,259	8,356
Provision for fall in value of investments	2,246	-	2,297	19
Other expenses	38,878	34,075	50,152	42,892
	<b>111,766</b>	96,367	<b>123,422</b>	104,883
<b>PROFIT FROM OPERATIONS</b>	<b>42,342</b>	39,896	<b>39,748</b>	41,880
Share of Profit / (Loss) of associates (net of Income tax)	-	-	(57)	132
<b>PROFIT BEFORE INCOME TAX</b>	<b>42,342</b>	39,896	<b>39,691</b>	42,012
Less: Income tax expense	13,855	12,078	14,153	12,561
<b>PROFIT FOR THE YEAR</b>	<b>28,487</b>	27,818	<b>25,538</b>	29,451
<b>Attributable to:</b>	-	-	-	-
<b>Equity holders of the Bank</b>	<b>28,487</b>	27,818	<b>25,049</b>	28,997
<b>Minority interest</b>	-	-	<b>489</b>	454
<b>PROFIT FOR THE YEAR</b>	<b>28,487</b>	27,818	<b>25,538</b>	29,451
<b>BASIC EARNINGS PER SHARE (US\$)</b>	<b>0.12</b>	0.12	<b>0.11</b>	0.12
<b>DIVIDEND PER SHARE (US\$)</b>	<b>0.04</b>	0.03	<b>0.04</b>	0.03

Exchange rate of US\$ 1 was Rs. 113.00 as at 31.12.2008 (Rs. 108.65 as at 31.12.2007)

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

# Balance Sheet in US Dollars

As at 31st December	Bank		Group	
	2008 US\$. 000	2007 US\$. 000	2008 US\$. 000	2007 US\$. 000
<b>ASSETS</b>				
Cash and cash equivalents	206,212	176,334	208,495	177,407
Statutory deposit with Central Banks	104,844	123,386	104,973	123,386
Government treasury bills	-	-	6,718	10,643
Commercial papers	1,999	2,176	2,087	2,176
Securities purchased under re-sale agreements	12,389	31,753	22,471	53,927
Dealing securities	636	5,426	721	6,558
Investment securities	229,343	186,809	238,680	193,076
Bills of exchange	17,332	19,047	17,332	19,047
Loans and advances	1,427,450	1,334,425	1,411,166	1,319,971
Lease rentals receivable within one year	38,869	40,459	38,869	40,459
Lease rentals receivable after one year	62,805	81,855	62,805	81,855
Non-current assets held for sale	13	13	13	13
Investments in associates	1,171	1,218	1,272	1,519
Investments in joint venture	2,212	-	-	-
Investments in subsidiaries	19,284	21,111	-	-
Investment properties	1,659	1,736	1,560	1,662
Property, plant and equipment	60,758	55,983	123,018	121,321
Intangible assets	6,439	1,692	6,667	1,937
Other assets	65,613	60,215	71,648	63,198
<b>Total Assets</b>	<b>2,259,028</b>	<b>2,143,638</b>	<b>2,318,495</b>	<b>2,218,155</b>
<b>LIABILITIES</b>				
Deposits from customers	1,652,831	1,616,747	1,651,456	1,615,892
Dividends payable	1,127	279	1,127	279
Borrowings	136,295	91,097	136,293	91,159
Securities sold under re-purchase agreements	77,876	55,559	85,391	76,879
Bills payable	9,274	11,028	9,274	11,028
Current tax liabilities	21,068	14,167	21,383	14,774
Insurance provision - Life	-	-	12,040	8,106
Insurance provision - Non Life	-	-	4,161	3,134
Subordinated debentures	24,379	42,557	33,052	51,439
Deferred tax liabilities	7,720	5,575	7,723	5,592
Other liabilities	146,325	137,103	150,673	141,811
<b>Total Liabilities</b>	<b>2,076,895</b>	<b>1,974,112</b>	<b>2,112,573</b>	<b>2,020,093</b>
<b>EQUITY</b>				
Stated capital	44,773	46,566	44,773	46,566
Statutory reserve fund	8,697	7,563	8,697	7,563
Retained earnings	26,952	25,287	23,156	26,335
Other reserves	101,711	90,110	126,218	115,576
<b>Total Equity attributable to equity holders of the Bank</b>	<b>182,133</b>	<b>169,526</b>	<b>202,844</b>	<b>196,040</b>
<b>Minority interest</b>	<b>-</b>	<b>-</b>	<b>3,078</b>	<b>2,022</b>
<b>Total Equity</b>	<b>182,133</b>	<b>169,526</b>	<b>205,922</b>	<b>198,062</b>
<b>Total Liabilities and Equity</b>	<b>2,259,028</b>	<b>2,143,638</b>	<b>2,318,495</b>	<b>2,218,155</b>
Commitments and Contingencies	602,354	533,489	602,354	533,489

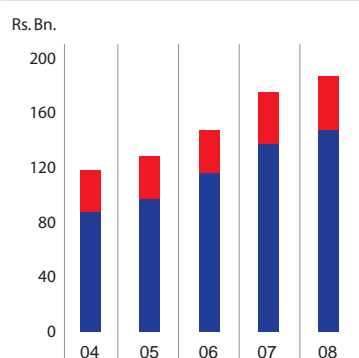
Exchange rate of US\$ 1 was Rs. 113.00 as at 31.12.2008 (Rs. 108.65 as at 31.12.2007)

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# Analysis of Deposits

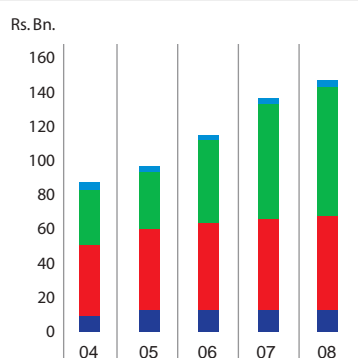
	2004 Rs 000	2005 Rs 000	2006 Rs 000	2007 Rs 000	2008 Rs 000
<b>Local Currency Deposits</b>					
Current	8,852,609	12,511,256	12,635,473	12,482,701	<b>12,748,863</b>
Savings	42,108,475	47,380,753	50,697,086	53,565,590	<b>54,544,453</b>
Time	31,920,537	33,587,699	48,869,303	66,836,282	<b>75,828,902</b>
Certificates of Deposit	4,448,095	3,634,393	3,348,716	4,021,045	<b>4,269,993</b>
	<b>87,329,716</b>	<b>97,114,101</b>	<b>115,550,578</b>	<b>136,905,618</b>	<b>147,392,211</b>
<b>Foreign Currency Deposits</b>					
Current	2,331,555	1,013,589	1,188,634	1,348,574	<b>1,522,500</b>
Savings	15,009,655	14,166,198	13,600,463	15,784,655	<b>14,178,854</b>
Time	13,853,008	15,989,793	17,217,780	21,620,726	<b>23,676,297</b>
	<b>31,194,218</b>	<b>31,169,580</b>	<b>32,006,877</b>	<b>38,753,955</b>	<b>39,377,651</b>
<b>Total Deposits</b>					
Refinance	2,066,198	2,711,810	3,582,587	5,749,624	<b>6,424,054</b>
Total Deposits & Refinance	<b>120,590,132</b>	<b>130,995,491</b>	<b>151,140,042</b>	<b>181,409,197</b>	<b>193,193,916</b>

Analysis of Total Deposits



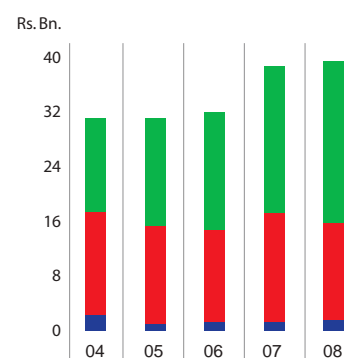
■ Local Currency Deposits  
■ Foreign Currency Deposits

Analysis of Local Currency Deposits



■ Current ■ Savings ■ Time  
■ Certificates of Deposit

Analysis of Foreign Currency Deposits

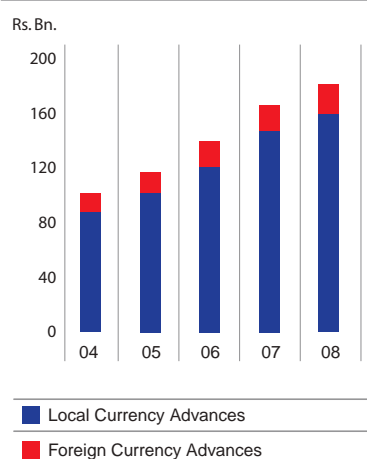


■ Current ■ Savings ■ Time

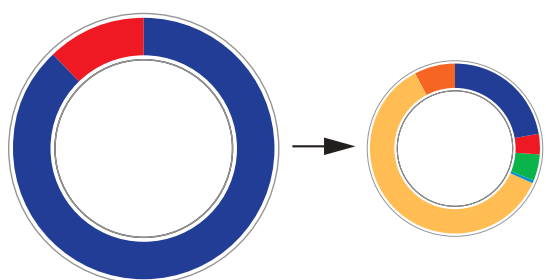
# Analysis of Advances

	2004 Rs 000	2005 Rs 000	2006 Rs 000	2007 Rs 000	2008 Rs 000
<b>Local Currency Advances</b>					
Overdrafts	20,165,063	22,952,834	27,455,224	33,776,672	<b>35,393,588</b>
Short Term Loans	4,215,046	5,366,187	5,636,464	5,129,706	<b>7,074,630</b>
Trust Receipts	4,957,006	5,193,080	6,876,898	7,097,272	<b>7,882,525</b>
Packing Credit	521,945	523,517	618,787	763,188	<b>849,408</b>
Term Loans	50,714,867	58,657,612	68,451,741	86,692,434	<b>96,306,516</b>
	<b>80,573,927</b>	<b>92,693,230</b>	<b>109,039,114</b>	<b>133,459,272</b>	<b>147,506,667</b>
Leasing Facilities	7,130,368	9,261,500	12,036,467	13,772,361	<b>11,980,853</b>
<b>Total</b>	<b>83,489,249</b>	<b>96,588,543</b>	<b>115,439,117</b>	<b>147,231,633</b>	<b>159,487,520</b>
<b>Foreign Currency Advances</b>					
	13,702,580	15,381,438	18,412,257	18,988,347	<b>22,397,201</b>
<b>Total</b>	<b>101,406,875</b>	<b>117,336,168</b>	<b>139,487,838</b>	<b>166,219,980</b>	<b>181,884,721</b>

