



Vardhāna Bank

We have a lot to offer.
Annual Report '08

We have a lot to offer

DFCC Vardhana Bank is growing - expanding its reach, its products and services. We have a lot to offer, which is depicted in our annual report this year by an abundant rice harvest. Paddy cultivation also requires collective effort to ensure a successful harvest, which reflects the team spirit that guides all our endeavours.

*We're Stable and
symbolise public trust*

DFCC Vardhana Bank has proven its stability over the years, having withstood challenges in both the local and external environment. The highest level of confidence depositors have placed on us is amply reflected in the 57% deposit growth Vardhana Bank achieved when the average growth rate in the whole banking industry was a low 8%.

*We're expanding.
Rapidly.*

In 2008 we grew our network to 43 branches across the island. From a mere 3 branch network in 2004 to reach 43 in 4 years with state of the art technology to support the operations, is rapid expansion by any standards.

We have great people.

We believe teamwork is the driving force behind our success. Our staff consists of caring, committed and highly motivated individuals who work as responsible professionals for the betterment of the bank.

Our Vision

To provide exceptional commercial banking services to our customers.

Our 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.

Our Values

- Integrity and transparency in all transactions
- Objective assessment of risks in making financial commitments
- Adherence to all relevant laws and regulations
- Commitment to deliver enduring value to customers and depositors
- Minimum bureaucracy and fast decision making
- Teamwork for better performance
- Merit-based recruitment of and performance-based rewards for the staff

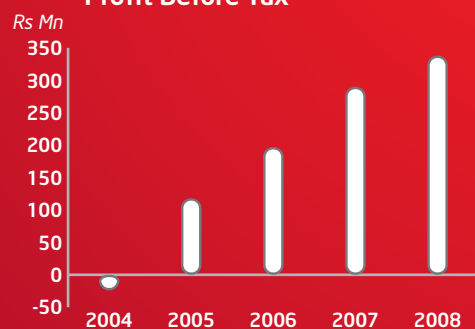
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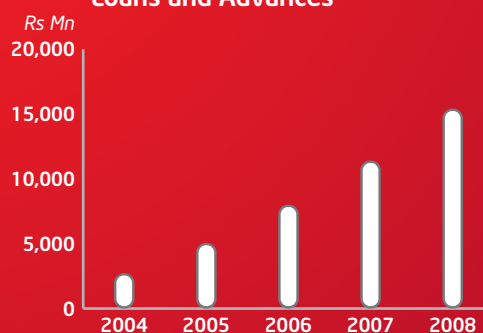
Financial Highlights

<i>For the year ended 31st December</i>	2008 <i>Rs 'Mn</i>	2007 <i>Rs 'Mn</i>	2006 <i>Rs 'Mn</i>	2005 <i>Rs 'Mn</i>	2004 <i>Rs 'Mn</i>
Results for the year					
Gross income	3,498	2,248	1,655	674	286
Net profit before VAT and tax	439	340	253	143	(23)
Income tax and VAT on profit	328	187	136	64	6
Net profit after taxation	111	153	117	79	(29)
At the year end					
Shareholders' funds	2,628	2,528	1,482	905	325
Deposits from customers	18,972	12,117	7,812	5,064	2,695
Loans and advances	15,420	11,414	8,016	5,064	2,732
Investor ratios					
Earnings per share (Rs)	0.60	1.27	1.30	1.52	(1.03)
Net assets value per share (Rs)	14.27	13.72	12.51	10.23	8.47
Return on average assets (%)	0.5	1.1	1.4	2.1	-1.0
Return on average shareholders' funds (%)	4.3	9.4	11.5	15.0	-11.9
Capital adequacy ratios					
Tier I (%)	17.5	18.1	15.2	16.3	12.2
Tier II (%)	18.5	19.0	16.3	18.8	12.2

Profit Before Tax



Loans and Advances



Deposits



Total Assets



Events



January

The Managing Director at the opening of the new Branch in Chillaw in the North Western province. The main economic activities of the area include fisheries, plantation of coconut and minor agricultural crops as well as processing of coconut based products.

February



The participants at the opening of the Maharagama Branch. Branch expansion has been a key strategy of the Bank during the past three years and has seen the Branch network grow to 42 at the end of the year.



March

The Nugegoda Branch completed its first anniversary in March 2008. The Branch commemorated the event with the chanting of Seth Pirith followed by an alms-giving to the Maha Sanga.

April



The Mobile Banking Unit takes the services of the Bank to people who have not hitherto used the services of the Bank. This has benefited the people by giving them an opportunity to start a useful banking relationship.



May

Vardhana Junior savings accounts have high acceptance among parents as an effective medium of investing in children's future. Parents opening accounts at a promotional event conducted to popularise this savings scheme.

June



Savings promotion campaigns focussed on children's savings products were conducted during this month and were well received by the public. Children are seen actively participating in such a promotional event conducted by Wattala Branch, in this photograph.



July

DVB signed a Memorandum of Understanding with the Lanka Electricity Company Ltd which will enable the customers to assign their settlement of monthly electricity bills to the Bank.

August



The vision of DFCC Vardhana Bank's corporate social responsibility initiative is to guide children 'Towards an Exemplary Society'. This was launched in selected schools country-wide.



September

A number of business promotional events and deposit mobilisation campaigns were conducted with the active participation of staff of all grades. Pictured here are some of the participants at a promotional event conducted by the Gangodawila Branch.

October



The Wellawatte branch was ceremonially opened with participation of several Directors of the Bank and important customers. This is an important addition to the Branches within the Colombo city.



November

DVB signed a Memorandum of Understanding with Lanka Bell Ltd allowing subscribers of the Lanka Bell telephone network to settle their monthly bills through the Bank. The utility bill payment scheme is another service provided to our personal banking customers.

December



The opening of the Horana Branch is another significant event in the Branch expansion programme. The branch was ceremonially opened by the CEO of the Bank and the Branch Manager.

Chairman's Review

On behalf of the Board of Directors of DFCC Vardhana Bank Ltd, I am pleased to welcome you to the 13th Annual General Meeting and present the Annual Report and Accounts for the year 2008. The year has been a difficult one for the country in general and the banking industry in particular. For the Bank, it was one of mixed results though the bank was firmly on track in relation to its long-term strategic goals.

Economic Environment

The year 2008 was marked by the global economic turmoil that began with the sharp rise in oil and commodity prices in the run-up to the Olympics, followed by the United States' sub-prime mortgage crisis and the unprecedented financial meltdown experienced by the world since the great recession in the 1930s. This led to a series of bankruptcies of leading US financial institutions while many others reported staggering losses relating to sub-prime mortgage assets. The crisis had wider global ramifications and spread far beyond the shores of America causing other bankruptcies of European financial institutions. While the governments are working on economic bailout and fiscal stimulus packages that may ultimately cost them billions of dollars, Alan Greenspan, who spearheaded the US economic growth for many years, declared that he had found a fundamental flaw in the laissez-faire ideology which he promoted for over two decades. It is hardly surprising that the rest of the world was questioning the wisdom about the markets.

The global economy is transiting from a long period of strong developing-country led growth to one of great uncertainty as the financial crisis in developed countries affects markets worldwide. The World Bank forecasts that the world GDP growth rate will be 2.5% in 2008 and 0.9% in 2009, down from 5% in 2007. The collapse in global growth reversed the surge in commodity prices that characterised the first half of the year. World trade has suffered a significant blow with the decrease in consumption and investment in developed countries which were major markets for the export goods and services of Asian, African and Latin-American countries. The failing industries, large scale job losses and government investments in acquiring large stakes in banks and business enterprises could trigger protectionist tendencies in countries that once supported world-wide expansion of free trade policies. The protectionism and nationalist economic sentiments could have catastrophic consequences for the world economy.

The Sri Lankan economy was not immune to the shocks and after-effects the world economy suffered. During the first half of the year, escalation of oil and commodity prices drove currency depreciation and domestic inflation to levels not seen for a number

of years. The subdued investments and consumption across the developed markets were slowing the demand for goods and services that are major exports and sources of foreign currency earnings for Sri Lanka. This has caused the demand for and the prices of export commodities such as tea, rubber and a range of non-traditional exports to plummet. The country also experienced a significant reduction of industrial output exported such as readymade garments. This has brought business cash flows and corporate profits under severe pressure. The banks' credit portfolio risks increase as the business entities suffer due to the adverse impact of these events.

Operational Performance

The report of the Chief Executive Officer contains a detailed assessment of the operational performance of the Bank during 2008. It would be sufficient to say that the Bank maintained the strong momentum of growth during 2008 though its profitability suffered from a multitude of factors. These included non-performing assets, high operational costs and an income tax rate which amounted to 67% of the pre-tax profits etc. Total assets of the Bank grew by 47% from Rs. 16.9 billion to Rs. 24.8 billion driven by a strong growth of customer deposits by 57% from Rs. 12.1 billion to Rs. 19 billion. Both these growth indicators surpassed the banking industry averages for the period. The Bank improved its liquid assets to 34% of total assets and reduced advance/deposit ratio below the limits set by the prudential guidelines of the Central Bank of Sri Lanka.

The profit before taxation after providing for all expenses and provisions amounted to Rs. 338 million compared with the pre-tax profit of Rs. 290 million in 2007. The income tax provision thereon amounted to Rs. 227 million or 67% of the profit before tax. This is among the highest income tax rates experienced anywhere within the financial services industry. The profit after taxation amounted to Rs. 111 million which is a decline of Rs. 42 million from the previous year.

The provision of the Inland Revenue Law that disallows specific provision for loan impairment of over 1% of the loan portfolio is out of line with the present realities of the business environment. Such provisions effectively sap the ability of banks to withstand the pressures of adverse macroeconomic conditions. This is in an environment where the effective tax rates applicable to banking institutions are among the highest in relation to corporate profits in Sri Lanka.



“We will continue to invest for profitable growth in line with our strategy to transform the Bank into a leading financial institution in the country.”

Chairman's Review... *Contd*

The Bank added 11 new branch offices to its network during the year increasing the number of branches to 43 at the end of 2008. The Bank has the approval of the Central Bank to open four more branches within the first six months of 2009. This effectively completes the ambitious branch expansion strategy implemented over a period of three years.

The adverse business conditions did not permit the Bank to achieve its growth targets in the new branches as rapidly as originally planned. As such, a sub-optimisation exists in relation to the capital outlays invested in the branches as well as their recurrent annual expenditure. Nevertheless, they remain a sound foundation for the Bank to launch its new phase of business development. We would not be in an undue haste to grow the asset base of the branches disregarding the risks that new business acquisitions could have in economically unstable times.

A challenge experienced by the Bank was to find qualified personnel to man rapidly expanding operations in geographic and functional terms. The banking industry felt a skill shortage due to an inadequate supply as well as emigration of experienced staff to countries that offered better wage opportunities. An operational strategy of the Bank would be to fill this gap during 2009.

Economic Interventions

Future growth prospects in the banking sector would be closely aligned to the management of the economic fundamentals within the country as well as performance of the world economy. The governments and Central Bankers worldwide seem poised to take fiscal and monetary interventions to deliver much needed economic revival. Major Central Banks have cut interest rates to spur growth and prop up their financial systems afflicted by deep pessimism. The Central Bank of Sri Lanka reduced the Treasury Bill rates to 18% and the reserve ratio to 7% from 10% earlier. These measures would add liquidity to the banking system and would make credit cheaper to investors.

The other side of the equation is to adopt incentive packages to help adversely affected industry sectors. The Central Bank of Sri Lanka's stimulus package to the finance companies would help them weather strains brought on by credit portfolio risks. The sectors that would require direct assistance include tea plantation and production, minor agricultural crops, readymade garments, tourism etc. These interventions, apart from directly helping the affected industries, would lessen the credit risk of banks' exposures to these industry segments.

Positioning the Bank for Future Growth

The Bank's investments in physical expansion, IT infrastructure and recruitment of manpower in economically difficult times show its confidence in the resilience of the Sri Lankan economy. They are aimed at transforming the Bank into a major contributor to the economy and building a significant presence in all emerging and resurgent sectors. In this regard, we have observed major positive developments taking root within past several years.

- a) There have been key public investments in infrastructure development, such as the road network, which have suffered from decades-long neglect. The poor state of their development has been a key obstacle to economic growth and countrywide development.
- b) The liberalised telecommunication sector seems to perform exceedingly well in terms of expansion and competition including access to broadband services with satisfactory levels of penetration.
- c) Key investment projects that were embroiled in controversy over the last 20 years such as coal-fired power-generating plants and irrigation and hydro power projects have taken off.
- d) The demand for private college level and professional education and private healthcare services are fast developing sectors dependant on the domestic demand irrespective of the international trade environment.
- e) The Government has largely reduced fuel and electricity subsidies which imposed major constraints on the fiscal and monetary management of the economy.
- f) The heavy defence spending which was in excess of 15% of the government expenditure or over 2.5% of the GDP has shown prospects of creating development opportunities and returns in economic terms.
- g) The protracted high intensity security operations of the Government seem to liberate the terrain and people from authoritarian and repressive conditions.

These factors have the potential to create tangible payoffs when the world economy would eventually rebound out of the present crisis.

Outlook for the Future

The financial industry has been the centre of the current crisis. As such, the governments have to intervene in order to restore public trust and confidence in the banking system. The governments also have to bailout industries that have suffered from the depressed market demand to prevent job losses and social costs associated



with it. This round of interventions would not necessarily mark a return to old style centrally controlled economic systems. Around three decades earlier, governments in most countries owned steel companies, national airlines, telephone companies, banks and the like. The tariffs in the world were several times higher than they are today. The governments would not be any more efficient in owning and running business enterprises than they were in the past. It is unimaginable that countries would roll back their economies to such conditions.

The free market economic systems have provided continuous growth and higher standards of living in countries that liberalised markets and adopted free trade policies. Sri Lanka elevated itself to a middle income level country after pursuing liberalised economic policies for around two decades. In the past, countries have responded to financial crises by aggressive reforms and regulations. These measures helped restore credibility in their systems and to attract new capital. The current financial crisis calls for more intensive regulation of the banking and financial services industry and revamping systems that have either failed or accelerated their collapse. The higher regulation will not be a return to centrally controlled economies of the past.

Finally, I would like to place on record my appreciation of the unstinted support I received from my fellow Directors. I also thank the Managing Director, Chief Operating Officer and the Senior Management for their dedication and hard work. I am grateful to the shareholders for the confidence placed in me to lead the Bank into the future. We will continue to invest for profitable growth in line with our strategy to transform the Bank into a leading financial institution in the country.

J. M. S. Brito
Chairman

March 25, 2009

Managing Director / Chief Executive Officer's Report

It is with pleasure that I present the Chief Executive Officer's Report on the operations of DFCC Vardhana Bank for the year 2008.

Business Environment

The year 2008 was one of great challenges for the banking sector in Sri Lanka as was the case globally. Domestic inflation remained high for most of the year. Soaring global prices of fuel and commodities and its impact on the value of the domestic currency was the major cause of sustained high inflation. This together with the expansionary macroeconomic policies caused interest rates to remain high for a large part of the year. The higher interest rates reduced credit growth from 18.9% in 2007 to 6% during 2008. The Government took direct action to curtail import trade to reduce the pressure of high prices of imports as well as defence related spending on the foreign currency reserves of the country. These conditions changed dramatically as the ripple effects of the global financial crisis relating to the sub-prime mortgage crisis of the USA spread globally. Oil and commodity prices plummeted in world markets as demand drastically declined with most prominent economies in the world going into recession. The worldwide reduction in prices helped cool the domestic inflation caused by high import prices and eased the high market interest rates. However, this did not improve market conditions for bank operations as most export oriented sectors suffered from total lack of or greatly reduced demand in export markets. The adverse impact of this has affected the cash flows and profitability of most business enterprises. As a result, credit risk relating to lending portfolios of the banking sector has significantly heightened. This has caused the banks to restrict credit expansion on the one hand, while on the other, the demand for credit too is sliding as fewer new investments are taking place.

The financial sector has also experienced several high profile liability defaults by unregulated financial institutions. This has dented the public confidence in savings in non-state sector institutions, be they banks or other financial institutions. In the short term, this has been to the disadvantage of prudently managed banking institutions. However, in the long-term, this should correct the public perception of unrealistically high yielding deposits offered in the marketplace.

Asset Growth

DFCC Vardhana Bank (DVB) sustained the strong growth momentum during 2008 despite the turbulent business environment experienced globally and locally throughout the year. Total assets of the Bank grew by Rs. 7.9 billion or 47% from Rs. 16.9 billion to Rs. 24.8 billion during the year. Asset growth was driven by the robust expansion of the liability portfolio with

customer deposits generating Rs. 6.9 billion or 87% of the increase. With the growth in the liability base, DVB increased the liquid asset holding to Rs. 7 billion or 28% of total assets. The comparable figure for the previous year was 20%. The Bank presently holds a higher proportion of liquid assets as a larger proportion of the funds mobilised have been invested in guilt-edged assets rather than in direct lending. As a result, money market investments have increased by 133% to Rs. 7 billion from the Rs. 3 billion a year before. The proportion of loans and advances in the asset structure declined from 66% to 59% though the loan portfolio itself grew by Rs. 4 billion. The present structure of deployment of assets provides better liquidity to the Bank while decreasing exposure to credit risk. This has steadied the advance to deposit ratio to a state more favourable than the benchmark set by the Central Bank. This is more prudent deployment of funds at a time when credit risk exposure in customer lending tends to be high.

Growth in Loans and Advances Portfolio

The loans and advances portfolio of the domestic and foreign currency banking units grew from Rs. 11.4 billion to Rs. 15.4 billion registering a 35% growth during 2008. Average credit growth in the banking sector during the year was in the region of 7.5%. The substantial growth in the DVB portfolio was achieved while taking precautions to avoid extraordinary risks that credit expansion entailed in a year when business enterprises faced many difficulties. The new lending represented customer acquisitions in newly set up branches and funding to existing customers. They were largely asset backed credit exposures to business entities and individuals with reasonably good track records in their respective fields, be it trade, industry, professions or vocations.

Corporate credit represented Rs. 8.6 billion or 57% of the loans and advances portfolio while the balance Rs. 6.8 billion was credit granted in the branch banking sector. Of the loans outstanding, overdraft balances accounted for Rs. 8.4 billion or 54% while trade loans accounted for Rs. 4.1 billion or 26%. The term loans amounted to Rs. 2.4 billion or 15.7% of the portfolio.

