



Annual Report & Accounts
2005

Vision

To provide exceptional commercial banking services to our customers.

Mission

"Our mission is to meet the expectations as well as the general and selective needs of our customers by offering a range of innovative banking and financial products and services, finely tuned to the achievement of speed and efficiency by using the most modern technology."

"Our services will be delivered by a caring, committed and highly skilled professional team maintaining traditions and standards of excellence in their responses and practices thereby adding value to customers, employees, shareholders and society."



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Vardhana Bank

Chairman's Statement

During the year, DFCC Vardhana Bank's main focus has been the enhancement of business by a concentrated effort on mobilizing deposits and improving the volume as well as the quality of lending.



Dear Shareholder

It is my pleasure to present to you the Annual Report and Accounts of the DFCC Vardhana Bank (DVB). for the year ended 31st December, 2005.

For a country that started the year in the wake of the Tsunami, the worst ever disaster of its history and an unprecedented crisis in the oil market, a growth rate of 6% can be considered commendable. The inflow of foreign aid in the aftermath of the Tsunami, prudent monetary policy, favourable weather conditions, positive developments in international trade and increase in remittances were some of the main factors that helped the country to achieve this growth rate. These positive developments in the economy helped the Bank to sustain its growth momentum even beyond expectations.

The combined effect of the high growth rate in the advances portfolio, customer deposits, net interest income fee, income achieved by the Bank, enabled it to post a profit before tax of Rs 118 million and profit after tax of Rs 79 million during this year wiping out previous year's losses in full. Projected targets were satisfactorily achieved, reflecting the effectiveness of successful management strategies adopted. The excellent team work of dynamic and well trained staff is a major contributory factor to this success.

During the year, DVB's main focus has been the enhancement of business by a concentrated effort on mobilizing deposits and improving the volume as well as the quality of lending. The customers of our parent company, DFCC Bank now have easy access to the commercial banking services provided by Vardhana on account of many of our branches being located in the same premises. Although our initial target market has been the client base of DFCC Bank, it is apparent that the personalized and efficient services provided have attracted many new customers, as well.

The Bank continued with the expansion of its branch network and now has 13 branches, as a result of opening branches in Borella and Kaduruwela during the year.

With the migration to a common platform for the IT system for DVB and DFCC, we hope to maximize

on the advantages in terms of inter-connectivity between the two banks and the resultant swift delivery of services.

Fitch Rating Lanka Ltd has reaffirmed the Bank's AA – (sri) rating which denotes a continuation of the low expectation of credit risk and indicates the observation of the fundamental requirements of prudential banking. A more aggressive and proactive role was played by the Sub-Committees of the Board on issues relating to credit & compliance, audit and general good governance to ensure the maintenance of the high standards expected of a commercial bank.

Presently the paid-up capital of the Bank stands at Rs 884.071 million. In terms of capital requirement, a planned programme for the steady infusion of capital into the Bank to achieve the statutory requirement of Rs 2.5 billion in the year 2007 is underway. It is noteworthy that there is a degree of contradiction in policies being implemented raising capital requirements on the one hand thereby expecting further investment from shareholders and on the other hand introducing a more stringent tax regime on banks with the imposition of the highest tax slab which has a negative impact on potential investors.

I take this opportunity to thank Mr. Nihal Jinasena who resigned from the Board on 12th September 2005 for his valuable contribution to the Bank.

I wish to thank all our Customers and Shareholders for their continuing support and to express my gratitude to the officials of the Central Bank for their guidance, and acknowledge the valuable contribution made by fellow Board members, the Managing Director, Chief Operating Officer and all the employees, for the success of the Bank in 2005. We now look ahead to the future with confidence and determination to achieve the targets set for the year 2006.


J M S Brito
Chairman

22 March 2006

The unprecedented growth rates achieved make DVB the fastest growing bank not only among the small banks but within the entire commercial banking sector in Sri Lanka.

THE FASTEST GROWING BANK IN SRI LANKA

It is with great pleasure that I present the CEO's report for the 2005 Annual Report of DFCC Vardhana Bank (DVB). The year was characterised by the remarkable turnaround of DVB into a profitable and fast growing financial institution with robust performance indicators. Significantly, this was achieved only in the second full year of operations after being acquired by DFCC and rebranded as DFCC Vardhana Bank. A highlight of this performance is the material growth in all key areas of operations such as total assets, loans and advances, time and demand deposits, interest income, fee income, profit generation and above all shareholder funds. The unprecedented growth rates achieved make DVB the fastest growing bank not only among the small banks but in the entire commercial banking sector in Sri Lanka.

ASSET AND LIABILITY GROWTH

The income generating loans and advances as well as inter-bank placements grew from Rs 2.6 billion as at 31st December 2004 to Rs 4.9 billion as at 31st December 2005. This represents an expansion of these assets by Rs 2.29 billion or a proportionate

growth of 87% over the previous year. The growth of the deposit base has been equally large at 87.9% or an increase of Rs 2.4 billion from the end of 2004 to reach Rs 5 billion as at the end of 2005.

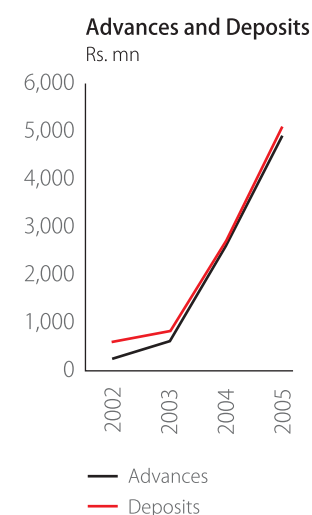
NET INTEREST INCOME

The net interest income earned during the year amounted to Rs 234 million. This represents an expansion of Rs 137 million or, in proportionate terms, a growth of 141% compared with the previous year. Evidently, this increase of the net income generation is well above the expansion of the asset portfolio and the outstanding customer deposit figure. This disproportionate increase in the net interest income was a result of the expanding business volume represented by the credit portfolio and inter-bank placements while maintaining the cost of funds mobilized at around 6.6%. Admittedly, the capital infusion of Rs 500 million received mainly from DFCC Bank also contributed to this remarkable achievement in the rate of income growth.

The table set out below depicts the underlying financial values that produced the growth rates of key operational areas discussed above.



Year Ended 31 Dec	2005 Rs. Millions	2004 Rs. Millions	CHANGE (%)
Net interest income	234.40	97.27	141
Interest income	556.81	224.97	148
Other income	117.62	61.04	93
Loans and advances	4,916.71	2,631.21	87
Deposits from customers	5,064.41	2,695.10	88
Shareholders funds	904.65	325.44	178
Operating expenses	233.49	182.28	28
Profit/loss for the year	79.21	-28.76	
Loan loss provision	9.10	-4.13	



CEO's Report contd.

The Bank has relationships with a large network of correspondent banks worldwide representing Sri Lanka's major trading partner countries in the world.

Clearly, the growth momentum represented by the above indicators is much above industry averages in the country. Albeit from a smaller base, this quantitative growth qualifies the DVB to be the fastest growing commercial bank in Sri Lanka.

TRADING INTERNATIONALLY

The Bank has relationships with a large network of correspondent banks worldwide representing Sri Lanka's major trading partner countries in the world. We are equipped to handle the trade finance business of a multitude of clients who have trade relationships with diverse countries and suppliers. We count some established and prominent corporate customers in our trade finance business portfolio. The trade finance business of the Bank showed a turnover of Rs 11 billion during the year. This is a sharp increase over the trade finance business volume of Rs. 2.2 billion recorded during the last year.

The number of LCs opened last year by import customers through us was 1,315 while the other import bills handled numbered 1,972. The number of LCs and import bills handled in the previous year was 752. This shows growing popularity of this business line with importers of the country. The Bank also needs large export volumes in order to operate a successful trade finance department and to effectively manage our foreign exchange exposures. Therefore, we would strive to claim a larger share of the export market, as well.

MANAGING THE COFFERS

The treasury continued to make gains supported by the growing trade finance volumes. The net foreign exchange gain rose to Rs. 40.8 million from the previous year's figure of Rs. 20.4 million contributing to the bottom line of the Bank significantly.

The Treasury department affirmed its market presence gaining recognition from the trading counterparties, which is evidenced by the enhanced accommodation given to us by banking institutions in the inter-bank market.

We would look at the coming year with greater expectations to enhance our presence in the foreign exchange market, to grow our trading volumes and to enhance the treasury contribution to the bottom line of the Bank.

MANAGEMENT OF OVERHEAD COSTS

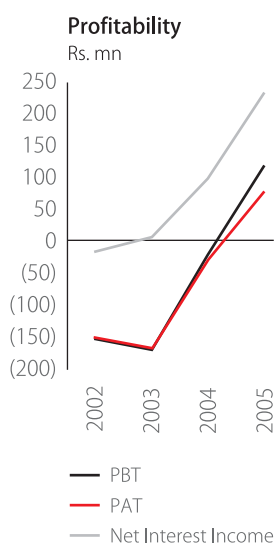
We have been particularly successful in containing expansion of the overhead costs while promoting a rapid growth of the balance sheet and income of the Bank. The operating expenses of the Bank grew by 28% even after allowing for a 38.6% increase of the personnel costs. This is significant in comparison with the growth of operating income by 122% during the year.