Analysis of Total Advances



Analysis of Advances - 2008



Local Currency - 88%	Overdrafts - 22%
Foreign Currency - 12%	Short Term Loans - 4%
	Trust Receipts - 5%
	Packing Credit - 1%
	Term Loans - 60%
	Leasing Facilities - 8%

Analysis of Advances by Security - 2008



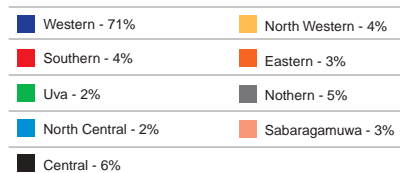
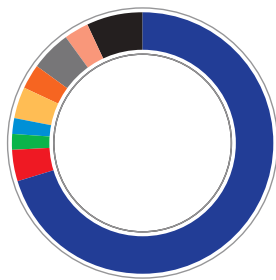
Secured by cash, quoted shares & other readily realisable assets - 15%
Secured by mortgage over immovable assets - 40%
Secured by mortgage over movable assets - 20%
Others (clean and third party guarantees - 25%)

# Province-wise Analysis of Deposits & Advances

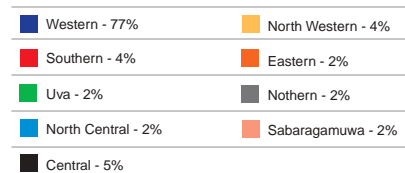
## Province-wise Analysis of Deposits & Advances as at 31st December 2008

Province	No of Branches	Deposits (Rs Mn)	%	Advances Including Leasing (Rs Mn)	%	Deposit Utilisation %
WESTERN	87	132,335	71	139,582	77	105
SOUTHERN	17	6,789	4	7,441	4	110
UVA	10	3,706	2	3,155	2	85
NORTH CENTRAL	6	3,178	2	2,972	2	94
NORTH WESTERN	13	7,389	4	7,411	4	100
EASTERN	9	6,281	3	4,222	2	67
NORTHERN	7	9,653	5	3,697	2	38
SABARAGAMUWA	10	5,273	3	4,425	2	84
CENTRAL	18	12,166	6	8,980	5	74
<b>TOTAL</b>	<b>177</b>	<b>186,770</b>	<b>100</b>	<b>181,885</b>	<b>100</b>	<b>97</b>

Provincewise Deposits - 2008



Provincewise Advances - 2008

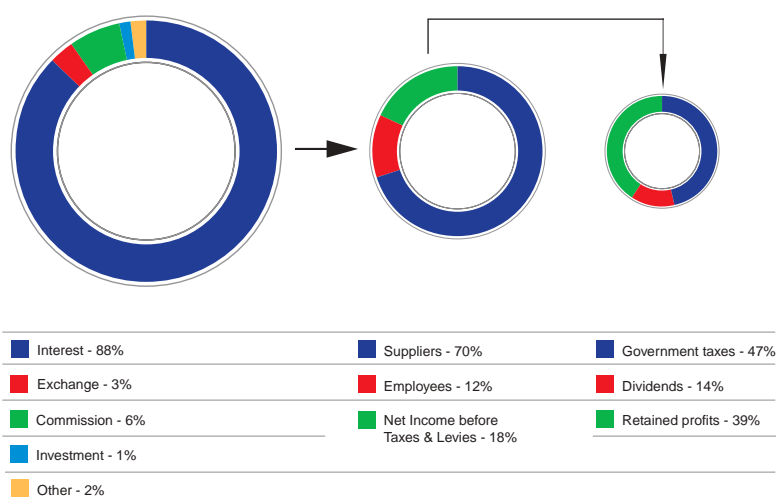




# Sources & Utilisation of Income

	2004 Rs 000	2005 Rs 000	2006 Rs 000	2007 Rs 000	2008 Rs 000
<b>SOURCES OF INCOME</b>					
Interest	11,469,335	14,129,874	18,451,961	26,250,038	32,431,158
Exchange	662,176	646,460	772,826	1,114,313	1,166,979
Commission	1,519,924	1,663,545	1,795,340	2,081,569	2,364,434
Investment	288,193	329,322	225,722	125,142	538,321
Other	147,730	146,113	247,847	423,656	665,023
<b>Total</b>	<b>14,087,358</b>	<b>16,915,314</b>	<b>21,493,696</b>	<b>29,994,718</b>	<b>37,165,915</b>
<b>UTILISATION OF INCOME</b>					
<b>Employees</b>					
Salaries and other payments to Staff	2,414,137	2,741,656	3,164,917	3,657,112	4,348,690
<b>Suppliers</b>					
Interest Paid	5,962,041	7,280,851	9,797,449	15,189,698	19,751,667
Other expenses	4,418,999	4,922,800	4,529,175	5,544,177	6,501,302
	10,381,040	12,203,651	14,326,624	20,733,875	26,252,969
Net Income before Government Taxes and Levies	1,292,181	1,970,007	4,002,155	5,603,731	6,564,255
<b>Government</b>					
Provision for Income Tax, Provision for Financial Services VAT, Debits Tax and Stamp Duty	315,799	396,910	1,781,665	2,306,885	3,075,755
<b>Shareholders</b>					
Dividends	350,350	471,059	588,824	824,353	942,118
Retained Profits	626,032	1,102,038	1,631,666	2,472,493	2,546,382
<b>Total</b>	<b>14,087,358</b>	<b>16,915,314</b>	<b>21,493,696</b>	<b>29,994,718</b>	<b>37,165,915</b>

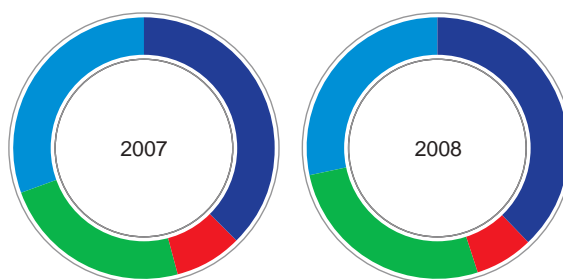
Sources & Utilisation of Income - 2008



# Value Added Statement

	2007 Rs 000	%	2008 Rs 000	%
<b>Value Added</b>				
Income earned by providing banking services	29,735,195		36,265,814	
cost of services	19,341,808		24,269,260	
Value added by banking services	10,393,387		11,996,554	
Non-banking income	259,523		900,101	
Provision for bad debts	(907,913)		(1,413,078)	
	9,744,997		11,483,577	
<b>Value Allocated to Employees</b>				
Salaries,wages & other benefits	3,657,112	37	4,348,690	38
<b>To Providers of Capital</b>				
Dividends to shareholders	824,353	8	942,118	8
<b>To Government</b>				
Provision for Financial Services VAT	1,240,912		1,768,012	
Provision for Income Tax	1,037,908		1,296,148	
Debits Tax	7,022		8,074	
Stamp Duty	17,963	24	1,793	27
	2,303,805		3,074,027	
<b>To Expansion and Growth</b>				
Retained Income	2,198,103	23	2,276,862	20
Depreciation	487,234	5	572,360	5
Deferred Taxation	274,390	3	269,520	2
	9,744,997	100	11,483,577	100

Analysis of Value Addition



■ Value allocated to employees 2008 - (38%) 2007 - (37%)

■ To providers of capital 2008 - (8%) 2007 - (8%)

■ To Government 2008 - (27%) 2007 - (24%)

■ To expansion and growth - 2008 - (27%) 2007 - (31%)