Corporate Banking

Corporate banking customers include business organisations of varying sizes engaged in various production and service activities. They include manufacturing, information technology, infrastructure development, commercial property development, trading, tea plantation, processing and export and hotel and tourism sectors. A fair number of them are common customers of DFCC Bank. The fixed long and medium capital requirements of such clients are



“Credit growth in unstable macroeconomic conditions calls for adoption of stringent risk management measures. Under present circumstances careful management of credit risk with sound lending practices would be an important consideration.”

Managing Director / Chief Executive Officer's Report ... Contd

provided by DFCC Bank while DVB provided trade finance and working capital finance.

Branch Banking and Small and Medium Enterprise Finance

The branch banking clientele constitute small and medium enterprises and individual customers engaged in economic activities such as trade, distribution, transportation, small agri-business, cultivation etc. This is an important category of customers engaged in economic activities in the regions, contributing significantly to rural economic development and employment creation.

Personal Banking Services

The other significant segment of the Bank's clientele include personal banking customers whose borrowing requirements are for activities such as housing, acquisition of consumer durables and overseas education. The product and service offering include demand and savings deposits, fixed deposits, foreign currency deposits, housing loans, personal loans and cash-backed advances, gold-pledge loans and remittance services and travel related services.

As business units grow, customer acquisition and retention remains at the heart of our business strategy. The types of customers we serve have varying demands. The customer relation function is geared to approach each customer group uniquely with the focus on fast and efficient service delivery.

During the year 2008, the Bank expanded its gold pawning operations to cover 41 branches. Subsequent to the soft launch of this product in 2007, the Bank had a modest gold-pledged lending portfolio of Rs. 20 million at the beginning of 2008. This portfolio grew to Rs. 112 million during the year. In the coming year, we expect to intensify access of this product to personal banking customers as a convenient source of bank finance.

The Bank was compelled to delay the anticipated launch of credit cards by a few months and the product is scheduled for launch in March 2009 with the issue of Gold and Classic cards in affiliation with Visa International. The credit card will be accepted by the worldwide Visa dealer network. Arrangements have been made to launch Vardhana Gift Certificates with several denominations aimed at personal banking customers.

International Trade

In 2008, the value of bills and documentary credit relating to export business grew by 23% while the same for import business

increased by 9%. The main reason for reduction in growth of the import trade volume was restrictions imposed by the Central Bank of Sri Lanka on financing of import trade. Through the enhanced service excellence made possible by the use of the stabilised Bank Trade Application Package, DVB was able to cater to our existing and new customers in a professional and efficient manner.

During the year, DVB expanded correspondence banking relationships with several more international banks providing a greater depth to its customer serviceability in international trade. The higher visibility among foreign banks allows DVB better flexibility to service international trade customers. Although global markets are experiencing an economic downturn, DVB hopes to maintain the volume of trade transactions and achieve at least a modest growth during 2009 using enhanced service standards practiced at DVB.

Growth in Customer Deposit Base

Customer deposits continued to remain the main funding source of the Bank's operations. Presently, deposits contribute 76% of the Bank's funding resources. The year under review saw a healthy growth in the customer deposit base with an increase of 58% while the overall growth of customer deposits in the banking industry was in the region of a mere 7%. Total customer deposits as at 31.12.2008 stood at Rs.18.9 billion, an increase of Rs. 6.8 billion compared to the Rs. 12.1 billion deposits as at 31.12 2007. This is a significant achievement in a particularly difficult year in which DVB was able to further consolidate its standing as one of the most stable banks in the country providing much needed confidence to the public as a deposit taking institution. The main factors that contributed to this growth were the close linkage to the parent, DFCC Bank, the high rating as reflected in the Fitch Rating AA- continuously maintained over the last five years, high brand visibility of the deposit product range and the professional and personalised service rendered by the relationship banking staff. Customer deposit growth has been further assisted by the rapid expansion of the branch network and the promotional work undertaken by the Mobile Banking Unit.

During the year, savings deposits grew by Rs. 1 billion or 15% of the increase in the customer deposit base. However, the proportion of savings deposits in the total deposit portfolio increased only marginally from 11.2% to 12.4%. Improving the proportion of savings deposits in the customer deposit mix will continue to receive our attention in the future as well.



Capital Resources and Borrowings

Capital resources of the Bank stood at Rs. 2.63 billion as at 31.12.2008, which is an increase of Rs.100 million over the previous year. Equity capital amounted to 10.6% of total funding resources as at end of the year while it accounted for 15% a year previously. The decrease in the proportion of capital was due to the rapid growth of the deposit liability base surpassing the profit growth of the Bank. The capital of the Bank meets the capital adequacy requirements under the Basel II convention with Tier 1 and Tier 2 capital equivalent to 17.5% and 18.5% of the risk weighted assets.

Other non-deposit borrowings of the Bank as at 31.12.2008 amounted to Rs. 2.2 billion or 8.8% of the total resource base. This constitutes inter-bank borrowings, treasury bill re-purchase liabilities and the like. These are placed in short-term money market investments and generate interest spreads as income on treasury operations. The Bank did not have to access inter-bank sources except as intermittent borrowings as it possessed excess liquidity throughout the year.

Interest and Other Income

Interest income on loans and advances amounted to Rs. 2,643 million. The corresponding figure for 2007 was Rs 1,812 million. This represents an income growth of 46% while the underlying loan portfolio grew by only 35%. The interest yield relating to this income is 23% of the average loan and advances portfolio. Income growth was derived mainly from the portfolio growth and to a lesser extent by rate increases. Market interest rates remained high throughout the year as macroeconomic factors remained unchanged from the previous year. The Bank's lending contracts provide for re-pricing of all lending at annual or shorter intervals. As such, benefits of any favourable movement of market interest rates can be speedily passed on to customers.

Other non-fund based fee and commission income increased by around Rs. 45 million to Rs. 229 million. This income relates to the commission earned on documentary credit facilities of the International Division as well as credit and performance guarantees issued to customers.

Interest Costs

Interest costs on borrowings and customer deposits were Rs. 2,031 million during 2008 compared to Rs. 1,273 million incurred in 2007. The weighted average interest cost is 13.6%.

Operational expenses (other than loan impairment provision and financial services VAT) for 2008 amounted to Rs. 741 million compared with a corresponding figure of Rs. 533 million in 2007 representing an overall increase of 39%. The main areas of this increase were staff costs, premises, equipment and establishment expenses and a greater proportion of these related to branch related expansion. The cost/income ratio, excluding loan loss provisions, for 2008 is 50.5% as compared with 54.7% for the previous year. There will be a natural reduction of this ratio as the branches set up during the past two years build up adequate income generating business relative to their capacity.

Foreign Currency Remittances

Remittances from Sri Lankan expatriate workers employed overseas are a main source of foreign currency earnings of the country. Many banks are geared to facilitate foreign currency remittances by workers and offer services convenient to both the sender and the beneficiary. The tie-up of DVB with the Western Union Money Transfer Service resulted in the growth of inward remittance volume.

Treasury Operations

Treasury operations contributed a net income of Rs. 623 million in 2008 compared with Rs. 249 million earned in 2007. Net gain from treasury bill repurchase transactions amounted to Rs. 37.2 million including the notional tax credit of 10% imputed for tax deducted at source.

Loan Loss Provision

Total net loan loss provision made in the accounts in 2008 amounted to Rs. 287 million as against Rs.101 million made in the previous year. A substantial proportion of this provision related to several large credit exposures. The provision made in the accounts is well above the minimum regulatory requirements. The Bank made a conscious attempt to recognise all exposures that carry a potential risk of impairment based on criteria more stringent than the minimum imposed by the regulator.

As at 31.12.2008, the total loan loss provision stands at Rs. 501 million or 3.2 percent of the loans and advances portfolio, while the comparative figures for 2007 were Rs. 217 million and 2% respectively. This shows that most credit exposures with potential for default are covered by the provision as reflected in the provision cover ratio of 40%. The net non-performing loan (NPL) ratio remained stable at about 4.5% as at 31.12.2008. The credit risk management now receives a greater emphasis to improve the

Managing Director / Chief Executive Officer's Report ... Contd

quality of the Bank's credit exposures to borrowers and counterparties to transactions.

Net Earnings and Returns to Investors

Profit before tax (PBT) for the year amounted to Rs. 338 million which is an increase of 17% compared with the PBT of Rs. 290 million in 2007. The provision for taxation amounted to Rs. 227 million or 67% of PBT. The income tax provision for 2007 was 47% of the pre-tax profits. The profit after taxation (PAT) attributable to the shareholders amounted to Rs. 111 million. This reflects a reduction of PAT by Rs. 42 million or a proportion of 38%. The main factor that contributed for the reduced profitability was the higher provision made for loan losses in 2008. The policy of the Bank on classification of NPLs is designed to recognise the full scale of the potential credit loss and is decidedly more stringent than the criteria specified by the regulator. The resultant interest suspensions and the provisions had a larger adverse impact on profitability than the regulatory minimum.

The reduction of net earnings was compounded by the regulation in the Inland Revenue Law that disallows deduction of loan loss provisions from income in excess of 1% of the loan portfolio. This resulted in the Bank having to pay an additional Rs. 32 million as income tax. This regulation implies a premise in law that credit risk management in banks is a matter for control with punitive fiscal interventions. It is oblivious of the external macroeconomic factors that could cause impairment to credit granted by banks. This is a misconceived legislative provision designed to deal negatively with situations that demand fiscal concessions.

We will make a concerted effort to recover the provided loans and to minimise new loans crossing into non-performing category in 2009. With this objective, a Special Recovery Unit has been set up at DVB to intensify recovery efforts of branches and to focus on collection of loans.

The net earnings of Rs. 111 million represents an earnings per share (EPS) of Rs. 0.60 compared with the EPS of Rs. 1.3 recorded in the previous year.

Branches and Distribution Outlets

In 2008, the Bank added 11 new branches to increase the network of branches to 43, though the branch rationalisation plan approved by the Central Bank of Sri Lanka allows an increase up to 47 branches. The Bank opened two of the remaining four branches in

Nuwara-Eliya and Kalawana in January 2009 while the other two branches will be opened in Avissawella and Ambalangoda before the end of June 2009.

This completes the branch expansion plan executed by the Bank within the last three years with the objective of giving the Bank an adequate physical presence island-wide. The locations selected for the new branches were primarily population centres and localities where economic activity is concentrated. The expansion was a contributory factor to the high growth in deposits and advances during 2008. The key challenge ahead will be to provide the branches with trained staff and thereby provide a satisfactory standard of banking services to customers.

During 2008 DVB signed a memorandum of understanding with the Sri Lanka Post to set up Banking Units in 400 post offices. The Bank opened five such units during 2008 and the approval of the Central Bank of Sri Lanka has been received to open a further 25 Post Office Banking Units during 2009. This initiative would enhance the Bank's access to a large segment of the population while Sri Lanka Post would be able to earn significant fee income.

Adoption of Information and Communication Technology (ICT)

In 2008 the Bank made further investments in strategic and operational ICT to introduce, consolidate and enhance IT systems with a focus on improving internal operational efficiency and customer serviceability. More specifically, an image based cheque management system, a utility payment system and a margin trading system were introduced to the ICT portfolio. The first initiative was to automate the inward and outward clearing process by capturing cheques in image form at the point of origin and transmitting them electronically to the Clearing Centre. The system has an interface with the national Cheque Imaging and Truncation System (CITS). The second initiative allows the Bank to handle utility bill payments, insurance premium payments, loan repayments etc of the general public and routes the collections to the respective institutions. This system commissioned in the third quarter of 2008, enabled DVB to collect payments on behalf of Dialog Telecom PLC and Sri Lanka Telecom Ltd. The third ICT initiative supports the Bank's margin trading operation by maintaining an active interface with stockbrokers and the Core Banking System thereby increasing efficiency in terms of accuracy and speed of settlements and collections. In addition to these three new initiatives, the ATM network too was further expanded during the year.



Another significant initiative in 2008 was the designing of the ICT framework required for credit and debit card operations and sharing of the ATM networks begun in strategic alliance with Sampath Bank PLC. Once in operation, both banks would benefit from expanded scope and economies of scale. Further, in alliance with Synapsys Ltd, preparatory work has begun to introduce a mobile banking solution, which would support an agent-based on-line collection mechanism through handheld data transmitting devices together with certain other customer relationship management features. This technology would enable DVB to increase its reach with low marginal investment and reduced per-transaction costs. Preparations were also made for a technology upgrade of the core banking solution with envisaged increases in efficiency. The Bank will continue to invest in ICT to improve banking service delivery standards that would provide strategic advantages to the Bank.

Human Resource Management

Total HR cadre of the Bank stands at 407 employees of all grades. This includes 386 staff members of DVB and 21 employees seconded for full-time work from DFCC Bank. Total number of staff as at the end of 2007 was 302 employees. Personnel cost increased by 38% to Rs. 270 million in 2008 from Rs.195 million in 2007. The increase was mainly driven by the enhanced staff numbers and annual salary adjustments effected during 2008. A major effort of human resource management during the year was on recruitment of 156 new employees into the managerial and operational grades. This high level of recruitment was needed to staff the new branches opened and as replacements for 52 resignations. Most staff that left the service of the Bank did so for pursuing higher education and for accepting career opportunities overseas. For the first time, DVB recruited a batch of management trainees with graduate level and/or professional qualifications. They are being assigned to work in different functional areas on a rotational basis to provide them with a wide hands-on exposure of management and operational functions supported by relevant technical study material and specialised classroom training.

The HR policies place emphasis on continuous professional education for upgrading the knowledge and skill base of the staff. The primary focus of training provided to frontline sales and counter staff during the year was customer service and marketing skills. Special attempts are made to customise training opportunities to match skill and personal development requirements of individual or groups of employees. The Bank actively encourages its employees to pursue relevant study courses leading to academic and professional qualifications.

The performance appraisal process was further refined during 2008 to objectively evaluate the performance of individual employees in relation to key performance targets set at the beginning of the year as well as desired behavioural attributes pertaining to customer service, work practices and office routines. This process enables the Bank to compensate employees based on performance in a realistic and unbiased manner.

Corporate Communications and Business Promotion

The corporate communication strategy focused on the projection of the strong affiliation of DVB with DFCC Bank as two operationally interlinked banking institutions. With this objective DVB continued with the *Two-Banks-in-One* TV commercial. This was supplemented by a campaign in the print media with a view to establishing in the public perception, the close association of the two banks.

The advertising and business promotion strategies were directed at promoting the branded liability products such as *Dhana Vardhana* fixed deposits and *Mega Bonus* savings accounts. The theme of the message carried in the TV and Radio commercials was to position DVB as a strong and reliable partner to whom the general public can entrust their lifelong savings for good returns. The brand accounting and feedback have revealed that the two brands are established as good options for saving money.

Future Outlook

With the setting up of four branches during the first half of 2009, DVB will be completing the branch expansion programme launched three years ago to expand the physical distribution network to 47 branches. The addition of 25 more DVB window offices at post offices during the year will provide an unprecedented momentum to the Bank's growth plan. With this we would have established our presence in a widely spread geographical area. This network of service outlets would be the critical mass of our presence in population centres as well as commercial centres. These window offices are on the same information technology platform as DVB branches and use uniform banking software to provide an efficient and satisfying banking experience to customers. These advanced systems would be optimally used by placing trained and experienced frontline banking personnel in all locations to deliver a high quality banking service.

New branches of DVB have not reached optimal level of operations in terms of number of customers serviced or business volumes handled in relation to capacity. These branches need to acquire quality customers and build up robust lending portfolios and stable

Managing Director / Chief Executive Officer's Report ... Contd

customer deposit bases. This is an effort in which we need to muster the support of all our staff and significantly enhance the support provided by the Head Office to business units. As the current business environment is unsuitable for growth in lending, this year too we will concentrate more on building the liability portfolio of branches as was done during most of last year.

As constantly emerging evidence indicates, depressed demand conditions in world trade and commerce can be expected to continue well into 2009. Credit growth in unstable macroeconomic conditions calls for adoption of stringent risk management measures. Under present circumstances careful management of credit risk with sound lending practices would be an important consideration. This requirement would be addressed by strengthening the scope and intensity of the credit risk management framework within the Bank. Though the liquidity position is well within prudential parameters, maturity profiles in asset and liability structures will be tightly managed. We have fortified the integrated risk management systems at the Bank and Group levels to effectively meet this requirement.

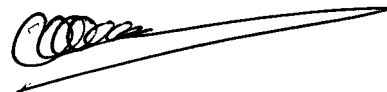
The Bank has geared enterprise management procedures in line with the regulatory corporate governance, risk management and disclosure rules. The implementation of an integrated risk management framework should improve identification, accounting and reporting of financial risks pertaining to our operations in accordance with internationally accepted best practices.

The positive developments in the internal security situation and inclusion of the Eastern and Northern regions of the country in the mainstream political and economic process would create new development opportunities. The reconstruction of physical and human infrastructure ravaged by the prolonged conflict should prop-up internal demand to supplement depressed external market demand. This is a development opportunity that the Sri Lankan business community should embrace with a passion for national service. The Bank would position itself to be a contributor as well as a beneficiary of this process in the years ahead.

Conclusion

The support and guidance that we received from the Central Bank of Sri Lanka need commendation. I wish to convey my appreciation to the Chairman and the Board of Directors for their support, which was a source of encouragement to me. My management and staff have worked with dedication and commitment throughout the year for which I am grateful. I also acknowledge the support I received

from my corporate management team at all times. I also wish to thank the shareholders for the trust and confidence placed in the Bank despite unfavourable market conditions. I am grateful to the customers for their continued patronage of the services of the Bank.



L. G. Perera
Managing Director/Chief Executive Officer

March 25, 2009

Board of Directors



Mr. J. M. S. Brito *Chairman*

LLB (London), FCA (England & Wales), MBA (London)

Appointed to the Board in October 2005. Deputy Chairman and Managing Director of Aitken Spence & Company PLC, Chairman of DFCC Bank Ltd. A former Chairman of Sri Lankan Airlines. Former member of the Strategic Enterprise Management Agency (SEMA). Served on the post-tsunami Presidential Task Force for Rebuilding the Nation (TAFREN) and the Public Enterprises Reform Commission. Has gained extensive management experience serving organisations such as PricewaterhouseCoopers, British Eveready PLC and the World Bank.



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

BEcon (Hons), Postgraduate Diploma in Applied Social Statistics, MBA.

Appointed to the Board in August 2003. Formerly, held the position of Executive Vice President (Lending) of DFCC Bank Ltd. Has extensive experience in project lending, corporate finance, investment banking, SME financing etc. Has participated in numerous training programmes sponsored by the World Bank, ADB, ADFIAP and other local and foreign institutions.