This curtailment of expenses was partly facilitated by sharing the physical infrastructure facilities of DFCC which led to a reduction of 18% in premises and establishment expenses. We attribute these efficiencies to synergistic advantages of operating in common with much mature DFCC and not to passing of any financial benefits. DFCC firmly subscribes to the principle of non-subsidisation of inter-company services and priced all such services overtly at market prices plus any VAT payable thereon. Needless to say, that this principle applies in the reverse direction as well. Similarly, DVB had the access to the group IT, marketing, treasury, human resources and administration capabilities under the centralised group services concept of DFCC Bank.

PROFITABILITY

DVB for the first time in its history ended a financial year with a profit in 2005. As compared to a loss of Rs 23.98 million made in 2004, the year under consideration ended with a profit before tax of Rs 118.53 million on which the income tax liability is Rs 39.32 million.

However, the most significant achievement of DVB is the net profit of Rs. 79.2 million recorded for the year ended 31st December 2005. This should be highlighted against the net loss of Rs. 28 million recorded in the preceding year and much larger





losses recorded consecutively in years before. This enabled the Bank to fully recoup the accumulated losses of Rs. 58.6 million brought forward from the previous year and also to have an operating surplus of Rs. 16.6 million on the balance sheet. As a result, there is no depletion of the paid up capital of the Bank as at present. Future operations will enable the Bank to grow the revenue reserves at an accelerated pace.

INFORMATION TECHNOLOGY INFRASTRUCTURE

The year under review saw the Bank going through major changes in the area of information technology (IT) adoption. One major task was the decision to change the core banking application which was in use for over five years. The Bank took a strategic decision to implement Net Symbols core banking modules from the software solutions supplier, Systems Access Ltd. The migration of the software application systems intensively involved efforts of most key IT and operational staff in implementation of the system. The Net Symbols system now adopted has a very high level of automation and straight through processing, thus minimizing manual intervention. The system is scheduled to be fully functional and in operation by early April 2006.

Another major task undertaken by IT was the relocation of the Head Office and ensuring availability of all systems subsequent to the relocation.

In addition, IT was also involved in providing connectivity to all new branches and the relocated branches to make banking seamlessly integrated to customers facilitating conduct of banking transactions from any of the branches. The ATM network which stood at six was expanded to eleven during the year under review.

Year 2006 has many activities lined up for enhancing reach of the bank-wide application of IT. These include the implementation of a software application to cover the trade services, commissioning of a disaster recovery site, putting in place a redundant wide area network (WAN) to back-up failures of the regular WAN and introduction of IP Telephony, to name a few.

DISTRIBUTION NETWORK

The main branch of the Bank previously located at the Duplication Road was moved to a more spacious and convenient location at W A D Ramanayake Mawatha, Colombo 2. The present location is adjacent to the Colombo Office of DFCC and offers more banking convenience to the common customers of both banks. Similarly, trade finance and import customers will now have ready access to the International Department situated at the same premises.

The Bank also added Kaduruwela and Borella branches to its network making the number of branches in operation thirteen. This network has a wide geographical reach to cover all major regions of the island. Also, network of V-Tell machines expanded to eleven which enable 24 hour banking to a large segment of the customers and keeps us on par with the competition. Improving accessibility of banking services to retail banking customers is high on our agenda for securing a larger share of the market. We hope to progressively expand our network of branches, service points and ATMs in the coming financial year as well.

CORPORATE GOVERNANCE

As a member of the DFCC Group, DVB is committed to the highest standards of business integrity, ethical values, regulatory compliance and corporate governance practices. In recognition of the need for stronger oversight of the Board over operations of the Bank, another independent director with proven track record in specialisations beneficial for the bank management was invited to assume Board membership. The Bank consistently recognised rights of the minority shareholders and retains a directorship to a representative member of the minority shareholder group. Other Board directors nominated by DFCC Bank represent specialist skills in functional management areas vital for management of the Bank.

The Bank also received a capital infusion of Rs. 500 million through a rights issue. This was to allow the Bank to be compliant with a directive of the Central Bank of Sri Lanka (CBSL) for commercial banks

As a member of the DFCC Group, DVB is committed to the highest standards of business integrity, ethical values, regulatory compliance and corporate governance practices.



CEO's Report contd.

The prudent and efficient management of assets shall yield trust and confidence among all stakeholders of the Bank.

to have capital resources not less than Rs 2,500 million by the year 2007. The DFCC Bank has given a commitment to make further capital contributions required for DVB to be in compliance with the CBSL directive before the prescribed dates.

The rating AA-(sri) assigned to us in September, 2004 by Fitch Ratings Lanka Ltd was affirmed again. AA- (sri) rating denotes very low expectation of credit risk. It indicates very strong capacity for timely payment of financial commitments which is not significantly vulnerable to foreseeable events. We may expect the Bank to have more sound rating as it improves the income and balance sheet ratios in the future. It is noteworthy that the credit rating assigned to DVB is higher than those assigned to some of the large and long established commercial banks in Sri Lanka.

The prudent and efficient management of assets shall yield trust and confidence among all stakeholders of the Bank. The Basle II capital requirements and risk management strategies shall be implemented by us as mandated by the Regulator, the CBSL. Although we have gained the trust, confidence and goodwill of our stakeholders, we shall continue to strengthen and build on this trust and confidence of all the stakeholder groups.

HUMAN RESOURCE MANAGEMENT

In an external environment characterised by consistent innovation and increasing competition, the internal operating dynamics of DVB have to continually evolve for the Bank to become a significant force in the financial services market. Towards this end, a pre-requisite is the availability of a pool of high quality human resources. Realising this need, the Bank made a conscious effort to attract the best talents the market has to offer. Having a dynamic and superior workforce is a key to steer the Bank towards achieving quite challenging goals the Bank has set for itself in the context of the fast evolving external business environment. This strategy saw the Bank recruiting 40 new staff members to fill perceived gaps in the manpower availability. The resulting total staff strength stands at 122 at the end of the year.

While recruiting employees with the required attributes is merely one facet of the process, developing, motivating and retaining them is more complex and demanding. Throughout the year, many initiatives were launched to train and develop the staff to adequately meet the demands of their respective jobs. Accordingly, 111 employees participated at 23 structured local training programmes conducted mostly by external training institutions. In addition, three managerial level staff participated in a management development programme conducted exclusively for management staff of DFCC and DVB by Jawaharlal Nehru Institute for Development Banking in Hyderabad, India.

During the year under review the Bank sourced a banking solution and this necessitated the setting up of a multi-disciplinary team to evaluate, customise and implement the application. It is noteworthy that DVB had the required human resources in-house to co-opt for this important project with minimum reliance on external consultants.

Overall revisions were effected to the staff remuneration package to align it closer to market rates in the banking sector. This also entailed increase of other perquisites such as travelling allowance and medical benefits. The focus of review was to increasingly link remuneration to individual and organizational performance rather than providing blanket salary adjustments. Aligned to this salary revision will be a performance based increment and bonus scheme which is in line with the remuneration policy of DFCC. This initiative will help create a strong performance oriented culture across the Bank.

Notwithstanding many initiatives introduced during FY 2005, there still remain further interventions to be made to bring the human capital of DVB on par with best HR practices in the financial sector. As such, human capital development will continue to be a main area of focus in the years to come.

CUSTOMER RELATIONS

In the highly competitive commercial banking sector, we recognise the customer banker relationship as



a key ingredient to success. We have to recognize that building trust and lasting relationships is not a function of advertising or marketing, but a function of superior service and constant delivery of best value to the customers. Thus we shall endeavour to reach out to our very discerning group of customers with a flexible product range and excellent service quality.

OUTLOOK

As stated in my review last year, in the extremely competitive environment of commercial banking, the smaller players will have to run more than twice as fast as the big players, even to maintain the market share. First and foremost, we shall not allow the spectacular performance achieved last year to lull us into a state of complacency.

We shall aggressively expand our branch and delivery network beyond DFCC's network in selected locations. In doing so, we shall prudently focus on the more lucrative mid segment of the market which could yield better margins. We will continue to innovate new products and venture into areas of banking hitherto unexplored by us.

The service network, telecommunication and IT infrastructure, efficient and capable staff, customer-oriented work ethics and efficient management of costs should lead us to greater success in the future.

We must not be oblivious to the fact that a quick start will not always guarantee victory in the final race. To sustain a reasonable growth we will have to run faster and work harder until we have built the critical mass that will produce a sustained growth in the years to come.

ACKNOWLEDGEMENTS

Like in any endeavour in life or business, this turnaround did not happen by chance. It was unmistakably the result of relentless effort level of our committed staff who took up the challenge to make DFCC Vardhana Bank a force to reckon with in the banking industry. I deeply appreciate the role performed by each and every member of our staff to

produce the turnaround of the Bank in such a short period of time. In this task, the support I received from the senior management team of the Bank, ably led by the Chief Operating Officer, Mr Lakshman Silva, was truly excellent.