# Quarterly Statistics

For the three months ended	2007				2008			
	December 31st	September 30th	June 30th	March 31st	December 31st	September 30th	June 30th	March 31st
<b>Balance Sheet Data</b>								
<b>(Rs Mn)</b>								
Total Assets	232,906	226,992	218,673	206,692	255,270	249,684	238,982	232,465
Loans, Leases and Bills	168,590	161,388	151,898	145,822	184,140	170,176	165,623	164,734
Deposits	175,660	168,220	160,381	154,490	186,770	182,846	178,184	175,589
Shareholders' Funds	18,419	17,061	16,361	12,951	20,581	20,158	19,167	18,347
Average Assets	229,949	222,833	212,683	201,381	252,477	244,333	235,724	232,686
<b>Income Statement Data</b>								
<b>(Rs 000)</b>								
Net Interest Income	2,937,433	2,846,424	2,822,149	2,454,334	3,611,556	3,085,644	2,982,853	2,999,438
Foreign Exchange Profit	333,490	282,875	252,912	245,036	315,906	271,267	294,999	284,807
Other Income	620,626	571,549	613,047	545,103	557,106	987,501	1,096,697	630,455
Total Revenue	3,891,549	3,700,848	3,688,108	3,244,473	4,484,568	4,344,412	4,374,549	3,914,700
Provision for Loan Losses	105,009	(136,897)	(160,981)	(435,002)	(283,217)	(156,152)	(246,636)	(177,214)
Non-interest Expenses	(2,338,365)	(2,385,080)	(2,566,478)	(2,272,430)	(3,104,413)	(2,778,274)	(3,022,627)	(2,565,048)
Provision for Income Tax	(382,438)	(397,090)	(311,216)	(221,554)	(438,886)	(420,083)	(285,582)	(421,117)
Net Profit after Tax	1,275,755	781,781	649,433	315,487	658,052	989,903	819,704	751,321
<b>Ordinary Share Information</b>								
<b>Market Price</b>								
<b>per share (Rs)</b>	V	NV	V	NV	V	NV	V	NV
High	123.00	56.50	106.25	48.75	103.00	48.50	225.00	120.00
Low	99.75	44.00	90.25	37.75	90.00	35.50	100.00	47.00
Closing	122.50	53.25	101.25	44.75	94.75	42.50	100.00	47.75
Book value per Ordinary Share	78.20	72.44	69.46	54.99	87.38	85.59	81.38	77.90
V - Voting NV - Non-Voting								
<b>Financial Measures</b>								
<b>Profitability</b>								
Return on Average Shareholders' Equity (Annualised)	19.3%	15.5%	13.18%	9.75%	16.5%	17.7%	16.7%	16.3%
<b>Productivity</b>								
Non-interest Expenses to Total Revenue	60.09%	64.45%	69.59%	70.04%	69.22%	63.95%	69.10%	65.52%
<b>Capital</b>								
<b>Risk weighted capital ratios</b>								
Tier 1	10.32%	8.45%	8.90%	9.06%	9.25%	8.53%	9.12%	8.03%
Total (Tier 1 + 2)	12.08%	10.20%	10.42%	10.20%	11.40%	10.60%	11.59%	10.40%
<b>Asset Quality</b>								
Provision for Credit losses to average loans	-0.06%	0.09%	0.11%	0.31%	0.16%	0.09%	0.15%	0.11%

# Ten Year Statistical Summary

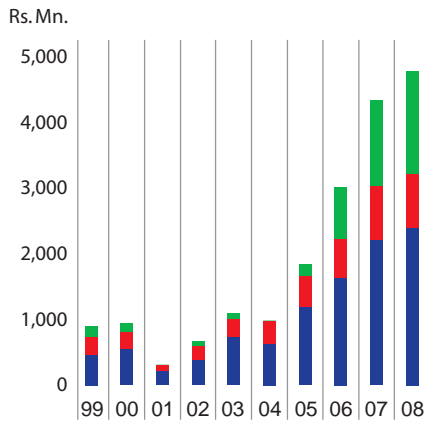
Year ended 31st December (Rs Mn)	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
<b>OPERATING RESULTS</b>										
Income	7,723	9,641	11,564	11,799	14,831	14,087	16,915	21,494	29,995	<b>37,166</b>
Interest Income	64,880	7,940	9,336	9,399	11,537	11,469	14,130	18,452	26,250	<b>32,431</b>
Interest Expense	4,088	5,281	7,201	6,258	6,909	5,962	7,281	9,797	15,190	<b>19,752</b>
Exchange Income	313	364	516	382	506	662	646	773	1,114	<b>1,167</b>
Other Income	930	1,337	1,712	2,018	2,788	1,956	2,139	2,269	2,630	<b>3,568</b>
Operating Expenses	2,741	3,411	4,061	4,873	6,830	7,175	7,785	8,677	10,470	<b>12,630</b>
Profit before Income Tax	894	949	301	669	1,092	950	1,850	3,019	4,335	<b>4,785</b>
Income Tax on Profit	176	149	(2)	80	83	(26)	195	799	1,312	<b>1,566</b>
Profit after Taxation	718	800	303	589	1,008	976	1,655	2,220	3,022	<b>3,219</b>
<b>SHAREHOLDERS' FUNDS</b>										
Share Capital	650	650	650	715	715	1,001	1,178	1,178	2,355	<b>2,355</b>
Reserves	4,358	4,898	5,103	5,520	6,278	8,051	10,062	11,752	16,064	<b>18,226</b>
Total	5,008	5,548	5,753	6,235	6,993	9,052	11,239	12,930	18,419	<b>20,581</b>
<b>LIABILITIES</b>										
Customer Deposits	53,858	62,758	75,599	87,884	101,026	118,524	128,284	147,557	175,660	<b>186,770</b>
Refinance Borrowings	1,636	1,655	1,565	1,659	1,764	2,066	2,712	3,583	5,750	<b>6,424</b>
Other Liabilities	15,732	17,540	15,999	19,354	23,161	22,787	23,463	31,687	32,472	<b>40,623</b>
Deferred Taxation	121	155	215	304	387	350	314	314	606	<b>872</b>
Total	76,355	87,656	99,131	115,436	133,331	152,780	166,012	196,070	232,906	<b>255,270</b>
<b>ASSETS</b>										
Bills of Exchange	3,122	4,546	3,153	2,690	2,412	2,077	2,027	1,911	2,069	<b>1,959</b>
Loans and Advances	39,885	47,240	50,473	62,152	75,326	88,594	101,609	119,997	144,985	<b>161,302</b>
Lease Rentals Receivable	2,741	2,969	2,898	4,032	5,085	6,838	8,864	11,552	13,289	<b>11,489</b>
Cash, Short Term Funds and Statutory Deposits with Central Bank of Sri Lanka	17,768	14,875	17,377	21,479	21,119	25,013	24,400	30,200	32,565	<b>35,149</b>
Property, Plant & Equipment	1,914	2,273	2,509	2,781	3,414	3,387	3,059	2,908	6,083	<b>6,866</b>
Other Assets	10,924	15,752	22,721	22,302	25,975	26,870	26,053	29,502	33,915	<b>38,505</b>
Total	76,355	87,656	99,131	115,436	133,331	152,780	166,012	196,070	232,906	<b>255,270</b>
<b>RATIOS</b>										
Return on Average Shareholders Funds (%)	17	15	5	10	15	12	16	18	19	<b>17</b>
Income Growth (%)	15	25	20	2	26	(5)	20	27	40	<b>24</b>
Return on Average Assets (%)	1.0	1.0	0.3	0.6	0.8	0.7	1.0	1.2	1.4	<b>1.3</b>
Rate of Dividends (%)	40	40	15	30	40	35	40	50	35	<b>40</b>
Dividend Cover (times)	2.8	3.1	3.1	2.8	3.5	2.8	3.5	3.8	3.7	<b>3.4</b>
Gross Dividends (Rs. Mn)	260	260	98	215	286	350	471	589	824	<b>942</b>
Advance to Deposits & Refinance (%)	83	85	73	78	81	81	86	88	88	<b>90</b>
Property, Plant & Equipment to Shareholders' Funds (%)	38	41	44	45	49	37	27	22	33	<b>33</b>
Total Assets to Shareholders' Funds (times)	15	16	17	19	19	17	15	15	13	<b>12</b>
<b>(As specified in the Banking Act No. 30 of 1988)</b>										
Capital Funds to Liabilities including Contingent Liabilities (%)	1.0	1.2	1.2	1.2	1.0	1.0	1.0	1.0	1.3	<b>1.1</b>
Liquid Assets to Liabilities (%)	25	25	28	32	27	25	24	22	22	<b>22</b>
<b>SHARE INFORMATION</b>										
Market Value per Share (Rs.)										
-Voting	87.00	46.25	52.00	79.00	69.00	57.00	112.50	155.75	122.50	<b>69.75</b>
-Non Voting	-	36.75	36.00	47.00	36.75	32.75	41.50	70.00	53.25	<b>32.00</b>
Earnings per Share (Rs.)	9.75	10.86	4.11	8.00	13.69	12.51	15.09	18.86	12.83	<b>13.67</b>
Earnings per Share (Diluted) (Rs.) *	3.05	3.40	1.29	2.50	4.28	4.15	7.02	9.43	12.83	<b>13.67</b>
Price Earnings Ratio	8.92	4.26	12.65	9.88	5.04	4.56	7.46	16.52	9.55	<b>5.10</b>
Net Assets per Share (Diluted) (Rs.) **	21.26	23.55	24.43	26.47	29.69	38.43	47.72	54.90	78.20	<b>87.38</b>
<b>OTHER INFORMATION</b>										
No. of Employees	4,035	4,119	4,137	4,280	4,203	4,180	4,259	4,287	4,334	<b>4,395</b>
No. of Branches	111	117	123	137	138	142	148	151	167	<b>177</b>
No. of Student Banking Centres	67	101	122	144	151	152	152	152	152	<b>152</b>
No. of other Financial Centres	95	104	110	110	110	110	113	113	114	<b>114</b>

\* Earnings per share has been adjusted for existing number of shares issued

\*\* Net Assets per share has been computed for the existing number of shares issued