Ms. Y. N. Perera *Senior Director*

Appointed to the Board in May 2002. Director / Chairperson of Mercantile Merchant Bank Ltd. She possesses extensive experience in management of private sector enterprises. Served as Director / Chairperson of a number of limited liability companies in finance, travel and leisure sectors.



Mr. A. N. Fonseka **BSc (Hons), FCIB (London)**

Appointed to the Board in February 2009. Director / CEO of DFCC Bank Ltd, Chairman of the Colombo Stock Exchange and a Vice Chairman of the Association of Development Financing Institutions in Asia and the Pacific (ADFIAP). Serves on the Advisory Committee on Finance and Banking of the Ceylon Chamber of Commerce. Member of the National Institute of Business Management, Financial Sector, Capital Markets and Legal Reform Clusters of the National Council for Economic Development (NECD) and of the National Payments Council and Inter-regulatory Institutions Council. Previously, had a long career with HSBC and held positions such as Deputy CEO of HSBC Sri Lanka.



Board of Directors... *Contd*



Mr. J. A. R. E. M. Machado

FCIB (London), FFA (London), FIEXA (London), FCI (London), DIP in Journalism.

Appointed to the Board in October 2004. Had a long career with Hatton National Bank PLC serving in areas of corporate banking, international, personal banking, operations etc.



Mr. S. Nagarajah

FCA, FCMA, FCCA

Appointed to the Board in August 2003. Executive Vice President (Finance) of DFCC Bank Ltd. He previously held the positions of Head of Project Finance and Internal Audit with DFCC Bank. Had initial training with a firm of Chartered Accountants and held managerial positions in the mercantile sector.



Mr. L. H. A. L. Silva

Chief Operating Officer

B.Com, MBA

Appointed to the Board in October 2008. Senior Vice President of DFCC Bank Ltd. Has wide exposure in project finance, financial leasing, branch banking and operations and received training in these areas locally and overseas.

Initiated professional career with the Department of Inland Revenue of Sri Lanka.



Mr. L. N. de S. Wijeyeratne

FCA

Appointed to the Board in October 2008. He has over 30 years experience in finance both locally and internationally. Served as the Finance Director of Richard Pieris PLC for over ten years until 2008. Currently serves as an independent Director of several listed and unlisted companies.



Ms. R. A. P. Withana

FCA, FCMA, MBA

Appointed to the Board in August 2003. Senior Vice President (Operations) of DFCC Bank Ltd. She previously held the positions of Head of Credit Administration and Accounts and Reporting with DFCC Bank. Had initial training with a firm of Chartered Accountants where she was appointed as a Partner after acquiring the full qualification.



Mr. W. A. Mendis

Company Secretary

FCA, ACMA, MBA

Formerly, a Senior Vice President of DFCC Bank Ltd



Management Team

L G Perera

Managing Director/ Chief Executive Officer

BEcon (Hons.), MBA, PGD in Applied Social Statistics

Mr Lakshman Silva

Executive Director / Chief Operating Officer

BCom, MBA

Mr Palitha Gamage

Head of Corporate Credit

BSc (Eng) (Hons), MIESL, CEng, ACMA, MBA

Mrs Shanthi Goonaratne

Head of Branch Credit

BSc, AIB, MBA

Mr Achintha Hewanayake

Head of International

BSc, MSc (Keele UK), ACMA, CISA

Mr Prasanna Kannangara

Head of Compliance and Internal Audit

ACIB (London), FCCA (London)

Mr Asoka Mendis

Head of Credit Risk and Quality Control

BA (Hons), FCA, ACMA, MBA

Mr Hemanath Samaranayaka

Head of Customer Relations

BSc (Hons) (UK), Grad. Dip in Finance, SNR AIB (Australia)

Mr Indaka Weerasekera

Head of Transaction Processing & Risk Control

Dip. in Banking and Finance (University of Wales)

Mr Gamunu Gunasumana

Senior Manager (Personal Financial Services and Credit Cards)

BSc, MBA, PGD in Business and Financial Administration.

Mr Nishantha Jayawardena

Senior Manager (Operations)

BSc, AIB, PEDBMgt, Dip.CBSL, PDALMgt

Mr Wijesekera Keerthithilaka

Senior Manager (Branch Credit)

AIM (SL), Dip. in Bank Management

Mrs Jayangani Perera

Senior Manager (Credit Administration)

BCom (Hons)

Mrs Darshini Wettasinghe

Senior Manager (Accounting & Reporting)

BSc (Bus. Admin.), ACMA, ACA, ASA (Australia)

Mrs Priyadarshini Attanayake

Manager (Credit)

Dip. In Finance and Bank Management, Dip. in Credit Management

Mr Prasanna Premaratne

Manager (International)

AIB (SL), CIMA(Passed finalist)

Mrs Sepali Ranawana

Manager (Legal & Secretarial)

LLB, Attorney at Law

Mr Arthur Perera

Co-ordinator Trade Finance

ACIB (London)

The Treasury, Human Resource Management, Marketing, Business Promotion and Planning functions are performed at the Group level by specially earmarked officers.

Risk Management



Risk management is a core activity within DFCC Vardhana Bank which aims at achieving an appropriate trade-off between risks and returns to produce optimum shareholder value. Adoption of a comprehensive risk management framework is essential to identify the risks the Bank assumes in daily operations and to control them adequately. It assumes a greater significance in the current depressed global and domestic economic environment. The risk management framework is designed to manage risks in a manner consistent with the Bank's objectives relating to risks and returns. A strong integrated risk-management process provides a sound foundation for the Bank to conduct its operations. As per the Mandatory Code of Corporate Governance issued by the Central Bank for Licensed Banks in Sri Lanka, the risk management is the responsibility of the Board of Directors. The Board has formed the Integrated Risk Management Committee to exercise an oversight over the effectiveness of the risk management systems and processes of the Bank.

Objectives

The objective of risk management is not necessarily to minimise risks in all situations. It does not mean that the Bank would unnecessarily expose itself to unmitigated risks. The Bank manages risks through a process which involves identification, measurement, control and monitoring of risks that arise from transactions and other activities. The Bank seeks to adhere to the following principles in management of risks pertaining to transactions and other operational activities.

- (a) Individuals who take or manage risks clearly understand it
- (b) Risk taking decisions are explicit and clear
- (c) The expected payoffs compensate for the risks taken

- (d) Risk taking decisions are in line with the business strategy set up by the Board
- (e) The risk exposures are within the limits established by the Board of Directors
- (f) Sufficient capital is available as a buffer to cover the risks assumed by the Bank

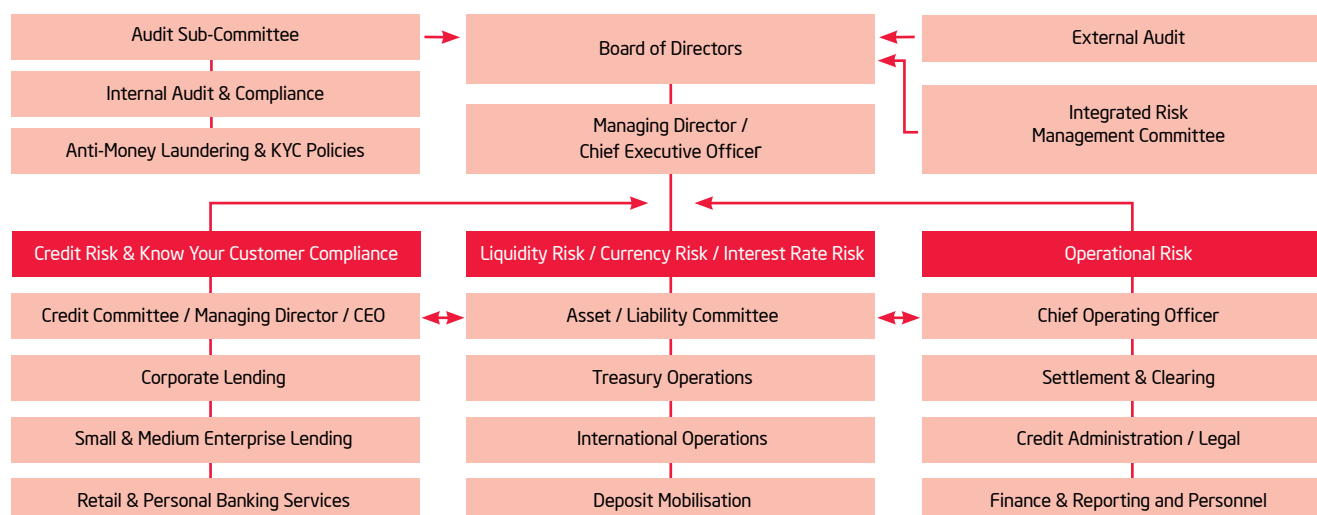
An enterprise-wide risk management framework steeped in these policies assists the Bank to operate within a sound and controlled management culture.

Risk Management Organisation

A primary requirement in an Enterprise-wide Risk Management process is to have a practical risk management infrastructure that will enable the Bank to manage risk within acceptable limits. The risk management framework of the Bank is comprised of four key elements:

- (a) An organisation structure that reinforces responsibility and accountability.
- (b) Well defined policies and procedures reinforced with intensive training.
- (c) Proprietary risk management methodologies and tools.
- (d) A risk reporting system designed to continuously monitor and identify potential risk management issues.

The risk management within the Bank is not an activity performed by a few individuals or a department. It is a part of an overriding commitment under which all business units are accountable for the risks they take. Accountability in relation to risks assumed by the persons responsible for the decisions is an integral part of the risk management process.



Risk Management... *Contd*

Credit Risk

Most simply defined, credit risk is the potential that a borrower or a counterparty will fail to meet its obligations in accordance with agreed terms. The credit risk is the most significant risk faced by the Bank. The goal of credit risk management is to maximise the risk-adjusted rate of return and to maintain credit risk exposure within acceptable parameters. The Bank manages the credit risk inherent in the entire lending portfolio on a macro level as well as the risks in individual credit transactions. The credit risk management approach is comprised of the following key elements:

- (a) Segregation of the lending, credit administration and follow-up functions.
- (b) Standardised credit appraisal procedures and legal documentation standards designed to ensure high quality of loans up-front.
- (c) Proprietary credit grading techniques and methodologies that provide a consistent basis for credit appraisal and monitoring.
- (d) Maintaining loans and advances within prudent levels in relation to deposit liabilities and investing appropriate percentages of such funding in marketable securities.
- (e) Lending portfolio exposure, concentration and monitoring of limits for diversification of the credit risk to the extent possible.
- (f) Robust collection efforts and loss mitigation procedures in relation to non-performing loans.

Segregation of Duties

The ultimate responsibility for credit risk management rests with the Chief Executive Officer and the Board of Directors. They are supported by the Group Asset / Liability and Group Credit Committees, which are independent of the business units. The Board of Directors has delegated the authority for credit approval and related activities to managerial levels on clearly defined parameters. This constitutes a multilayer approval process and clearly segregates the credit approval and origination roles.

Standardised Appraisal and Credit Enhancement Procedures

Due to the Bank's emphasis on lending to corporate customers and small and medium enterprises, we grant relatively large corporate loans as well as a considerable number of medium and small business loans to a clientele spread across several geographical regions. Therefore, loan appraisal procedures have to become thorough and stringent. The credit appraisal processes of the Bank have following characteristics.

- (a) Credit appraisal relating to large loans is carried out by senior staff having considerable experience in such work and also with inputs from those who are familiar with the unique risks and funding needs of the sectors financed.
- (b) The project due diligence on large exposures commence before the actual credit application is submitted.
- (c) Small and medium scale lending is subject to a structured evaluation process on a set of pre-determined criteria designed to assess potential risk embedded in these exposures.
- (d) All credit enhancements are subject to mandatory appraisal and approval processes.
- (e) All existing credit exposures are reviewed annually or at shorter intervals in order to have updated assessments of their potential risk.

The credit appraisal process focuses on the borrower's past credit performance, the status with the CRIB, financial position and debt payment capacity, the terms and conditions of proposed credit facilities, industry performance and economic trends. The exposures are secured to an extent considered necessary. The approval of loans is done by officers with the delegated authority for lending determined on individual and group exposure criteria.

Risk Rating Tools and Methodologies

The Bank has a system in place to rate each individual borrower by application of an Internal Rating System based on a risk rating model. It rates borrowers by application of a set of uniform criteria. The internal rating of the borrowers is updated when:

- (a) Credit facilities are approved to new borrowers or counterparties to transactions.
- (b) Existing limits are enhanced by provision of additional facilities.
- (c) Existing exposures are rescheduled or restructured
- (d) Routine reviews fall due on all credit limits which need annual extension.

This process ensures that an updated credit risk rating is available on all borrowers other than on cash-backed exposures.

Exposure Limits and Portfolio Management

The Bank uses exposure and concentration limits on a macro level to maintain the credit risk within acceptable tolerances. It monitors portfolio concentration limits on individual exposure as well as industry and geographical concentrations. These concentration limits are taken into account when new credit facilities are considered.



Standardised Collection Efforts and other Loss Mitigation Procedures

Despite application of appraisal and monitoring standards, a proportion of loans could become non-performing due to industry specific or individual borrower related factors. The Bank's debt collection and recovery procedures have the following characteristics.

- a) Regular monitoring of the performance of accounts via exception reports and other tools available to the credit officers.
- b) Periodic borrower site visits and financial reviews are undertaken.
- c) Loan officers are required to review each credit at least yearly to detect any early signs of deterioration in a borrower's ability to repay existing loans.
- d) A Recovery Unit has been formed at the Head Office to ensure that effective action is taken for collection of past due exposures.
- e) Hardcore past due loans are referred to the Special Loan Administration Department for taking recovery action. They are equipped with necessary personnel and skills for debt restructuring, litigation and parate execution for recovery action as required in each individual case.

Anti Money Laundering (AML) and Know Your Customer (KYC)

The Bank has recognised that sound AML and KYC policies and procedures not only contribute to overall safety and soundness of business operations but they also protect it from becoming a vehicle for money laundering, terrorist financing and other unlawful activities. To this end, the Bank is compliant with the Convention on the Supervision of Terrorist Financing Act No 25 of 2005, Prevention of Money Laundering Act No 5 of 2006, Financial Transaction Reporting Act No 6 of 2006 and the directions issued by the Financial Intelligence Unit (FIU) set up under the latter Act to mitigate the risk of the Bank channelling funds gained from unlawful activities. The essential elements of the KYC programme include the following:

- a) A customer acceptance policy uniformly exercised by all business units
- b) Application of routine customer identification procedures as per the internal policies and directions issued by FIU.
- c) On-going monitoring of accounts.
- d) Procedures to identify suspicious transactions and reporting such to FIU.
- e) Regular training of staff especially new recruits employed by the bank on AML and KYC.

In order to further enhance above risk management procedures, the bank is in the process of securing a software package encompassing all statutory and bank requirements on AML and KYC.

Market Risk

Market risk is the risk that the value of on and off-balance sheet positions will be adversely affected by movements in market rates or prices such as interest rates, foreign exchange rates resulting in a loss of earnings and capital. The Asset/Liability Committee (ALCO) has the primary responsibility of managing the market risk.

Interest Rate Risk

Interest rate risk arises when there are mismatches between lending and funding positions which are subject to interest rate adjustment within a specified period. The immediate impact of variation in interest rate is on the Bank's net interest income and spreads on lending. Interest rate risk occurs due to:

- (a) Differences between the timing of rate changes in lending and borrowing instruments. (re-pricing risk);
- (b) Changing rate relationships among different yield curves effecting bank activities (basis risk);
- (c) Changing rate relationships across the range of maturities (yield curve risk);
- (d) Interest-related options embedded in bank products (options risk).

The Bank's exposure to interest rate risk is controlled by following product pricing methodologies:

- (a) Short-term lending such as overdrafts, revolving limits and loans with maturities of less than one year are made at fixed rates and subjected to mandatory internal reviews at frequencies of less than one year.
- (b) Lending agreements of accommodation backed by deposits have a provision for re-pricing with changes in the rates of underlying deposits.
- (c) All term loans are priced at variable rates with re-pricing intervals not exceeding one year. The re-pricing is based on benchmarks sensitive to movement of market interest rates such as the average weighted prime lending rate.
- (d) All lending agreements have overriding price revision clauses which allow the Bank to adjust pricing suitably in exceptional situations.
- (e) The Bank's exposure to interest related options is not material to have any significant adverse impact on the earnings.

Due to the comfort offered by these safeguards, the Bank has not felt the need to track rate exposures more systematically by application of Re-pricing Gap Models.

Risk Management... *Contd*

Foreign Exchange / Currency Risk

It is the current or prospective risk to earnings and capital arising from adverse movements in currency exchange rates in relation to foreign currency transactions or assets. The position with regard to current exposure to this risk is as follows:

- (a) Total foreign currency assets are matched by liabilities of the same currency with equal or longer tenor.
- (b) Short-term trade related finance in foreign currency, mainly US Dollars, is funded by foreign currency customer deposits.
- (c) The Group Treasury actively manages the exchange risk by applying limits on single dealer, currency, overall exposure and maturity. These limits are conservative and commensurate with the scale of operations.

Liquidity Risk

Liquidity risk is the risk that the Bank is unable to fund its current obligations and operations in the most cost efficient manner. The mechanism in place to effectively monitor the short, medium and long-term liquidity risks are as follows:

- (a) Regular cash-flow forecasts and liquidity ratio analyses by the ALCO.
- (b) Maturity gap analyses are consistently updated and monitored by the ALCO to track any material exposures that require action.
- (c) Material concentration of assets and liabilities are tracked to identify potential sources of liquidity risk.
- (d) Ability to rollover borrowings and customer deposit to provide liquidity support to the Bank.
- (e) For short-term liquidity support, the Bank has access to the money market sources at competitive rates.

Diversification of the liability structure and sources of funding is a key focus of the Bank at present.

Operational Risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and system or from external events. The focus areas of operations risk management and action taken to continually strengthen controls are listed below:

- (a) Efficient and effective maintenance of the information technology systems including the IT security policy.
- (b) Regularly evaluating the adequacy and effectiveness of the internal control structure to changing operational requirements of the Bank.
- (c) Continuous assessment of the operational and financial reporting infrastructure to ensure that it is adequate to handle emerging business and financial reporting developments.

- (d) Effective internal audit function to provide assurance about integrity of information systems, compliance with regulations and effectiveness of the internal controls.
- (e) Mitigation of the risk of human error by adequately training the employees, documenting comprehensive policies and procedures.

The whole exercise of the operational risk management is to identify events that are likely to cause losses.



The DFCC Vardhana Bank Ltd is committed to best practices of Corporate Governance and complies with the corporate governance practices recommended by the Central Bank of Sri Lanka and with the Code of Best Practice on Corporate Governance issued by the Institute of Chartered Accountants of Sri Lanka. We strive to earn and retain the trust of our shareholders and other stakeholders through our commitment to sound principles of corporate governance.

