HABIB BANK LIMITED - SRI LANKA BRANCH

FINANCIAL STATEMENTS
31 DECEMBER 2016

HABIB BANK LIMITED - SRI LANKA BRANCH

FINANCIAL STATEMENTS - 31 DECEMBER 2016

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Independent Auditor's Report
To the head office management of Habib Bank Limited - Sri Lanka Branch

Report on the Financial Statements

1 We have audited the accompanying financial statements of Habib Bank Limited - Sri Lanka Branch, which comprise the statement of financial position as at 31 December 2016, and the statement of profit or loss and other comprehensive income, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information as set out in pages 6 to 52.

Management's Responsibility for the Financial Statements

2 Management is responsible for the preparation of financial statements that give a true and fair view in accordance with Sri Lanka Accounting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

3 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 comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

4 An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers the internal control relevant to the entity's preparation of financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting principles used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of financial statements.

5 We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

6 In our opinion the financial statements give a true and fair view of the financial position of Habib Bank Limited - Sri Lanka Branch as at 31 December 2016, and its financial performance and its cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

30 March 2017
COLOMBO

PricewaterhouseCoopers
CHARTERED ACCOUNTANTS

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HABIB BANK LIMITED - SRI LANKA BRANCH

Statement of financial position

(all amounts in Sri Lanka Rupees)

	Notes	Year ended 31 December 2016	2015 Restated
Assets			
Cash and cash equivalents	4	1,247,248,959	574,284,558
Balances with Central Bank of Sri Lanka	5	1,306,270,622	1,176,890,848
Reverse repurchase agreements	6	300,122,805	-
Placements with financial institutions	7	209,875,028	101,678,082
Financial assets - held to maturity	8	496,843,435	596,592,762
Other financial assets	9	2,361,981,453	2,551,045,789
Loans and advances to customers	10	4,971,237,077	3,504,586,122
Other assets	11	106,951,182	78,859,870
Income tax receivable		48,167,386	36,558,923
Property, plant and equipment	12	228,211,703	256,494,140
Deferred tax assets	18	33,163,331	28,648,249
Total assets		**11,310,072,981**	**8,905,639,343**
Liabilities			
Due to banks	13	778,075,831	63,579,625
Due to customers	14	3,350,124,158	1,742,246,379
Borrowings	15	1,354,453,125	1,502,147,628
Other liabilities	16	57,766,512	40,368,957
Employee benefit liability	17	46,938,173	41,103,395
Total liabilities		5,587,357,799	3,389,445,984
Equity			
Assigned capital	19	4,938,390,143	4,938,390,143
Statutory reserve fund	20	67,859,739	62,317,045
Revaluation reserve	21	96,622,625	96,622,625
Exchange equalisation of capital	22	506,134,837	410,762,244
Exchange equalisation of reserve	23	9,871,054	8,170,383
Retained earnings / (loss)	24	103,836,784	(69,081)
Total equity		5,722,715,182	5,516,193,359
Total liabilities and equity		**11,310,072,981**	**8,905,639,343**
Contingent liabilities and commitments	37.2.4.1	2,415,994,347	3,268,701,622

The management is responsible for the preparation and presentation of these Financial Statements.

Signed for and on behalf of the management by:

Arif M Ali
Regional General Manager
Sri Lanka and Maldives

Fathima Zahara Mohamed
Manager - Financial Control

The Notes to the Financial Statements from pages 06 to 52 form an integral part of these Financial Statements.

30 March 2017
Colombo

PricewaterhouseCoopers

HABIB BANK LIMITED - SRI LANKA BRANCH

Statement of profit or loss and other comprehensive income

(all amounts in Sri Lanka Rupees)

	Notes	Year ended 31 December 2016	2015
Interest income	25	662,190,873	391,334,534
Interest expense	26	(163,428,121)	(77,668,167)
Net interest income		498,762,752	313,666,367
Fees and commission income	27	26,144,439	21,619,991
Net trading income		-	983,781
Other operating income	28	45,570,418	17,596,599
Total operating income		570,477,609	353,866,738
Impairment (charge) / reversal on loans and advances	29	(14,207,418)	4,416,747
Net operating income		556,270,191	358,283,485
Personnel expenses	30	(250,355,011)	(207,890,314)
Depreciation of property plant and equipment	12	(43,725,660)	(33,654,329)
Other operating expenses	31	(110,890,300)	(96,892,627)
Total operating expenses		(404,970,970)	(338,437,270)
Operating profit before Value Added Tax (VAT) on financial services		151,299,221	19,846,215
Value Added Tax (VAT) on financial services		(45,469,170)	(21,440,601)
Profit before income tax		105,830,051	(1,594,385)
Income tax expense	32	5,023,831	2,845,849
Profit for the year		**110,853,882**	**1,251,464**
Other comprehensive income			
Other comprehensive income not to be reclassified to profit and loss in subsequent periods			
Acturial (loss) /gain on retirement benefit obligation	17	(1,951,838)	(1,747,187)
Exchange differences on translation of foreign currency capital	22	95,372,593	185,717,195
Exchange differences on translations of foreign currency reserves	23	1,700,671	1,685,847
Income tax on other comprehensive income	32	546,515	489,212
Other comprehensive income for the year net of tax		95,667,941	186,145,066
Total comprehensive income for the year		**206,521,822**	**187,396,530**

The Notes to the Financial Statements from pages 06 to 52 form an integral part of these Financial Statements.

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Statement of changes in equity

(all amounts in Sri Lanka Rupees)

	Notes	Assigned capital	Statutory reserve fund	Revaluation reserve	Exchange equalisation of capital	Exchange equalisation of reserve	Retained earnings	Total
As at 31 January 2015		3,728,549,605	62,254,472	96,622,625	225,045,049	6,484,536	300,047,005	4,419,003,292
Capital funds received from Head Office	19	909,793,533	-	-	-	-	-	909,793,533
Profit for the year	24	-	-	-	-	-	1,251,467	1,251,467
Other comprehensive income	21/22/23/24	-	-	-	185,717,195	1,685,847	(1,257,975)	186,145,067
Transfer to statutory reserve fund	20/24	-	62,573	-	-	-	(62,573)	-
Profit capitalization during the year	24	300,047,005	-	-	-	-	(300,047,005)	-
As at 31 December 2015		**4,938,390,143**	**62,317,045**	**96,622,625**	**410,762,244**	**8,170,383**	**(69,081)**	**5,516,193,359**
Profit for the year	24	-	-	-	-	-	110,853,882	110,853,882
Other comprehensive income	21/22/23/24	-	-	-	95,372,593	1,700,671	(1,405,323)	95,667,940
Transfer to statutory reserve fund	20/24	-	5,542,694	-	-	-	(5,542,694)	-
As at 31 December 2016		**4,938,390,143**	**67,859,739**	**96,622,625**	**506,134,837**	**9,871,054**	**103,836,784**	**5,722,715,181**

The Notes to the Financial Statements from pages 06 to 52 form an integral part of these Financial Statements.

HABIB BANK LIMITED - SRI LANKA BRANCH

Cash flow statement

(all amounts in Sri Lanka Rupees)

	Note	Year ended 31 December 2016	2015 Restated
Cash flows from operating activities			
Net cash flow from operating activities before income tax (A)		163,155,595	27,132,446
Income tax paid		(12,663,727)	(5,548,298)
Operating profit before changes in operating assets and liabilities		150,491,868	21,584,148
Decrease in operating assets	33.1	(1,614,089,662)	(633,003,050)
Increase / (decrease) in operating liabilities	33.2	1,500,690,778	(37,980,696)
Net cash flow from operating activities		37,092,984	(649,399,597)
Cash flows from investing activities			
Purchase of property plant and equipment	12.5	(15,468,014)	(80,114,410)
Dividends received	28	558,000	510,750
Proceeds from sale of property plant and equipment		74,325	-
		(14,835,689)	(79,603,660)
Cash flow from financing activities			
Funds received from Head Office	19	-	909,793,533
		-	909,793,533
Exchange differences on translations of foreign currency capital and reserves	22/23	97,073,263	187,403,042
Net increase / (decrease) in cash and cash equivalents		119,330,558	368,193,318
Cash and cash equivalents at the beginning of the year		1,751,175,406	1,382,982,088
Cash and cash equivalents at the end of the year		**1,870,505,963**	**1,751,175,406**
Reconciliation of cash and cash equivalents			
Cash in hand	4	96,639,491	106,280,397
Balances with banks	4	1,102,590,982	131,948,777
Money at call and short notice	4	48,018,486	336,055,384
Statutory deposit with Central Bank of Sri Lanka	5	135,532,640	51,811,647
Money held at Central Bank of Sri Lanka - foreign currency	5	1,170,737,982	1,125,079,201
Due to banks	13	(683,013,618)	-
		1,870,505,963	**1,751,175,406**
A. RECONCILIATION OF OPERATING PROFIT			
Profit / (loss) before tax		105,830,051	(1,594,385)
Gain on disposal of property, plant and equipment		(49,533)	-
Depreciation of property plant and equipment	12.2	43,725,660	33,654,328
Impairment charge/(reversal) for loans and advances	29	14,207,418	(4,416,747)
Dividend income	28	(558,000)	(510,750)
		163,155,595	**27,132,446**

The Notes to the Financial Statements from pages 06 to 52 form an integral part of these Financial Statements.