I thank the Chairman and the Board of Directors for placing confidence in our team. The support I received from the Board for the managerial initiatives was a great encouragement to all of us. I constantly had ready access to the prudent counsel and advice of the Chairman Mr J M S Brito and CEO of DFCC Bank, Mr Nihal Fonseka, on all matters of significance. I am failing in my duty if I do not make special mention of Dr Nihal Jinaseena, who functioned as the Chairman of the Bank until September 2005 for the invaluable contribution he made to the process of transformation of the Bank at a crucial time. I extend my gratitude to the broad group of customers of the Bank for the trust and confidence they continue to place in the Bank.

L G Perera

Managing Director / Chief Executive Officer

22 March 2006



Board of Directors

Mr J. M. S. Brito - Chairman

LLB (Lond), FCA (UK), MBA (Lond)

Mr. Brito is currently the Chairman of DFCC Bank, Deputy Chairman and Managing Director of Aitken Spence Group of Companies, Non Executive Director of Sri Lanka Insurance Corporation.

Mr. L. G. Perera – Managing Director/Chief Executive Officer

MBA, B.Econ., Post.Grad.Dip. in Applied Social Statistics

Mr. S. Nagarajah - Director

FCA (SL), FCMA (UK), FCCA (UK)

Executive Vice President – Finance, DFCC Bank

Mr. J. H. D. B Abeyaratna - Director

ACA, CFA

Senior Vice President – Corporate Banking, DFCC Bank

Ms. R.A.P. Withana - Director

MBA, FCA, FCMA

Senior Vice President – Operations, DFCC Bank

Mrs. Y.N. Perera - Director

Chairperson, MMBL Group

Mr. J.A.R.E.M. Machado – Director

FCIB (Lond), FFA (Lond), FIEA (Lond), FI Com. (Lond)

DIP Journalism (SL), Banking Consultant

Mr. T. K. Bandaranayake – Director

BSc (Cey), FCA (SL)

Senior Partner – Ernst & Young



Management Team

L G Perera - Managing Director/Chief Executive Officer

L H A Lakshman Silva - Chief Operating Officer

Shanthi Goonaratne - Head of Credit

A D Hemanatha Samaranayaka - Head of Customer Relations

Prasanna Kannangara - Head of Compliance & Internal Audit

Rohan Peiris - Head of IT

Dilukshi Sirimane - Company Secretary

Arthur Perera - Head of International

Indaka Weerasekera - Head of Treasury

Nishantha Jayawardena - Senior Operations Manager

Achintha Hewanayake - Senior Manager Credit

Jayangani Perera - Assistant Vice President – Trade Finance

Dharshini Wettasinghe - Manager Accounting & Reporting

Prasanna Premaratne - Manager International



Directors' Report

The directors have pleasure in submitting their report and the audited accounts of DFCC Vardhana Bank for the year ended 31 December 2005.

The directors have pleasure in submitting their Report and the audited accounts of DFCC Vardhana Bank for the year ended 31 December 2005.

REVIEW OF THE YEAR

The Chairman's statement and Chief Executive's Report give details of the Bank's operation during the year under review.

PRINCIPAL ACTIVITY

The principal activity of the Company is the operation of a bank in terms of the Banking Act No.30 of 1988 and the amendments thereto.

BRANCHES

Two new branches were opened during the year under review bringing the total number of branches to 13.

Borella Branch was opened on 22.07.2005

Kaduruwela Branch was opened on 27.10.2005

The Anuradhapura Branch was relocated in a more spacious building in the city center on 06.04.2005.

PROFIT AND APPROPRIATIONS

	Rs. 000
Accumulated loss on 31.12.2004	58,631
Profit for the year	79,207
Transfer to Statutory Reserve Fund	3,960
Accumulated profit on 31.12.2005	16,616

CAPITAL EXPENDITURE

The total expenditure on the acquisition of property and equipment during the year amounted to Rs. 42.351 Mn as against Rs. 32.306 Mn in the previous year. The details of property and equipment are shown in Note 16 on page 31.

SHARE CAPITAL

The issued and paid up share capital as at 31 December 2005 was Rs. 884.071 million comprising 88,407,100 ordinary shares of Rs. 10 each in comparison to the issued and paid up capital of Rs. 384.071 Mn as at 31 December 2004. The increase is a result of a rights issue of 50 million shares of Rs. 10 each in September 2005 which was fully subscribed.

SHAREHOLDING

As at 31 December 2005 there were 66 registered shareholders constituted as follows:

	No. of Shareholders
Less than 500	04
501 to 5000 shares	22
5001 to 10000 shares	13
10001 to 20000 shares	10
20001 to 30000 shares	04
30001 to 50000 shares	-
50001 to 100000 shares	04
100001 to 1000000 shares	08
over 1000000 shares	01
	66



DIRECTORS INTERESTS IN SHARES

No director holds shares in the Bank in his or her personal capacity.

MAJOR SHAREHOLDER OF DFCC VARDHANA BANK AS AT 31 DECEMBER 2005

Shareholder	No. of Shares	% Cumulative
DFCC Bank	84,167,321	95.204%

DIRECTORS

The following were directors of DFCC Vardhana Bank during the year ended 31 December 2005.

Dr. T N Jinasena - Chairman

Resigned on 12.09.2005

Mr. J M S Brito - Chairman

Appointed on. 11.10.2005

Mr. L G Perera - Director/Managing Director

Mr. S Nagarajah - Director

Mr. J H D B Abeyaratne - Director

Mrs. Y N Perera - Director

Ms. R A P Withana - Director

Mr. M Machado - Director

Mr. T K Bandaranayake - Director

Appointed on 28.03.2005

The Directors retiring in terms of Article 93 and 87 of the Articles of Association of the Company and offering themselves for re-election at the AGM on 31 May 2006 are:

Mr. J M S Brito
Mrs. Y N Perera
Mr. S Nagarajah
Mr. J H D B Abeyaratne
(See Notice of Meeting on Page 39)

DIRECTORS' INTERESTS IN CONTRACTS

Directors' interests in contracts with DFCC Vardhana Bank, both direct and indirect, are declared in Note 24 on page 35. These interests have been declared at Directors' meeting held on 22nd March 2006.

GOING CONCERN

The Board is satisfied that the Bank has adequate resources to continue its operations in the foreseeable future and the financial statements are prepared on this basis.

RE-APPOINTMENT OF AUDITORS

Messrs KPMG Ford Rhodes, Thornton & Company have expressed their willingness to continue in office as auditors of DFCC Vardhana Bank for the year ending 31 December 2006. A Resolution pertaining to their re-appointment and authorizing the directors to determine their remuneration will be proposed at the Annual General Meeting.

By Order of the Board

Dilukshi Sirimane
Company Secretary

22 March 2006



Corporate Governance

Corporate Governance deals with the role of the Board of Directors, the framework of internal controls and the manner in which companies are led and managed. The Board is committed to the review and updating of the Bank's corporate governance structure taking into consideration current market practice and the best practices guidelines issued by the Institute of Chartered Accountants of Sri Lanka.

The Board of Directors is responsible for the corporate governance of the Bank. The main function of the Board is to oversee the business and the affairs of the Bank. It is also responsible for the formulation of strategic objectives, policy framework, the approval of annual budgets (including major capital expenditure), regular reviews of financial performance compared to budgets, the appointment and evaluation of the performance of the Chief Executive Officer (CEO), and the periodic and timely reporting to shareholders.

It also has the task of ensuring that the Senior Management team has the necessary skills and experience to perform their functions effectively in the best interest of the Bank, and that there are sufficient parameters in place for monitoring the performance of management.

The Board comprises eight Directors including one Executive Director who is the Managing Director/CEO. Board meetings are held once a month and varied sub committees of the Board meet on a regular basis. In addition to the regular meetings matters are referred to the Board and its sub committees through circulation. As the majority of Directors are non-executive, independent judgement is brought to bear on the decision making process of the Bank.

The Bank's financial statements are prepared in accordance with the Sri Lanka Accounting Standards, the Companies Act No. 17 of 1982 and the Banking Act. No. 30 of 1988 with amendments thereto. The financial statements are published quarterly and annually on time in compliance with statutory disclosure requirements, which the Board approves prior to publication.



Financial Statements

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Directors' Responsibility for Financial Reporting

The Bank's Financial Statements for the year 2005 prepared and presented in this report are in conformity with the requirements of Sri Lanka Accounting Standards, Companies Act. 17 of 1982 and the Banking Act No. 30 of 1988. The Financial Statements reflect a true and fair view of the state of affairs of the Bank as at that date. Financial information presented in this report is consistent with that in the Financial Statements.

The Board of Directors has instituted an effective and comprehensive system of internal control. This comprises Internal Checks, Internal Audit and the whole system of financial and other controls required to carry on the business of banking in an orderly manner, safeguard its assets and secure as far as practicable the accuracy and reliability of the records.