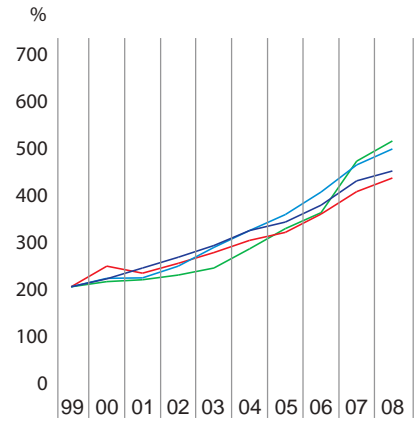
# Ten Year Graphical Review

Distribution of Profit



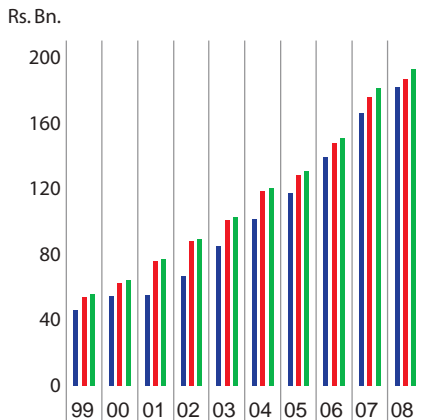
■ Profit Available After Appropriation  
 ■ Dividends ■ Taxation

Balance Sheet Growth (Base Year 1999)



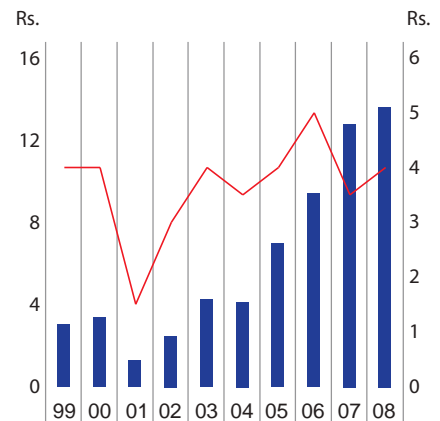
— Deposits — Total Assets  
 — Advances — Shareholders' Funds

Advances, Deposits & Re-Finance Borrowings



■ Advances ■ Deposits ■ Deposits & Refinance Borrowings

Earnings per Share and Dividends per Share



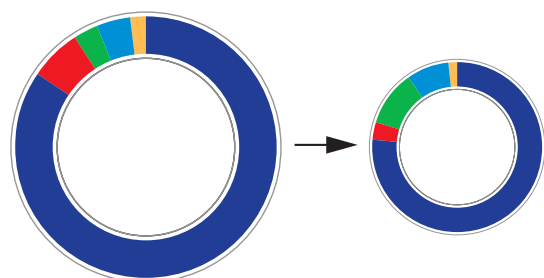
■ Earnings per Share (Diluted) — Dividends per Share

# Segmental Analysis

Business Segments	Banking		Leasing		Dealings *		Property		Insurance		Total	
	2007 Rs.000	2008 Rs.000	2007 Rs.000	2008 Rs.000	2007 Rs.000	2008 Rs.000	2007 Rs.000	2008 Rs.000	2007 Rs.000	2008 Rs.000	2007 Rs.000	2008 Rs.000
Interest	24,109,650	30,119,107	-	-	806,736	439,625	216	-	200,866	342,561	25,117,468	30,901,293
Exchange	1,114,313	1,166,979	-	-	-	132	-	-	1,183	-	1,115,496	1,167,111
Lease / Premium / Brokering Income	-	-	2,140,388	2,312,051	71,577	58,822	-	-	1,167,439	1,383,165	3,379,404	3,754,038
Commissions / Rent	2,081,569	2,364,434	-	-	387	854	610,011	702,464	-	-	2,691,967	3,067,752
Other	548,798	1,203,344	-	-	24,801	31,616	-	169	1,144	1,629	574,743	1,236,758
<b>Total Revenue</b>	<b>27,854,330</b>	<b>34,853,864</b>	<b>2,140,388</b>	<b>2,312,051</b>	<b>903,501</b>	<b>531,049</b>	<b>610,227</b>	<b>702,633</b>	<b>1,370,632</b>	<b>1,727,355</b>	<b>32,879,078</b>	<b>40,126,952</b>

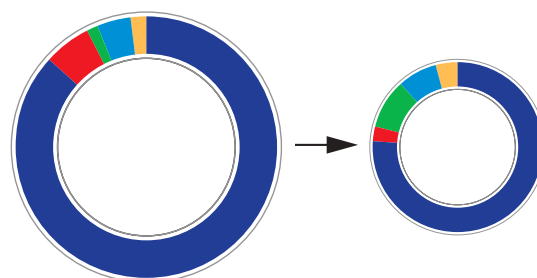
\* Stock Broking and Security Dealings

Segmental Analysis of Revenue - 2007



Banking - 85%	Interest - 77%
Leasing - 6%	Exchange - 3%
Dealing - 3%	Leasing - 10%
Insurance - 4%	Commission - 8%
Property - 2%	Other - 2%

Segmental Analysis of Revenue - 2008



Banking - 87%	Interest - 77%
Leasing - 6%	Exchange - 3%
Dealing - 1%	Leasing - 9%
Insurance - 4%	Commission - 8%
Property - 2%	Other - 3%

# Share & Debenture Information

## 1. STOCK EXCHANGE LISTING

The issued ordinary shares of Hatton National Bank PLC are listed with the Colombo Stock Exchange. The audited Income Statement for the year ended 31st December 2008 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 4,120 registered Voting Shareholders as at 31st December 2008 (2007 - 4,218) distributed as follows:

	Resident			Non-Resident			Total		
	No of shareholders	No of shares	%	No of shareholders	No of shares	%	No of shareholders	No of shares	%
1 - 1,000	2,507	824,336	0.67	27	10,554	0.02	2,534	834,890	0.50
1,001 - 5,000	921	2,103,003	1.70	20	43,480	0.10	941	2,146,483	1.28
5,001 - 10,000	215	1,559,831	1.26	9	60,764	0.14	224	1,620,595	0.96
10,001 - 50,000	318	6,634,035	5.36	10	150,500	0.34	328	6,784,535	4.04
50,001 - 100,000	44	3,110,539	2.51	1	55,550	0.13	45	3,166,089	1.88
100,001 - 500,000	36	6,452,856	5.21	1	110,000	0.25	37	6,562,856	3.91
500,001 - 1,000,000	1	897,664	0.73	-	-	-	1	897,664	0.53
Over 1,000,000	8	102,210,392	82.56	2	43,774,606	99.02	10	145,984,998	86.90
<b>Total</b>	<b>4,050</b>	<b>123,792,656</b>	<b>100.00</b>	<b>70</b>	<b>44,205,454</b>	<b>100.00</b>	<b>4,120</b>	<b>167,998,110</b>	<b>100.00</b>

### Analysis of Shareholders Resident / Non-Resident

	31st December 2007			31st December 2008		
	No of Shareholders	No of Shares	%	No of Shareholders	No of Shares	%
Resident	4,142	124,529,266	73.75	4,050	123,792,656	73.69
Non-Resident	76	44,317,344	26.25	70	44,205,454	26.31
Total	4,218	168,846,610	100.00	4,120	167,998,110	100.00

### Individuals / Institutions

	31st December 2007			31st December 2008		
	No of Shareholders	No of Shares	%	No of Shareholders	No of Shares	%
Individuals	3,985	18,524,700	10.97	3,904	17,483,158	10.41
Institutions	233	150,321,910	89.03	216	150,514,952	89.59
Total	4,218	168,846,610	100.00	4,120	167,998,110	100.00

As at 31st December 2008, the average size of holding of ordinary shareholding was 40,776 voting shares. (31st December 2007 - 40,030 voting shares)

As per the Rule No. 8.7 (h) of the Colombo Stock Exchange, the percentage of public holding as at 31st December 2008 was 52 approximately.

# Share & Debenture Information

## SHARE INFORMATION - NON VOTING

There were 11,920 registered non voting Shareholders as at 31st December 2008 (2007 - 12,469) distributed as follows:

	Resident			Non-Resident			Total		
	No of Share-holders	No of Shares	%	No of Share-holders	No of Shares	%	No of Share-holders	No of Shares	%
1 - 1,000	7,315	2,486,671	5.79	47	19,748	0.61	7,362	2,506,419	5.43
1,001 - 5,000	3,606	7,834,578	18.24	38	102,920	3.16	3,644	7,937,498	17.18
5,001 - 10,000	421	3,066,658	7.14	7	48,040	1.48	428	3,114,698	6.74
10,001 - 50,000	410	8,276,108	19.27	11	188,360	5.79	421	8,464,468	18.32
50,001 - 100,000	24	1,700,086	3.96	1	54,100	1.66	25	1,754,186	3.80
100,001 - 500,000	30	5,583,735	13.00	1	154,000	4.74	31	5,737,735	12.42
500,001 - 1,000,000	5	3,461,322	8.06	1	707,500	21.76	6	4,168,822	9.02
Over 1,000,000	2	10,538,874	24.54	1	1,977,300	60.80	3	12,516,174	27.09
<b>Total</b>	<b>11,813</b>	<b>42,948,032</b>	<b>100.00</b>	<b>107</b>	<b>3,251,968</b>	<b>100.00</b>	<b>11,920</b>	<b>46,200,000</b>	<b>100.00</b>

### Analysis of Shareholders Resident / Non-Resident

	31st December 2007			31st December 2008		
	No of Shareholders	No of Shares	%	No of Shareholders	No of Shares	%
Resident	12,357	44,632,040	96.61	11,813	42,948,032	92.96
Non-Resident	112	1,567,960	3.39	107	3,251,968	7.04
Total	12,469	46,200,000	100.00	11,920	46,200,000	100.00

### Individuals / Institutions

	31st December 2007			31st December 2008		
	No of Shareholders	No of Shares	%	No of Shareholders	No of Shares	%
Individuals	12,240	28,281,232	61.21	11,709	26,069,049	56.43
Institutions	229	17,918,768	38.79	211	20,130,951	43.57
Total	12,469	46,200,000	100.00	11,920	46,200,000	100.00

As at 31st December 2008, the average size of ordinary shareholding was 3,876 non voting shares. (31st December 2007 - 3,705 non voting shares)

As per the Rule No. 8.7 (h) of the Colombo Stock Exchange, the percentage of public holding as at 31st December 2008 was 95 approximately.