HABIB BANK LIMITED - SRI LANKA BRANCH

Notes to the financial statements

(all amounts in Sri Lanka Rupees)

1 Corporate information

1.1 General

Habib Bank Limited - Sri Lanka Branch (‘Bank”) is a licensed commercial bank established under the Banking Act No 30 of 1988. It is a foreign branch of Habib Bank Limited, which is incorporated in Pakistan. The registered office of the Bank is located at No.140-142, 2nd Cross Street, Colombo 11.

1.2 Principal Activities and Nature of Operations

The principal activities of the Bank continued to be banking and related activities such as accepting deposits, corporate and retail banking, personal financial services, foreign currency operations, trade services, dealing in government securities and other related services.

1.3 Date of Authorisation for issue

The Financial Statements of Habib Bank Limited – Sri Lanka Branch for the year ended 31 December 2016 were authorized for issue by the local management on 30 March 2017.

2 Summary of significant accounting policies

2.1 Basis of preparation

The financial statements of the Bank have been prepared on a historical cost basis, except otherwise indicated including freehold land and building which have been subsequently revalued.

The financial statements are presented in Sri Lankan Rupees (Rs), except when otherwise indicated.

2.1.1 Statement of compliance

The financial statements of the Bank have been prepared in accordance with Sri Lanka Accounting Standards (commonly referred by the term “SLFRS”) as issued by Institute of Chartered Accountants of Sri Lanka.

The preparation and presentation of these financial statements is in compliance with the requirements of the Companies Act No.07 of 2007.

The presentation of these financial statements is in compliance with the requirements of the Banking Act No. 30 of 1988.

2.1.2 Presentation of financial statements

The Bank presents its statement of financial position broadly in order of liquidity. An analysis regarding recovery or settlement within 12 months after the reporting date (current) and more than 12 months after the reporting date (non–current) is presented in Note 35 to the financial statements.

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

HABIB BANK LIMITED - SRI LANKA BRANCH

Notes to the financial statements (contd)

2 Summary of significant accounting policies (contd)

2.1.2 Presentation of financial statements (contd)

Financial assets and financial liabilities are offset and the net amount reported in the statement of financial position only when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the assets and settle the liability simultaneously. Income and expenses are not offset in the Statement of Comprehensive Income unless required or permitted by any accounting standard or interpretation.

2.1.3 Changes in accounting policies

The accounting policies adopted are consistent with those of the previous financial year.

2.2 Significant accounting judgements, estimates and assumptions

In the process of applying the Bank's accounting policies, management has exercised judgement and estimates in determining the amounts recognised in the financial statements. Use of available information, estimates and assumptions and application of judgement is inherent in the preparation of Financial Statements as they affect the application of accounting policies and the recorded amounts in the Financial Statements. The Bank believes its estimates including the valuation of assets and liabilities as appropriate. Estimates of underlying assumptions are reviewed on a continuous basis. However the actual results may differ from those estimates. The most significant uses of judgements and estimates are as follows:

2.2.1 Impairment losses on loans and advances

The Bank reviews its individually significant loans and advances at each financial reporting date to assess whether an impairment loss should be recorded in the Statement of Comprehensive Income. In particular, management's judgement is required in the estimation of the amount and timing of future cash flows when determining the impairment loss. These estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the allowance.

Loans and advances that have been assessed individually and found to be not impaired and all individually insignificant loans and advances are assessed collectively, in groups of assets with similar characteristics, to determine whether provision should be made based on incurred loss events for which there is objective evidence, but the effects of which are not yet evident. The collective assessment takes account of data from the loan portfolio such as levels of arrears, credit utilisation, loan-to-collateral ratios, etc. and judgements on the effect of concentrations of risks and economic data (including levels of unemployment, inflation, GDP growth rate etc.).

The impairment loss on loans and advances is disclosed in more detail in Note 2.3.4 and Note 10 to the financial statements.

2.2.2 Employee benefit liability - gratuity

The cost of the defined benefit plan – gratuity is determined using an actuarial valuation. Actuarial valuation involves making assumptions about discount rates, future salary increases, remaining working life of employees and mortality rates. Due to the long term nature of these obligations, such estimates are subject to significant uncertainty. The details of the employee benefit liability are disclosed in Note 17 to the financial statements.

HABIB BANK LIMITED - SRI LANKA BRANCH

Notes to the financial statements (contd)

2 Summary of significant accounting policies (contd)

2 .2 Summary of significant accounting policies (contd)

2.2.3 Fair value of property plant and equipment

The freehold land and buildings of the Bank are reflected at revalued amounts. The Bank engaged independent valuation specialist to determine the fair value of such properties. When current market prices of similar assets are available, such evidence has been considered in estimating the fair value of these assets. Refer Note 12 to the financial statements.

2.2.4 Fair value of financial instruments

Where the fair values of financial assets and financial liabilities disclosed in the financial statements cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The inputs to these models are derived from observable market data where possible, but if this is not available, judgment is required to establish fair values. The judgments include considerations of liquidity and inputs such as discount rates. The valuation of financial instruments is described in more detail in Note 36.

2.2.5 Deferred tax assets

Deferred tax assets are recognised in respect of tax losses to the extent that it is probable that future taxable profits will be available against which such tax losses can be set off. Judgement is required to determine the amount of deferred tax assets that can be recognised, based upon the likely timing and level of future taxable profits. The details of the deferred tax asset are described in more detail in Note 2.3.12 and Note 18 to the financial statements.

2.3 Summary of significant accounting policies

2.3.1 Foreign currency translation

Transactions in foreign currencies are initially recorded at the rate of exchange prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the rate of exchange at the reporting date. All differences arising are taken in to Statement of Comprehensive Income. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the spot exchange rates as at the dates of recognition.

The Bank’s local operations comprise of the Domestic Banking Unit (DBU) and the Foreign Currency Banking Unit (FCBU).

These financial statements of Habib Bank Limited – Sri Lanka Branch (“Bank”) have been prepared by amalgamating the results of the Domestic Banking Unit (DBU) and the Foreign Currency Banking Unit (FCBU) operations and the financial position of the both units. Each unit determines its own functional currency. Accordingly the functional currency of the Domestic Banking Unit is Sri Lankan Rupees and the Foreign Currency Banking Unit is United States Dollars. The presentation currency for both units is Sri Lankan Rupee.

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Notes to the financial statements (contd)

2 Summary of significant accounting policies (contd)

2.3 Summary of significant accounting policies (contd)

2.3.1 Foreign currency translation (contd)

Accordingly, the results and financial position of Foreign Currency Banking Unit (FCBU) are translated to Sri Lankan Rupees as follows:

The assets, liabilities and assigned capital of Foreign Currency Banking Unit operations are translated to Sri Lankan Rupees at spot exchange rates at the reporting date. The income and expenses of the Foreign Currency Banking Unit operations are translated at monthly average rates.

Foreign currency differences arising on the translation of FCBU operations to presentation currency are recognised in Other Comprehensive Income.

2.3.2 Fair value measurement

Fair value related disclosures for assets measured at fair value or financial instruments that are not measured at fair value, for which fair values are disclosed, are summarised in Note 36 to the financial statements.

The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

The Bank uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the Financial Statements are categorised within the fair value hierarchy, as described below:

Level 1	Quoted (unadjusted) market prices in active markets for identical assets or
Level 2	Valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable.
Level 3	Valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable.

For assets and liabilities that are recognised in the Financial Statements at fair value on a recurring basis, the Bank determines whether transfers have occurred between levels in the hierarchy by re-assessing categorisation (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period.

The management determines the policies and procedures for both recurring and non- recurring fair value measurements.

For the purpose of fair value disclosures, the Bank has determined classes of assets and liabilities on the basis of the nature, characteristics and risks of the asset or liability and the level of the fair value hierarchy as explained above.

HABIB BANK LIMITED - SRI LANKA BRANCH

Notes to the financial statements (contd)

2 Summary of significant accounting policies (contd)

2.3 Summary of Significant Accounting Policies (contd)

2.3.3 Financial Instruments – Initial recognition and subsequent measurement

(i) Date of recognition

All financial assets and liabilities are initially recognized on the trade date, i.e., the date that the Bank becomes a party to the contractual provisions of the instrument. This includes ’regular way trades’: purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place.

(ii) Initial measurement of financial instruments

The classification of financial instruments at initial recognition depends on their purpose and characteristics and the management’s intention in acquiring them. All financial instruments are measured initially at it's fair value plus transaction costs, except in the case of financial assets and financial liabilities recorded at fair value through profit or loss.

(iii) Derivatives recorded at fair value through profit or loss

The Bank uses derivatives such as Forward Foreign Exchange Contracts. Derivatives are recorded at fair value and carried as assets when their fair value is positive and as liabilities when their fair value is negative. Changes in the fair value of derivatives are included in 'Net Trading Income' in the Income Statement.