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

The Board of Directors oversee the management's responsibilities for financial reporting through their regular meeting reviews and the Audit committee. The Audit Committee reviews and approves the financial information contained in the Annual Report and oversees the management's responsibilities for the preparation and presentation of Financial Statements and the effectiveness of the internal control system in the Bank.

The Bank Supervision Department of the Central Bank of Sri Lanka carries out examinations of the records and the affairs of the Bank as deemed necessary to ensure conformity to the provisions of the Banking Act and the regulations formulated thereunder.

M/s. KPMG Ford, Rhodes, Thornton & Co., the Auditors, have examined the Financial Statements made available by the Board of Directors together with all financial records, related data, minutes of Directors meetings and express their opinion which appears as Report of the Auditors on page 16 of the Annual Report.

By Order of the Board

Dilukshi Sirimane
Company Secretary

22 March 2006



Report from the Audit Sub Committee

The Audit Committee comprises four Non-Executive Directors of the Bank with the Company Secretary functioning as the Secretary. The Managing Director/Chief Executive Officer, the Chief Operating Officer & Head of Compliance & Internal Audit attend the committee meetings by invitation.

The Audit Committee is empowered to examine the adequacy and effectiveness of internal control systems, assess compliance with regulatory requirements, review the statutory accounts and published financial statements, consider contents of Internal Audit Reports and recommend appointment and remuneration of the External Auditors.

During the year ended 31 December 2005, four Audit Committee meetings were held. The Committee reviewed the Bank's quarterly and annual financial statements and recommended to the Board their publication.

With the approval of the Board, the Audit Committee has engaged the services of a firm of Chartered Accountants to supplement the bank's Internal Audit function in carrying out periodic outstation branch audits. Representatives from the firm are invited to the Audit Committee Meetings convened to discuss their reports.

The Audit Committee considered the Internal Audit Reports prepared by the Head of Compliance & Internal Audit, covering the nature of issue, response by the Department Heads and corrective action taken by management to overcome the noted deficiencies.

The External Auditors attended two Committee Meetings on request. At these Meetings, the scope of the Audit, detailed findings and the Auditors' independence were reviewed.

The Committee is of the view that adequate controls and procedures are in place to provide reasonable assurance that the financial position of the Bank is well monitored. The Committee also focused on the business risk management process, with emphasis on risks faced and steps taken to address them.

The Audit Committee has recommended to the Board of Directors that, KPMG Ford, Rhodes, Thornton & Co., be re-appointed as Auditors for the year to 31st December 2006, subject to the approval of shareholders at the Annual General Meeting.

T.K. Bandaranayake
Chairman - Audit Committee

22 March 2006



Report of the Auditors



KPMG Ford, Rhodes, Thornton & Co.
(Chartered Accountants)
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P. O. Box 186,
Colombo 00300,
Sri Lanka.

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Internet : www.lk.kpmg.com

TO THE MEMBERS OF DFCC VARDHANA BANK LIMITED

We have audited the balance sheet of DFCC Vardhana Bank Limited as at 31st December, 2005 and the related statements of income, changes in equity and cash flow for the year then ended, together with the accounting policies and notes exhibited on pages 17 to 38 of the financial statements.

Respective Responsibilities of Directors and Auditors

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

Basis of Opinion

We conducted our audit in accordance with the Sri Lanka Auditing Standards, which require that we plan and perform the audit to obtain reasonable assurance about whether the said financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the said financial statements, assessing the accounting principles used and significant estimates made by the Directors, evaluating the overall presentation of the financial statements, and determining whether the said financial statements are prepared and presented in accordance with the Sri Lanka Accounting Standards. We have obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purposes of our audit. We therefore believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion, so far as appears from our examination, the Bank maintained proper books of account for the year ended 31st December, 2005, and to the best of our information and according to the explanations given to us, the said balance sheet and related statements of income, changes in equity and cash flow and the accounting policies and notes thereto, which are in agreement with the said books and have been prepared and presented in accordance with the Sri Lanka Accounting Standards, provide the information

required by the Companies Act No. 17 of 1982, the Banking Act No. 30 of 1988 and give a true and fair view of the Bank's state of affairs of the Bank as at 31st December, 2005 and of its profit and cash flows for the year then ended.

Directors' Interests in Contracts with the Company

According to the information made available to us, the Directors of the Bank were not directly or indirectly interested in contracts with the Bank during the year ended 31 December 2005 except as stated in Note 24 to these financial statements.

Chartered Accountants

Colombo
22nd March 2006



Principal Accounting Policies

1 General

1.1 Constitution of legal entity

DFCC Vardhana Bank Limited is a public limited liability company incorporated and domiciled in Sri Lanka. It is licensed by Central Bank of Sri Lanka to conduct domestic and off shore banking business under the provisions of Banking Act No. 30 of 1988.

DFCC Vardhana Bank Limited is a subsidiary company of DFCC Bank, which is licensed by Central Bank of Sri Lanka as a specialized bank. DFCC Bank owns 95.2% of DFCC Vardhana Bank Limited.

1.2 Approval of financial statements by directors

Financial statements were authorised for issue by the Board of Directors on 22 March 2006.

1.3 Principal activities

DFCC Vardhana Bank Limited is currently engaged in activities related to commercial banking. It accepts demand and savings customer deposits and provides credit, travel and trade finance related services.

1.4 Accounting convention

The financial statements are presented in Sri Lanka rupees, rounded to the nearest thousand. The balance sheet, income statement, statement of changes in equity and cash flow statement, unless otherwise stated herein, are prepared under the historic cost convention in conformity with generally accepted accounting principles applied consistently and in compliance with the accounting standards (SLAS) prescribed by the Institute of Chartered Accountants of Sri Lanka. Exceptions to the historic cost convention of accounting relate to foreign currency translations described in accounting policy 1.5.

1.5 Foreign currency translation

1.5.1 Transactions in overseas currencies are translated to Sri Lanka rupees at the exchange rate ruling at the date of transaction. Monetary assets and liabilities denominated in foreign currencies are translated at the exchange rates ruling on the balance sheet date. Exchange rates used are the middle spot rates.

1.5.2 Any exchange gain or loss arising from the settlement or translation of the Bank's monetary assets and liabilities at rates different from those which were initially recorded are recognised in the income statement.

1.5.3 Forward exchange contracts are disclosed net and valued at the forward market rates ruling on the date of the balance sheet.

1.6 Taxation

1.6.1 Income tax

Provision for taxation is based on the profit or loss for the year adjusted for taxation purposes in accordance with provisions of the Inland Revenue Act No. 38 of 2000, as amended by subsequent legislation.

1.6.2 Deferred taxation liability

This is computed using the balance sheet liability method, providing for timing differences between the carrying amount of assets for financial reporting purposes and the amounts used for taxation purposes. The tax charge or reduction relating to timing differences is computed, using tax rates enacted.

1.6.3 Deferred tax assets

Tax saving relating to tax loss brought forward from prior years are recognized only to the extent of deferred tax liability relating to the timing differences between the carrying amount of assets for financial reporting purposes and amounts used for taxation purposes.

The deferred tax asset relating to the tax effect on timing differences between the carrying amount of gratuity liability for financial reporting purposes and amount used for taxation purposes is not recognised as there is no reasonable expectation of realization of this asset in the foreseeable future.

1.6.4 Offset of deferred tax liability against deferred tax assets

Deferred tax liability and the related charge in the income statement computed as in 1.6.2 has been offset against the deferred tax asset and the related tax saving computed as in 1.6.3.

1.6.5 Value added tax

The value base for value added tax for the Bank is the adjusted accounting profit before tax and emoluments of employees. The adjustment to the accounting profit before tax is for economic depreciation computed on prescribed rates instead of the rates adopted in the financial statements.

1.7 Comparative information

Where items are regrouped, comparative information is also adjusted.

2 Assets and Bases of their Valuation

2.1 Treasury bills and other securities eligible for rediscounting with Central Bank

Investments in treasury bills and treasury bonds held to maturity are stated at the cost of acquisition increased by amortised discount or decreased by amortised premium as appropriate.

2.2 Treasury bills purchased under re-sale agreements

These are loans collateralised by the purchase of treasury bills and/or guaranteed commercial papers from the counter party to whom the loans are granted. The sale by the counter party is subject to a commitment by the bank to sell back the underlying debt securities to the borrower at a pre-determined price. These loans are stated in the balance sheet at cost increased by accrued interest.

2.3 Loans and advances

These are stated in the balance sheet net of provisions for possible loan losses and interest in suspense. The provisions for possible loan losses include both specific and general provision.



Principal Accounting Policies contd.

2.4 Investment securities

These are acquired and held for yield or capital appreciation in the medium/long term and are carried at cost reduced by, where appropriate, the diminution in value, which is other than temporary. Cost determined on a weighted average basis includes incidental cost of acquisition.

2.5 Property and equipment

2.5.1 The cost of an asset comprises its purchase price and any directly attributable cost of bringing the asset to working condition for its intended use.

The assets are stated at cost less accumulated depreciation, which is provided for on the basis specified in 2.5.2.