## 3. SHARE TRADING

	2007	2008
<b>Voting Shares</b>		
Number of transactions	4,370	1,942
Number of shares traded (Mn)	30.3	2.6
Rank (As per CSE)	18	119
Value of shares traded (Rs Mn)	3,309.8	287.6
Rank (As per CSE)	5	47
<b>Non-Voting Shares</b>		
Number of transactions	17,669	6,691
Number of shares traded (Mn)	18.2	7.7
Value of shares traded (Rs Mn)	1,126.4	387.4



#### 4. DIVIDENDS

	2007	2008
Interim (Rs)	-	1.00 Paid in December 2008
Final (Rs)	3.50 Paid in April 2008	3.00 Proposed to be paid in April 2009

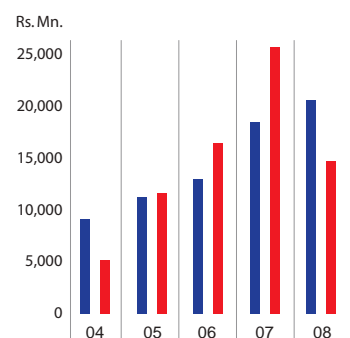
#### 5. EARNINGS

	2007	2008
Earnings Per Share (Rs)	12.83	13.67
Price Earnings Ratio (Times)	9.55	5.10

#### 6. MARKET VALUE

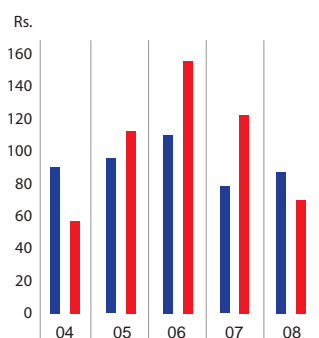
	Highest Rs	Lowest Rs	Year End Rs
2004 - Voting	80.00	50.25	57.00
- Non Voting	47.00	30.00	32.75
2005 - Voting	148.00	51.75	112.50
- Non Voting	65.75	32.25	41.50
2006 - Voting	161.00	100.00	155.75
- Non Voting	74.25	39.00	70.00
2007 - Voting	225.00	90.00	122.50
- Non Voting	120.00	35.00	53.25
<b>2008 - Voting</b>	<b>135.00</b>	<b>65.00</b>	<b>69.75</b>
<b>- Non Voting</b>	<b>57.50</b>	<b>31.00</b>	<b>32.00</b>

Shareholders' Funds & Market Capitalisation



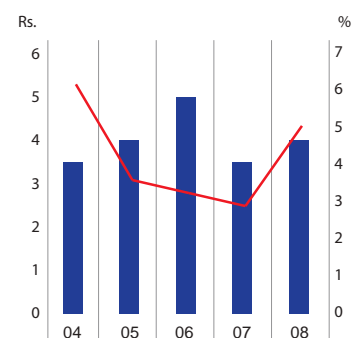
■ Shareholders' Funds  
■ Market Capitalisation

Net Assets per Share & Market Value per Share



■ Net Assets per Share  
■ Market Value per Share (Voting)

Dividend per Share & Dividend Yield



■ Dividend per Share  
— Dividend Yield (%)

#### 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	Market Capitalisation Ranking
2004	9,052	5,146	382,065	1.35	20
2005	11,239	11,608	584,040	1.99	10
2006	12,930	16,361	834,763	1.95	10
2007	18,419	25,653	820,652	3.13	6
<b>2008</b>	<b>20,581</b>	<b>14,684</b>	<b>488,813</b>	<b>3.00</b>	<b>7</b>

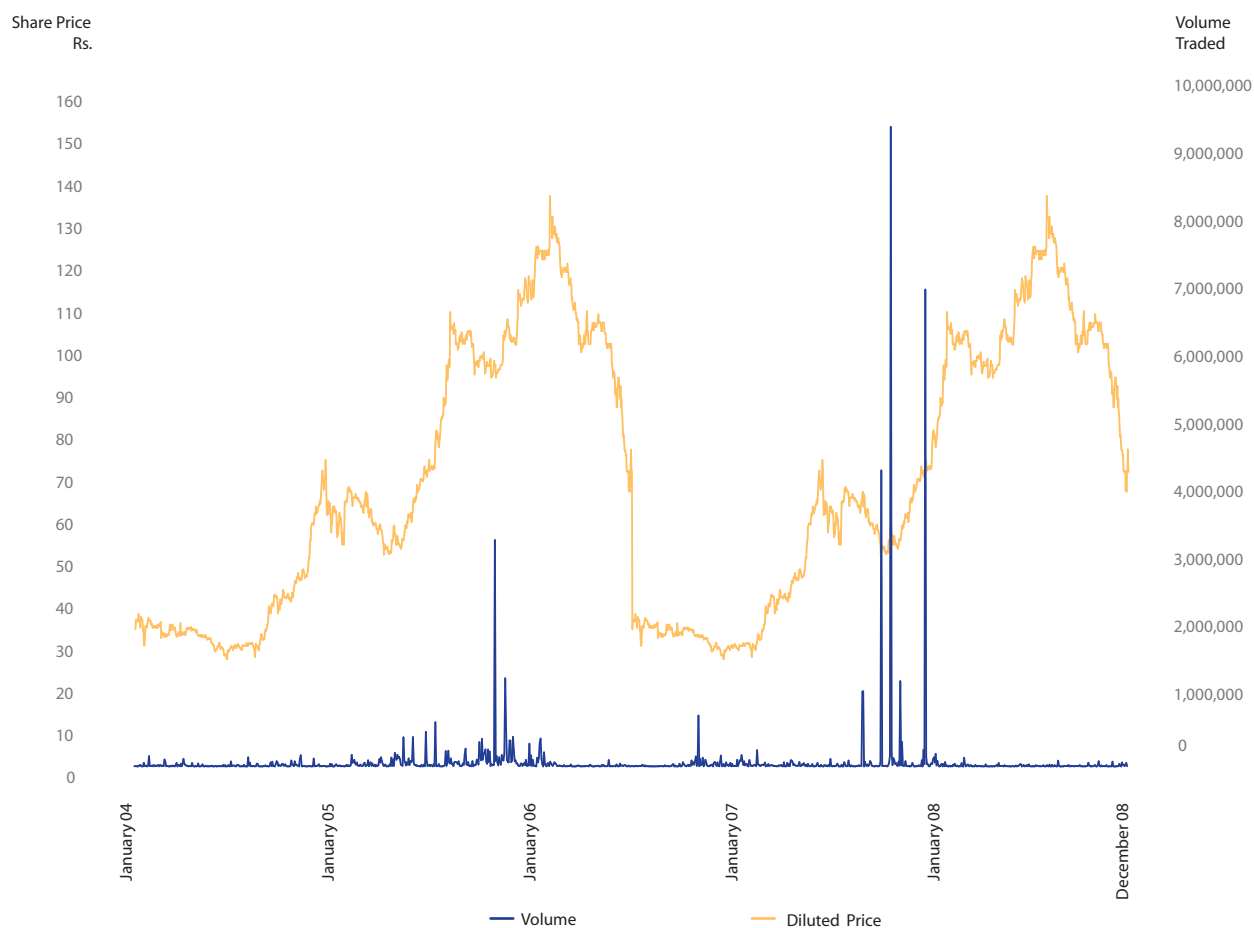
\* HNB Market Capitalisation includes both Voting & Non Voting shares

# Share & Debenture Information

## 8. RECORD OF SCRIP ISSUES

Year	Issue	Basis	No. of Shares	Increase in Share Capital (Rs)	Share Capital (Rs)
	Prior to public issue		50,000	500,000	500,000
1971	Public issue		220,000	2,200,000	2,700,000
1977	Rights issue (@ Rs10/-)	42:50	230,000	2,300,000	5,000,000
1980	Rights issue (@ Rs10/-)	1:1	500,000	5,000,000	10,000,000
1982	Bonus	1:1	1,000,000	10,000,000	20,000,000
1988	Bonus	1:1	2,000,000	20,000,000	40,000,000
1990	Bonus	1:2	2,000,000	20,000,000	60,000,000
1993	Bonus	1:1	6,000,000	60,000,000	120,000,000
1996	Bonus	2:3	8,000,000	80,000,000	200,000,000
1998	Bonus	1:2	10,000,000	100,000,000	300,000,000
1999	Bonus	2:3	20,000,000	200,000,000	500,000,000
1999	Rights (non voting @ Rs70/-)	3:10	15,000,000	150,000,000	650,000,000
2001	Bonus	1:10	6,500,000	65,000,000	715,000,000
2004	Rights (voting @ Rs55/-)	2:5	22,000,000	220,000,000	935,000,000
2004	Rights (non voting @ Rs33/-)	2:5	6,600,000	66,000,000	1,001,000,000
2005	Issue of underlying shares for GDR	-	17,664,700	176,647,000	1,177,647,000
2007	Bonus	1:1	117,764,700	1,177,647,000	2,355,294,000
	<b>Total</b>		<b>235,529,400</b>	<b>2,355,294,000</b>	