(iv) Financial assets - subsequent measurement

The subsequent measurement of financial assets depends on their classification. The Bank’s financial assets comprise of Held to Maturity Financial Assets and Other Financial Assets and Loans and Advances to Customers which are classified as Loans and Receivables.

(a) Financial assets - held to maturity

Held to maturity financial assets are non–derivative financial assets with fixed or determinable payments and fixed maturities, which the bank has the intention and ability to hold to maturity. After initial measurement, held to maturity financial investments are subsequently measured at amortized cost using the Effective interest Rate (EIR), less impairment. Amortized cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the EIR. The amortization is included in “Interest Income” in the Income Statement.

If the Bank were to sell or reclassify more than an insignificant amount of held to maturity assets before maturity (other than in certain specific circumstances), the entire category would be tainted and would have to be reclassified as available for sale. Furthermore, the Bank would be prohibited from classifying any financial asset as held to maturity during the following two years under LKAS 39.

(b) Other Financial Assets and Loans and Advances to Customers

“Other Financial Assets” and “Loans and Advances” to customers’ include non–derivative financial assets with fixed or determinable payments that are not quoted in an active market.

After initial measurement, “Other Financial Assets” and “Loans and Advances to Customers” are subsequently measured at amortized cost using the effective interest rate, less allowance for impairment. Amortized cost is calculated taking in to account any fees and costs that are integral part of the EIR. The amortization is included in the “Interest Income” in the Income Statement. The losses arising from impairment are recognized in the Income Statement in “Impairment Charge”.

HABIB BANK LIMITED - SRI LANKA BRANCH

Notes to the financial statements (contd)

2 Summary of significant accounting policies (contd)

2.3 Summary of Significant Accounting Policies (contd)

2.3.3 Financial Instruments – Initial recognition and subsequent measurement (contd)

(V) Financial Liabilities - Subsequent measurement

Bank's financial liabilities include due to customers, due to banks, borrowings and other financial liabilities.

The subsequent measurement of financial liabilities depends on their classification as follows:

Due to customers/ banks

Due Customers/ banks include deposits and are subsequently measured at amortised cost using the effective interest rate method. Gains and losses are recognised in the Income Statement through the effective interest rate method (EIR) amortisation process.

Borrowings/ Other financial liabilities

After initial measurement, Other Borrowings/ and other financial liabilities are subsequently measured at amortised cost using EIR. Amortised Cost is calculated by taking in to account any discount or premium on the issue and costs that are an integral part of the EIR.

2.3.4 Impairment of financial assets

The Bank assesses, at each reporting date, whether there is any objective evidence that a financial asset or a group of financial assets are impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated.

Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, the probability that they will enter bankruptcy or other financial reorganisation, default in interest or principal payments, and where observable data indicates that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

Financial assets carried at amortised cost

For financial assets carried at amortised cost, the Bank first assesses individually whether objective evidence of impairment exists for financial assets. If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the Statement of Comprehensive Income.

HABIB BANK LIMITED - SRI LANKA BRANCH

Notes to the financial statements (contd)

2 Summary of significant accounting policies (contd)

2.3.4 Impairment of financial assets (contd)

Financial assets carried at amortised cost (contd)

Loans together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realised or has been transferred to the Bank. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the allowance account. If a future write-off is later recovered, the recovery is recognised in the other operating income in the Statement of comprehensive income.

The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the interest rate prevailed at the last reprising date.

Refer Note 10 to the financial statements for details of impairment losses on financial assets carried at amortised cost.

2.3.5 Derecognition of financial assets and financial Liabilities

(i) Financial assets

- A financial asset is derecognised when:
- The rights to receive cash flows from the asset have expired or
- The Bank has transferred substantially all the risks and rewards of the asset

(ii) Financial liabilities

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires. Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability. The difference between the carrying value of the original financial liability and the consideration paid is recognised in profit or loss.

2.3.6 Reverse Repurchase Agreements

Securities purchased under agreements to resell at a specified future date are not recognised in the statement of financial position. The consideration paid, including accrued interest, is recorded in the statement of financial position, within 'Reverse Repurchase Agreements', reflecting the transaction's economic substance as a loan by the Bank. The difference between the purchase and resale prices is recorded in 'Interest Income' and is accrued over the life of the agreement using the effective interest rate.

2.3.7 Property Plant and Equipment

Property, Plant and Equipment except for land and buildings is stated at cost excluding cost of day to day servicing, less accumulated depreciation and accumulated impairment value, if any. The Bank reviews its assets residual values, useful lives and method of depreciation at each reporting date. Judgement by the management is exercised in the estimation of these values, rates, methods and hence they are subject to uncertainly.

HABIB BANK LIMITED - SRI LANKA BRANCH

Notes to the financial statements (contd)

2 Summary of significant accounting policies (contd)

2.3 Summary of Significant Accounting Policies (contd)

2.3.7 Property plant and equipment (contd)

Land and buildings are measured at fair value, less accumulated depreciation on buildings, and impairment losses recognised at the date of revaluation. Valuations are performed with sufficient frequency to ensure that the fair value of a revalued asset does not differ materially from its carrying amount.

A revaluation surplus is recognised in other comprehensive income and credited to the asset revaluation reserve in equity. However, to the extent that it reverses a revaluation deficit of the same asset previously recognised in the income statement, in which case the increase is recognised in the income statement. A revaluation deficit is recognised in profit or loss, except to the extent that it offsets an existing surplus on the same asset recognised in the asset revaluation reserve. Refer Note 12 and 21 to the financial statements for revaluation of land and buildings.

Depreciation is calculated using the straight line method to write down the cost of property, plant and equipment to their residual values over their estimated useful lives from the time asset is placed in use. Land are not depreciated. The estimated useful lives are as follows,

Freehold buildings	20 Years
Leasehold buildings	Over the period of lease
Motor vehicles	5 Years
Furniture, fixtures and fittings	5 Years
Computer equipment	5 Years

Property, plant and equipment is derecognised on disposal or when no future economic benefits are expected from its use. Any gain or loss arising on derecognition of the assets (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is recognised in “Other operating income” or “Other operating expense” as appropriate in the Statement of comprehensive income in the year the asset is derecognised.

2.3.8 Impairment of non-financial assets

The Bank assesses at each reporting date whether there is an indication that an asset may be impaired. If any indication exists, or when annual impairment testing for an asset is required, the Bank estimates the asset’s recoverable amount. An asset’s recoverable amount is the higher of an asset’s fair value less costs to sell and its value in use. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered to be impaired and is written down to its recoverable amount.

2.3.9 Financial guarantees

In the ordinary course of business, the Bank gives financial guarantees, consisting of letter of credit, guarantees and acceptances. Financial guarantees are initially recognised in the Financial Statements (with in “Other Liabilities”) at fair value, being the premium received. Subsequent to the initial recognition, the Bank’s liability under each guarantee is measured at the higher of the amount initially recognised less cumulative amortisation recognised in the Income Statement, and the best estimate of expenditure required to settle any financial obligation arising as a result of guarantee.

HABIB BANK LIMITED - SRI LANKA BRANCH

Notes to the financial statements (contd)

2 *Summary of significant accounting policies (contd)*

2.3 Summary of significant accounting policies (contd)

2.3.9 Financial guarantees (contd)

Any increase in the liability relating to financial guarantee is recorded in the Income Statement in "Impairment Charge". The premium received is recognised in the Income Statement in "Fees and Commission Income" on a straight line basis over the life of the guarantee.

2.3.10 Employee benefit liability

(a) Defined benefit plan - gratuity

The Bank measures the present value of the promised retirement benefits of gratuity which is a defined benefit plan using the actuarial valuation method. The actuarial valuation involves making assumptions about discount rate, future salary increase rate and mortality rates etc. Due to the long term nature of these plans, such estimates are subject to significant uncertainty. All assumptions are reviewed at each reporting date. Accordingly the employee benefit liability is based on the actuarial valuation as at 31 December 2016 carried out by Messrs Actuarial and Management Consultants (Private) Limited, actuaries. Refer Note 17 to the financial statements for details on Gratuity.

The gratuity liability is not externally funded.

(b) Defined contribution plans - Employees' provident fund and employees' trust fund

Employees are eligible for Employees' provident fund contributions and Employees' trust fund contributions in line with the respective statutes and regulations. The Bank contributes 12% of gross emoluments of employees to an approved private provident fund and 3% to the Employees' Trust Fund respectively.

2.3.11 Provisions

Provisions are recognised when the Bank has a present obligation (legal or constructive) as a result of past event, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. The expenses relating to any provision net of any reimbursement is presented in the Statement of comprehensive income.

2.3.12 Taxes

Current Income Tax

Current income tax assets and liabilities for the current and prior years are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted, at the reporting date.

Income tax on profits from Domestic Banking Unit and Foreign Currency Banking Unit is calculated at the rate of 28%.