The Annual Corporate Governance Report to be Published in the Annual Report in Terms of Section 3 (1) (xvi) of the Banking Act Direction No 11 of 2007.

Responsibilities of the Board:

- (i) The Board has taken action to strengthen the safety and soundness of the Bank by the implementation of the following:
 - (a) Exercising oversight over formulation of the Annual Business Plans and the Budgets in respect of each year.
 - (b) Evaluation of risks and identification of measures to control and mitigate such risks.
 - (c) Assess, through the Audit Committee, the effectiveness of the internal control and financial reporting systems by examination of the External and Internal Audit reports and the Central Bank on-site inspection reports.
- (ii) The Board has appointed the Chairman and the Chief Executive Officer with distinctly different roles and responsibilities.
- (iii) The Board agrees on the calendar of monthly scheduled meeting dates at the beginning of each year. Additional Board meetings are scheduled on a need basis. All meetings involve active participation of the Directors entitled to attend. Obtaining the Board's approval through the circulation of written resolutions or papers is rare.
- (iv) The Directors may initiate matters for inclusion in the agenda of any of the Board meetings.
- (v) The meeting dates are predetermined and known to all the Directors. The Agenda and Board papers are circulated to all the Directors at least five days before the scheduled meeting dates.
- (vi) The Articles of Association of the Bank provide that any director, who has not attended the immediately preceding three consecutive meetings held, shall cease to be a Director.
- (vii) The Board has appointed the Company Secretary as per Section 43 of the Banking Act No 30 of 1988. A primary responsibility of the Secretary is to handle the secretariat services to the Board and to carry out the other statutory

- functions relating to that position.
- (viii) All Directors have access to advice and services of the Company Secretary to ensure that the Board procedures and all applicable regulations are followed.
- (ix) The Company Secretary compiles the minutes of Board meetings and they are approved by the Directors at the subsequent meeting. The approved minutes are signed by the Chairman and added to the Minute Book. It is available for inspection by any Director.
- (x) The Board minutes are drawn with sufficient details and indicate the decisions made and the reasons and rationale for making such decisions.
- (xi) The Directors may seek independent professional advice, at the Bank's expense, to assist the relevant Director to discharge his / her duties, if the circumstances so require.
- (xii) The Articles of Association provide for a Director who is directly or indirectly interested in a contract or a proposed contract with the Bank to declare the nature of his interest in accordance with the provisions of the relevant statutes. The Directors make relevant declarations under Section 192 (2) of the Companies Act No 07 of 2007.
- (xiii) The Board has ensured that the Bank is adequately capitalised above the level required by the Monetary Board. Please refer the Capital Adequacy shown in the Financial Highlights on page 3.

The Board's composition:

- (i) Presently, the Board of Directors of the Bank consists of nine members and the composition of the Board meets the requirement of the relevant Central Bank Direction.
- (ii) The Board consists of two Executive Directors including the Chief Executive Officer.
- (iii) The two Executive Directors possess over fifteen years of relevant banking experience at senior managerial positions.

Criteria to assess the fitness and propriety of Directors

- (i) All the Directors meet the relevant age criterion.
- (ii) All the Directors meet the fitness and propriety criteria specified in 3 (3) of the Banking Act Direction No 11 of 2007.

Management functions delegated by the Board

- (i) The Board has delegated specified decision-making authority to the Management Committees, CEO and Senior Management. The accounting and reporting systems are in place for the Board to assess the effectiveness of utilisation of the delegated authority. The objective of such delegation

Corporate Governance... Contd

of authority is to ensure effective conduct of the business. The extent of the delegation is relative to the business requirements.

- (ii) The Board periodically reviews the delegation processes and make relevant changes to suit constantly evolving needs of the Bank.

The Chairman and Chief Executive Officer

- (i) The roles of the Chairman and the Chief Executive Officer are performed by two separate individuals.
- (ii) As the Chairman does not meet the criteria for an Independent Director, the Board has designated an Independent Director as a Senior Director.
- (iii) The Chairman presides over the Board meetings and provides effective leadership to the Board of Directors to discharge its responsibilities.
- (iv) The agenda for the Board meetings is drawn up by the Company Secretary and is approved by the Chairman at the Board meetings.
- (v) The Chairman ensures that all the Directors are properly briefed of the issues arising at the Board meetings and that they receive adequate information in a timely manner.
- (vi) The Chairman does not involve himself in management functions or direct supervision of key management personnel of the Bank.
- (vii) The Chief Executive Officer functions as the Head of the Management Team and is in-charge of the day-to-day management of the Bank's operations and business.

Board appointed Committees

The Board has appointed the following sub-committees.

- (a) The Audit Sub-Committee
- (b) The Board Nominations Committee
- (c) The Board Human Resources and Remuneration Committee
- (d) The Board Integrated Risk Management Committee

The above Sub-committees report to the Board of Directors. The Board Sub-committees listed in (b), (c) and (d) above were appointed with effect from 01.01.2009. The details relating to the Board Sub-Committees are given on pages from 27 to 29.

Related Party Transactions

The following procedures are in place to avoid any conflicts of interest referred to in the Direction.

- (a) The Articles of Association provide that a Director who is in anyway, whether directly or indirectly, interested in a contract or a proposed contract with the company shall declare the nature of his interest in accordance with the provisions of the Statutes.
- (b) The Directors also make disclosures under Section 192 (2) of the Companies Act relating to transactions in which they are "interested" as defined in Section 191 of the Act.
- (c) Appropriate entries are made in the Interest Register of the declarations made under (b) above.

Compliance with the Corporate Governance Rules as Required by Section 3 (8) of the Banking Act Direction No 11 of 2007 of the Central Bank of Sri Lanka

(i)	The Board shall ensure that:	
(a)	Annual audited financial statements and quarterly financial statements are prepared and published in accordance with the formats prescribed by the supervisory and regulatory authorities and applicable accounting standards.	Complied with.
(b)	Such statements are published in the newspapers in an abridged form, in Sinhala, Tamil and English.	Complied with.
(ii)	The Board shall ensure that the following minimum disclosures are made in the Annual Report:	
(a)	A statement to the effect that the annual audited financial statements have been prepared in line with applicable accounting standards and regulatory requirements, inclusive of specific disclosures.	Please refer the Directors' Report on page 32.



(ii) The Board shall ensure that the following minimum disclosures are made in the Annual Report: Contd.		
(b)	A report by the Board on the Bank's internal control mechanism that confirms that the financial reporting system has been designed to provide reasonable assurance regarding the reliability of financial reporting and that the preparation of financial statements for external purposes has been done in accordance with relevant accounting principles and regulatory requirements.	Please refer the Directors' Report on page 34.
(c)	Details of directors, including names, fitness and propriety, transactions with the bank and the total of fees/remuneration paid by the bank.	Please refer the Directors profile on page 17 and Note 9 to the Financial Statements.
(d)	Total net accommodation as defined in 3(7) (iii) granted to each category of related parties shall also be disclosed as a percentage of the bank's regulatory capital.	Please refer Note 32 to the Financial Statements.
(e)	The aggregate values of remuneration paid by the bank to its key management personnel and the aggregate values of the transactions of the bank with its key management personnel, set out by broad categories such as remuneration paid, accommodation granted and deposits or investments made in the bank.	Please refer Note 32.3 to the Financial Statements.
(f)	A report setting out details of the compliance with prudential requirements, regulations, laws and internal controls and measures taken to rectify any material non-compliances.	Please refer the Directors' Report on pages 32 to 34.
(g)	A statement of the regulatory and supervisory concerns on lapses in the Bank's risk management, or non-compliance with these Directions that have been pointed out by the Director of Bank Supervision, if so directed by the Monetary Board to be disclosed to the public, together with the measures taken by the bank to address such concerns.	No direction issued by Monetary Board.

The Board Appointed Committees

The Board of Directors have appointed the following Sub-committees of the Board in accordance with the generally accepted practice of Corporate Governance.

Audit Committee

The members of the Audit Committee are:

Mr L N de S Wijeyeratne - Chairman	Independent Non-executive Director
Ms Y N Perera – Senior Director	Independent Non-executive Director
Mr J A R E M Machado	Independent Non-executive Director
Ms R A P Withana	Non-executive Director

Corporate Governance... Contd

The Chairman of the committee is a Chartered Accountant, trained in the audit practice. He possesses extensive experience in industry, commerce and finance sectors. In addition, Ms R A P Withana is a Chartered Accountant with significant work exposure in audit, finance and banking sectors. The Senior Director, Ms Y N Perera, has a wide exposure in the governance of private sector enterprises. Mr J A R E M Machado is a professional banker with extensive

training and experience in commercial banking. The experience of all members of the Audit Committee has been at higher managerial levels of their respective fields of expertise. The Head of Audit and Compliance, Mr Prasanna Kannagara, is a Chartered Certified Accountant with a long career record in the banking industry.

Human Resource and Remuneration Committee

The members of the Human Resource and Remuneration Committee are:

Mr J M S Brito - Chairman	Non-executive Director
Mr A N Fonseka	Non-executive Director
Mr L G Perera - Managing Director / CEO	Executive Director
Mr L N de S Wijeyeratne	Independent Non-executive Director

The Committee is responsible for the human resource management and remuneration pertaining to the Directors, CEO and key management personnel of the Bank.

- (a) Determine the remuneration policy relating to the Directors, Chief Executive Officer (CEO) and key management personnel of the Bank.

- (b) Decide on goals and performance targets for the Directors, CEO and the key management personnel.
- (c) Evaluate the performance of the CEO and key management personnel against the set goals and targets and determine the basis for revising remuneration, benefits and other performance-based payments.

Nominations Committee

The members of the Nomination Committee are:

Ms Y N Perera - Chairperson	Independent Non-executive Director
Mr J M S Brito	Non-executive Director
Mr J A R E M Machado	Independent Non-executive Director

The Chief Executive Officer is invited to be present at the meetings. The areas of responsibility of Nominations Committee are as follows:

- (a) To implement a procedure to select / appoint new directors, the CEO and key management personnel.
- (b) Consider and recommend (or not recommend) the re-election of current directors taking into account the performance and contribution made towards the overall discharge of the Board's responsibilities.

- (c) Determine the criteria such as qualifications, experience and key attributes required for appointment or promotion to the post of CEO and the key management positions.
- (d) Ensure that the directors, CEO and key management personnel are fit and proper persons to hold office based on their performance and as per relevant statutory requirements.
- (e) Recommend from time to time, the requirements of additional / new expertise and the succession arrangements for retiring directors and key management personnel.



Integrated Risk Management Committee

The members of the Integrated Risk Management Committee are:

Mr J M S Brito - Chairman	Non-executive Director
Mr A N Fonseka	Non-executive Director
Mr J A R E M Machado	Independent Non-executive Director
Mr S Nagarajah	Non-executive Director
Mr L G Perera - Managing Director / CEO	Executive Director
Mr L H A L Silva - Chief Operating Officer	Executive Director
Ms M Gunawardhena	Head of Group Treasury

The Committee obtains the involvement of relevant key management personnel representing broad risk categories in making decisions within the framework of the authority and responsibility assigned to it. The areas of responsibility of this Committee are as follows:

- (a) Assess all risks pertaining to the business of the Bank such as credit, market, liquidity, operational and strategic risks on a continuous basis using appropriate methodologies and indicators.
- (b) Review the adequacy and effectiveness of all management level committees such as the credit committee and the asset/liability committee to address and to manage risks within quantitative and qualitative risk limits as specified by the Committee.
- (c) Adopt corrective action to mitigate the effects of specific risks where such risks are at levels beyond the limits set out in Bank's policies and regulatory and supervisory requirements.
- (d) Assess the Bank's compliance with the laws, regulations, internal controls and approved policies pertaining to risks in all areas of business operations.

Sustainability Report

Corporate sustainability refers to a wide range of non-financial responsibilities expected of corporate entities by their stakeholders such as shareholders, customers, employees and the general public. Sustainability is about environmental protection, economic growth and achieving social equity. These goals are in congruence with broader business objectives of DFCC Vardhana Bank. A sustainable culture mixes easily with our work ethics, customer service standards, employee relations etc. The Bank's shifting standards on improving efficiency, reducing waste, saving energy, enhancing productivity and safety at work have positive impact on the environment, are socially responsible and lead to a more profitable business.

Product Responsibility

The Bank has a large and diversified customer base dispersed over most parts of the country. The Bank is committed to provide them with a customised service covering most of their business needs. We offer a wide range of products and services to customers due to our presence with DFCC Bank in most of the business locations. We cross-sell the products and services of both Banks from our common branches giving customers a range of options for meeting their specific needs.

The two Banks share collateral offered to secure loans, wherever practicable, to further facilitate customers' access to our banking products and services. This provides a unique opportunity for customers to leverage their relationship with one Bank to access the products of the other and to use banking products that would best suit their business requirements.

Another measure that the Bank has adopted to be more responsive to the customer needs is segmentation of customers into the broader groups such as the corporate customers, small and medium enterprises (SME) and personal banking clients. This approach helps the Bank design products and service standards to match their unique requirements. All frontline business units have earmarked personnel to provide customised service to our clientele.

The lending processes ensure that the repayment capacity of the borrowers is carefully assessed to prevent any over exposures which can be detrimental to the borrowers' interests. Similarly, we use a panel of professional valuers to determine realistically the value of mortgages and advise customers to operate within affordable levels of finance.

The in-house lawyers of the Bank routinely advice clients regarding the status of their title on property offered to the Bank as collateral

in relation to lending. This is a value adding process that helps borrowers to identify any defects of ownership of project properties and address them up-front and avoid future disputes relating to such assets.

The Bank lines-up services such as Letters of Credit with appropriate credit lines for meeting any contingencies that may arise on arrival of goods depending on the specific needs of customers. Similarly, the export credit schemes have helped many exporters to fund their working capital requirements.

The Bank carefully nurtures its personal banking customers with service standards and products which cater for their diverse needs. The deposit customers have access to an array of fast delivery deposit-backed lending schemes to meet their personal fund requirements. We also offer other products such as gift certificates, credit cards etc designed to meet the needs of personal banking customers.

The Bank has instituted standardised customer identification procedures to guard against the possibility of the bank accounts being used for money laundering, financing terrorists and other unlawful activities.

Human Resource Management Practices

The HRM practices of the Bank are focused on selection of qualified staff, providing them with training and retaining them for a long career. The staff recruitment is based on merit determined on requisite qualifications, aptitudes and other suitability criteria.

The Bank invests significantly in training and development of the staff on a continuous basis. We also create many opportunities for the staff to enhance their skills and competencies. The objective is to develop them as versatile individuals capable of performing well on their work assignments as well as improving their personal profiles.

The Bank employs objective performance evaluation practices to measure individual performance and openly communicates performance assessments with respective individual staff members. We also support them with relevant training and advise to address any gaps in knowledge, exposure or behavioural attributes.

We recognise excellence in performance, professionalism and effectiveness as determining factors in career advancement. We also reward good performance for reinforcing efficiency and manage unsatisfactory performance with understanding.



Open communication throughout the organisation is encouraged and opportunities to share individual perspectives are created through social events etc. Our regular marketing and promotional campaigns, group assignments help enhancing this inclusive culture. We engage them in operational and strategic decision making for encouraging participation and improving performance.

The Bank provides the medical benefits covering staff and immediate family members, maternity leave, leave and superannuation benefits as per statutory standards.

We eschew child labour and unethical work practices and are committed to treating all people with respect and dignity.

The safety standards and work environment of all our offices are on par with the best practices in the banking industry.

Corporate Social Responsibility

We recognise that our business operations have certain adverse effects on the environment. They include greenhouse gas emissions relating to the use of electricity in our offices, use of office and hired vehicles and the like. As a banking institution the work in our offices tend to consume a large quantity of paper. We have put in place work practices to consciously minimise the use of these resources. We incrementally build-on the environmental awareness with a view to minimising the carbon footprint of our operations.

Internal correspondence and communication in all our offices is via email and use of paper on this account has been eliminated. They are rarely printed as we retain them in retrievable electronic storage.

The workflow relating to approval of credit facilities is automated facilitating the transmission of all reports, analyses, recommendations, approvals etc electronically.

Travel between offices is reduced as the voice enabled office network system provides unrestrained connectivity for voice communication.

We extensively re-use stationery, envelopes etc in our offices for printing draft reports, internal letters etc to reduce the use of paper.

We do not use air-conditioning on holidays and switch off central air-conditioning half an hour before close of office on normal work days to save electricity consumption. The officers shut down fans and switch off lights when they leave their workstations.

We pool transport requests as far as practicable to optimise the use of vehicles and use a regular shuttle transport service between DFCC Bank and DVB Head Office where the staff traffic is heaviest.

We expect these behavioural practices to cascade into the homes of our employees making their overall impact larger.

In addition, the focal point of our corporate social responsibility has been managing environmental and social initiatives. In 2008, DVB and DFCC Bank together launched corporate social responsibility initiatives for 2009 onwards. The new approach to CSR will place priority on empowering children by creating opportunities for acquiring new skills. The programme includes giving computers to schools, equipping laboratories and libraries, supplementing the curriculum with field trips, seminars and workshops for children. This outreach programme recognises that educating children has lasting effects on the nation.

Enhancing public school education through an early learning programme centred on the Japanese discipline of '5S' and the '3R' principles (Re-use, Recycle, Reduce) will be DFCC/DVB's social priority for the next five years, beginning 2009. The programme is designed specifically to advance the skills young children need to thrive in a competitive world. Teacher training and parent guidance will be a key part of the crucial work of inculcating in children good habits and respect for the environment. The training will enable teachers to effectively weave the disciplines into the early-learning classrooms. Parents are expected to encourage children to take the disciplines beyond the classroom and into their homes.

The vision of DFCC's CSR initiative is to guide children 'Towards an Exemplary Society'. The programme will be initially launched in selected schools country-wide but will continue to include more schools as the years roll and is planned to be made available to a number of needy schools in the future.

In October, the Bank organised an amateur photo exhibition and competition titled 'Sobha 2008' to raise awareness on the need to protect the environment. Selected photographs from the exhibition will be displayed in schools in an effort to inculcate in children a sense of appreciation for the beauty of Sri Lanka.

An exhibition featuring 1000 photographs of sights, fauna and flora of Sri Lanka of nearly 500 amateur photographers selected from Sobha 2008, was concluded recently at the Lionel Wendt Art Gallery. The photos of 12 finalists were featured in the Bank's calendars for 2009. The event is a forerunner to a programme on environmental conservation by the two banks.