## 9. PRICE VOLUME CHART



## 20 MAJOR VOTING SHAREHOLDERS - 31ST DECEMBER

Name	2007 No. of Shares	2008	
		No. of Shares	% on Total Capital
1 Deutsche Bank Trust Company Americas	35,329,400	<b>35,329,400</b>	15.00
2 Brown and Company Limited	17,158,690	<b>17,158,690</b>	7.29
3 CBD Exports Limited	15,384,600	<b>15,384,600</b>	6.53
4 Milford Exports (Ceylon) Limited	15,373,050	<b>15,373,050</b>	6.53
5 Stassen Exports Limited	13,324,850	<b>13,324,850</b>	5.66
6 Panchalingam Associates (Pvt) Limited	12,232,942	<b>12,232,942</b>	5.19
7 Sri Lanka Insurance Corporation Limited (Life fund)	11,499,132	<b>11,533,832</b>	4.90
8 Standard Finance Limited	11,240,720	<b>11,240,720</b>	4.77
9 Sonetto Holdings Limited	8,445,206	<b>8,445,206</b>	3.59
10 Distilleries Company of Sri Lanka Limited	5,961,708	<b>5,961,708</b>	2.53
11 Mr Sinnathamby Visuvanathan	897,664	<b>897,664</b>	0.38
12 Employees Trust Fund Board	115,246	<b>427,146</b>	0.18
13 Freudenberg Shipping Agencies Limited	255,800	<b>348,700</b>	0.15
14 Mrs Pushpa Narhari Bhatt	* 344,960	<b>344,960</b>	0.15
15 Ms Ponweera Arachchige Pemawathie	336,788	<b>336,788</b>	0.14
16 Mr Somapala Bope Hewage (Estate)	322,200	<b>322,200</b>	0.14
17 N Vaitilingam & Company Limited	220,000	<b>310,500</b>	0.13
18 Mr Ajith Lasantha Devasurendra	311,100	<b>297,100</b>	0.13
19 Eagle Insurance Company Limited - A/c No.3	253,200	<b>238,200</b>	0.10
20 Mr Mohamed Junaid Mohamed Zarook	204,432	<b>204,432</b>	0.09
Sub Total	149,211,688	<b>149,712,688</b>	63.56
** Unregistered Shares	20,482,790	<b>21,331,290</b>	9.06
Balance held by 4,100 Voting Shareholders	19,634,922	<b>18,285,422</b>	7.76
Total Voting Shares	189,329,400	<b>189,329,400</b>	80.38
Shares held by 11,920 Non Voting Shareholders	46,200,000	<b>46,200,000</b>	19.62
Total No. of Ordinary Shares	235,529,400	<b>235,529,400</b>	100.00

\* Transfer (by inheritance) was pending

\*\* Approximately 21,331,290 shares purchased by some foreign investors during the period October 2007 – February 2008, through the Central Depository Systems (Pvt) Ltd of the Colombo Stock Exchange, were still pending registration. The Bank was awaiting sufficient information/documents, in order to satisfy that the investments conformed to the provisions of the Banking Act/regulations thereunder and other statutory provisions prior to registering and recognising the investors as shareholders. That was to ensure that the Bank does not become a party to any violation of statutory obligations.

## 20 MAJOR NON-VOTING SHAREHOLDERS - 31ST DECEMBER

Name	2007 No. of Shares	2008	
		No. of Shares	% on Total Capital
1 Legalinc Trustee Services (Pvt) Limited	9,133,274	<b>9,133,274</b>	3.88%
2 Bank of New York - Bear Stearns Securities Corporation	-	<b>1,977,300</b>	0.84%
3 Nawaloka Developments (Pvt) Limited	1,405,600	<b>1,405,600</b>	0.60%
4 Mr Weerahennedige Kingsley Valentine Mazonod Fernando & Mrs Kurukulasuriya Weerasinghe Shirani Helen Fernando	876,400	<b>816,900</b>	0.35%
5 DFCC Bank A/c 1	797,600	<b>797,600</b>	0.34%
6 Mellon-Frontaura Global Frontier Fund LLC	-	<b>707,500</b>	0.30%
7 Distilleries Company of Sri Lanka Limited	675,132	<b>675,132</b>	0.29%
8 Employees Trust Fund Board - Standard Chartered Bank	353,880	<b>633,930</b>	0.27%
9 Mr Dickowita Kankanamege Weeratunga	537,760	<b>537,760</b>	0.23%
10 Mr Sinnathamby Visuvanathan	440,000	<b>440,000</b>	0.19%
11 Hatton National Bank Limited - A/c No.2	338,638	<b>338,638</b>	0.14%
12 M C A Trading Company (Pvt) Limited	330,000	<b>330,000</b>	0.14%
13 Miss Shanika Antoinette Fernando	319,700	<b>312,700</b>	0.13%
14 Ceylon Grain Elevators Limited	275,000	<b>275,000</b>	0.12%
15 Bank of Ceylon A/c Ceybank Century Growth Fund	55,000	<b>258,900</b>	0.11%
16 Miss Weerahennedige Niroshika Celestine Fernando	254,800	<b>254,200</b>	0.11%
17 Mr Duleep Fairlie George Dalpethado	184,263	<b>252,999</b>	0.11%
18 Lanka Synthetic Fibre Company Limited	220,000	<b>220,000</b>	0.09%
19 Sri Lanka Insurance Corporation Limited - General Fund	202,994	<b>202,994</b>	0.09%
20 Wayamba Cooperative Rural Banks Union Limited	195,000	<b>195,000</b>	0.08%
Sub Total	16,595,041	<b>19,765,427</b>	8.39%
Balance held by 11,900 Non Voting Shareholders	29,604,959	<b>26,434,573</b>	11.22%
Total No. of Non Voting Ordinary Shares	46,200,000	<b>46,200,000</b>	19.62%
Balance held by 4,120 Voting Shareholders	168,846,610	<b>167,998,110</b>	71.33%
Unregistered Shares	20,482,790	<b>21,331,290</b>	9.06%
Total Voting Shares	189,329,400	<b>189,329,400</b>	80.38%
Total No. of Ordinary Shares	235,529,400	<b>235,529,400</b>	100.00%

# Share & Debenture Information

## HNB DEBENTURES 2002

### i) Market Value

12 months ended 31st December

These debentures have not traded for the period ended 31st December 2008

### ii) Interest Income

12 months ended 31st December

	2007		2008	
	Coupon Interest	Yield of comparable Govt. Security	Coupon Interest	Yield of comparable Govt. Security
7 year Fixed Rate (14.00% p.a.)	14.00	18.30	<b>14.00</b>	<b>18.75</b>
7 year Floating Rate (TB + 1.10% p.a.)*	17.00	18.30	<b>17.00</b>	<b>18.75</b>
10 year Fixed Rate (14.20% p.a.)	14.20	16.90	<b>14.20</b>	<b>19.61</b>
10 year Floating Rate (TB +1.25% p.a.)*	17.00	16.90	<b>17.00</b>	<b>19.61</b>

\* The floating rate debentures have a cap of 17.00% p.a. and a floor of 12.00% p.a.

For an investment of Rs. 100/-. The above rupee coupon interest rates are applicable for the next interest payment due on the 15th of February 2009.

## HNB DEBENTURES 2006

### i) Market Value

12 months ended 31st December

These debentures have not traded for the period ended 31st December 2008

### ii) Interest Income

12 months ended 31st December

	2007		2008	
	Coupon Interest	Yield of comparable Govt. Security	Coupon Interest	Yield of comparable Govt. Security
6 year Floating Rate (TB + 2.25% p.a.) *	16.00	16.90	<b>16.00</b>	<b>19.61</b>
7 year Floating Rate (TB + 2.25% p.a.) *	16.00	17.44	<b>16.00</b>	<b>18.34</b>
8 year Floating Rate (TB + 2.25% p.a.) *	16.00	17.63	<b>16.00</b>	<b>17.65</b>
15 year Fixed Rate (11.00% p.a.)	11.00	N/T	<b>11.00</b>	<b>N/T</b>
18 year Fixed Rate (11.25% p.a.)	11.25	N/T	<b>11.25</b>	<b>16.78</b>

\* The floating rate debentures have a cap of 16.00% p.a. and a floor of 8.00% p.a.

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

For an investment of Rs 100/-. The above rupee coupon interest rates are applicable for the next interest payment due on the 30th of June 2009.

## HNB DEBENTURES 2007

### i) Market Value

12 months ended 31st December

These debentures have not traded for the period ended 31st December 2008

### ii) Interest Income

12 months ended 31st December

	2007		2008	
	Coupon Interest	Yield of comparable Govt. Security	Coupon Interest	Yield of comparable Govt. Security
10 year Fixed Rate (16.00% p.a.)	16.00	17.63	16.00	17.18
15 year Floating Rate (16.75% p.a.)	16.75	N/T	16.75	16.78
N/T – Not Traded for the period ended 31st December				

For an investment of Rs. 100/-. The above rupee coupon interest rates are applicable for the next interest payment due on the 30th of June 2009.

## HNB DEBENTURES 2008

### i) Market Value

12 months ended 31st December

These debentures were not listed as at 31st December 2008

### ii) Interest Income

12 months ended 31st December

	2007		2008	
	Coupon Interest	Yield of comparable Govt. Security	Coupon Interest	Yield of comparable Govt. Security
5 year Floating Rate (TB + 1.00% p.a.)	N/A	N/A	19.45	18.38
7 year Floating Rate (TB + 1.25% p.a.)	N/A	N/A	19.70	17.65
10 year Floating Rate (TB + 1.50% p.a.)	N/A	N/A	19.95	16.49
10 year Fixed Rate (16.00% p.a.)	N/A	N/A	16.00	16.49
15 year Fixed Rate (16.75% p.a.)	N/A	N/A	16.75	16.78

For an investment of Rs. 100/-. The above rupee coupon interest rates are applicable for the next interest payment due on the 30th of June 2009.