HABIB BANK LIMITED - SRI LANKA BRANCH

Notes to the financial statements (contd)

2 *Summary of significant accounting policies (contd)*

2.3 Summary of Significant Accounting Policies (contd)

2.3.12 Taxes (contd)

Deferred tax

Deferred tax is provided on temporary differences at the reporting date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes at the reporting date. Deferred tax liabilities are recognised for all taxable temporary differences. Deferred tax assets are recognised for all deductible temporary differences.

The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the reporting date.

Deferred tax assets and deferred tax liabilities are offset if a legally enforceable right exists to set off current tax assets against current income tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

Value Added Tax (VAT) on financial services

During the year, Bank's total 'value addition' was subjected to 15% VAT between 2 May to 10 July 2016 and 1 November to 31 December 2016, and 11% for the remaining period on financial services as per Section 25A of the Value Added Tax Act No. 14 of 2002 and amendments there to. (2015- 11%).

Nation Building Tax on Value Added Tax (VAT) on financial services

According to the Nation Building Tax Act, No. 09 of 2009 and subsequent amendments thereto, importers, Manufacturers, service providers and traders are liable to pay Nation Building Tax on the liable turnover for every quarter at the rate of 2%. The business of Banking or Finance was exempted from Nation Building Tax up to 31 December 2013 and the exemption was removed with effect from 01.01.2014.

Accordingly from 01.01.2014 Bank was subjected to Nation Building Tax which is payable at 2% of Bank's total 'value addition'.

Crop insurance levy

During the year, Bank was subjected to Crop Insurance Levy which is payable as 1% of profit after tax payable to the National Insurance Trust Board effective from 01 April 2013.

2.3.13 Revenue recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Bank and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognised.

HABIB BANK LIMITED - SRI LANKA BRANCH

Notes to the financial statements (contd)

2 *Summary of significant accounting policies (contd)*

2.3 Summary of significant accounting policies (contd)

2.3.13 Revenue recognition (contd)

Interest income and expenses

For all financial instruments interest income or expense is recorded using Effective Interest Rate (EIR). EIR is the rate that exactly discounts the estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or liability. The calculation takes in to account all contractual terms of the financial instrument and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the EIR, but not future impairment loss.

The carrying amount of the financial asset or liability is adjusted if the Bank revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original EIR and the change in carrying amount is recorded as 'Interest Income' for financial assets and 'Interest Expense' for financial liabilities.

Fee and commission income

The Bank earns fees and commissions from a diverse range of services it provides to customers. Fee Income can be divided to following two categories,

(i) Fee income earned from services that are provided over a certain period of time

Fees earned for the provision of services over a period of time are accrued over that period. These fees include commission income.

(ii) Fee income from Providing transaction services

Fees arising from negotiating or participating in the negotiation of a transaction for a third party are recognised on completion of the underlying transaction.

(iii) Net trading income

Net trading income comprise of results arising from trading activities including gains and losses on foreign exchange forward contracts.

(iv) Dividend income

Dividend income is recognised when the Bank's right to receive the payment is established.

(v) Other income

Other income is recognised on an accrual basis.

(vi) Other expenses

All other expenses have been recognised in the financial statements as they are incurred in the period to which they relate. All expenditure incurred in the operation of the business and in maintaining capital assets in a state of efficiency has been charged to revenue in arriving at the Bank's profit for the year.

HABIB BANK LIMITED - SRI LANKA BRANCH

Notes to the financial statements (contd)

2 *Summary of significant accounting policies (contd)*

2.3 Summary of significant accounting policies (contd)

2.3.14 Contingent liabilities and commitments

To meet the financial needs of customers, the Bank enters into various commitments and contingent liabilities. Even though these obligations may not be recognized on the statement of financial position, they do contain credit risk and are therefore part of the overall risk of the Bank.

Financial guarantees and undrawn facilities

The maximum exposure to credit risk relating to a financial guarantee is the maximum amount the Bank would have to pay if the guarantee is called upon. Undrawn commitments mainly consist of unutilized credit facilities granted to customers where the Bank reserves the right to unconditionally cancel or recall the facility at its discretion.

2.3.15 Cash flow statement

The Cash Flow Statement has been prepared by using the “Indirect Method” in accordance with LKAS 7 on Statement of Cash Flows, whereby gross cash receipts and gross cash payments of operating activities, financing activities and investing activities have been recognised. Cash and Cash Equivalents mainly comprise of cash balances, placements, balances with Central Bank of Sri Lanka, highly liquid investments of which original maturity of 3 months or less and net of any amount due from banks.

2.3.16 Sri Lanka accounting standards adopted and issued but not yet effective

(a) New accounting standards, amendments and interpretations adopted in 2016

(i) LKAS 16, ‘Property, Plant and Equipment’ and LKAS 38, ‘Intangible Assets’, clarify that a revenue-based method of depreciation is generally not appropriate.

(ii) SLFRS 7, ‘Financial Instruments: Disclosures’, provide specific guidance for transferred financial assets to help management to determine whether the terms of a servicing arrangement constitute ‘continuing involvement’ and, therefore, whether the asset qualifies for derecognition. It further clarifies that the additional disclosures relating to the offsetting of financial assets and financial liabilities only need to be included in interim reports if required by LKAS 34 ‘Interim Financial Reporting’.

(iii) LKAS 19, ‘Employee Benefits’, clarify that when determining the discount rate for post-employment benefit obligations, it is the currency that the liabilities are denominated in that is important and not the country where they arise.

(iv) LKAS 1, ‘Presentation of Financial Statements’, amendments is made in the context of the IASB’s Disclosure Initiative, which explores how financial statement disclosures can be improved. LKAS 1 provide clarifications on a number of issues, including: materiality, disaggregation and subtotals, notes to the financial statements and OCI arising from investments accounted for under the equity method.

(b) New accounting standards, amendments and interpretations issued but not yet adopted.

The following new standards and amendments to standards had been issued but were not mandatory for annual reporting periods ending 31 December 2016.

(i) Amendments to LKAS 7 ‘Statement of Cash Flows – Disclosure Initiative’ introduce an additional disclosure on changes in liabilities arising from financing activities. The amendments to the standard are effective for accounting periods beginning on or after 1 January 2017.

HABIB BANK LIMITED - SRI LANKA BRANCH

Notes to the financial statements (contd)

2 *Summary of significant accounting policies (contd)*

2.3.16 Sri Lanka accounting standards adopted and issued but not yet effective (contd)

(b) New accounting standards, amendments and interpretations issued but not yet adopted.

(ii) Amendments to LKAS 12 'Income Taxes - Recognition of Deferred Tax Assets for Unrealised Losses' (effective from 1 January 2017) clarify the requirements for recognising deferred tax assets on unrealised losses arising from deductible temporary difference on asset carried at fair value. In addition, in evaluating whether an entity will have sufficient taxable profits in future periods against which deductible temporary differences can be utilised, the amendments require an entity to compare the deductible temporary differences with future taxable profits that excludes tax deductions resulting from the reversal of those temporary differences. The amendments to the standard are effective for accounting periods beginning on or after 1 January 2017.

(iii) SLFRS 9 'Financial Instruments', retains but simplifies the mixed measurement model in LKAS 39 'Financial Instruments: Recognition and Measurement' and establishes a single model that has only three primary classification categories for financial assets: amortised cost, fair value through profit or loss and fair value through Other Comprehensive Income ("OCI") for certain financial assets that are debt instruments.

Classification of debt assets will be driven by the entity's business model for managing the financial assets and the contractual cash flow characteristics of the financial assets. A debt instrument is measured at amortised cost only if the entity is holding it to collect contractual cash flows and the cash flows represent principal and interest. All other debt and equity instruments, including investments in complex debt instruments and equity investments, must be recognised at fair value. All fair value movements on financial assets are taken through the profit or loss, except for equity investments that are not held for trading, which may be recorded in the profit or loss or in reserves without subsequent recycling to the profit or loss.

For financial liabilities, the standard retains most of the LKAS 39 requirements. These include amortised cost accounting for most financial liabilities, with bifurcation of embedded derivatives. The main change is that, in cases where the fair value option is taken for financial liabilities, the part of a fair value change due to an entity's own credit risk is recorded in OCI rather than the profit or loss, unless this creates an accounting mismatch.

The new hedge accounting rules align hedge accounting more closely with common risk management practices. As a general rule, it will be easier to apply hedge accounting going forward. Further, SLFRS 9 introduces a new expected credit losses model on impairment for all financial assets that replaces the incurred loss impairment model used in LKAS 39. The expected credit losses model is forward-looking and eliminates the need for a trigger event to have occurred before credit losses are recognised.

SLFRS 9 also introduces expanded disclosure requirements and a change in presentation .The standard is effective for accounting periods beginning on or after 1 January 2018. Early adoption is permitted.

(iv) SLFRS 15 'Revenue from contracts with customers' replaces LKAS 18 'Revenue' and LKAS 11 'Construction contracts' and related interpretations. The core principle in SLFRS 15 is that an entity recognises revenue to depict the transfer of promised goods or services to the customer in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

Revenue is recognised when a customer obtains control of goods or services, i.e. when the customer has the ability to direct the use of and obtain the benefits from the goods or services.