Annual Report of the Board of Directors

The Directors of the DFCC Vardhana Bank Limited (Bank) have pleasure in presenting their Annual Report on the affairs of the Company for the year ended 31 December 2008 together with the audited Financial Statements for the year. The details set out herein provide pertinent information required by the Companies Act No. 07 of 2007 and the Banking Act No. 30 of 1988 (as amended).

Principal Activities

The principal activities of the Bank constitute banking and related operations such as accepting local currency deposits, resident and non-resident foreign currency deposits, corporate banking, trade financing, personal banking, off-shore banking, project financing, corporate and retail lending, travel related services, issuing credit and debit cards, remittance services, investment in government securities etc.

The Branches of the Bank, their addresses and telephone numbers are listed on page 68.

Review of Business

The Chairman's Report (pages 6 to 9) and the Managing Director / Chief Executive Officer's Review (pages 10 to 16) provide a review of the Bank's business and performance during the year with comments on the financial results and financial position of the Bank. These reports, together with the Financial Statements, reflect the state of affairs of the Bank.

Financial Statements

The Financial Statements for the year ended 31 December 2008 of the Bank are set out on pages 36 to 67 of this report. The Directors confirm that the Financial Statements have been prepared and presented in accordance with the Sri Lanka Accounting Standards and provide the information required by the Companies Act No 07 of 2007 and the Banking Act No 30 of 1988.

Auditor's Report

The Auditor's Report on the Financial Statements for the year ended 31 December 2008 of the Bank is given on page 38.

Accounting Policies

The Accounting policies adopted in the preparation of the Financial Statements are given on pages 44 to 52. There were no changes in the accounting policies adopted in preparation of the Financial Statements other than that stated in Note 4.11 to the Financial Statements given on page 52.

Income

The income of the Bank for 2008 was Rs 3,498 million (2007 – Rs 2,248 million). The make-up of the income is given in Note 5 to the Financial Statements.

Profits and Appropriations

The net profit and appropriations during the year are set out below:

	2008 Rs '000	2007 Rs '000
Profit before taxation	337,689	290,310
Less: Taxation	226,525	137,310
Profit after taxation	111,164	153,000
Retained profit brought forward	432,985	287,635
Balance available for appropriation:	544,149	440,635
Appropriations:		
Transfer to Statutory Reserve Fund	(5,558)	(7,650)
Final Dividend Proposed - 2007/2008	(11,051)	-
Retained profit carried forward	527,540	432,985

The movement of these reserves is shown in the Statement of Changes of Equity on page 41.

Statutory Payments

The Directors to the best of their knowledge and belief are satisfied that all statutory payments relating to employees and the Government that were due as at the Balance Sheet date have been paid, or where relevant, sufficiently provided for.

Capital Expenditure

The capital expenditure incurred during the year amounted to Rs 176.3 million (2007 – Rs 186.2 million). The movements of property and equipment and intangible assets are set out in Note 20 and 21 to the financial statements.

Dividend

The Directors recommend to the shareholders, the payment of a first and final dividend of 10 cents per share (2007 – 6 cents per share) for the financial year 2008 to be paid to the holders of ordinary shares registered in the books of the company as at 31 December 2008. In recommending the payment of this dividend, the Directors unanimously declare that in their opinion the company will satisfy the solvency test stipulated in Section 57 of the Companies Act No 07 of 2007 immediately after the distribution is made and have obtained a certificate of solvency from the auditors to this effect.



Share Information

Information relating to stated capital of the company is given in Note 29 to the Financial Statements. There were 60 registered shareholders in the Register of Members as at 31 December 2008. DFCC Bank Ltd held 176,054,535 shares or 95.6% of the issued shares of the Bank as at 31 December 2008.

The Bank has been informed of a direction of the Monetary Board of the Central Bank of Sri Lanka, in terms of the Banking Act Direction No. 1 of 2007, that DFCC Bank Ltd shall dispose of and / or reduce the material interest acquired in DFCC Vardhana Bank Ltd to 15% of the issued capital carrying voting rights on or before 23 April 2012.

Interests Register

The Bank maintains the Directors' Interests Register conforming to the provisions of the Companies Act. The Directors of the Bank have made declarations as provided in Section 192 (2) of the Companies Act. Note 32.3.3 and 32.4 of the Financial Statements provide details of their interests in transactions with the Bank. The transactions with entities where a Director of the Bank neither have control nor exercise significant influence but only holds directorships are disclosed in the table 1 given below.

Directors' Shareholdings

The Directors, including their spouses and dependent children, did not hold shares of the Bank as on the Balance Sheet date nor did they have any acquisitions or disposals of shares during the year.

Directors' Remuneration

The Directors' remuneration in respect of the year 2008 is given in Note 9 to the Financial Statements on page 9.

Corporate Donations

Donations by the Company during the year amounted to Rs 70,000/- . (2007 Rs 115,000/-).

Board of Directors

The names of the Directors who held office as at 31 December 2008 are given below.

Non-Executive Directors

Mr. J. M. S. Brito (*Chairman*)
Mr. S. Nagarajah
Ms. R. A. P. Withana

Executive Directors

Mr. L. G. Perera (*Managing Director*)
Mr. L. H. A. L. Silva (*Chief Operating Officer*)

Independent Non-Executive Directors

Mr. J. A. R. E. M. Machado
Ms. Y. N. Perera
Mr. L. N. de S. Wijeyeratne

No other Director held office during the year. The Board of Directors appointed Mr A N Fonseka as a Director with effect from 02 February 2009.

Brief profiles of the Directors appear on pages 17 and 19. The appointments of the Directors have been approved by the Director of Bank Supervision of the Central Bank of Sri Lanka in terms of Section 42 of the Banking Act.

Table 1: Lending Transactions with Bank

Name of Director (Relationship)	Nature of Transaction	Aggregate Amount of Accommodation As at 31st December 2008	
		Rs. Mn. Limit	Rs. Mn. Outstanding
J. M. S. Brito - <i>Chairman</i>	Overdraft facility	56	45.01Cr
Y. N. Perera - <i>Director/Chairperson</i>	Overdraft facility	6	4.20
L. G. Perera - <i>Director</i>	Current account excess	-	0.03

Annual Report of the Board of Directors... Contd

The following Directors retire by rotation at the Annual General Meeting in terms of Section 87 of the Articles of Association of the Company.

Mr. J.M.S. Brito
Mr. S. Nagarajah

The following directors appointed by the Board of Directors as per Article 93 will hold office until the Annual General Meeting and will be eligible for re-election.

Mr. A. N. Fonseka
Mr. L. H. A. L. Silva
Mr. L. N. de S. Wijeyeratne

The above Directors, being eligible for appointment, offer themselves for election as Directors of the Company at the AGM. The Nominations Committee of the Board has recommended their re-appointment. The Board of Directors recommends their election as the Directors of the Company at the AGM.

Auditors

The Financial Statements for the year ended 31 December 2008 have been audited by Messrs KPMG Ford, Rhodes, Thornton & Co, Chartered Accountants. The following payment was made to them during the year.

Audit fees and audit related expenses - Rs 821,000/-
(Rs 592,000/- for 2007).

They did not undertake any non-audit work during the year. As far as the Directors are aware, the Auditors do not have any relationships, other than that of Auditor, with the Bank.

The Auditors have expressed their willingness to continue in office for the year ending on 31 December 2009. A Resolution relating to

their reappointment and authorising the Directors to determine their remuneration will be submitted at the Annual General Meeting.

Internal Controls

The Directors have instituted appropriate systems of internal control to carry on the business of the Bank in an orderly manner and to ensure, as far as practicable, the accuracy and reliability of financial records. They also have taken such steps as are reasonably open to them to safeguard the assets of the Bank and to prevent and detect frauds and other irregularities.

Corporate Governance

The Directors have taken appropriate action for the Bank to be in compliance with the Direction No 11 of 2007 of the Central Bank of Sri Lanka pertaining to the Corporate Governance for Licensed Commercial Banks in Sri Lanka. The Corporate Governance Report is given on pages 25 to 29.

Events Occurring After the Balance Sheet Date

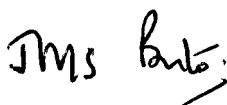
No events have occurred since the Balance Sheet date that would require adjustment to or disclosure in the accounts other than those disclosed in Note 33.1 to the Financial Statements on page 67.

Going Concern

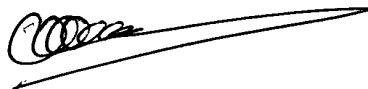
The Board is satisfied that the Bank has adequate resources to continue its operations in the foreseeable future. Therefore, they have adopted the going-concern basis in preparing the Financial Statements.

Annual General Meeting

The thirteenth Annual General Meeting of the Bank will be held on 28 May 2009 at 10.00 a.m. at the DFCC Bank, Head Office, No 73/5, Galle Road, Colombo 3. The Notice of the Annual General Meeting is given on page 69 of the Annual Report.



J. M. S. Brito
Chairman



L. G. Perera
Managing Director/CEO



W. A. Mendis
Company Secretary

March 25, 2009
Colombo



Financial Reports

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Statement of Directors' Responsibility

The Directors are responsible, under Section 148 (1) of the Companies Act No 07 of 2007, to ensure that proper accounting records are kept to disclose, with reasonable accuracy, the financial position and enable preparation of the financial statements. Accordingly, the Directors have caused the Bank to maintain proper accounting records which meet the statutory and financial reporting requirements.

The Directors are also responsible, under Sections 150 (1) and 151 (1) of the Companies Act, to prepare the Financial Statements for each year giving a true and fair view of the state of affairs of the company as at end of the year and of the profit and loss for the financial year.

They are also responsible to prepare and present the Financial Statements in accordance with the Sri Lanka Accounting Standards and provide the information required by the Companies Act No 07 of 2007 and the Banking Act No 30 of 1988.

The Directors consider that they have adopted appropriate accounting policies based on reasonable and prudent judgements and applied them consistently.

The Directors acknowledge their responsibility for the Bank's system of internal controls which is designed to provide assurance on maintenance of proper accounting records and the reliability of financial information generated and safeguarding of the assets of the Bank. However, any system of internal controls can provide reasonable and not absolute assurance that errors and irregularities are either prevented or detected within a reasonable period of time.

The Auditors, Messrs KPMG Ford, Rhodes, Thornton & Co., were given access to all accounting records, other documents and all business locations of the Bank to undertake the inspections they considered appropriate to form their opinion on the Financial Statements. They were also provided with all the information and explanations required for the purpose of the audit.

By Order of the Board



W. A. Mendis
Company Secretary

March 25, 2009
Colombo

Audit Committee Report

During the year under review Mr. J A R E M Machado who is an Independent Non-Executive Director of the Board functioned as the Chairman of the Audit Committee. In addition, there was another Independent Non-Executive Director and a Non-Executive Director making the total of three committee members for the current year. The Head of Compliance and Internal Audit functions as the Secretary to the Audit Committee. The Managing Director/Chief Executive Officer, Director/Chief Operating Officer and Head of Compliance and Internal Audit attend the Audit Committee Meetings by invitation.

The Board Audit Committee held six meetings during the year.

At the inception of 2009 Mr L N de S Wijeyeratne who is an Independent Non-Executive Director of the Board was appointed as the Chairman of the Audit Committee making the number of members to four.

The Board of Directors have now appointed all the Board Committees as required by the Banking Act Directions No.11 of 27 December 2007 on Corporate Governance and is compliant as regards to its compositions.

The voluntary services rendered by Mr. T K Bandaranayake as a Consultant to the Audit Committee has added considerable value to its functioning for which we are very thankful.

Audit Committee function

- The Committee examined the quarterly and annual financial statements of the Bank and its compliance with all statutory requirements and Sri Lanka Accounting Standards. Where relevant, the External Auditors and the Head of Finance were present during the examination of the above financial statements.
- The External Auditors were present on three occasions during the year where the financial statements for 2007 were discussed in detail as well as the audit plan for 2008. The Audit Committee members also brought to the attention of the External Auditors their concerns which were to be addressed during the audit for the year 2008.
- The Audit Committee engaged the services of a firm of external consultants on the IT audit, whose members had considerable IT audit experience in Banks, to carry out an audit of a selected area of the core banking system. We intend to expand the IT audit to cover other areas of the core banking system in the coming year.
- During the year, with the expansion in the branch network, the committee obtained the services of two firms of Chartered Accountants to carry out the branch audits. In addition, Internal Audit Department of the Bank carries out a comprehensive audit of the branches and departments.
- Enhancements of internal controls took priority with its implementation across the branches and departments of the bank. Chairman would write directly to the Branch Managers /Heads of Depts calling for explanations where applicable, on the observations made at the Board Audit Committee meetings. Necessary action would be taken thereafter depending on the responses received.

It is the opinion of the Audit Committee that adequate internal controls are in place which are being updated and enhanced on an on-going basis as per above and hence providing reasonable assurance that the assets of the bank are safeguarded and that the financial position of the bank is well monitored.

The Audit Committee has recommended to the Board of Directors that, KPMG Ford, Rhodes, Thornton & Co. be re-appointed as Auditors for the year 31st December 2009, subject to the approval of shareholders at the Annual General Meeting.



L. N. de S. Wijeyeratne
Chairman – Audit Committee

March 25, 2009

Report of the Auditors



KPMG Ford, Rhodes, Thornton & Co.
(Chartered Accountants)
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INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF DFCC VARDHANA BANK LIMITED

Report on the Financial Statements

We have audited the accompanying financial statements of DFCC Vardhana Bank Limited, which comprise the balance sheet as at December 31, 2008, 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.

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 December 31, 2008 and the financial statements give a true and fair view of the Company's state of affairs as at December 31, 2008 and its profit and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

Report on Other Legal and Regulatory Requirements

These financial statements also comply with the requirements of Section 151(2) of the Companies Act No. 07 of 2007 and present the information required by the Banking Act No. 30 of 1988.

Chartered Accountants

March 25, 2009
Colombo, Sri Lanka

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A.N. Fernando FCA
Ms. M. P. Perera FCA
T.J.S. Rajakarier FCA
Ms. S.M.B. Jayasekara ACA

S. Sirikananathan FCA
P.Y.S. Perera FCA
W.W.J.C. Perera FCA
W.K.D.C. Abeyrathne ACA

M.R. Mihular FCA
C.P. Jayatilake FCA
Ms. S. Joseph ACA
S.T.D. Perera ACA

Income Statement

For the year ended 31st December

	Notes	2008 Rs '000	2007 Rs '000
Income	5	3,498,273	2,248,091
Interest income	6	3,212,690	1,937,732
Interest expense	7	2,031,116	1,273,506
Net interest income		1,181,574	664,226
Net foreign exchange profit		16,082	103,181
Fee and commission income		229,112	184,246
Other income	8	40,389	22,932
Operating income		1,467,157	974,585
Less: operating expenses	9		
Personnel expenses		269,988	195,261
Provision for staff retirement benefits		2,435	4,529
Premises, equipment and establishment expenses		230,541	159,313
Fee expenses		35,436	27,024
Provision for loan losses and write-off	10	287,213	101,046
Other overhead expenses		202,785	147,586
Value added tax on financial services		101,070	49,516
Operating expenses		1,129,468	684,275
Profit before income tax		337,689	290,310
Less: Income tax expense	11	226,525	137,310
Profit for the year		111,164	153,000
Basic earnings per share, Rs	12	0.60	1.27

Notes to the Financial Statements from pages 44 to 67 form an integral part of these Financial Statements.

Balance Sheet

As at 31 December

	Notes	2008 Rs '000	2007 Rs '000
Assets			
Cash and short term funds	13	2,177,373	2,578,199
Balances with Central Bank of Sri Lanka	14	768,383	611,301
Treasury bills and bonds eligible for rediscounting with Central Bank	15	5,764,172	872,090
Securities purchased under resale agreements		171,564	475,000
Bills of exchange	16	326,171	492,668
Loans and advances	17	14,426,000	10,628,910
Interest receivable	18	179,569	140,472
Investment securities	19	2,030	3,030
Property and equipment	20	320,977	250,202
Intangible assets	21	120,066	116,177
Deferred tax asset	22	-	82,823
Other assets	23	548,428	642,903
Total assets		24,804,733	16,893,775
Liabilities			
Deposits from customers	24	18,972,099	12,117,145
Borrowing	25	2,189,882	1,144,085
Group balances payable	26	19,050	37,065
Current tax		46,321	52,683
Retirement benefit obligation	27	11,064	9,069
Deferred tax liability	22	4,889	-
Other liabilities	28	933,491	1,005,904
Total Liabilities		22,176,796	14,365,951
Equity			
Stated capital	29	2,077,387	2,077,387
Reserve fund		23,010	17,452
Retained earnings		527,540	432,985
Total equity - attributable to the equity holders of the Bank		2,627,937	2,527,824
Total liabilities and equity		24,804,733	16,893,775
Commitments and contingencies	30	7,394,581	6,760,832

Notes to the Financial Statements from pages 44 to 67 form an integral part of these Financial Statements.

These financial statements are in compliance with the requirements of Companies Act No. 07 of 2007.



Ms. D. S. J. Wettasinghe

Senior Manager Accounting & Reporting

For and on behalf of the Board of Directors,



J. M. S. Brito

Chairman



L. G. Perera

Managing Director / CEO

Colombo
March 25, 2009

Statement of Changes in Equity

	Stated Capital * Rs '000	Attributable to equity holders of the Bank		Total Rs '000
		Statutory Reserve Fund ** Rs '000	Retained profit Rs '000	
Balance as at 31/12/2006	1,184,071	9,802	287,635	1,481,508
Profit for the year	-	-	153,000	153,000
Right issue of new shares	893,316	-	-	893,316
Transfer to statutory reserve fund	-	7,650	(7,650)	-
Balance as at 31/12/2007	<u>2,077,387</u>	<u>17,452</u>	<u>432,985</u>	<u>2,527,824</u>
Final dividend approved for 2007	-	-	(11,051)	(11,051)
Profit for the year	-	-	111,164	111,164
Transfer to statutory reserve fund	-	5,558	(5,558)	-
Balance as at 31/12/2008	<u>2,077,387</u>	<u>23,010</u>	<u>527,540</u>	<u>2,627,937</u>

Notes to the Financial Statements from pages 44 to 67 form an integral part of these Financial Statements.

* 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 reclassified as stated capital.