2.5.2 Depreciation is provided at the following rates on a straight-line basis such that the cost of the asset is amortised over the period appropriate to the estimated life of the type of asset.

Computer equipment including software	-	20% per annum
Office equipment and motor vehicles	-	20% per annum
Furniture, fixtures & fittings	-	10% per annum

Depreciation commences in the month the asset is commissioned for use in the business of the Bank and ceases in the month of disposal.

Prior to 1 January 2005 the rates of depreciation were

Computer equipment including software	-	25% per annum
Furniture, fixtures & fittings	-	20% per annum

No depreciation was provided in the year of purchase and full depreciation was made in the year of disposal

3 Liabilities and Provisions

3.1 Borrowing under repurchase agreements

These are borrowing collateralised by sale of treasury bills or treasury bonds held by the Bank to the counter party from whom the Bank borrowed, subject to a commitment to repurchase them at a pre-determined price. Such securities remain on the balance sheet of the Bank and the liability is recorded in respect of the consideration received and interest accrued thereon.

3.2 Provision for gratuity

Provision for gratuity payable under the Payment of Gratuity Act No. 12 of 1983 is made for all employees. The computation of the provision is based on half month's qualifying salary at the end of the financial year, for each completed year of service commencing from the first year of service. The provision is not externally funded and not actuarially valued.

3.3 Provision for liabilities

A provision is recognized in the balance sheet when the Bank has a legal or constructive obligation as a result of a past event, and it is

probable that an outflow of economic benefits will be required to settle the obligation.

3.4 Commitments and contingent liabilities

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

3.5 Events after the balance sheet date

All material and important events which occur between the balance sheet date and the date on which the financial statements are authorized for issue, and the financial impact on the condition of assets and liabilities are disclosed in note 25 to the financial statements.

4 Revenue and Expense Recognition

4.1 Interest income

Interest receivable is generally recognized on an accrual basis. Interest ceases to be taken to revenue after the interest or principal is in arrears for three (3) months or more and thereafter such income is recognised on receipt basis. In such cases the interest accrued up to three months is also eliminated from the income and transferred to interest in suspense.

4.2 Imputation of tax credit on interest income from treasury bills

Interest income from treasury bills is grossed up by the addition of the tax credit imputed to 10% withholding tax on discount allowed at the time of issue. This imputation credit is 1/9th of the net income

4.3 Discount or premium on purchase of dated debt securities

The premium or discount is amortised through the income statement over the period from the date of purchase to the date of maturity.

4.4 Dividend income

Interim dividend on shares is recognised as income in the period in which it is declared by the directors and final dividend on shares is recognised as income in the period in which it is approved by the shareholders of the investee company.

4.5 Fee and commission income

These are recognised as revenue on cash basis.

4.6 Interest expenses and other expenses

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

4.7 Defined contribution plan

All employees of the Bank are members of the Employees Provident Fund and Employees Trust Fund to which the Bank contributes 15% and 3% respectively of such employee's qualifying salary.

4.8 Bad and doubtful debts

Debts comprise loans and advances and bills of exchange.



Specific provisions are made for possible loan losses on the basis of a continuous review of all advances to customers and are in accordance with the direction issued by the Central Bank of Sri Lanka.

The specific provision is on a graduated scale based on the amount of outstanding principal net of realisable security value (net exposure at risk) as given below:

Age of arrears	Classification	Provision required net of realisable value of security
6-12 months	Sub-standard	20%
12-18 months	Doubtful	50%
18 months and over	Loss	100%

The general provision relates to potential losses not separately identified but known from experience to exist in the overdrafts.

4.9 Forward exchange transactions

Unrealised gains and losses arising from valuation of forward exchange contracts are recognised in the income statement.

5 Cash Flow

The cash flow has been prepared by using the "Direct Method" of preparing cash flows in accordance with the SLAS -9. Cash equivalents are short term (a maturity of 3 months or less from the date of acquisition) highly liquid investments that are readily convertible to known amounts of cash and which are subject to insignificant risks of changes in value.

6. Business Segment Reporting

The segment is a distinguishable component of the company that is engaged either providing products or services or in providing products or services within a particular economic environment, which is subject to risks and rewards that are different from those of other segments.

Currently the banking business is the sole business segment.



Income Statement

For the year ended 31 December

	Notes	2005 Rs '000	2004 Rs '000
Income	1	674,428	286,007
Interest income	2	556,808	224,971
Interest expense	3	322,407	127,700
Net interest income		234,401	97,271
Other income	4	117,620	61,036
Operating income		352,021	158,307
Personnel costs		69,513	50,144
Provision for/(reversal of) staff retirement benefits		1,192	(94)
Premises, equipment and establishment expenses		69,141	84,608
Fee expenses		5,315	2,740
Provision for/(recovery of) bad and doubtful debts	5	9,103	(4,133)
Other overhead expenses		54,715	47,959
Value added tax on financial services		24,511	1,059
Operating expenses	6	233,490	182,283
Operating profit/(loss) before income tax		118,531	(23,976)
Income tax	7	39,324	4,789
Profit/(loss) for the year		79,207	(28,765)
Earnings/(loss) per share, Rs	8	1.52	(1.03)

The accounting policies from pages 17 to 19 and the notes from pages 25 to 38 form an integral part of these financial statements.

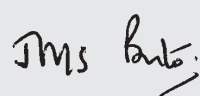


Balance Sheet

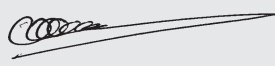
As at 31 December	Notes	2005 Rs '000	2004 Rs '000
Assets			
Cash and short term funds	9	765,753	445,496
Balances with Central Bank of Sri Lanka	10	693,789	282,901
Treasury bills and other securities eligible for rediscounting with Central Bank	11	223,309	226,069
Treasury bills purchased under resale agreements		175,082	202,152
Bills of exchange	12	124,982	77,080
Loans and advances	13	4,791,732	2,554,126
Investment securities	14	1,030	1,030
Interest receivable		40,262	20,292
Other assets	15	37,321	89,913
Property and equipment	16	83,532	79,041
Total assets		6,936,792	3,978,100
Liabilities			
Deposits from customers	17	5,064,407	2,695,097
Borrowing	18	236,979	679,990
Group balances payable	19	18,804	10,936
Tax payable		38,381	4,789
Other liabilities	20	673,574	261,848
		6,032,145	3,652,660
Shareholders' funds			
Share capital	21	884,071	384,071
Reserve fund		3,960	0
Retained profit /(loss)		16,616	(58,631)
		904,647	325,440
Total liabilities and shareholders' funds		6,936,792	3,978,100
Commitments and contingencies	22	4,559,888	1,565,230

The accounting policies from pages 17 to 19 and the notes from pages 25 to 38 form an integral part of these financial statements.


For and on behalf of the Board of Directors,



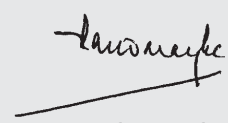
JMS Brito
Chairman



LG Perera
Managing Director



Mrs. YN Perera
Director



TK Bandaranayake
Director

Colombo
22 March 2006



Statement of Changes in Equity

	Share capital	Reserve fund **	Retained profit/(loss)	Total
	Rs '000	Rs '000	Rs '000	Rs '000
Balance on 31/12/2003	256,071	0	(29,866)	226,205
Rights issue of new shares	128,000	-	-	128,000
Profit / (Loss) for the year	-	-	(28,765)	(28,765)
Balance on 31/12/2004	384,071	0	(58,631)	325,440
Rights issue of new shares	500,000	-	-	500,000
Profit for the year	-	-	79,207	79,207
Transfer to statutory reserve fund	-	3,960	(3,960)	0
Balance on 31/12/2005	884,071	3,960	16,616	904,647

**Reserve fund is a statutory reserve created as per direction issued by the Central Bank of Sri Lanka under Section 20 (1) of the Banking Act No 30 of 1988 as amended by Banking (Amendment) Act No 33 of 1995.

Computation of transfer	Rs' 000
Profit after tax	79,207
Minimum amount to be transferred @ 5%	3,960



Cash Flow Statement

For the year ended 31 December	2005 Rs '000	2004 Rs '000
Cash flow from operating activities		
Interest receipts	536,837	210,104
Fees and commission receipts	54,503	24,366
Interest payments	(279,009)	(105,532)
Receipts from other operating activities	62,920	36,654
Cash payments to employees and suppliers	(91,538)	(134,361)
Operating profit before changes in operating assets	283,713	31,231
(Increase)/decrease in operating assets		
Deposits held for regulatory or monetary control purposes	(410,889)	(232,591)
Funds advanced to customers	(2,294,611)	(2,008,835)
Others	62,607	(42,924)
Increase /(decrease) in operating liabilities		
Deposits from customers	2,418,197	1,846,583
Negotiable certificates of deposit	(48,887)	66,913
Others	269,993	172,409
Net cash flow from operating activities before income tax	280,123	(167,214)
Income tax paid	(12,411)	0
Net cash flow from operating activities	267,712	(167,214)
Cash flow from investing activities		
Treasury bills eligible for rediscounting with Central Bank	2,867	(96,576)
Income from investment securities	7	16
Sale proceeds from disposal of property and equipment	200	0
Purchase of property and equipment	(42,351)	(32,306)
Net cash flow from investing activities	(39,277)	(128,866)
Cash Flow from financing activities		
Proceeds from the issue of ordinary shares	500,000	128,000
Bank borrowing	(363,920)	462,101
Borrowing under repurchase agreements	(71,222)	(262,019)
Net Cash flow from financing activities	64,858	328,082
Net increase in cash and cash equivalents	293,293	32,002
Cash and cash equivalents at beginning of the year	746,288	714,286
Cash and cash equivalents at end of the year	1,039,581	746,288



Cash Flow Statement contd.