HABIB BANK LIMITED - SRI LANKA BRANCH

Notes to the financial statements (contd)

2 *Summary of significant accounting policies (contd)*

2.3 Summary of significant accounting policies (contd)

2.3.16 Sri Lanka accounting standards adopted and issued but not yet effective (contd)

(b) New accounting standards, amendments and interpretations issued but not yet adopted.

A new five-step process is applied before revenue can be recognised:

- Identify contracts with customers
- Identify the separate performance obligations
- Determine the transaction price of the contract;
- Allocate the transaction price to each of the separate performance obligations; and
- Recognise the revenue as each performance obligation is satisfied.

(v) SLFRS 16, 'Leases' supersedes LKAS 17 'Leases' and the related interpretations. Under SLFRS 16, a lease is a contract (or part of a contract) that conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

SLFRS 16 eliminates the classification of leases by the lessee as either finance leases (on balance sheet) or operating leases (off balance sheet). SLFRS 16 requires a lessee to recognise a "right-of-use" of the underlying asset and a lease liability reflecting future lease payments for most leases. The right-of-use asset is depreciated in accordance with the principle in LKAS 16 'Property, Plant and Equipment' and the lease liability is accreted over time with interest expense recognised in the income statement.

For lessors, SLFRS 16 retains most of the requirements in LKAS 17. Lessors continue to classify all leases as either operating leases or finance leases and account for them differently.

The standard is effective for accounting periods beginning on or after 1 January 2019. Early adoption is permitted if SLFRS 15 'Revenue from Contracts with Customers' has also been applied.

The impact of SLFRS 9 'Financial Instruments', SLFRS 15 'Revenue from Contracts with Customers' and SLFRS 16 'Leases' are still being assessed.

There are no other standards or IFRIC interpretations that are not yet effective that would be expected to have a material impact to the Branch.

HABIB BANK LIMITED - SRI LANKA BRANCH

Notes to the financial statements (contd)
(all amounts in Sri Lanka Rupees)

3. Analysis of financial instruments by measurement basis

Assets	2016	2015 Restated
Loans and receivables at amotised cost		
Cash and cash equivalents	1,247,248,959	574,284,558
Balances with Central Bank of Sri Lanka	1,306,270,622	1,176,890,848
Reverse repurchase agreements	300,122,805	-
Placement with financial institution	209,875,028	101,678,082
Other financial assets	2,361,981,453	2,551,045,789
Loans and advances to customers	4,971,237,077	3,504,586,122
Total loans and receivables at amotised cost	**10,396,735,945**	**7,908,485,399**
Held to maturity investments		
Financial assets - held to maturity	496,843,435	596,592,762
Total financial assets	**10,893,579,379**	**8,505,078,161**

Liabilities	2016	2015 Restated
Financial liabilities at amortised cost		
Due to banks	778,075,831	63,579,625
Due to customers	3,350,124,158	1,742,246,379
Other borrowings	1,354,453,125	1,502,147,629
Total financial liabilities	**5,482,653,114**	**3,307,973,633**

4. Cash and cash equivalents

	2016	2015 Restated
Cash in Hand - Local Currency	96,377,278	101,423,274
Cash in Hand - Foreign Currency (United States Dollar)	262,213	4,857,123
Balances with Banks	1,102,590,982	131,948,777
Money at Call and Short Notice	48,018,486	336,055,384
	1,247,248,959	**574,284,558**

4.1 Restatement of comparative balances

The bank has used Memorandum Inter-Branch accounts and Inter-Branch Settlement accounts to record internal transactions between its own divisions (FCBU and DBU). However, two of such accounts have not been eliminated in the preparation of financial statements in the prior years. This has resulted in an error where both assets (Cash with banks) and liabilities (Balances due to banks) of the bank have been overstated by the same amount (no impact on the income statement). This error was corrected retrospectively during the year (i.e including the comparatives) as required by LKAS 8.

Further, placements made by the bank in financial institutions (Wakala Placements) which was presented under Other financial assets in the previous year, has been presented as a separate line item alone with the comparative figures. (Note 7)

	Cash & cash equivalents	Balances due to banks	Placements with financial institutions
Balance as at 31 December 2015 - as previously stated	4,612,748,445	(4,000,365,430)	-
Re-statement	(4,038,463,887)	3,936,785,805	101,678,082
Balance as at 31 December 2015 - as restated	**574,284,558**	**(63,579,625)**	**101,678,082**

HABIB BANK LIMITED - SRI LANKA BRANCH

Notes to the financial statements (contd)

(all amounts in Sri Lanka Rupees)

5. Balances with central bank of Sri Lanka

	2016	2015
Statutory Deposit with Central Bank of Sri Lanka [Note 5.1]	135,532,640	51,811,647
Money held at Central Bank of Sri Lanka in United States Dollars [Note 5.2]	1,170,737,982	1,125,079,201
	1,306,270,622	**1,176,890,848**

5.1 As required by the provisions of section 93 of the Monetary Law Act, a cash balance is required to be maintained with the Central Bank of Sri Lanka. As at 31 December 2016, the minimum cash reserve requirement was 7.5 % (2015 - 6%)of the rupee deposit liabilities of Domestic Banking Unit. There is no reserve requirement for foreign currency deposit liabilities in Domestic Banking Unit and the deposit liabilities in Foreign Currency Banking Unit.

5.2 As required by circular dated 29 July 2005 "Request to Maintain Capital in Foreign Currency" of the Central Bank of Sri Lanka the Bank can maintain capital in foreign currency up to maximum of 50% of the new capital brought in, provided 25% of such foreign currency capital to be retained at Reserve Fund of Central Bank of Sri Lanka and balance 25% of such reserve funds to be used for lending to BOI companies. Accordingly this balance represents the 25% held at Central Bank of Sri Lanka.

6. Reverse repurchase agreements

	2016	2015
Due from Banks	300,122,805	-
	300,122,805	**-**

The balance as at 31 December 2016 represents the investments in Reverse Repurchases Agreements with Central Bank of Sri Lanka.

7. Placements with financial institutions

	2016	2015
Wakala placements	209,875,028	101,678,082
	209,875,028	**101,678,082**

The above balance represents placement with Richard Pieris and Company PLC amounting to Rs. LKR 107.87 Mn (2016 - Rs. 43.5 Mn) and LOLC Finance PLC Rs. 100 Mn (2016 -Nil) which mature in year 2017.

8. Financial assets - held to maturity

	2016	2015
Government Treasury Bills	496,843,435	596,592,762
	496,843,435	**596,592,762**

HABIB BANK LIMITED - SRI LANKA BRANCH

Notes to the financial statements (contd)

(all amounts in Sri Lanka Rupees)

8. Financial assets - held to maturity (contd)

	2016	2015
Government treasury bills	496,843,435	596,592,762
	496,843,435	**596,592,762**

9. Other financial assets

	2016	2015
Sri Lanka Development Bonds [Note 9.1]	1,221,177,781	1,458,920,210
Trust Certificates [Note 9.2]	835,367,805	786,729,921
Debentures [Note 9.3]	304,855,867	304,815,658
Unquoted Investments [Note 9.4]	580,000	580,000
	2,361,981,453	**2,551,045,789**

9.1 Sri Lanka Development Bonds

The investment in Sri Lanka Development Bonds amounts to USD 8 Mn and mature in year 2017. (2015 - USD 10 Mn and mature in year 2016).

9.2 Trust certificates

The above balance represents investment in trust certificates of Peoples Leasing Company PLC amounting to Rs. 787.3 Mn which mature in year 2017 (Rs. 665.7Mn) ,2018 (Rs. 110.1 Mn) and 2019 (Rs.11.5 Mn). [(2015 - trust certificates of Peoples Leasing Company PLC Rs. 768 Mn which mature in year 2016 (Rs. 616 Mn), and 2017 (Rs. 152 Mn)].

9.3 Debentures

The above balance represents investment in debentures of Richard Pieris and Company PLC amounting to Rs. 43.5 Mn (2015 - Rs. 43.5 Mn) and Seylan Bank PLC Rs. 250 Mn (2015 -Rs. 250 Mn) which mature in year 2017 and 2018 respectively.

9.4 Unquoted Investments	2016	2015
Lanka Clear (Private) Limited (50,000 ordinary shares of Rs. 10/- each)	500,000	500,000
Credit Information Bureau of Sri Lanka (800 ordinary shares of Rs. 100/- each)	80,000	80,000
	580,000	**580,000**

Management's valuation of investments in unquoted share investment amounts to Rs. 580,000/- and has been determined assuming that the cost to be fairly representative of it's fair value.