** Statutory Reserve Fund

Statutory 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 to statutory reserve fund	2008 Rs' 000	2007 Rs' 000
Profit after tax	111,164	153,000
Minimum amount to be transferred @ 5%	5,558	7,650

Cash Flow Statement

For the year ended 31st December

	2008 Rs '000	2007 Rs '000
Cash flow from operating activities		
Interest receipts	2,565,694	1,779,195
Fees and commission receipts	229,112	184,246
Interest payments	(1,879,368)	(1,171,714)
Receipts from other operating activities	62,259	132,654
Cash payments to employees and suppliers	(721,890)	(411,990)
Value added tax paid	(94,627)	(47,093)
Operating profit before changes in operating assets	<u>161,180</u>	<u>465,298</u>
(Increase)/decrease in operating assets		
Deposits held for regulatory or monetary control purposes	(157,082)	(132,634)
Funds advanced to customers	(3,811,438)	(3,396,766)
Others	83,085	(307,716)
Increase /(decrease) in operating liabilities		
Deposits from customers	6,803,701	4,343,988
Negotiable certificates of deposit	51,253	(39,173)
Others	(168,081)	263,715
Net cash generated from operating activities before Income tax	<u>2,962,618</u>	<u>1,196,712</u>
Income tax paid	(93,986)	(68,159)
Net cash flow generated from operating activities (a)	<u>2,868,632</u>	<u>1,128,553</u>
Cash flow from investing activities		
Treasury bills eligible for rediscounting with Central Bank -more than 3 months	(3,162,944)	(285,282)
Income from investment securities	104	122
Interest receipts from Treasury bills	455,411	65,839
Disposal of property & equipment	44	1,500
Purchase of investment securities	1,000	(2,000)
Purchase of property and equipment	(176,383)	(186,201)
Net cash flow used in investing activities	<u>(2,882,768)</u>	<u>(406,022)</u>
Cash Flow from financing activities		
Proceeds from the sale of ordinary shares	-	893,316
Bank borrowing	418,414	(680,021)
Borrowing under repurchase agreements	627,383	472,404
Dividends paid	(11,051)	-
Net Cash flow from financing activities	<u>1,034,746</u>	<u>685,699</u>
Net increase in cash and cash equivalents	1,020,610	1,408,230
Cash and cash equivalents at beginning of period	3,278,407	1,870,177
Cash and cash equivalents at end of the period	<u>4,299,017</u>	<u>3,278,407</u>
Composition of cash and cash equivalent at end of the period		
Cash and short term funds (note 13)	2,177,373	2,578,199
Treasury bills and other securities eligible for rediscounting with CBSL-less than 3 months	1,950,080	225,208
Treasury bills purchased under resale agreements - less than 3 months	171,564	475,000
	<u>4,299,017</u>	<u>3,278,407</u>

For the year ended 31st December

	2008 Rs '000	2007 Rs '000
Note a		
Reconciliation of profit for the year to net cash flow generated from operating activities		
Profit after taxation	111,164	153,000
Add/(Less)		
Dividend Income	(104)	(122)
Provision for loan losses	287,213	101,046
Gain from mark to market on dealing securities	5,696	6,471
Notional tax credit on treasury bills & bonds	(51,189)	(2,361)
Increase/(decrease) in deferred tax	(87,712)	(54,193)
Increase/(decrease) in income tax	125,624	76,251
(Increase)/decrease in operating assets	(3,885,435)	(3,837,115)
Increase/(decrease) in operating liabilities	6,686,873	4,568,530
Net change in other receivables and payables	(425,173)	40,020
Loss on disposal of property and equipment	196	192
Depreciation - property and equipment	62,318	40,803
Amortisation - intangible assets	39,161	36,031
Operating profit before changes in operating assets	2,868,632	1,128,553

Notes to the Financial Statements

1. Reporting Entity

DFCC Vardhana Bank Limited ("Bank") is a public limited liability company incorporated in 1995 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. As per section 487(2) of Companies Act No 7 of 2007 the company has been re registered. The registered office of the Bank is situated at 73, W A D Ramanayake Mawatha, Colombo 02.

DFCC Bank which is licensed by the Central Bank of Sri Lanka as a specialized bank, is the parent company of the Bank, and owns 95.58% of the Bank.

The number of staff of the Bank as at 31st December 2008 is 407. (2007 - 302)

1.1 Principal Activities

Bank is currently engaged in activities related to commercial banking such as accepting deposits, providing corporate and retail credit, foreign currency operations, trade finance and treasury related services.

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

2. Basis of Preparation

2.1 Statement of Compliance

The Financial Statements have been prepared in compliance with Sri Lanka Accounting Standards laid down by the Institute of Chartered Accountants of Sri Lanka, and comply with the requirements of Companies Act No. 07 of 2007 and Banking Act No. 30 of 1988 and subsequent amendments thereto.

2.2 Approval of Financial Statements by Directors

The Financial statements were authorized for issue by the Board of Directors on 25 March 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 securities held for trading, which are measured at market value.

2.4 Functional and Presentation Currency

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

2.5 Use of Accounting Estimates and Judgments

The preparation of financial statements requires management to make judgments, 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 recognized in the period in which the estimate is revised and in any future periods affected.

Information about the significant areas of estimation and uncertainty that have the most significant effect on the amounts recognized in the financial statements are described below.

2.5.1 Provision for Loan Losses

In addition to the specific provisions for possible loan losses made on the basis of continuous review of all loans and advances to customers in accordance with the Sri Lanka Accounting Standard 23, "Revenue Recognition and Disclosures in the Financial Statements of Banks" and the directions issued by the Central Bank of Sri Lanka, the Bank evaluates the need for additional provisions for loans and advances based upon management's best estimate of recoverability. In estimating the recoverability the management makes judgments about the borrower's financial situation, the workout strategy and the net realisable value of any underlying collateral or significant impairment of debt service capacity of the borrower.

2.5.2 Classification of Dealing (Trading) and Investment Securities

The classification of investment securities is based on the positive intention of the management and the financial capacity to hold certain investments to maturity. In the event of a change of intention evidenced by management action of active trading, such investments are transferred to dealing securities, which represent securities held for trading.

The classification of these securities determines the recognition of the carrying amount of these securities in the balance sheet with a consequential adjustment to the reported results.

2.5.3 Assessment of Impairment

The assessment of impairment in tangible and intangible assets includes the estimation of the value in use of the asset computed at the present value of the best estimates of future cash flows generated by the asset adjusted for associated risks. The estimation has inherent uncertainties.

Impairment losses if any are charged to the income statement immediately.

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. 27.

3. Materiality and Aggregation

Each material class of similar items is presented separately in the financial statements. Items of dissimilar nature or function are presented separately unless they are immaterial.

4. Significant Accounting Policies

The accounting policies set out below have been applied consistently to all periods presented in these financial statements. The accounting policies of the Bank have been consistently applied and deviations if any, have been disclosed accordingly.

4.1 Foreign Currency Translation

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

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 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. Income and expenses of the Foreign Currency Banking Unit is translated at the average rate.

Forward Exchange Contracts are valued at the forward market rates ruling on the date of the Balance Sheet. Resulting net unrealised gains and losses on the open (trading) forward transactions are dealt with through the Income Statement.

4.2 Assets and Bases of their Valuation

4.2.1 Cash and short-term funds

Cash and short-term funds include cash in hand and balances with banks. They are brought to account at the face value or the gross value where appropriate.

Notes to the Financial Statements... Contd

4.2.2 Statutory Deposit with Central Bank of Sri Lanka

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 details of reserve requirements are given in note no 14. There are no reserve requirement for deposit liabilities of the Foreign Currency Banking Unit and foreign currency deposits liabilities in the Domestic Banking Unit.

4.2.3 Government of Sri Lanka Treasury Bills and Bonds

i) Investment in Treasury Bills and Bonds Held for Dealing

These are the marketable, dated debt securities in respect of which the Bank has the expressed intention of trading in the domestic debt market and are included in the balance sheet at the market value as a sub category of treasury bills and other securities eligible for rediscounting with the Central Bank of Sri Lanka.

The market value is determined using the middle rate of buy and sell quotes for the treasury bills and bonds eligible for rediscounting with the Central Bank of Sri Lanka provided by secondary market intermediaries.

The securities are recognized at cost initially on acquisition and thereafter marked to market on the balance sheet date in accordance with the direction issued by Central Bank of Sri Lanka on 'Prudential norms for classification, valuation and operation of the Bank's investment portfolio' dated 1 March 2006.

ii) Investment in Treasury Bills and Bonds Held to Maturity

These are dated debt securities in respect of which the Bank has expressed intention and ability to hold until maturity. These are included in the balance sheet as a sub category of treasury bills and other securities eligible for re-discounting with the Central Bank of Sri Lanka.

Investments in treasury bills and treasury bonds held to maturity are included in the balance sheet at cost adjusted for the amortisation of premium or discount arising on acquisition.

4.2.4 Securities Purchased under Resale Agreements (Reverse Repurchase Transactions)

These are loans collateralized by the purchase of treasury bills 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.

4.2.5 Investment in Ordinary Shares

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

4.2.6 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). The provision for possible loan losses include both specific and general provision.

4.2.6.1 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".

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.

4.2.6.2 Provision for Loan Losses

(a) Specific provision for loan losses

In accordance with the Direction issued by the Central Bank of Sri Lanka on 8th 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 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.

(b) General Provision

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 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.

4.2.6.3 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". 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.

4.2.7 Property, Plant and Equipment

Property, Plant & Equipment are tangible items that are held for servicing, or for administrative purpose; and are expected to be used during more than one period.

4.2.7.1 Basis of Recognition

Property, Plant & equipment are recognized if it is probable that future economic benefits associated with the asset will flow to the Bank and cost of the asset can be measured reliably.

4.2.7.2 Measurement

The cost of an asset comprises its purchase price or cost of construction 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, and any accumulated impairment losses. The depreciation is provided for on the basis outlined in 4.2.7.6.

Notes to the Financial Statements... Contd

4.2.7.3 Cost Model

The Bank applies cost model to Property, Plant & Equipment and records at cost of purchase or construction together with any incidental expenses thereon less accumulated depreciation and any accumulated impairment losses.

4.2.7.4 Subsequent Costs

The cost of replacing part of an item of Property and Equipment is recognized in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Bank and its cost can be measured reliably. The costs of day to day servicing of Property, Plant and Equipment are charged to the Income Statement as incurred.

4.2.7.5 De-recognition

The carrying amount of an item of Property, Plant & Equipment is derecognized on disposal or when no future economic benefits are expected from its 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 derecognized.

4.2.7.6 Depreciation

Depreciation is provided at the following rates on a straight-line basis such that the cost of the asset is depreciated over the period appropriate to the estimated life of the type of asset. The rates of depreciation are as follows:

Computer equipment	- 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.

Depreciation method, useful life and residual values are re-assessed annually on Balance Sheet dates.

4.2.8 Intangible Assets – Computer Application Software

All software licensed for use by the Bank, not constituting an integral part of related hardware are included in the balance sheet under the category intangible asset and carried at cost less cumulative amortization and any impairment losses.

The initial acquisition cost comprises license fee paid at the inception, import duties, non-refunded able taxes and levies, cost of customizing the software to meet the specific requirements of the Bank and other directly attributable expenditure in preparing the asset for its intended use.

The cost is amortized using the straight-line method, at the rate of 20% per annum commencing from the date the application software is available for use. The amortised amount is based on the best estimate of the useful life, such that the cost is amortised fully at the end of the useful life during which the Bank has legal right of use. The amortised cost is recognized as an expense.

The initial cost is enhanced by subsequent expenditure incurred by further customization to meet ancillary transaction processing and reporting requirements tailor-made for the use of the Bank constituting an improvement to the software.

Computer application software is stated at cost less accumulated amortization and accumulated impairment losses, if any.

4.2.9 Impairment

The identifiable assets of the Company are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any, such indication exists the recoverable amount of the asset is estimated and shown in the balance sheet. The impairment loss is taken to the income statement.

4.3 Liabilities and Provisions

4.3.1 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.

4.3.2 Borrowings

Borrowings include, borrowings from financial institutions and borrowing under repurchase agreements. They are brought to account at the gross value of the outstanding balance.

4.3.3 Securities Sold Under Re Purchase Agreement

This relates to treasury bills and bonds sold subject to a commitment to repurchase them at a predetermined price. Such treasury bills and bonds remain on the balance sheet and the liability is recorded in respect of the consideration received. The liability is disclosed as borrowing under repurchase agreement. Treasury bills and bonds are not marked to market since the corresponding liability is also not marked to market.

4.3.4 Employee Benefits

4.3.4.1 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.

Contributions to defined contribution plans are recognized as an expense in the income statement as incurred.

4.3.4.2 Defined Benefit Plan

Up to 31 December 2007, provisions had been made for retirement gratuities in the financial statements of the Bank 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 is applicable to Financial Statements covering annual period commencing on or after 1 July 2007, became effective for the Bank from the financial year commencing from 1 January 2008. The Bank has adopted the actuarial valuation method.

Accordingly, from 1st January 2008 the Bank has made provisions for gratuities based on the actuarial valuation, performed by a qualified actuary, Piyal S. Goonetilleke and Associates. The gratuity liabilities are not externally funded.

4.3.5 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, that can be estimated reliably and it is probable that an outflow of economic benefits will be required to settle the obligation.

4.3.6 Commitments and Contingent Liabilities

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

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.

4.3.7 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 no 33.

4.4 Revenue and Expense Recognition

4.4.1 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. 4.2.6. 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'.

Interest income from investments is recognised on an accrual basis.

Notes to the Financial Statements... *Contd*

4.4.2 Notional Tax Credit on Interest Income from Treasury Bills and Bonds

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

4.4.3 Discount or Premium on Purchase of Dated Debt Securities

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

4.4.4 Dividend Income

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

4.4.5 Discounts on Bills of Exchange

Discount charges on bills of exchange discounted are taken to revenue on redemption of bills of exchange.

4.4.6 Fee and Commission Income

These are recognized as income in the period in which entitlement to the consideration arises.

4.4.7 Gains on Disposal of Dated Debt Securities

The difference between net proceeds and the carrying amount of the debt securities disposed of is recognized as income.

4.4.8 Gain or Loss on Sale of Property and Equipment

Recognized as income in the period in which the sale occurs and is classified as other income.

4.4.9 Securities Purchased Under Re-sale Agreements

The difference between the purchase price and sale price represents interest income and is recognized in the income statement over the period of the re-sale agreement.

4.4.10 Mark to Market Gains on Dealing Securities

Gains or losses on dated dealing debt securities that arise by adjusting the carrying value of these securities to market value are recognized in the income statement.

4.4.11 Marked to Market Gains /Losses on Forward Exchange Contracts

Gains or Losses on forward exchange contracts that arise by adjusting the carrying value of the off balance sheet forward exchange contracts to market value on balance sheet date are recognized in the income statement.

4.4.12 Foreign Exchange Income

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 dealt in the income statement.

4.4.13 Interest Expenses and Other Expenses

Interest and other expenses have been recognized in the period in which they are incurred.

4.4.14 Sale and Repurchase Agreements

Where treasury bills /bonds are sold subject to a commitment to repurchase them at a predetermined price (Repos) the difference between sales and repurchase price is recognized as an expense over the life of the agreement.

4.4.15 Fee and Commission Expenses

Fee and commission expenses are recognized on an accrual basis.

4.5 Income Tax Expense

Income tax expense for the year comprises current and deferred tax. Income tax is recognized in the Income Statement.

4.5.1 Current Tax

Current tax is the expected tax payable on the profit for the year adjusted for taxation purposes in accordance with the provisions of the Inland Revenue Act No 10 of 2006, as amended by subsequent legislation.

Current tax expense includes any adjustment to tax payable in respect of previous years.

4.5.2 Deferred Tax

Deferred tax 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 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.

4.5.3 Value Added Tax on Financial Services

The value base for value added tax on financial services 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.

4.6 Earnings per Share

The Bank presents basic 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 number of ordinary shares outstanding during the period.

4.7 Business Segment Reporting

A 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.

4.8 Cash Flow

The cash flow has been prepared by using the 'Direct Method' of preparing cash flows in accordance with the SLAS - 9. Cash and 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.

4.9 Comparative Information

Where items are recognized comparative information is also adjusted.

4.10 Directors Responsibility Statement

Directors acknowledge the responsibility for true and fair presentation of the financial statements in accordance with the books of account and Sri Lanka Accounting Standards. Further elaboration of the Directors' responsibility is in page 36.

Notes to the Financial Statements... *Contd*

4.11 First Time Adoption of SLAS 16 (expand)

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 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.

Any shortfall or excess between the actuarially valued liabilities and the balances outstanding in these provision accounts is recognized immediately as a charge or income to the income statement in the period of the valuation.

4.12 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.

4.12.1 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).

4.12.2 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.

For the year ended 31 December

	2008 Rs '000	2007 Rs '000
5 Income		
Interest income (Note 6)	3,212,690	1,937,732
Fee and commission income	229,112	184,246
Net foreign exchange profit	16,082	103,181
Other income (Note 8)	40,389	22,932
	<u>3,498,273</u>	<u>2,248,091</u>

Net foreign exchange profit

The Bank engages in funding swap between US dollar and Sri Lanka rupees to benefit from interest rate arbitrage. The foreign exchange income is net of swap costs. The apparent decline in the foreign exchange income in the current period is compensated by the interest income derived in Sri Lanka rupees reported under interest income.

For the year ended 31 December

	2008 Rs '000	2007 Rs '000
6 Interest income		
Loans and advances	2,643,308	1,812,192
Treasury bills and placements with other banks	569,382	125,540
	<u>3,212,690</u>	<u>1,937,732</u>

Section 137 of the Inland Revenue Act No. 10 of 2006 provides that a company which derives interest income from the secondary market transactions in government securities be entitled to a notional tax credit, provided such interest income form part of the statutory income of the Bank for that year of assessment.

Treasury bill interest income includes Rs 47.5 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 2008. The amount relating to the previous financial year was Rs 0.4 million.

For the year ended 31 December

	2008 Rs '000	2007 Rs '000
7 Interest expense		
Deposits	1,880,059	983,277
Bank borrowing	151,057	290,229
	<u>2,031,116</u>	<u>1,273,506</u>
8 Other income		
Dividend income from investment securities - unquoted	104	122
(Loss) / gain on treasury bills and bonds	(1,591)	761
Net gain on Repo transactions	37,256	19,197
Unrealised gain on treasury bills and bonds	2,066	-
(Loss) / gain on disposal on property and equipment	(196)	(192)
Other operating income	2,750	3,044
	<u>40,389</u>	<u>22,932</u>

Net gain on Repo transactions includes Rs 3.7 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 2008. The amount relating to the previous financial year was Rs 1.9 million.