For the year ended 31 December	2005 Rs '000	2004 Rs '000
Composition of cash and cash equivalent at end of the year		
Cash and short term funds	765,753	445,496
Treasury bills and other securities eligible for rediscounting with Central Bank of Sri Lanka - less than 3 months	98,746	98,640
Treasury bills purchased under resale agreements - less than 3 months	175,082	202,152
	1,039,581	746,288
Reconciliation of Operating Profit/(Loss) with Cash Flow from Operating Activities		
Operating profit/(loss) before taxation	118,531	(23,976)
Add/(Less)		
Dividend Income	(7)	(16)
Loan losses and provisions	9,103	(4,133)
Net change in other receivables and payables	118,235	1,709
Depreciation	37,851	57,647
	283,713	31,231
Operating profit before changes in operating assets	283,713	31,231



Notes to the Financial Statements

For the year ended 31 December	2005 Rs '000	2004 Rs '000
1 Income		
Interest income	556,808	224,971
Other income	117,620	61,036
	674,428	286,007
2 Interest income		
Loans and advances	489,425	183,043
Treasury bills and placements with other banks	67,383	41,928
	556,808	224,971
Treasury bill interest income includes Rs 1.5 million, which is the notional tax credit of 10% imputed for the withholding tax deducted / paid at source in respect of the year ended 31 December 2005. The amount relating to the previous financial year is Rs 3.3 million.		
3 Interest expense		
Deposits	257,629	79,221
Bank borrowing	45,746	39,426
Treasury bills under repurchase agreements	19,032	9,053
	322,407	127,700
4 Other income		
Net foreign exchange gain	40,882	20,445
Dividend income from investment securities - unquoted	7	16
Fee and commission income	54,503	24,366
Gains on treasury bonds	8	2
Other operating income	22,220	16,207
	117,620	61,036
5 Provision for/(recovery of) bad and doubtful debts		
5.1 Specific provision		
Provision for the year	30,581	14,403
Loans written off	814	0
	31,395	14,403
Less :Recoveries during the year	42,527	18,536
	(11,132)	(4,133)
5.2 General provision		
Provision for the year	20,235	0
	9,103	(4,133)



Notes to the Financial Statements contd.

For the year ended 31 December	2005 Rs '000	2004 Rs '000
6 Operating expenses		
Operating expenses include the following:		
Employer's contribution to Employees' Provident Fund	5,402	3,838
Employer's contribution to Employees' Trust Fund	1,078	758
Auditors' remuneration	380	330
Depreciation	37,851	57,647
Legal expenses	317	462
Directors' fees	699	0
Managing director's remuneration	4,248	0
7 Income tax		
7.1 Income tax of the bank has been provided at 32.5% on the taxable income. Tax charge is based on taxable profits which differs from profit/loss for financial reporting purposes. These differences are explained in the following reconciliation statement.		
Profit/(loss) before tax as per income statement	118,531	(23,976)
Disallowed expenses and provisions	85,524	58,348
Capital allowances on property and equipment	(14,876)	(10,604)
Profit on disposal of fixed assets	(191)	0
Dividend income	(7)	(16)
Income from investment in Sri Lanka Development Bonds	(2,480)	0
Gratuity paid during the year	(352)	(1,083)
Assessable income	186,149	22,669
Offset of brought forward tax losses (limited to 35% of assessable income)	(65,152)	(7,934)
Taxable income	120,997	14,735
Tax at normal company tax rate at 32.5%	39,324	4,789
Tax rate on accounting profit %	33%	
7.2 Tax loss		
Tax loss on 1 January	583,903	591,837
Less: tax loss claimed against taxable profits	65,152	7,934
Tax loss on 31 December	518,751	583,903



8 Earnings/loss per share

Earnings per share has been calculated by dividing the profit for the year by 51,968,744 being the weighted average number of ordinary shares outstanding during the year.(27,810,379 shares in 2004) The weighted average number of ordinary shares is the number of ordinary shares outstanding on 1 January 2005 adjusted by the number of new shares issued during the year multiplied by a time weighting factor as given below.

	Number of shares	Time in days	Weights	Weighted average number of shares
Balance on 1 January 2005	38,407,100	266	0.73	27,989,832
Rights issue on 23 September 2005	50,000,000			
Balance on 23 September 2005	88,407,100	99	0.27	23,978,912
		365		51,968,744

Previous year loss per share is not adjusted as the rights issue was at the par value.

	31.12.2005 Rs '000	31.12.2004 Rs '000
9 Cash and short term funds		
Cash in hand	184,638	142,498
Due from banks	102,100	0
Placements / balances with foreign banks	479,015	302,998
	765,753	445,496

10 Balances with Central Bank of Sri Lanka

This includes the non-interest bearing cash deposit held for regulatory or monetary control purposes. The minimum deposit is 10% of customer deposit liabilities denominated in Sri Lanka rupees

11 Treasury bills and other securities eligible for rediscounting with Central Bank

Treasury bills and bonds eligible for rediscounting with Central Bank are held to maturity

12 Bills of exchange

Export bills	81,453	40,009
Import bills	6,241	28,586
Local bills	37,288	8,485
	124,982	77,080



Notes to the Financial Statements contd.

	31.12.2005 Rs '000	31.12.2004 Rs '000
13 Loans and advances		
13.1 Balance on 31 December		
Overdrafts	2,510,269	1,238,800
Loans	1,626,007	833,423
Trust receipt loans	782,739	575,995
Staff loans	20,016	5,783
Others	361	805
	4,939,392	2,654,806
Less:- Loan loss provision - specific	53,504	57,148
Loan loss provision - general	11,934	0
Interest in suspense	82,222	43,532
	4,791,732	2,554,126
13.2 Movement in loan loss provision - specific		
Balance on 1 January	57,148	61,281
Add: provision for the year	30,582	14,403
Less: recoveries in the year	34,226	18,536
Balance on 31 December	53,504	57,148
13.3 Movement in loan loss provision - general		
Balance on 1 January	0	0
Add: provision for the year	20,235	0
Less: recoveries in the year	8,301	0
Balance on 31 December	11,934	0
13.4 Movement in interest in suspense		
Balance on 1 January	43,532	23,469
Add: transfer during the year	89,999	27,286
Less: recoveries in the year	51,309	7,223
Balance on 31 December	82,222	43,532



13.5 Non-performing loans and advances

This relates to the portfolio on which the interest income is recognised on receipt basis.

	31.12.2005	Percentage of total loans and advances	31.12.2004	Percentage of total loans and advances
	Rs '000		Rs '000	
Non-performing loans and advances	229,473	4.65	179,347	6.76
Less: Interest in suspense included in overdrafts	78,193		43,272	
Net non-performing loans and advances	151,280	3.11	136,075	5.21
Less: Loan loss provision [Note 13.2 & 13.3]	65,438		57,148	
Net exposure	85,842	1.79	78,927	3.09

The realisable value of tangible securities is computed in accordance with the hair cut rule prescribed by the Central Bank of Sri Lanka. This requires the application of prescribed discounts given below, to the forced sale value based on age of arrears of the loans, bills of exchange and other credit facilities for the purpose of determining the net exposure at risk

Age of arrears	Applicable discount percentage on the forced sale value
6-30 months	25%
Over 30 months and below 42 months	40%
Over 42 months and below 54 months	50%
Over 54 months and below 66 months	60%
Over 66 months	At the discretion of management

	31.12.2005	31.12.2004
	Rs '000	Rs '000
13.6 Concentration of credit risk sectoral analysis of loans and advances		
Food, beverages and tobacco	222,467	84,540
Rubber and leather products	54,117	157,632
Metals, chemicals and engineering	9,766	415,456
Services	619,698	406,492
Exports	766,905	446,741
Imports	498,078	373,159
Trading	806,129	250,722
Financial	188,126	76,246
Consumption	707,746	143,394
Miscellaneous	1,066,360	300,424
	4,939,392	2,654,806



Notes to the Financial Statements contd.

	31.12.2005 Rs '000	31.12.2004 Rs '000
14 Investment securities		
Unquoted	1,030	1,030

	31.12.2005		31.12.2004	
	Number of ordinary shares	Cost Rs '000	Number of ordinary shares	Cost Rs '000
14.1 Unquoted				
Credit Information Bureau of Sri Lanka (Shares of Rs 100 each)	300	30	300	30
Lankaclear (Pvt) Ltd (Shares of Rs 10 each)	100,000	1,000	100,000	1,000
		1,030		1,030
Directors' valuation		1,030		1,030

Directors value these investments at cost.