HABIB BANK LIMITED - SRI LANKA BRANCH

Notes to the financial statements (contd)
(all amounts in Sri Lanka Rupees)

10. Loans and advances to customers

	2016	2015
Gross loans and receivables	5,027,061,530	3,547,821,208
Less:		
Individual impairment [Note 10.3.1]	(34,338,005)	(26,806,700)
Collective impairment [Note 10.3.2]	(21,486,448)	(16,428,386)
Net loans and receivables [Note 10.1]	**4,971,237,077**	**3,504,586,122**

10.1 Gross loans and advances by product

	2016	2015
Term loans	1,563,718,924	993,609,865
Overdraft	1,927,195,184	1,205,777,783
Consumer loans	-	2,720,000
Short term loans	958,561,508	656,503,079
Trade finance loans	527,460,946	638,216,712
	4,976,936,563	3,496,827,439
Allowance for impairment losses [Note 10.3]	(55,824,453)	(43,235,086)
	4,921,112,110	(43,235,086)
Staff loans	63,890,095	63,189,687
Less : Allowance for Day 1 Difference	(13,765,128)	(12,195,918)
	50,124,967	50,993,769
	4,971,237,077	**3,504,586,122**

HABIB BANK LIMITED - SRI LANKA BRANCH

Notes to the financial statements (contd)
(all amounts in Sri Lanka Rupees)

10. Loans and advances to customers (contd)

10.2 Gross loans and advances by currency

	2016	2015
Local currency - Sri Lankan Rupees	2,629,568,760	1,569,261,232
Foreign currency - United States Dollar	2,341,668,317	1,935,324,890
	4,971,237,077	**3,504,586,122**

10.3 Impairment allowance for loans and advances to customers

	2016	2015
Balance as at 1 January	43,235,086	50,325,988
Impairment charge / (reversal) during the year	14,207,418	(4,416,747)
Balance written off during the year	(1,945,812)	(3,309,278)
Exchange Impact on revaluation of foreign currency Impairment	327,761	635,123
Balance as at 31 December	**55,824,453**	**43,235,086**

10.3.1 Movement in individual impairment allowance for loans and advances

	2016	2015
Impairment - as at 1 January	26,806,700	31,749,526
Impairment charge / (reversal) during the year	9,477,120	(2,268,670)
Balance written off during the year	(1,945,812)	(3,309,278)
Exchange Impact on revaluation of foreign currency Impairment	(3)	635,123
Impairment - as at 31 December	**34,338,005**	**26,806,700**

10.3.2 Movement in collective impairment allowance for loans and advances

	2016	2015
Impairment - as at 01 January	16,428,386	18,576,463
Net impairment charge for the year	4,730,298	(2,148,077)
Exchange Impact on revaluation of foreign currency Impairment	327,764	-
Impairment - as at 31 December	**21,486,448**	**16,428,386**

11. Other assets

	2016	2015
Deposits and prepayments	41,281,401	42,631,281
Unamortised staff cost	13,765,128	12,195,918
Other assets*	51,904,653	24,032,671
	106,951,182	**78,859,870**

*Inward and Outward net cheque clearing balance to be settled by the Lanka Clear (Private) Limited amounting to Rs. 42,690,242/- (2015- Rs. 19,068,622/-) is included in the Other Assets balance as at 31 December 2016.

HABIB BANK LIMITED - SRI LANKA BRANCH

Notes to the financial statements (contd)

(all amounts in Sri Lanka Rupees)

12. Property, plant and equipment

12.1 Gross carrying amounts

	Balance As at 01.01.2016	Additions	Disposals/ Transfers and Write-offs	Balance As at 31.12.2016
At cost / revaluation				
Freehold land	65,200,000	-		65,200,000
Freehold building	52,905,477	-		52,905,477
Motor vehicles	23,250,000	-		23,250,000
Computer, furniture and fittings	166,122,001	13,882,248	(1,553,235)	178,451,014
	307,477,478	13,882,248	(1,553,235)	319,806,491
Leasehold building improvements	44,382,688	1,585,766	-	45,968,454
	44,382,688	1,585,766	-	45,968,454
Total gross carrying amount	**351,860,166**	**15,468,014**	**(1,553,235)**	**365,774,946**

12.2 Accumulated depreciation

	Balance As at 01.01.2016	Charge for the year	Disposals/ Transfers and Write-offs	Balance As at 31.12.2016
At cost / revaluation				
Freehold building	2,860,351	2,644,219	-	5,504,570
Motor vehicles	12,100,000	4,650,000	-	16,750,000
Computer, furniture and fittings	63,578,773	29,218,671	(1,528,443)	91,269,000
	78,539,124	36,512,890	(1,528,443)	113,523,570
Leasehold building improvements	16,826,902	7,212,770	-	24,039,672
	16,826,902	7,212,770	-	24,039,672
Total accumulated depreciation	**95,366,026**	**43,725,660**	**(1,528,443)**	**137,563,242**

12.3 Net book values

	2016 Rs.	2015 Rs.
At cost /revaluation		
Freehold land	65,200,000	65,200,000
Freehold land	47,400,907	50,045,126
Freehold building	6,500,000	11,150,000
Motor vehicles	87,182,014	102,543,228
Computer, furniture and fittings	206,282,921	228,938,354
Leasehold building improvements	21,928,782	27,555,786
Total carrying amount of property, plant and equipment	**228,211,703**	**256,494,140**

HABIB BANK LIMITED - SRI LANKA BRANCH

Notes to the financial statements (contd)

(all amounts in Sri Lanka Rupees)

12. Property, plant and equipment (contd)

12.4 Revaluation of land and buildings

The revalued land and buildings consist of office properties situated at No 140-142, Second Cross Street, Colombo 11. Management determined that these constitute one class of asset under SLFRS 13, based on the nature, characteristics and risks of the property.

Fair value of the properties was determined using the market comparable method at a market price of Rs.118,000,000/-. The valuation performed by the valuer is based on market prices, similar properties adjusted for differences in the nature, location or condition of the specific property. As at the date of revaluation on 18 December 2014, the properties' fair value was determined by Mr.G.A Gunasegaram, Fellow Member of the Institute of Valuers Sri Lanka. Fair value measurement disclosures for revalued land and buildings are provided in Note 36 to the financial statements.

Significant unobservable valuation input: Range

Land value per perch.	Rs. 8,000,000
Building value per square metre	Rs. 6,000 – Rs. 7,500

Increases(decreases) in estimated price per square metre in isolation would result in a higher (lower) fair value.

Reconciliation of fair value	**2014**
	Rs.
As at 01 January 2014	34,727,798
Additions during the year	22,359,634
Transfer of depreciation related to revalued building	(13,313,487)
Level 3 revaluation recognised based on the valuation	9,026,055
As at 31 December 2014	**52,800,000**

12.5 During the financial year, the Bank acquired Property, plant and equipment to the aggregate value of Rs 15,468,014 (2015- Rs.80,114,410). Cash payments amounting to Rs.15,468,014 (2015 - Rs.70,402,405) were made during the year for purchase of Property plant and equipment.

12.6 Property, plant and equipment includes fully depreciated assets having a gross carrying amount of Rs. 46,556,804 (2015- 43,896,771).

13. Due to banks

	2016	**2015**
		Restated
Bank overdrafts	683,013,618	-
Deposits from other banks	95,062,213	63,579,625
	778,075,831	**63,579,625**

14. Due to customers

14.1 Due to customers - by products

	2016	**2015**
Demand deposits	586,845,430	584,598,927
Savings deposits	820,163,928	514,548,441
Time deposits	1,762,845,972	438,921,086
Call deposits	170,181,082	189,624,821
Margin balances	10,087,746	14,553,104
	3,350,124,158	**1,742,246,379**

14.2 Due to customers - by currency

Local currency - Sri Lankan Rupees	2,276,023,782	1,086,368,742
Foreign currency - United States Dollar	1,067,987,315	646,674,901
Foreign currency - others	6,113,061	9,202,736
	3,350,124,158	**1,742,246,379**

HABIB BANK LIMITED - SRI LANKA BRANCH

Notes to the financial statements (contd)
(all amounts in Sri Lanka Rupees)

15. Other borrowings

	2016	2015
15.1 Short term loans		
Habib Bank Limited - KEPZ	752,218,750	-
Habib Bank Limited - Karachi	602,234,375	-
Habib Bank Limited - New York	-	144,320,377
Indian Bank - Colombo	-	780,246,230
Habib Bank Limited - Kabul	-	577,581,021
	1,354,453,125	**1,502,147,628**

16. Other liabilities

	2016	2015
Accrued expenses	34,046,207	4,350,215
Bills payable	22,956,284	18,720,806
Other liabilities	764,021	17,297,936
	57,766,512	**40,368,957**

17. Employee benefit liability

	2016	2015
As at 1 January	41,103,395	42,122,560
Current service cost	2,911,880	2,400,426
Interest cost	4,110,339	3,791,030
Acturial gains on retirement benefit obligation	1,951,838	1,747,187
(-) Payments during the year	(2,979,864)	(3,809,890)
(-) Gratuity payable to those who left during the period	(159,415)	(5,147,919)
As at 31 December	**46,938,173**	**41,103,395**

17.1 Bank measures the Present Value of Defined Benefit Obligation (PVDBO) with the advice of an actuary using the Projected Unit Credit Method.