Ratios	2007	2008
Debentures to Equity Ratio (%)	25	13
Debenture Interest Cover (times)	7.14	9.28

# Glossary of Financial / Banking Terms

## **ACCRUAL BASIS**

Recognising the effects of transactions and other events when they occur without waiting for receipt or payment of cash or cash equivalent.

## **ASSOCIATE**

An associate is an entity, including an unincorporated entity such as a partnership, over which the investor has significant influence and that is neither a subsidiary nor an interest in a joint venture.

## **BIS SURPLUS**

The total Capital Adequacy in excess of the minimum stipulated by Basel International Standards and as modified to suit local requirements by the Central Bank of Sri Lanka.

## **CAPITAL ADEQUACY RATIO**

The percentage of risk-adjusted assets supported by capital as defined under the framework of risk-based capital standards developed by the Bank for International Settlements (BIS) and as modified to suit local requirements by the Central Bank of Sri Lanka.

## **CAPITAL RESERVE**

Capital Reserves consist of revaluation reserves arising from revaluation of properties owned by the Bank and Reserve Fund set aside for specific purposes defined under the Banking Act, No. 30 of 1988 and shall not be reduced or impaired without the approval of the Monetary Board.

## **CASH EQUIVALENTS**

Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

## **COMMITMENT TO EXTEND CREDIT**

Credit facilities available to clients either in the form of loans, bankers' acceptances and other, on-balance sheet financing, or through off-balance sheet products such as guarantees and letters of credit.

## **CONTINGENT LIABILITIES**

Conditions or situations at the balance sheet date, the financial effect of which are to be determined by the future events which may or may not occur.

## **COST INCOME RATIO**

Operating expenses as a percentage of net income.

## **COST METHOD**

Cost method is a method of accounting for an investment whereby the investment is recognised at cost. The investor recognises income from the investment only to the extent that the investor receives distributions from accumulated profits of the investee arising after the date of acquisition. Distributions received in excess of such profits are regarded as a recovery of investment and are recognised as a reduction of the cost of the investment.

## **COST-PUSH INFLATION**

A continuous increase in average price levels due to an increase in production costs.

## **DEFERRED TAX**

Sum set aside in the financial statements for taxation that may become payable in a financial year other than the current financial year.

## **DIVIDEND COVER**

Profit after tax divided by gross dividends. This ratio measures the number of times dividend is covered by the current year's distributable profits.

## **DIVIDEND YIELD**

Dividend earned per share as a percentage of its market value.

## **DOCUMENTARY LETTERS OF CREDIT (L/C's)**

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.

## **EARNINGS PER SHARE (EPS)**

Profit attributable to ordinary shareholders, divided by the number of ordinary shares in issue.

## **EFFECTIVE TAX RATE**

Provision for taxation excluding deferred taxation divided by the profit before tax.

## **EQUITY METHOD**

The equity method is a method of accounting whereby the investment is initially recognised at cost and adjusted thereafter for the post-acquisition changes in the investor's share of net assets of the investee. The profit or loss of the investor includes the investor's share of the profit or loss of the investee.

## **FAIR VALUE**

Fair Value is the amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction.

## **FOREIGN EXCHANGE INCOME**

The realised gain recorded when assets or liabilities denominated in foreign currencies are translated into Sri Lankan Rupees on the balance sheet date at prevailing rates which differ from those rates in force at inception or on the previous balance sheet date. Foreign exchange income also arises from trading in foreign currencies.

## **GENERAL PROVISIONS**

General provisions are established for leasing transactions, housing loans, pawning advances and others for anticipated losses on aggregate exposures where credit losses cannot yet be determined on an individual facility basis.

## **GROSS DIVIDENDS**

The portion of profit inclusive of tax withheld distributed to shareholders.

## **GROUP**

A group is a parent and all its subsidiaries.

## **GUARANTEES**

Primarily represent irrevocable assurances that a bank will make payments in the event that its customer cannot meet his / her financial obligations to third parties. Certain other guarantees represent non-financial undertakings such as bid and performance bonds.

## **IMPAIRMENT**

This occurs when recoverable amount of an asset is less than its carrying amount.

## **INTANGIBLE ASSET**

An identifiable non-monetary asset without physical substance held for use in the production / supply of goods / services or for rental to others or for administrative purposes.

## **INTEREST MARGIN**

Net interest income as a percentage of average interest earning assets.

## **INTEREST SPREAD**

This represents the difference between the average interest rate earned and the average interest rate paid on funds.

### **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.

### **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.

### **LIQUID ASSETS**

Assets that are held in cash or in a form that can be converted to cash readily, such as deposits with other banks, bills of exchange and treasury bills.

### **LOAN LOSS PROVISION**

Please refer Provision for Bad and Doubtful Debts below.

### **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.

### **NET ASSET VALUE PER SHARE**

Shareholders' Funds divided by the number of ordinary shares in issue.

### **NET-INTEREST INCOME**

The difference between what a bank earns on assets such as loans and securities and what it pays on liabilities such as deposits, refinance funds and inter-bank borrowings.

### **NON-PERFORMING ADVANCES**

All loans are classified as non-performing when a payment is 90 days in arrears.

### **NON-PERFORMING ADVANCES COVER (NPA COVER)**

Cumulative loan provision as a percentage of total Non-Performing Advances (net of Interest in Suspense).

### **NPA RATIO**

Total non-performing advances (net of Interest in Suspense) divided by total advances portfolio (net of Interest in Suspense).

### **OPERATIONAL RISK**

This refers to the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events.

### **PARENT**

A parent is an entity that has one or more subsidiaries.

### **PRICE EARNINGS RATIO (P/E RATIO)**

Market price of an ordinary share divided by earnings per share (EPS).

### **PROVISION FOR BAD AND DOUBTFUL DEBTS**

A charge to income which is added to the allowance for loan losses. Specific provisions are established to reduce the book value of specific assets (primarily loans) to estimated realisable values.

### **RETURN ON AVERAGE ASSETS (ROA)**

Net income expressed as a percentage of average total assets, used along with ROE, as a measure of profitability and as a basis of intra-industry performance comparison.

### **RETURN ON AVERAGE EQUITY (ROE)**

Net income, less preferred share dividends if any, expressed as a percentage of average ordinary shareholders' equity.

### **REVENUE RESERVE**

Reserves set aside for future distribution and investment.

### **REPURCHASE AGREEMENT**

This is a Contract to sell and subsequently repurchase government securities at a given price on a specified future date.

### **REVERSE REPURCHASE AGREEMENT**

Transaction involving the purchase of government securities by a bank or dealer and resale back to the seller at a given price on a specific future date.

### **RISK-ADJUSTED ASSETS**

Used in the calculation of risk-based capital ratios. The face amount of lower risk assets is discounted using risk weighting factors in order to reflect a comparable risk per rupee among all types of assets. The risk inherent in off-balance sheet instruments is also recognised, first by adjusting notional values to balance sheet (or credit) equivalents and then by applying appropriate risk weighting factors.

### **RIGHTS ISSUE**

Issue of shares to the existing shareholders at an agreed price, generally lower than market price.

### **SEGMENT REPORTING**

Segment reporting indicates the contribution to the revenue derived from business segments such as banking operations, leasing operations, stock broking & securities dealings, property and insurance.

### **SHARE PREMIUM**

Amount paid by a shareholder, over and above the par value of a share.

### **SHAREHOLDERS' FUNDS**

Shareholders' funds consist of issued and fully paid ordinary share capital plus capital and revenue reserves.

### **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.

### **TIER 1 CAPITAL**

Consists of the sum total of paid up ordinary shares, non cumulative, non redeemable preference shares, share premium, statutory reserve fund, published retained profits, general and other reserves, less goodwill.

### **TIER 2 CAPITAL**

Consists of the sum total of revaluation reserves, general provisions, hybrid capital instruments and approved subordinated debentures.

### **TOTAL CAPITAL**

Total Capital is the sum of Tier 1 Capital and Tier 2 Capital.

### **VALUE ADDED**

Value added is the wealth created by providing banking services less the cost of providing such services. The value added is allocated among the employees, the providers of capital, to government by way of taxes and retained for expansion and growth.

# Notice of Meeting

Notice is hereby given that the Fortieth (40th) Annual General Meeting of the Hatton National Bank PLC is convened on Tuesday the Thirty First (31st) of March 2009 at the Auditorium on Level 22 of "HNB Towers" at No. 479, T B Jayah Mawatha, Colombo 10, at 10.00 in the forenoon when the following Ordinary Business will be transacted.

To receive and consider the Annual Report of the Board of Directors along with the Financial Statements of the Company for the year ended 31st December 2008, the Auditors' Report thereon.

To declare a final dividend of Rs 3.00/- per share as recommended by the Directors to the shareholders.

To re-appoint Mr M V Theagarajah a Director of the Company and to adopt the following resolution :-

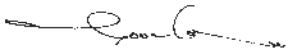
## RESOLUTION

"That Mr Manickam Vallipuram Theagarajah who has attained the age of 70 years on 13th October 2001, be and is hereby re-appointed a Director of the Company and it is hereby declared that the age limit of 70 years referred to in Section 210 of the Companies Act, No. 7 of 2007, shall not apply to the said Director".