	31.12.2005 Rs '000	31.12.2004 Rs '000
15 Other assets		
Deposits and prepayments	10,316	7,871
Stocks of stationery	1,716	1,671
Clearing account balances	4,382	9,307
Other receivables	20,907	71,064
	37,321	89,913



16 Property and equipment

	Computer equipment and software Rs '000	Office equipment Rs '000	Furniture, fixtures & fittings Rs '000	Motor Vehicles Rs '000	2005 Total Rs '000	2004 Total Rs '000
Cost on 1 January	229,874	13,820	39,062	0	282,756	250,450
Additions for the year	13,740	2,339	19,950	6,322	42,351	32,306
Less: Disposals during the year	0	0	6,815	0	6,815	0
Cost on 31 December	243,614	16,159	52,197	6,322	318,292	282,756
Accumulated depreciation on 1 January	173,315	7,298	23,102	0	203,715	146,068
Charge for the year	30,620	2,079	4,146	1,006	37,851	57,647
Less: Accumulated depreciation on disposal	0	0	6,806	0	6,806	0
Accumulated depreciation on 31 December	203,935	9,377	20,442	1,006	234,760	203,715
Net book value on 31 December 2005	39,679	6,782	31,755	5,316	83,532	
Net book value on 31 December 2004	56,559	6,522	15,960	0		79,041

	31.12.2005 Rs '000	31.12.2004 Rs '000
17 Deposits from customers		
Demand deposits	331,720	331,161
Savings deposits	511,912	400,953
Time deposits	4,141,324	1,882,956
Certificates of deposits	24,367	73,254
Others	55,084	6,773
	5,064,407	2,695,097
17.1 Analysis of deposits		
Deposits from banks	242,360	453,763
Deposits from finance companies	26,383	27,472
Deposits from other customers	4,795,664	2,213,862
	5,064,407	2,695,097
18 Borrowing		
Balances with foreign banks	10,354	4,143
Borrowing from DFCC Bank	122,000	500,000
Borrowing under repurchase agreements	104,625	175,847
	236,979	679,990
Due within one year	114,979	679,990



Notes to the Financial Statements contd.

	31.12.2005 Rs '000	31.12.2004 Rs '000
19 Group balances payable		
DFCC Bank	18,804	10,936
20 Other liabilities		
Interest payable	75,931	32,533
Provision for gratuity	3,749	2,910
Account payable	108,193	27,972
Cheques pending realisation	432,564	169,209
Others	53,137	29,224
	673,574	261,848
20.1 Movement in provision for gratuity		
Balance on 1 January	2,910	4,087
Add: provision for the year	1,191	(94)
Less: payments	352	1,083
Balance on 31 December	3,749	2,910
21 Share Capital		
Authorised share capital		
750,000,000 ordinary shares of Rs.10/- each	7,500,000	7,500,000
Issued and fully paid share capital		
Balance on 1 January		
38,407,100 ordinary shares of Rs 10/- each (25,607,100 shares in 2004)	384,071	256,071
Add: Rights issue		
50,000,000 shares of Rs 10/- each (12,800,000 shares in 2004)	500,000	128,000
Balance on 31 December		
88,407,100 shares of Rs 10/- each (38,407,100 shares in 2004)	884,071	384,071



	31.12.2005 Rs '000	31.12.2004 Rs '000
22 Contingent liabilities and commitments		
22.1 Commitments and contingent liabilities		
In the normal course of business, the Bank makes various commitments and incurs certain contingent liabilities with legal recourse to its customers.		
No material losses are anticipated as a result of these transactions.		
Commitments	696,369	291,826
Contingent liabilities		
Acceptances	352,262	166,465
Guarantees	1,407,744	584,261
Bid bonds	27,035	46,435
Documentary letters of credit	1,453,411	231,871
Forward contracts (Net)	272,886	0
Bills for collection	350,181	244,372
	3,863,519	1,273,404
Commitments and contingent liabilities	4,559,888	1,565,230

22.2 Commitments in ordinary course of business

22.2.1 Litigation against the Bank

There was no outstanding litigation against the Bank at the year end.

22.2.2 Capital expenditure approved by the board of directors

The board of directors have approved Rs. 1.2 million for purchase of computer equipment as at 31 December 2005.

23 Maturity profile of assets and liabilities

23.1 Definition of maturity

23.1.1 Time interval between balance sheet date and contractual maturity date, as defined in Sri Lanka Accounting Standard 23, "Revenue Recognition and Disclosures in the Financial Statements of Banks", in respect of assets and liabilities with contractual maturity dates.

23.1.2 Time interval between balance sheet date and expected date of realization of assets and repayment of liabilities as defined by Central Bank of Sri Lanka for assets and liabilities with no contractual maturity dates.



Notes to the Financial Statements contd.

23.2 Profile

	Total	Up to		3 to 12		1 to 3		3 to 5		> 5 years	
	Rs. '000	Rs. '000	%	Rs. '000	%	Rs. '000	%	Rs. '000	%	Rs. '000	%
Assets with contractual maturity											
(Interest bearing assets)											
Treasury bills and other securities eligible											
for rediscounting with Central Bank	223,309	98,747	44	124,562	56	0	0	0	0	0	0
Treasury bills purchased under resale agreements											
	175,082	175,082	100	0	0	0	0	0	0	0	0
Bills of exchange	124,982	124,982	100	0	0	0	0	0	0	0	0
Loans and advances	4,791,732	3,170,415	66	1,353,284	28	232,363	5	11,183	0	24,487	1
	5,315,105	3,569,226	67	1,477,846	28	232,363	4	11,183	0	24,487	1
Other assets											
(Non-interest bearing assets)											
Cash and short term funds	765,753	765,753	100	0	0	0	0	0	0	0	0
Balances with Central Bank of Sri Lanka											
	693,789	693,789	100	0	0	0	0	0	0	0	0
Interest receivable	40,262	40,262	100	0	0	0	0	0	0	0	0
Investment securities	1,030	0	0	0	0	0	0	0	0	1,030	100
Other assets	37,321	29,933	80	3,110	9	1,774	5	1,224	3	1,280	3
Property and equipment	83,532	0	0	0	0	0	0	0	0	83,532	100
	1,621,687	1,529,737	95	3,110	0	1,774	0	1,224	0	85,842	5
Total assets	6,936,792	5,098,963	74	1,480,956	21	234,137	3	12,407	0	110,329	2
Liabilities with contractual maturity											
(Interest bearing liabilities)											
Deposits from customers	4,732,687	3,316,500	70	49,824	1	1,348,744	29	17,619	0	0	0
Bank borrowing	132,354	10,354	8	0	0	0	0	0	0	122,000	92
Borrowing under repurchase agreement											
	104,625	104,625	100	0	0	0	0	0	0	0	0
	4,969,666	3,431,479	69	49,824	1	1,348,744	27	17,619	0	122,000	3
Other liabilities											
(Non-interest bearing liabilities)											
Deposits from customers-demand	331,720	331,720	100	0	0	0	0	0	0	0	0
Group balances payable	18,804	18,804	100	0	0	0	0	0	0	0	0
Tax payable	38,381	38,381	100	0	0	0	0	0	0	0	0
Other liabilities	673,574	645,313	96	24,512	3	0	0	0	0	3,749	1
	1,062,479	1,034,218	97	24,512	2	0	0	0	0	3,749	1
Total liabilities	6,032,145	4,465,697	74	74,336	1	1,348,744	23	17,619	0	125,749	2



24 Directors' Interest in Contracts with the Bank and Related Party Transactions

24.1 Directors' interest in contracts

The Bank has entered into contracts in the ordinary course of its business with the following companies in which, a Director/Chairman of the Bank is/was also a Director/Chairman of the company.

Name of Director	Name of Company Contracted With	Position	Nature of Transaction
Mrs. Y N Perera	MMBL Management Services Pvt Ltd	Director	See note 24.3
Mr. JMS Brito	DFCC Bank Elpitiya Plantation Limited Sri Lanka Insurance Corporation Aitken Spence Plantation Management Limited	Chairman Chairman Director Chairman	See note 24.3
Mr. T K Bandaranayake	Ernst & Young	Partner	See note 24.3

24.2 Related party relationships

24.2.1 Mr. S Nagarajah, Mr. J H D B Abeyaratne and Ms. R A P Withana, who are directors of the Bank, are all employees of the holding company.

24.2.2 The Chief Operating Officer of the Bank is an employee of the holding company, seconded for service in the Bank

24.3 Related party transactions

24.3.1 The Bank has entered into service contracts in the ordinary course of its business with the following companies.

Name of Director	Name of Company Contracted With	Nature of Transaction	Amount Paid during the Year Rs
Mrs. Y N Perera	MMBL Management Services Pvt Ltd	Secretarial services	56,263
Mr. J M S Brito	Sri Lanka Insurance Corporation	Insurance	368,456
Mr. T K Bandaranayake	Ernst & Young	Tax consultancy	105,513

24.3.2 An overdraft facility of Rs 3 million collateralised by treasury bills has been granted to Mr. J H D B Abeyaratne.