The acturial valuation involves making assumptions about discount rates, future salary increases and mortality rates. Due to long term nature of these plans, such estimates are subject to significant uncertainty. All assumptions are reviewed at each reporting date.

Accordingly, the employee benefits obligation is based on the acturial valuation as at 31 December 2016, carried out by Messrs Acturial and Management Consultants (Private) Limited, actuaries.

The key assumptions used by the management include the following,	2016	2015
Rate of interest	11%	10%
Rate of salary increase	11%	8%
Retirement age	55 Years	55 Years
Average future working life of employees	7.32 years	7.13 years

17.2 Net benefit expense categorised under personal expenses,	2016	2015
Current service cost	2,911,880	2,400,426
Interest cost	4,110,339	3,791,030
	7,022,219	**6,191,456**

HABIB BANK LIMITED - SRI LANKA BRANCH

Notes to the financial statements (contd)
(all amounts in Sri Lanka Rupees)

17. Employee benefit liability (contd)

17.3 In order to illustrate the significance of the salary escalation rates and discount rates assumed in this valuation a sensitivity analysis for all employees assuming the above is as follows;

	2016	2015
1% increase in discount rate	(1,700,516)	(1,569,042)
1% decrease in discount rate	1,834,354	1,685,398
1% increase in salary escalation rate	1,919,234	1,791,995
1% decrease in salary escalation rate	(1,811,255)	(1,695,057)

18. Deferred tax asset

		2016	2015
	As at 1 January	(28,648,249)	(33,892,483)
	Charge during the Year	(4,515,082)	5,244,234
	As at 31 December	**(33,163,331)**	**(28,648,249)**
18.1.1	**Deferred tax liabilities**		
	Accelerated depreciation allowance for tax purposes - Property plant and equipment	13,783,930	9,522,962
	Revaluation of property plant and equipment	12,198,299	12,198,299
		25,982,229	21,721,261
18.1.2	**Deferred tax assets**		
	Employee benefit liability - gratuity	(13,142,688)	(11,508,950)
	Loan impairment	(6,016,206)	(4,599,945)
	Tax losses	(39,986,666)	(34,260,615)
		(59,145,560)	(50,369,510)
	Net deferred tax asset	**(33,163,331)**	**(28,648,249)**

Deferred tax has been determined based on the effective tax rate of 28% (2015 - 28%).

19. Assigned capital

	2016	2015
As at 1 January	4,938,390,143	3,728,549,605
Received from Head Office during the Year	-	909,793,533
Capitalisation of retained earnings during the year (Note 24)	-	300,047,005
As at 31 December	**4,938,390,143**	**4,938,390,143**

19.1 The assigned capital represents the capital injections remitted by head office, Habib Bank - Karachi to the Bank and Retained Earnings capitalised over the years.

20. Statutory reserve fund

	2016	2015
As at 1 January	62,317,045	62,254,472
Transfer from the profits during the year [Note 24]	5,542,694	62,573
As at 31 December	**67,859,739**	**62,317,045**

20.1 Five per centum of profits after tax is transferred to the Statutory Reserve Fund as required by section 20(1) of the Banking Act No 30 of 1988. This reserve fund will be used only for the purposes specified in Section 20 (2) of the Banking Act No 30 of 1988.

HABIB BANK LIMITED - SRI LANKA BRANCH

Notes to the financial statements (contd)

(all amounts in Sri Lanka Rupees)

21. Revaluation reserve

	2016	2015
As at 1 January	96,622,625	96,622,625
Revaluation of land and building net of deferred tax	-	-
As at 31 December	**96,622,625**	**96,622,625**

22. Exchange equalisation of capital

	2016	2015
As at 01 January	410,762,244	225,045,049
Exchange Differences on translations of Foreign Currency Capital	95,372,593	185,717,195
As at 31 December	**506,134,837**	**410,762,244**

Exchange Equalisation of Capital Reserve represents the net appreciation/depreciation of foreign currency capital maintained in Foreign Currency Banking Unit due to exchange rate fluctuations. It requires to reflect the Assigned Capital at the exchange rate prevailed on the date the capital was brought in, as specified by the Central Bank of Sri Lanka circular on "Request to maintain capital in foreign currency" dated 29 July 2005 and the impact due to exchange rate fluctuations is recorded in Exchange Equalisation of Capital.

23. Exchange equalisation of reserves

	2016	2015
As at 01 January	8,170,384	6,484,537
Exchange differences on translations of foreign currency reserves	1,700,670	1,685,847
As at 31 December	**9,871,054**	8,170,384

Exchange Equalisation of Reserve represents the effect of currency translation of Retained Earnings and Statutory Reserve Fund maintained in Foreign Currency Banking Unit due to exchange rate fluctuations.

24. Retained earnings / (loss)

	2016	2015
As at 1 January	(69,081)	300,047,005
Profit for the Year	110,853,882	1,251,467
Other comprehensive Income for the Year	(1,405,323)	(1,257,975)
Transfers to statutory reserve fund [Note 19]	(5,542,694)	(62,573)
Profit capitalisation during the year [Note 18]	-	(300,047,005)
As at 31 December	**103,836,782**	**(69,081)**

HABIB BANK LIMITED - SRI LANKA BRANCH

Notes to the financial statements (contd)

(all amounts in Sri Lanka Rupees)

25. Interest income

	2016	2015
Placements with Banks	34,021,350	28,466,859
Reverse repurchase agreements	1,499,449	672,829
Financial Assets - Held to Maturity	34,216,401	17,004,138
Other financial assets	194,347,294	112,822,748
Loans and Advances to Customers	398,106,379	232,367,958
	662,190,873	**391,334,534**

Interest Income earned from Government Securities (Treasury Bills, Treasury Bonds and Reverse Repurchase Agreements) for the year 2016 amounts to Rs.35,751,850/- (2015 - Rs. 17,676,976/-) and has been grossed up by adding notional tax receivable.

26. Interest expense

	2016	2015
Due to customers	103,676,647	50,168,661
Money market and other borrowings	59,751,474	27,499,505
	163,428,121	**77,668,167**

27. Fees and commission income

	2016	2015
Commission on trade finance facilities	17,319,149	13,652,333
Commission on Guarantees	3,538,506	2,040,024
Commission on Remittances	5,286,784	5,927,634
	26,144,439	**21,619,991**

28. Other operating income

	2016	2015
Dividend income	558,000	510,750
Foreign Exchange Gain	14,642,408	7,523,148
Other Income	30,370,010	9,562,702
	45,570,418	**17,596,599**

29. Impairment charge for loans and advances

	2016	2015
Individual impairment charge / (reversal)	9,477,120	(2,268,670)
Collective impairment charge / (reversal)	4,730,298	(2,148,077)
	14,207,418	**(4,416,747)**

30. Personnel expenses

	2016	2015
Salaries	100,160,742	86,046,997
Employee benefits - defined benefit plan [Gratuity] [Note 16.2]	7,022,219	6,191,456
Employee benefits - defined contribution plan		
Employee Provident Fund (EPF)	8,763,093	7,468,551
Employee Trust Fund (ETF)	2,082,246	1,764,370
Bonus	54,909,212	38,896,870
Other allowances	73,798,812	64,486,220
Amortisation of staff loan day 01 difference	3,618,687	3,035,850
	250,355,011	**207,890,314**

HABIB BANK LIMITED - SRI LANKA BRANCH

Notes to the financial statements (contd)
(all amounts in Sri Lanka Rupees)

31. Other operating expenses

	2016	2015
Auditors fees and expenses	1,900,302	1,118,880
Non audit fees and expenses	619,698	1,181,120
Legal fees	2,300,100	866,000
Marketing expenses	2,503,510	2,791,812
Transport	7,083,558	3,456,269
Other expenses	96,483,132	87,478,546
	110,890,300	**96,892,627**

32 Income tax expense

	2016	2015
Current income tax		
Current income tax on profit for the year [Note 33.1]	13,067,072	-
Under / (over) provision of current taxes in respect of prior years	(14,122,336)	(8,579,295)
	(1,055,264)	(8,579,295)
Deferred income tax		
Deferred tax charge / (reversal) for the year	(3,968,567)	5,733,446
Income tax expense reported in the income statement	**(5,023,831)**	**(2,845,849)**
Deferred income tax		
Deferred tax charge / (reversal) for the year	(546,515)	(489,212)
Income tax expense reported in the		
Statement of comprehensive income	(546,515)	(489,212)

32.1 Reconciliation of accounting profit and taxable income

	2016	2015
Accounting profit before taxation	105,830,051	(1,594,382)
Add: Disallowable expenses	129,957,854	94,660,246
Less: Allowable expenses and exempt income	(163,990,809)	(116,849,728)
	71,797,096	(23,783,864)
Less: Brought forward tax losses	(25,128,984)	-
Taxable income	46,668,112	(23,783,864)
Current income tax on profit for the year @ 28%	**13,067,072**	**-**
Effective income tax rate	**12%**	Nil

33. Cash flow information

	2016	2015 Restated
33.1 Increase / (decrease) in operating assets		
Reverse repurchase agreements	(300,122,805)	260,126,857
Placement with banks	(108,196,946)	(101,678,082)
Other financial assets including Held to Maturity	288,813,663	(1,213,321,508)
Loans and advances to customers	(1,466,492,264)	415,049,776
Other assets	(28,091,312)	6,819,908
	(1,614,089,663)	(633,003,050)
33.2 (Decrease) /increase in operating liabilities		
Due to banks (Vostro)	31,482,589	(95,755,764)
Due to customers	1,593,670,361	15,899,110
Other borrowing	(147,694,503)	47,485,628
Other liabilities	17,397,555	(2,843,318)
Employee benefit liability	5,834,778	(2,766,352)
	1,500,690,778	(37,980,696)

34. Related party disclosure

The Bank carries out transactions in the ordinary course of business on an arms length basis at commercial rates with related parties.