To re-appoint the Auditors for the ensuing year and to authorise the Directors to fix their remuneration.

To authorise the Directors to determine payments for the year 2009 for charitable and other purposes set out in the Companies Donations Act (Cap. 147).

By Order Of The Board



**Indrani Goonesekera**  
DGM (LEGAL) / Board Secretary

Colombo, Sri Lanka.  
13th February 2009

## Notes :

1. A member entitled to attend or attend and vote at the meeting is entitled to appoint a proxy to attend or attend and vote as the case may be, in his stead.
2. A proxy need not be a member of the Company. The Form of Proxy is enclosed.
3. The completed Form of Proxy should be deposited with the Board Secretary at the Registered Office of the Company at No: 479, T B Jayah Mawatha, Colombo 10, not less than 48 hours before the time appointed for holding the meeting.



# Form of Proxy (Voting)

I/We ..... of ..... being a member / members of the Hatton National Bank PLC, hereby appoint Rienzie Theobald Wijetilleke or failing him Rajendra Theagarajah or failing him Don Harold Stassen Jayawardena or failing him Manickam Vallipuram Theagarajah or failing him Rajpal Kumar Obeyesekere or failing him Pamela Christine Cooray or failing her Ranjeevan Seevaratnam or failing him ..... of ..... as my/our proxy, to represent me / us to ..... and to vote for me/us on my/our behalf at the Fortieth (40th) Annual General Meeting of the Company to be held at the Auditorium on Level 22 of "HNB Towers" at No. 479, T B Jayah Mawatha, Colombo 10 on the 31st day of March, 2009 at 10.00 in the forenoon and at any adjournment thereof and at every poll which may be taken in consequence thereof to vote :

To declare a dividend of Rs 3.00 per share	In favour	
	Against	
To re-appoint Mr M V Theagarajah, a Director of the Company	In favour	
	Against	
To re-appoint Auditors for the ensuing year/authorise the Directors to fix their remuneration.	In favour	
	Against	
To authorise the Directors to determine payments for charitable and other purposes	In favour	
	Against	

Mark your preference with "✓"

Signed this ..... day ..... 2009.

Signature/s .....

.....

Please provide the details :	
Shareholder's NIC No. / Company Registration No.	.....
Folio No. / Number of Shares held	.....
Proxy holder's NIC No. (if not a Director)	.....

**Note – See reverse hereof for instructions to complete the proxy**

# Form of Proxy (Voting)

## INSTRUCTIONS TO COMPLETE PROXY

1. The full name and the registered address of the shareholder appointing the proxy should be legibly entered in the Form of Proxy, duly signed and dated.
2. The completed Proxy should be deposited with the Board Secretary, at the Registered Office of the Company at No: 479, T B Jayah Mawatha, Colombo 10, not less than 48 hours before the time appointed for holding the Meeting.
3. The Proxy shall -
  - (a) in the case of an individual be signed by the shareholder or by his attorney, and if signed by an attorney, a notarially certified copy of the Power of Attorney should be attached to the completed Proxy if it has not already been registered with the Company.
  - (b) in the case of a company or corporate body, either be under its Common Seal or signed by its attorney or by an officer on behalf of the Company or corporate body in accordance with the Articles of Association or the Constitution of that Company or corporate body.

The Company may, but shall not be bound to, require evidence of the authority of any such attorney or officer.
  - (c) in the case of joint-holders, the first joint-holder has the power to sign the proxy without the concurrence of the other joint-holder/s.
4. Every alteration or addition to the Proxy must be duly authenticated by the full signature of the shareholder, signing the Proxy. Such signature should as far as possible be placed in proximity to the alteration or addition intended to be authenticated.

# Form of Proxy (Non-Voting)

I/We ..... of  
..... being a  
member / members of the Hatton National Bank PLC, hereby appoint, Rienzie Theobald Wijetilleke or failing him Rajendra Theagarajah  
or failing him Don Harold Stassen Jayawardena or failing him Manickam Vallipuram Theagarajah or failing him Rajpal Kumar Obeyesekere  
or failing him Pamela Christine Cooray, or failing her Ranjeevan Seevaratnam or failing him .....  
..... of  
..... as my / our proxy,  
to represent me / us at the Fortieth (40th) Annual General Meeting of the Company to be held at the Auditorium on Level 22 of “HNB  
Towers” at No. 479, T B Jayah Mawatha, Colombo 10 on the 31st day of March, 2009 at 10.00 in the forenoon and at any adjournment  
thereof:

Signed this ..... day ..... 2009.

Signature/s .....

.....

Please provide the details :

Shareholder's NIC No. / Company Registration No. ....

Folio No. / Number of Shares held .....

Proxy holder's NIC No. (if not a Director) .....

**Note – See reverse hereof for instructions to complete the proxy**

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  - (b) in the case of a company or corporate body, either be under its Common Seal or signed by its attorney or by an officer on behalf of the Company or corporate body in accordance with the Articles of Association or the Constitution of that Company or corporate body.

The Company may, but shall not be bound to, require evidence of the authority of any such attorney or officer.
  - (c) in the case of joint-holders, the first joint-holder has the power to sign the proxy without the concurrence of the other joint-holder/s.
4. Every alteration or addition to the Proxy must be duly authenticated by the full signature of the shareholder, signing the Proxy. Such signature should as far as possible be placed in proximity to the alteration or addition intended to be authenticated.

# Investor Feedback Form

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

Chief Financial Officer,  
Hatton National Bank Limited,  
No. 479, T.B. Jayah Mawatha (Darley Road)  
Colombo 10.  
Sri Lanka  
Email : nihalke@hnb.lk

Name : \_\_\_\_\_

Permanent Mailing Address : \_\_\_\_\_  
\_\_\_\_\_

Contact Numbers - (Tel) : \_\_\_\_\_

Country Code    Area Code    Number

- (Fax) : \_\_\_\_\_

Country Code    Area Code    Number

E-mail : \_\_\_\_\_

Name of Company : \_\_\_\_\_

(If Applicable)

Designation : \_\_\_\_\_

(If Applicable)

Company Address : \_\_\_\_\_

(If Applicable)

Queries/Comments

Please tick (✓) the appropriate box

Would you like to receive soft copies of the HNB annual and interim reports via e-mail?

Yes    No

Would you like to receive news and press releases of HNB via e-mail?

Would you like to receive any information on our products / services?



# CORPORATE INFORMATION

## NAME OF COMPANY

HATTON NATIONAL BANK PLC

## LEGAL FORM

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

## COMPANY REGISTRATION NUMBER

PQ 82 [previous PBS 613]

## STOCK EXCHANGE LISTING

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

## REGISTERED OFFICE

No. 479, T B Jayah Mawatha (Darley Road),  
P O Box 837, Colombo 10, SRI LANKA

## HEAD OFFICE

“HNB Towers”,

No. 479, T B Jayah Mawatha (Darley Road),  
P O Box 837, Colombo 10, SRI LANKA

Cable Address: HATNABANK

Telephone Nos. 2664664, 2662772, 4764764

Fax Nos. 2662814, 2662832 International-2446523

Telex Nos. 21259 Hatnbc Ce, 2166 Haynfx Ce

Swift : Bic Code - HBLILKLX

Email : [moreinfo@hnb.net](mailto:moreinfo@hnb.net)

Web : [www.hnb.net](http://www.hnb.net)

## BOARD OF DIRECTORS

Mr Rienzie T. Wijetilleke (Chairman)

Mr Rajendra Theagarajah (Managing Director / CEO)

Mr D H S Jayawardena

Mr M V Theagarajah

Mr R K Obeyesekere

Ms Pamela C. Cooray

Mr Ranjeevan Seevaratnam

## BOARD SECRETARY

Ms Indrani Goonesekera

Attorney-at-Law & Notary Public

## AUDIT COMMITTEE

Mr Ranjeevan Seevaratnam (Chairman)

Mr D H S Jayawardena

Ms Pamela C. Cooray

## AUDITORS

KPMG Ford, Rhodes, Thornton & Co.,  
Chartered Accountants

No. 32A, Sir Mohamed Macan Markar Mawatha,  
Colombo 3,  
SRI LANKA

## CREDIT RATINGS

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

## ASSOCIATE COMPANIES

Browns Engineering (Pvt) Ltd 32.63%  
*Construction & Engineering*

Lanka Ventures Ltd 20.07%  
*Venture Capital*

## JOINT VENTURE COMPANIES

Acuity Partners (Pvt) Ltd 50.00%  
*Financial Services*

## SUBSIDIARY COMPANIES

Sithma Development (Pvt) Ltd 100.00%  
*Property Development*

HNB Assurance PLC 60.00%  
*Insurance*

Majan Exchange LLC 40.00%  
*Remittances & Foreign Currency Exchange Services*

## INVESTOR INFORMATION

Institutional Investors, Stock Brokers and Security Analysts requiring financial information should contact the Chief Financial Officer at:

“HNB Towers”,

Level 16,

No. 479, T B Jayah Mawatha, (Darley Road),  
Colombo 10,  
SRI LANKA.

Telephone : 2662705, 2664705

Fax : 2662815

E-mail : [nihalke@hnb.lk](mailto:nihalke@hnb.lk)



# HNB

**HATTON NATIONAL BANK PLC**

“HNB Towers”,  
No. 479, T B Jayah Mawatha,  
(Darley Road),  
Colombo 10,  
Sri Lanka.

[www.hnb.net](http://www.hnb.net)