Notes to the Financial Statements... Contd

For the year ended 31 December

	2008 Rs '000	2007 Rs '000
9 Operating expenses		
Operating expenses include the following:		
Employer's contribution to employees' Provident Fund	18,669	13,110
Employer's contribution to employees' Trust Fund	3,732	2,609
Directors remuneration - fees	1,730	885
Auditors' remuneration		
Audit fees and expenses	775	592
Audit related fees and expenses	46	-
Depreciation - Property and equipment	62,318	40,803
Amortisation - Intangible assets	39,161	36,031
Other professional fees	1,405	2,245
Donations	70	115
10 Provision for loan losses and write-off		
10.1 Specific provision		
Provision for the year		
- Loans and advances	356,359	237,583
- Bills of exchange	11,021	5,282
Loans written off	3,070	-
	<u>370,450</u>	<u>242,865</u>
Less :Recoveries during the year		
- Loans and advances	123,420	184,160
- Bills of exchange	1,785	1,005
	<u>245,245</u>	<u>57,700</u>
10.2 General provision		
Provision for the year		
- Loans and advances	41,595	41,412
- Bills of exchange	373	1,934
	<u>287,213</u>	<u>101,046</u>

11 Income tax expense

11.1 Current tax of the Bank has been provided at 35% on the taxable income. Tax charge is based on taxable profits which differs from profit for financial reporting purposes. These differences are explained in the following reconciliation statement.

For the year ended

	2008 Rs '000	2007 Rs '000
Profit before tax as per income statement	337,689	290,310
Disallowed expenses and provisions	422,618	188,191
Loss on disposal of fixed assets	196	192
Less: Capital allowances on property and equipment	137,735	105,224
Dividend income	104	122
Net income from investment in Sri Lanka Development Bonds	10,754	5,930
Gratuity paid during the year	440	1,643
Assessable income	<u>611,470</u>	<u>365,774</u>
Less: Offset of brought forward tax losses (limited to 35% of assessable income)	214,015	128,021
Taxable income	<u>397,455</u>	<u>237,753</u>
Tax at normal company tax rate at 35%	<u>139,109</u>	<u>83,214</u>
Tax rate on accounting profit %	41%	29%

<i>For the year ended</i>	2008 Rs '000	2007 Rs '000
11.2 Tax losses		
Tax loss on 1 January	304,977	432,998
Add: Adjustment in respect of final tax return	199	-
Less: tax loss claimed against taxable profits	214,015	128,021
Unutilised tax loss on 31 December	<u>91,161</u>	<u>304,977</u>
11.3 Income tax expense		
<i>11.3.1 Current tax</i>		
Tax for the year	139,109	83,214
Less: Over provision in the prior year	296	97
	<u>138,813</u>	<u>83,117</u>
<i>11.3.2 Deferred tax expense</i>		
Charge from Deferred taxation (Note 22)	87,712	54,193
	<u>87,712</u>	<u>54,193</u>
Income tax expense	<u>226,525</u>	<u>137,310</u>

12 Earnings per share

Earnings per share has been calculated by dividing the profit after income tax for the year by 184,188,822 the number of ordinary shares outstanding during the year. (2007 - the weighted average number of ordinary shares were 120,750,011).

	2008	2007
Profit for the year Rs.	111,163,926	153,000,462
Number of shares (2007-Weighted average)	184,188,822	120,750,011
Basic earnings per share Rs.	0.60	1.27

<i>As at 31 December</i>	2008 Rs '000	2007 Rs '000
13 Cash and short term funds		
Cash in hand	616,412	489,701
Due from banks	1,412,667	1,602,674
Placements / balances with foreign banks	148,294	485,824
	<u>2,177,373</u>	<u>2,578,199</u>

14 Balances with the Central Bank of Sri Lanka

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. 4.2.2. 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.

Notes to the Financial Statements... Contd

As at 31 December

	2008 Rs '000	2007 Rs '000
15 Treasury bills and other securities eligible for rediscounting with Central Bank		
Treasury bills and bonds held for trading		
Held for repurchase transactions	1,122,442	-
Others	1,361,470	-
	<u>2,483,912</u>	<u>-</u>
Treasury bills and bonds held to maturity		
Held for repurchase transactions	116,265	491,990
Others	3,163,995	380,100
	<u>3,280,260</u>	<u>872,090</u>
	<u>5,764,172</u>	<u>872,090</u>
16 Bills of exchange		
16.1 Balance on 31 December		
Export bills	256,330	321,102
Import bills	86,555	178,320
	<u>342,885</u>	<u>499,422</u>
Less: Provision for bills of exchange - Specific (Note 16.2)	13,947	4,360
Provision for bills of exchange - General (Note 16.3)	2,767	2,394
	<u>326,171</u>	<u>492,668</u>
16.2 Movement in bills of exchange provision - specific		
Balance on 1 January	4,360	115
Add: Provision for the year (Note 10.1)	11,021	5,282
Exchange rate difference on foreign currency provision	351	-
Less: Recoveries during the year (Note 10.1)	1,785	1,005
Write off	-	32
Balance on 31 December	<u>13,947</u>	<u>4,360</u>
16.3 Movement in bills of exchange provision - general		
Balance on 1 January	2,394	461
Add: Provision for the year (Note 10.2)	373	1,933
Balance on 31 December	<u>2,767</u>	<u>2,394</u>
17 Loans and advances		
17.1 Balance on 31 December		
Overdrafts	8,377,716	5,371,315
Term loans	2,423,783	1,677,827
Trade loans	4,059,043	3,740,645
Gold pledge loans	112,580	19,855
Staff loans	56,965	55,191
Others	46,950	49,250
	<u>15,077,037</u>	<u>10,914,083</u>
Less:- Loan loss provision - Specific (Note 17.2)	390,517	158,391
Loan loss provision - General (Note 17.3)	94,123	52,528
Interest in suspense related to overdrafts (Note 17.4)	166,397	74,254
	<u>14,426,000</u>	<u>10,628,910</u>

	2008 Rs '000	2007 Rs '000
17.2 Movement in loan loss provision - Specific		
Balance on 1 January	158,391	115,038
Add: Provision for the year (Note 10.1)	356,359	237,583
Transfer from interest in suspense	563	12,526
Exchange rate difference on foreign currency provision	1,089	-
Less: Recoveries during the year (Note 10.1)	123,420	184,160
Write off of loans	2,465	22,126
Exchange rate difference on foreign currency recoveries	-	470
Balance on 31 December	<u>390,517</u>	<u>158,391</u>
17.3 Movement in loan loss provision - General		
Balance on 1 January	52,528	11,116
Add: Provision for the year (Note 10.2)	41,595	41,412
Balance on 31 December	<u>94,123</u>	<u>52,528</u>
17.4 Movement in interest in suspense for overdrafts		
Balance on 1 January	74,254	110,561
Add: Interest suspended during the year	355,067	229,527
Exchange rate difference on foreign currency interest in suspense	70	-
Less: Recoveries during the year	252,115	182,006
Write off of interests	10,879	77,743
Transfer to the provision	-	6,085
Balance on 31 December	<u>166,397</u>	<u>74,254</u>

17.5 Non-performing loans and advances

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

As at 31 December	2008 Rs '000	Percentage of total loans and advances	2007 Rs '000	Percentage of total loans and advances
Non-performing loans and advances (including bills)	1,366,926	8.86	790,170	6.92
Less: Interest in suspense included in overdrafts	<u>166,397</u>		<u>74,254</u>	
Net non-performing loans and advances (including bills)	1,200,528	7.87	715,916	6.31
Less: Loan loss provision (including bills)	<u>400,815</u>		<u>132,080</u>	
Net exposure	799,713	5.38	583,836	5.21
Net of tangible securities	<u>846,608</u>		<u>348,593</u>	

Percentage relates to the ratios of non performing credit exposure to the total credit exposure computed on gross and net basis.

Notes to the Financial Statements... Contd

	2008 Rs '000	2007 Rs '000
17.5.1 Allowances for Credit Losses		
Loans and advances (Note 17.2)	390,517	158,391
Bills of exchange (Note 16.2)	13,947	4,360
	<u>404,463</u>	<u>162,751</u>
Less: Provision relating to facilities currently performing Loans and advances	3,648	30,671
	<u>3,648</u>	<u>30,671</u>
Provision related to non-performing facilities	<u>400,815</u>	<u>132,080</u>

17.5.2 The realisable value of tangible securities is computed in accordance with the haircut 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.

The progressive discounts shall be as follows

Item	% of FSV of immovable property that can be considered as the value of security	
	Freehold property	Leasehold property
At the first time of provisioning	75	60
Period less than loss section		
Less than 12 months	75	60
More than 12 but less than 24 months	60	50
More than 24 but less than 36 months	50	40
More than 36 but less than 48 months	40	30
More than 48 months	Property should be reviewed on a regular basis and discounted further at the discretion of the bank's management	Nil

As at 31 December

	2008 Rs '000	2007 Rs '000
17.6 Concentration of credit risk		
Sectoral analysis of loans and advances		
Food, beverages and tobacco	189,008	39,049
Rubber and leather products	467,234	32,801
Metals, chemicals and engineering	302,458	514,360
Services	1,600,283	667,470
Exports	1,995,007	1,698,381
Imports	1,585,568	1,326,388
Trading	2,863,774	1,905,458
Financial	360,543	266,951
Consumption	839,688	1,688,002
Construction	190,041	350,316
Agricultural	742,808	377,875
Industrial	1,238,897	847,251
Tourism	1,030,656	218,678
Housing & property development	937,156	788,233
Others	733,916	192,870
	<u>15,077,037</u>	<u>10,914,083</u>
18 Interest receivables		
Loans (Note 18.1)	178,457	137,402
Bills of exchange (Note 18.2)	1,112	3,070
	<u>179,569</u>	<u>140,472</u>
18.1 Loans		
Interest on loans	355,347	200,859
Less: Interest in suspense for loans (Note 18.1.1)	176,890	63,457
Balance on 31 December	<u>178,457</u>	<u>137,402</u>
<i>18.1.1 Movement in interest in suspense for loans</i>		
Balance on 1 January	63,457	22,147
Add: Interest suspended during the year	309,670	234,524
Less: Recoveries during the year	194,418	186,773
Transfer to loan provision	563	6,441
Interest waivers	1,227	-
Exchange rate difference on foreign currency interest in suspense	29	-
Balance on 31 December	<u>176,890</u>	<u>63,457</u>
18.2 Bills of exchange		
Interest on bills of exchange	5,015	9,023
Less: Interest in suspense for bills of exchange (Note 18.2.1)	3,903	5,953
Balance on 31 December	<u>1,112</u>	<u>3,070</u>

Notes to the Financial Statements... Contd

As at 31 December

	2008 Rs '000	2007 Rs '000
18.2.1 Movement in interest in suspense for bills of exchange		
Balance on 1 January	5,953	-
Add: Interest suspended during the year	5,677	5,953
Exchange rate difference on foreign currency interest in suspense	1	-
Less: Recoveries during the year	7,728	-
Balance on 31 December	<u>3,903</u>	<u>5,953</u>
19 Investment securities		
Unquoted (Note 19.1)	<u>2,030</u>	<u>3,030</u>

As at 31 December

	2008		2007	
	Number of ordinary shares	Cost Rs '000	Number of ordinary shares	Cost Rs '000
19.1 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
Lanka Financial Services Bureau Limited (Shares of Rs 10/- each)	100,000	1,000	200,000	2,000
		<u>2,030</u>		<u>3,030</u>
Directors' valuation		<u>2,030</u>		<u>3,030</u>

20 Property and equipment

	Computer equipment Rs '000	Office equipment Rs '000	Furniture, fixtures & fittings Rs '000	Motor vehicles Rs '000	2008 Total Rs '000	2007 Total Rs '000
Cost on 1 January	147,115	57,226	159,248	17,267	380,856	230,684
Less: transfer to intangible assets	796	-	-	-	796	-
Additions for the year	49,318	30,182	54,442	-	133,942	153,157
Less: disposals during the year	-	5	355	-	360	2,985
Cost on 31 December	<u>195,637</u>	<u>87,403</u>	<u>213,335</u>	<u>17,267</u>	<u>513,642</u>	<u>380,856</u>
Accumulated depreciation on 1 January	70,524	18,738	37,154	4,238	130,654	91,144
Less: transfer to intangible assets	187	-	-	-	187	-
Charge for the year	28,076	13,042	17,747	3,453	62,318	40,803
Less: accumulated depreciation on disposal	-	3	117	-	120	1,293
Accumulated depreciation on 31 December	<u>98,413</u>	<u>31,777</u>	<u>54,784</u>	<u>7,691</u>	<u>192,665</u>	<u>130,654</u>
Net book value on 31 December 2008	<u>97,224</u>	<u>55,626</u>	<u>158,551</u>	<u>9,576</u>	<u>320,977</u>	
Net book value on 31 December 2007	<u>76,591</u>	<u>38,488</u>	<u>122,094</u>	<u>13,029</u>		<u>250,202</u>

21 Intangible Assets

<i>As at 31 December</i>	2008 Rs '000	2007 Rs '000
Cost on 1 January	346,345	313,303
Transfer from property and equipment	796	-
Additions for the year	42,441	33,042
Cost on 31 December	<u>389,582</u>	<u>346,345</u>
Accumulated depreciation on 1 January	230,168	194,137
Transfer from property and equipment	187	-
Amortisation for the year	39,161	36,031
Accumulated amortisation on 31 December	<u>269,516</u>	<u>230,168</u>
Net Book Value on 31 December	<u>120,066</u>	<u>116,177</u>
22 Deferred tax (liability) / assets (net)		
Deferred tax asset (Note 22.1)	31,907	106,743
Less: Deferred tax liability (Note 22.2)	36,796	23,920
	<u>(4,889)</u>	<u>82,823</u>

	2008		2007	
	Temporary difference Rs '000	Tax effect Rs '000	Temporary difference Rs '000	Tax effect Rs '000
22.1 Deferred tax asset				
Balance on 1 January	304,977	106,742	432,998	151,550
Add : Adjustment in respect of final tax return	199	70	-	-
Less : Reversal during the year	214,015	74,905	128,021	44,807
Balance on 31 December	<u>91,161</u>	<u>31,907</u>	<u>304,977</u>	<u>106,743</u>
22.2 Deferred tax liability				
Balance on 1 January	68,340	23,920	41,523	14,534
Originating during the year	36,788	12,876	26,817	9,386
Balance on 31 December	<u>105,128</u>	<u>36,796</u>	<u>68,340</u>	<u>23,920</u>

Deferred tax asset was not recognised on the general provision as at the balance sheet date, as it is not considered to be a temporary difference which will reverse in the foreseeable future.

Notes to the Financial Statements... Contd

As at 31 December

	2008 Rs '000	2007 Rs '000
23 Other assets		
Deposits and prepayments	67,515	45,023
Stocks of stationery	3,556	3,567
Clearing account balances	375,538	561,003
Other receivables	101,819	33,310
	<u>548,428</u>	<u>642,903</u>
24 Deposits from customers		
Demand deposits	712,384	628,469
Savings deposits	2,361,526	1,359,713
Time deposits	15,733,457	9,834,129
Certificates of deposits	84,793	33,540
Others	79,939	261,294
	<u>18,972,099</u>	<u>12,117,145</u>
24.1 Analysis of deposits		
Deposits from banks	1,884,718	1,513,884
Deposits from finance companies	54,907	74,420
Deposits from other customers	17,032,474	10,528,841
	<u>18,972,099</u>	<u>12,117,145</u>
25 Borrowings		
Balances with foreign banks	84,669	216,255
Balances with local banks	750,000	200,000
Borrowing from DFCC Bank	122,000	122,000
Borrowing under repurchase agreements	1,233,213	605,830
	<u>2,189,882</u>	<u>1,144,085</u>
Amount falling due within one year	2,067,882	1,022,085
Amount falling due more than one year	122,000	122,000
	<u>2,189,882</u>	<u>1,144,085</u>
26 Group balances payable		
DFCC Bank	19,050	37,065
27 Retirement benefit obligation		
Balance on 1 January	9,069	6,183
Add: Provision for the year	2,435	4,529
Less: Payments	440	1,643
Balance on 31 December	<u>11,064</u>	<u>9,069</u>

Based on the Sri Lanka Accounting Standard 16 (revised 2006) Employee Benefits, which became effective from the financial year commencing after 1st July 2007, Bank has adopted to apply the actuarial valuation method as explained in note 4.3.4.2 to these financial statements.

Principal assumptions used

(a) Discount rate	11.5%
(b) Expected percentage increase in salary	11.0%

<i>As at 31 December</i>	2008 Rs '000	2007 Rs '000
28 Other liabilities		
Interest payable	418,174	266,426
Account payable	90,745	136,334
Cheques pending realisation	380,791	562,159
Others	43,781	40,985
	<u>933,491</u>	<u>1,005,904</u>

29 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 reclassified as stated capital.

<i>As at 31 December</i>	2008 Rs '000	2007 Rs '000
Issued and fully paid share capital		
Balance on 1 January 184,188,822 ordinary shares (118,407,100 shares in 2007)	2,077,387	1,184,071
Add: Rights issue (65,781,722 shares in 2007)	-	893,316
Balance on 31 December 184,188,822 shares	<u>2,077,387</u>	<u>2,077,387</u>

30 Contingent liabilities and commitments

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.

<i>As at 31 December</i>	2008 Rs '000	2007 Rs '000
30.1 Contingent liabilities		
Acceptances	1,056,664	688,178
Guarantees	1,900,562	2,586,437
Bid bonds	35,644	50,008
Documentary letters of credit	815,049	1,529,287
Forward contracts	1,910,051	128,585
Bills for collection	661,923	872,454
	<u>6,379,893</u>	<u>5,854,949</u>

Notes to the Financial Statements... Contd

As at 31 December

	2008 Rs '000	2007 Rs '000
30.2 Commitments in ordinary course of business		
Commitments for unutilized credit facilities	903,791	802,142
Capital expenditure approved by the board of directors		
Contracted	45,922	31,035
Not contracted	64,975	72,706
	<u>1,014,688</u>	<u>905,883</u>
Commitments and contingent liabilities	<u>7,394,581</u>	<u>6,760,832</u>

30.3 Litigation against the Bank

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

31 Maturity profile of assets and liabilities

31.1 Definition of maturity

31.1.1 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

31.1.2 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.