Notes to the Financial Statements contd.

24.3.3 Accommodation granted by the holding company

Facility type	Terms	Facility limit Rs million	Balance outstanding Rs million
Short term loan	Each tranche is repayable in 3 months after the date of utilization and interest rate based on Interbank rate plus a premium determined at the date of utilization.		0
Medium term loan	Each tranche is repayable in 5 years from the date of utilization and interest repriced quarterly based on Sri Lanka Interbank Offer Rate plus a premium.	878	0*
Guarantee facility to secure borrowings by the bank	Guarantee commission is 0.5% per annum.		0*
Subordinated fixed term loan	Repayable in 5 years from the date of utilization at the rate of 11% per annum.	122	122

* Not utilized.

Other facilities granted by the holding company

Facility type	Balance outstanding
Borrowings under repurchase agreements collateralised by treasury bills held by the Bank.	Rs 4.9 million USD 5.3 million
Guarantees on behalf of their clients for the Bank to grant loans and advances	881 million
Letters of undertaking on behalf of their clients for the Bank to open letters of credit	414 million
Letters of undertaking on behalf of their clients for the Bank to grant shipping guarantees	532.million

24.3.4 The Bank has paid Rs.31 million as interest expenses on loans and Rs 0.8 million as commission expenses for guarantees to the holding company

24.3.5 The holding company carries out certain functions of the Bank and vice versa, in terms of the collaborative agreement between the Bank and the holding company. Following fees or recovery of costs were accounted for in the books of the Bank during the year.



Fees or recovery of costs charged by the holding company

Expense heading	Amount Rs. '000
Seconded employees	3,907
Charges for utility consumption	3,006
Advertisements and promotions	645
Rent for space	13,205
Other directly identifiable costs	761
	21,524

Fees or recovery of costs charged to the holding company

Expense heading	Amount Rs. '000
Rent for space	300
Charges for utility consumption	1,638
	1,938

24.3.6 The Bank has borrowed Rs 41.7 million from DFCC Stock Brokers (Pvt) Limited under repurchase agreement collateralised by treasury bills held by the Bank.

24.3.7 The Bank carries out transactions in the ordinary course of its business on an arm's length basis with companies in which a director of the Bank has significant influence by representation on the Board of Directors without a substantial shareholding. The facilities granted to the related parties listed below have been above the Central Bank Prime Lending Rate which was between the range 9.53% to 12.24%. These companies, names of directors and nature of transactions are listed below.

Party Accommodated	Name of Director/Position	Aggregate Amount of Accommodation		Nature of Transaction	Nature of the Security & Value
		Approved Rs million	Outstanding Rs million		
DFCC Bank	JMS Brito Chairman	202	51.8	Overdraft facility	Letter of set-off issued against the subordinated loan and any other sums due from DVB
DFCC Stock Brokers (Pvt) Ltd	{ S Nagarajah Director J H D B Abeyratne Director	50	15.8	Overdraft facility	Clean
Aitken Spence Plantation Management Ltd	JMS Brito Chairman	50	44.8	Overdraft facility	Mortgage of 4,958,677 shares of Elpitiya Plantation Limited valued at Rs 14.50 per share as at 31 December 2005
Elpitiya Plantations Ltd	JMS Brito Chairman	10.4 2.7	10.4 2.7	Letter of credit Forward exchange contracts	Letter of undertaking of 16.6 m by DFCC bank



Notes to the Financial Statements contd.

25 Events after the Balance Sheet Date

25.1 Value added tax (VAT) on financial services

The rate of VAT on financial services is increased from 15% to 20% with effect from 01 January 2006

25.2 Liquid assets ratio

The Bank was not required to maintain liquid assets on liabilities to DFCC Bank up to 31 December 2005.

Thereafter the Bank is required to maintain liquid assets of 20% on the standard basis applicable to Licensed Commercial Banks

No other circumstances have arisen which would require disclosure or adjustment to the financial statements

26 Comparative Figures

Comparative figures have been restated to conform to the year ended 31 December 2005 presentation.

27 Employee Population

As at 31 December 2005 - 118

As at 31 December 2004 - 95

28 Directors' Responsibility Statement

The Board of Directors take the responsibility for the preparation and presentation of these financial statements in accordance with the Sri Lanka Accounting and Auditing Standards Act No. 15 of 1995, Companies Act No. 17 of 1982 and the Banking Act No. 30 of 1988 and subsequent amendments thereto.

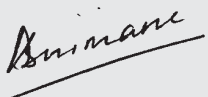


Notice of Meeting

Notice is hereby given that the 10th Annual General Meeting of DFCC Vardhana Bank Limited will be held at the DFCC Bank, Head Office No. 73/5, Galle Road, Colombo 3 on Wednesday the 31st of May 2006 at 10.00 a.m. for the following purposes :-

- (1) To confirm the minutes of the AGM held on 11.05.2005.
- (2) To consider and adopt the Report of the Directors and the Audited Statements of Accounts for the period 01.01.2005 to 31.12.2005 with the Report of the Auditors thereon ;
- (3) To re-elect Mr. J M S Brito who retires in terms of Article 93 of the Articles of Association of the Company, as a Director of the Company;
- (4) To re-elect Mrs Y N Perera who retires in terms of Article 87 of the Articles of Association of the Company, as a Director of the Company;
- (5) To re-elect Mr. S Nagarajah who retires in terms of Article 87 of the Articles of Association of the Company, as a Director of the Company;
- (6) To re-elect Mr. J H D B Abeyaratne who retires in terms of Article 87 of the Articles of Association of the Company, as a Director of the Company;
- (7) To re-appoint M/s KPMG Ford, Rhodes, Thornton & Company as Auditors of the Company for the ensuing year and to authorize the Directors to fix their remuneration.

By Order of the Board
DFCC VARDHANA BANK LIMITED



Company Secretary

Colombo
22 March 2006

NOTES:

- (1) A member is entitled to appoint a proxy who need not be a member to attend and vote instead of himself/herself. A form of Proxy is attached for this purpose. The instrument appointing a proxy must be deposited with the Company at its Registered Office at No. 73, W A D Ramanayake Mawatha Colombo 2, not less than forty-eight hours before the time appointed for the meeting.

Corporate Information

Name of Company

DFCC Vardhana Bank Limited.

Legal Form

Public Limited Liability Company
Incorporated on 25 August 1995

Registered Office

73, W A D Ramanayake Mawatha,
Colombo 2

Company Secretary

Dilukshi Sirimane

Registrars

MMBL Management Services (Pvt) Ltd
300, Galle Road, Colombo 3

Auditors

KPMG Ford, Rhodes, Thornton & Co.
Chartered Accountants
32A, Mohamed Macan Markar Mawatha
Colombo 3

Head Office

DFCC Vardhana Bank Ltd
73, W A D Ramanayake Mawatha, Colombo 2
Tel : 94-11-2371371
Fax : 94-11-2371372
E-mail : info@dfccvardhanabank.com
Web : www.dfccvardhanabank.com

DVB Branches

Anuradhapura

249, Maithripala Senanayake Mw, Anuradhapura
Telephone No 025-2223417
Fax : 025-2223418

Badulla

14 Udayaraja Mawatha, Badulla
Tel : 055-2230160
Fax : 055-2230163

City Office

73/5 Galle Road
Colombo 03
Tel : 2442244
Fax : 2442245

Gampaha

123 Bauddhaloka Mawatha, Gampaha
Tel : 033-2226104
Fax : 033-2226104

Gangodawila

601/1 Highlevel Road
Gangodawila, Nugegoda
Tel : 2442712
Fax : 5554206

Kandy

5 Deva Veediya, Kandy
Tel : 081-2234411
Fax : 081-2228460

Kurunegala

67, Colombo Road
Kurunegala
Tel : 037-2224142
Fax : 037-2224142

Malabe

7, Athurugiriya Road
Malabe
Tel : 2442714
Fax : 2442713

Matara

26 1/1 Anagarika Dharmapala Mw
Matara
Tel : 041-2225500
Fax : 041-2222585

Ratnapura

46 Bandaranaike Mawatha
Ratnapura
Tel : 045-2223667
Fax : 045-2223670

Borella

14, Cotta Road, Colombo 08
Tel : 011-2690069
Fax : 011-2690096

Kaduruwela

626, Main Street
Kaduruwela
Tel : 027-2223333
Fax : 027-2225858

Kotahena (Opened on 23.03.2006)

214, Srimath Bandaranaiyake Mawatha
Colombo 12.
Tel: 2438501
Fax: 2438502

DFCC Vardhana Bank Limited

73, W. A. D. Ramanayake Mawatha Colombo 2.

Tel: 94-11-2371371

Fax: 94-11-2371372

E-mail: info@dfccvardhanabank.com

Web: www.dfccvardhanabank.com



Vardhana Bank