31.2

	Total		Up to 3 months		3 to 12 months		1 to 3 years		3 to 5 years		> 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	5,764,172		1,950,080	33	1,646,611	29	2,167,481	38	0	0	0	0
Treasury bills purchased under												
resale agreements	171,564		171,564	100	0	0	0	0	0	0	0	0
Bills of exchange	326,171		324,357	99	1,814	1	0	0	0	0	0	0
Loans and advances	14,426,000		7,014,092	49	6,147,609	43	778,146	5	312,443	2	173,710	1
	<u>20,687,907</u>		<u>9,460,093</u>	45	<u>7,796,034</u>	38	<u>2,945,627</u>	14	<u>312,443</u>	2	<u>173,710</u>	1
Other assets												
(Non-interest bearing assets)												
Cash and short term funds	2,177,373		2,177,373	100	0	0	0	0	0	0	0	0
Balances with Central Bank of												
Sri Lanka	768,383		768,383	100	0	0	0	0	0	0	0	0
Interest receivable	179,569		142,353	80	18,429	10	12,019	7	4,095	2	2,673	1
Investment securities	2,030		0	0	0	0	0	0	0	0	2,030	100
Other assets	548,428		515,999	94	32,429	6	0	0	0	0	0	0
Property and equipment	320,977		0	0	0	0	0	0	0	0	320,977	100
Intangible Assets	120,066		0	0	0	0	0	0	0	0	120,066	100
	<u>4,116,826</u>		<u>3,604,108</u>	88	<u>50,858</u>	1	<u>12,019</u>	0	<u>4,095</u>	0	<u>445,746</u>	11
Total assets	<u>24,804,733</u>		<u>13,064,201</u>	53	<u>7,846,892</u>	32	<u>2,957,646</u>	12	<u>316,538</u>	1	<u>619,456</u>	2

31.2 Contd.

	Total Rs. 000	Up to 3 months Rs. 000	%	3 to 12 months Rs. 000	%	1 to 3 years Rs. 000	%	3 to 5 years Rs. 000	%	> 5 years Rs. 000	%
Liabilities with contractual maturity											
(Interest bearing liabilities)											
Deposits from customers	18,259,715	12,079,183	66	6,030,922	33	86,803	1	62,807	0	0	0
Bank borrowing	872,000	550,000	63	200,000	23	122,000	14	0	0	0	0
Borrowing under repurchase agreements	1,233,212	1,123,858	91	109,354	9	0	0	0	0	0	0
	<u>20,364,927</u>	<u>13,753,041</u>	68	<u>6,340,276</u>	31	<u>208,803</u>	1	<u>62,807</u>	0	<u>0</u>	0
Other liabilities											
(Non-interest bearing liabilities)											
Deposits from customers-demand	712,384	712,384	100	0	0	0	0	0	0	0	0
Balances with foreign banks	84,670	84,670	100	0	0	0	0	0	0	0	0
Group balances payable	19,050	19,050	100	0	0	0	0	0	0	0	0
Current tax payable	46,321	11,580	25	34,741	75	0	0	0	0	0	0
Deffered tax liability	4,889	2,445	50	2,444	50	0	0	0	0	0	0
Other liabilities	944,555	795,295	84	134,688	15	2,043	0	1,465	0	11,064	1
	<u>1,811,869</u>	<u>1,625,424</u>	90	<u>171,873</u>	9	<u>2,043</u>	0	<u>1,465</u>	0	<u>11,064</u>	1
Total liabilities	<u>22,176,796</u>	<u>15,378,465</u>	69	<u>6,512,149</u>	29	<u>210,846</u>	1	<u>64,272</u>	0	<u>11,064</u>	0

32 Related Party Disclosures

The Company carries out transactions in the ordinary course of its business with parties who are defined as related parties in Sri Lanka Accounting Standard No.30 -Related Party Disclosures (revised 2005), the details of which are reported below.

32.1 Transactions with Parent Company

32.1.1 Accommodation granted by the Parent Company

Facility type	Terms	2008		2007	
		Facility limit Rs. '000	Balance outstanding Rs. '000	Facility limit outstanding Rs. '000	Balance
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.	878,000	0*	878,000	-
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.				0*
Guarantee facility to secure borrowings by the bank	Guarantee commission is 0.5% per annum.				0*
Subordinated fixed term loan	Repayable in one installments (capital) after a grace period of 5 years from the date of disbursement at the rate of 11% per annum.	122,000	122,000	122,000	122,000

* Not utilized.

Notes to the Financial Statements... Contd

Facility type	2008 Rs. '000	2007 Rs. '000
32.1.2 Accommodation granted to parent company Overdraft Facility of Rs. 50 Mn	49,214 Cr	11,615 Cr

32.1.3 Deposits with and interest / commission to parent company

Nature of Transaction	2008 Rs. '000	2007 Rs. '000
Foreign currency deposits	1,834,001	1,408,165
Interest payable	5,004	8,416
Borrowing under repurchase agreements collateralized by treasury bills	230,000	237,000
Interest expenses on borrowings and deposits	90,797	121,242
Commission paid	259	1,463

32.1.4 Non lending transactions with the parent company

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

	2008 Rs. '000	2007 Rs. '000
a. Fees or recovery of costs charged by the Parent Company	154,127	78,580
b. Fees or recovery of cost charged to the Parent Company	7,108	9,135

Subsidiary/Joint Venture Companies	2008 Rs. '000	2007 Rs. '000
32.2 Transactions with subsidiary/joint venture companies of the parent company		
Acuity Partners (Pvt) Limited <i>DFCC Stock Brokers (Pvt) Ltd. ceased to be a subsidiary of DFCC Bank from 1st July 2008 and became a subsidiary of Acuity Partners (Pvt) Ltd. which is a Joint Venture of DFCC Bank.</i>		
Overdraft Facility of Rs. 50 Mn	846 Cr	231 Cr
Borrowing under repurchase agreements collateralized by treasury bills	81,200	51,500
Synapsys Limited		
Aggregate deposits held with the Bank	2,982	33,482
Borrowing under repurchase agreements collateralized by treasury bills	766	-
Payments made to IT related services	26,393	19,090
DFCC Consulting (Pvt) Limited		
Aggregate deposits held with the Bank	23,221	26,557
Lanka Industrial Estates Limited		
Aggregate deposits held with the Bank	72,097	44,152
Borrowing under repurchase agreements collateralized by treasury bills	29,915	-
Lanka Ventures Limited		
Aggregate deposits held with the Bank	5	35,003
Borrowing under repurchase agreements collateralized by treasury bills	21,640	-

32.3 Transactions with the Key Management Personnel (KMP) of the Bank.

32.3.1 Key Management Personnel

According to Sri Lanka Accounting Standard 30 (revised 2005) - "Related Party Disclosure", KMP are those having authority and responsibility for planning, directing and controlling the activities of the entity. Accordingly the KMP of the Bank are,

- The Board of Directors of the Bank, Chief Executive Officer, Chief Operating Officer, Head of Credit, Head of Customer Relations, Head of Credit Risk and Quality Control and Head of Corporate Credit, of the Bank and,
- Key Management Personnel of the Parent company.

	2008 Rs'000	2007 Rs'000
32.3.2 Compensation of Key Management Personnel		
Short term employment benefits	29,388	22,627
Post employment benefits	4,663	3,897
In addition to their salaries, the Company also provides non-cash benefits to KMP.		
32.3.3 Transactions with Key Management Personnel, and their close family members.		
(1) Deposits held by Key Management Personnel		
Aggregate deposits held by		
- Directors	14,614	5,853
- Other KMP's	20,410	11,398
Borrowing Under Repurchase Agreements		
- Directors	1,668	11,708
- Other KMP's	6,361	327
(2) Facilities held by Key Management Personnel		
Loans and Advances - Other KMP's (security - cash deposits)	1,526	205

32.4 Transaction 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 reported by the KMP further significant influence is also established if in the view of the respective KMP, he has the ability to influence the operating and financial policies of an entity even in the absence of a 20% shareholding.

	2008 Rs'000	2007 Rs'000
Aggregate Deposits held with the Bank	1,619	498
Payments made by the Bank for provision of secretarial services	104	113

33 Events after the Balance Sheet Date

33.1 Proposed Dividend

Directors have recommended the payment of a final dividend of 10 cents per share for the year ended 31 December 2008, which requires the approval of the shareholders at the Annual General Meeting to be held on the 28 May 2009. The Board of Directors confirm that the Bank has satisfied the solvency test in accordance with section 57 of the Companies Act No 7 of 2007 and have obtained certification from the auditors. The proposed final dividend exceeds the minimum distribution mandated by the Inland Revenue Act No 10 of 2006 and therefore the 15% deemed dividend tax, will not be imposed on the Bank.

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

34 Comparative Figures

Where items are regrouped, comparative information is also adjusted.

35 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 36 for the statement of Directors' Responsibility for financial reporting.

Branches and Extension Offices

ANURADHAPURA

249, Maithripala Senanayake Mawatha,
Anuradhapura
Telephone No. 025-2223417
Fax No. 025-2223418

BADULLA

14, Udayaraja Mawatha, Badulla
Telephone No. 055-2230160
Fax No. 055-2230162

BANDARAWELA

126, Main Street, Bandarawela
Telephone No. 057-2224849/50
Fax No. 057-2224851

BORELLA

14, Cotta Road, Borella, Colombo - 8
Telephone No. 2690069/90
Fax No. 2690096

CHILAW

44, Kurunegala Road, Chilaw
Telephone No. 032-2220236/37
Fax No. 032-2220301

CITY OFFICE

73/5, Galle Road, Colombo 03
Telephone No. 2442244
Fax No. 2442245

DAMBULLA

632, Anuradhapura Road, Dambulla
Telephone No. 066-2283553/4
Fax No. 066-2283555

DENIYAYA

No. 4, Pallegama Road, Deniyaya
Telephone No. 041-2273073/4
Fax No. 041-2273075

GALLE

93, Wakwella Road, Galle
Telephone No. 091-2227375
Fax No. 091-2227374

GAMPAHA

123, Baudhdhaloka Mawatha, Gampaha
Telephone No. 033-2226104
Fax No. 033-2226104

GAMPOLA

No. 73, Nuwara-Eliya Road, Gampola
Telephone No. 081-2350876/7
Fax No. 081-2350879

GANGODAWILA

601/1, Highlevel Road, Gangodawila,
Nugegoda
Telephone No. 2442712
Fax No. 5554206

HEAD OFFICE

73, W A D Ramanayake Mw., Colombo-2
Telephone No. 2371371
Fax No. 2371372

HORANA

49, Panadura Road, Horana
Telephone No. 034-2265331/2
Fax No. 034-2265330

KADAWATHA

No. 341, Kandy Road, Kadawatha
Telephone No. 2922340/1
Fax No. 2922342

KADURUWELA

626, Main Street, Kaduruwela
Telephone No. 027-2223333
Fax No. 027-2225858

KALUTARA

No 282, Main Street, Kalutara South
Telephone No. 034-2225560/1
Fax No. 034-2236364

KANDY

5 Deva Veediya, Kandy
Telephone No. 081-2234411
Fax No. 081-2228460

KATUNAYAKA

202/3, Katugastota Road, Kandy
Telephone No. 081-2213465/6
Fax No. 081-2213467

No. 60, Kandy Road, Kiribathgoda

Telephone No. 2910965/6
Fax No. 2910442

214, Srimath Bandaranayake Mawatha,

Colombo - 12
Telephone No. 2438500- 1
Fax No. 2438502

29, High Level Road, Kottawa

Telephone No. 2783886/7
Fax No. 2783888

KULIYAPITIYA

No 139, Madampe Road, Kuliyaipitiya
Telephone No. 037-2284564/5
Fax No. 037-2284566

KURUNEGALA

25, Rajapihilla Road, Kurunegala
Telephone No. 037-2224142
Fax No. 037-2224142

MAHARAGAMA

135, Highlevel Road, Maharagama
Telephone No. 2838668/2838555
Fax No. 2838669

MALABE

9, Athurugiriya Road, Malabe
Telephone No. 2442714
Fax No. 5552868

MATALE

No. 129, Main Street, Matale
Telephone No. 066-2234332/3
Fax No. 066-2234334

MATARA

5, Hakmana Road, Matara
Telephone No. 041-2225500
Fax No. 041-2222585

NAWALA

No 540, Nawala Road, Rajairiya
Telephone No. 28880880
Fax No. 2880898

NEGOMBO

389/A, Main Street, Negombo
Telephone No. 031-2227555/6
Fax No. 031-2227557

NUGEGODA

No 24, Nawala Road, Nugegoda
Telephone No. 2814038/9
Fax No. 2814040

PANADURA

114/A, Janapriya Mawatha, Panadura
Telephone No. 038-2241630/1
Fax No. 038-2241632

PERADENIYA

No.901/A, Peradeniya Road,
Kandy
Telephone No. 081-2387673/4
Fax No. 081-2387675

PILIYANDALA

No 1, Old Road, Piliyandala
Telephone No. 2609700/1
Fax No. 26097002

RATNAPURA

46, Bandaranaika Mawatha, Ratnapura
Telephone No. 045-2223667
Fax No. 045-2223670

WATTALA

424, Negombo Road, Heandala Junc., Wattala
Telephone No. 2949148/9
Fax No. 2949150

WELLAWATTE

No. 02, 33rd Lane, Wellawatte, Colombo-6
Telephone No. 2362741-2
Fax No. 2362743

Sri Lanka Post Office Banking Units

DICKWELLA

Customer Service Centre
Post Office
Dickwella
Telephone No. 0602406127

HAKMANA

Customer Service Centre
Post office
Hakmana
Telephone No. 0602406136

KOTTEGODA

Customer Service Centre
Post Office
Kottegoda
Telephone No. 0602406122

MATARA

Customer Service Centre
Post office
Matara.
Telephone No. 0602406124

WELIGAMA

Customer Service Centre
Post office
Weligama
Telephone No. 0602406123

Notice of Meeting

Notice is hereby given that the Thirteenth 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 Thursday the 28th May 2009 at 10.00 a.m. for the following purposes.

1. To receive, consider and adopt the Annual Report of the Board of Directors on the affairs of the Company and the Financial Statements for the year ended 31.12.2008 with the Report of the Auditors thereon.
2. To declare a first and final dividend of 10 cents per share on the ordinary shares of the Company.
3. To re-elect Mr. J. M. S. Brito who retires by rotation in terms of Article 87 as a Director of the Company.
4. To re-elect Mr. S. Nagarajah who retires by rotation in terms of Article 87 as a Director of the Company.
5. To elect Mr. A. N. Fonseka in terms of Article 93 as a Director of the Company.
6. To elect Mr. L. H. A. L. Silva in terms of Article 93 as a Director of the Company.
7. To elect Mr. L. N. de Silva Wijeyeratne in terms of Article 93 as a Director of the Company.
8. To re-appoint Messrs KPMG Ford, Rhodes, Thornton & Company as Auditors of the Company for the ensuing year and to authorise the Directors to determine their remuneration.

By Order of the Board



W. A. Mendis
Company Secretary

Colombo
Date : 25th March 2009

Notes:

1. A member is entitled to appoint a proxy to attend and vote on his/her behalf.
2. A proxy need not be a member of the Company. The Form of Proxy is attached for this purpose.
3. To be valid, the completed Form of Proxy should be deposited at the Registered Office of the Company at No. 73, W. A. D. Ramanayake Mawatha, Colombo 2, not less than forty eight hours before the time appointed for holding of the meeting.

Form of Proxy

I / We.....of
being

a member/s of DFCC Vardhana Bank Ltd, hereby appoint
 of or failing him/her

Mr. Joseph Michael Suresh Brito	or failing him
Mr. Anthony Nihal Fonseka	or failing him
Mr. Joseph Anthony Roch Expeditus Maxwell Machado	or failing him
Mr. Subramaniam Nagarajah	or failing him
Mr. Liyanage Gnanawardene Perera	or failing him
Ms. Yasodha Neiliya Perera	or failing her
Mr. Lokugan Hewage Ananda Lakshman Silva	or failing him
Mr. Lalit Nihal de Silva Wijeyeratne	or failing him
Ms. Ranmalie Anomi Patuwatha Withana	

as my/our proxy to represent me/us *..... and to vote on my/our behalf at the Annual General Meeting of the Company to be held on the 28th May 2009 and at any adjournment thereof and at every poll which may be taken in consequence thereof:

	For	Against
To adopt the Annual Report of the Board of Directors on the affairs of the Company and the Financial Statements for year ended 31.12.2008 with the Report of the Auditors thereon.	<input type="checkbox"/>	<input type="checkbox"/>
To declare a first and final dividend of 10 cents per share	<input type="checkbox"/>	<input type="checkbox"/>
To re-elect Mr. J. M. S. Brito as a Director of the Company	<input type="checkbox"/>	<input type="checkbox"/>
To re-elect Mr. S. Nagarajah as a Director of the Company	<input type="checkbox"/>	<input type="checkbox"/>
To elect Mr. A. N. Fonseka as a Director of the Company	<input type="checkbox"/>	<input type="checkbox"/>
To elect Mr. L. H. A. L. Silva as a Director of the Company	<input type="checkbox"/>	<input type="checkbox"/>
To elect Mr. L. N. de Silva Wijeyeratne as a Director of the Company.	<input type="checkbox"/>	<input type="checkbox"/>
To re-appoint Messrs KPMG Ford, Rhodes, Thornton & Company as Auditors of the Company for the ensuing year and to authorise the Directors to determine their remuneration.	<input type="checkbox"/>	<input type="checkbox"/>

(Please indicate with a "X" in the space provided how your Proxy is to vote on each resolution. If you do not do so, the Proxy will vote or abstain from voting at his/her discretion)

Signed this.....day of..... 2009

Signature/s

Please provide the details:

Shareholder's NIC No. / Company Registration No. :
 Number of shares held :
 Proxy holder's NIC No. (if not a Director) :

Instructions for completion of the Form of Proxy appear on the reverse of this form.

Form of Proxy... Contd

Instructions for Completion of the Form of Proxy

1. In order to appoint a proxy, this form duly completed, together with any power of attorney under which it is signed, must be deposited at the Registered Office of the Company, 73, W A D Ramanayake Mawatha, Colombo 2, not later than 48 hours prior to the time appointed for the holding of the meeting.
2. The proxy appointed need not be a shareholder of the Company.
3. In the event you wish your proxy to speak, please insert the words "to speak" immediately after the asterisk, and initial such inclusion.
4. In the case of a corporate shareholder, the Form of Proxy must be executed under its Common Seal or by its authorised signatories.

Corporate Information

Name of Company

DFCC Vardhana Bank Limited.

Legal Form

Public Limited Liability Company
Incorporated on 25 August 1995

Registered Office

No. 73, W A D Ramanayake Mawatha,
Colombo 2

Company Secretary

W. A. Mendis

Registrars

Pathfinder 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
No. 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

DFCC Vardhana Bank Limited

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

Tel : 94-11-2371371

Fax : 94-11-2371372

Email : info@dfccvardhanabank.com

www.dfccvardhanabank.com