Details of significant related party disclosures are as follows,

HABIB BANK LIMITED - SRI LANKA BRANCH

Notes to the financial statements (contd)

(all amounts in Sri Lanka Rupees)

34. Related party disclosure (contd)

34.1 Transactions with Key Management Personnel

Key Management Personnel (KMP) include the Regional General Manager - Habib Bank Limited Sri Lanka Branch having authority and responsibility for planning, directing and controlling the activities of the Habib Bank Limited - Sri Lanka Branch directly and indirectly.

	2016	2015
Short term employee benefits	59,907,369	69,189,324
	59,907,369	69,189,324
Deposits	22,886,220	25,986,112
	22,886,220	25,986,112
Interest expense	284,778	514,308
	284,778	514,308

34.2 Transactions with affiliate branches

Items in the statement of financial position

	2016	2015 Restated
Balances due from Banks (Nostro Balances)		
Habib Bank Limited - New York	364,390,757	65,428,220
Habib Bank Limited - Karachi	18,850,557	34,818,034
Habib Allied International Bank- UK	1,561,486	4,674,309
Habib Bank Limited - Belgium	1,541,615	4,170,317
Habib Bank Limited - Singapore	881,030	316,215
Habib Bank Limited - Bangladesh	751,920	1,786,134
	387,977,365	**111,193,229**
Balances due to Banks (Vostro Balances)		
Habib Bank Limited - Male	173,173	258,720
Habib Bank Limited - Central Branch - Oman	478,024	478,024
Habib Bank Limited - Deira Branch - Dubai	4,166	26,804
Habib Bank Limited - HO Treasury - Karachi	76,683,525	33,026,361
	77,338,888	**33,789,909**

	2016	2015
Other borrowings		
Habib Bank Limited - New York	-	144,320,377
Habib Bank Limited - Kabul	-	577,581,021
Habib Bank Limited - Karachi	602,234,375	-
Habib Bank Limited - KEPZ	752,218,750	-
	1,354,453,125	**721,901,398**
Items in the statement of comprehensive income		
Money market and other borrowings (Inter Branch borrowing related expense)	24,456,101	13,970,939
	24,456,101	**13,970,939**

34.3 Transactions with Habib Bank Limited - Employee Provident Fund

	2016	2015
Items in the Statement of Financial Position		
Liabilities		
Saving deposit	102,411,098	101,529,542
	102,411,098	**101,529,542**
Items in the Statement of Comprehensive Income		
Employee benefits - Employee Provident Fund	8,763,093	7,468,551
Interest expense	7,326,719	4,396,786
	16,089,812	**11,865,337**

HABIB BANK LIMITED - SRI LANKA BRANCH

Notes to the financial statements (contd)

(all amounts in Sri Lanka Rupees)

35. Maturity analysis of assets and liabilities

As at 31 December	Within 12 Months	After 12 Months	2016 Total	Within 12 Months	After 12 Months	2015 Total
Assets						
Cash and cash equivalents	1,247,248,959	-	1,247,248,959	574,284,558	-	574,284,558
Balances with Central Bank of Sri Lanka	135,532,640	1,170,737,982	1,306,270,622	51,811,647	1,125,079,201	1,176,890,848
Reverse repurchase agreements	300,122,805	-	300,122,805	-	-	-
Placements with financial institutions	209,875,028	-	209,875,028	101,678,082	-	101,678,082
Financial assets- Held to Maturity	496,843,435	-	496,843,435	596,592,762	-	596,592,762
Other financial assets	1,661,155,673	700,245,780	2,361,401,453	2,256,965,789	294,080,000	2,551,045,789
Loans and advances to customers	3,726,084,000	1,244,979,929	4,971,063,929	2,911,011,506	593,574,548	3,504,586,054
Other assets	73,772,478	33,178,704	106,951,182	45,071,300	33,788,572	78,859,872
Income tax receivable	48,167,386	-	48,167,386	36,558,923	-	36,558,923
Property, plant and equipment	-	228,211,703	228,211,703	-	256,494,140	256,494,140
Deferred tax asset		33,163,331	33,163,331	-	28,648,249	28,648,249
Total assets	**7,898,802,404**	**3,410,517,428**	**11,309,319,833**	**6,573,974,567**	**2,331,664,710**	**8,905,639,277**
Liabilities						
Due to banks	778,075,831	-	778,075,831	63,579,625	-	63,579,625
Due to customers	3,350,124,158	-	3,350,124,158	1,742,246,379	-	1,742,246,379
Other borrowings	1,354,453,125	-	1,354,453,125	1,502,147,688	-	1,502,147,688
Other liabilities	57,766,512	-	57,766,512	24,204,911	16,163,986.00	40,368,897
Employee benefit liability	-	46,938,173	46,938,173		41,103,395	41,103,395
Total liabilities	**5,540,419,626**	**46,938,173**	**5,587,357,799**	**3,332,178,604**	**57,267,381**	**3,389,445,986**

HABIB BANK LIMITED - SRI LANKA BRANCH

Notes to the financial statements (contd)
(all amounts in Sri Lanka Rupees)

36. Fair Value Measurement

36.1 Fair Value Measurement Hierarchy for Assets as at 31 December 2016

36.1.1 Assets measured at fair value

The following table provides an analysis of assets recorded at fair value by level of the fair value hierarchy in to which the fair value measurement is categorised. The amounts are based on the value recognized in the Statement of Financial Position in the Financial Statements. Please refer Note 2.3.2 to the Financial Statements to the Fair value measurement and fair value hierarchy.

Bank	Date of Valuation	Total	Quoted prices in active market (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)
As At 31 December 2016		**Rs.**	**Rs.**	**Rs.**	**Rs.**
Assets measured at fair value					
Land and Building					
Land	18 December 2014	65,200,000	-	-	65,200,000
Buildings	18 December 2014	52,580,000	-	-	52,580,000
		117,780,000	**-**	**-**	**117,780,000**

36.1.2 Assets not carried at fair value for which fair values are disclosed

As At 31 December 2016					
Other Financial Assets	31 December 2016	2,366,074,747	-	2,366,074,747	-
Loans and Advances to Customers	31 December 2016	4,970,259,652	-	4,970,259,652	-
		7,336,334,399	**-**	**7,336,334,399**	**-**

HABIB BANK LIMITED - SRI LANKA BRANCH

Notes to the financial statements (contd)
(all amounts in Sri Lanka Rupees)

36. Fair Value Measurement (contd)

36.2 Fair value of financial assets and liabilities not carried at fair value

The following describes the methodologies and assumptions used to determine the fair values for those financial instruments which are not already recorded at fair value in the Financial Statements.

Assets	2016 Fair Value Rs.	2016 Carrying Value Rs.	2015 Fair Value Rs.	2015 Carrying Value Rs.
Other financial assets	2,366,074,747	2,361,981,453	2,529,143,163	2,551,045,789
Loans and advances to customers	4,970,259,652	4,971,237,077	3,507,237,049	3,504,586,122
	7,336,334,399	**7,333,218,528**	**6,036,380,212**	**6,055,631,911**

Assets for which fair value approximates carrying value

For financial assets and financial liabilities that have a short term maturity (original maturities less than a year), it is assumed that the carrying amounts approximate their fair values.

The following is a list of financial instruments whose carrying amount is a reasonable approximation of fair value because, for example, they are short-term in nature to reprice to current market rates frequently;

Assets	Liabilities
Cash and Cash equivalents	Due to Banks
Balances with Central Bank of Sri Lanka	Other Borrowings
Reverse Repurchase Agreements	Due to Customers

Fixed rate financial instruments

Carrying amounts are considered as fair values for short term credit facilities. Loans and Advances with fixed interest rates were fair valued using market rates at which fresh loans were granted during the fourth quarter of the reporting year. Interest rates based on treasury bond rates with similar tenors with an adjustment for risk premium have been used to arrive at the fair value of debentures and trust certificates.

Based on Bank policy land and buildings were revalued and recognised in Level 2 and Level 3 respectively. Please refer Note 12.4 to the financial statements for more details.

HABIB BANK LIMITED - SRI LANKA BRANCH

Notes to the financial statements (contd)
(all amounts in Sri Lanka Rupees)

37. Risk management

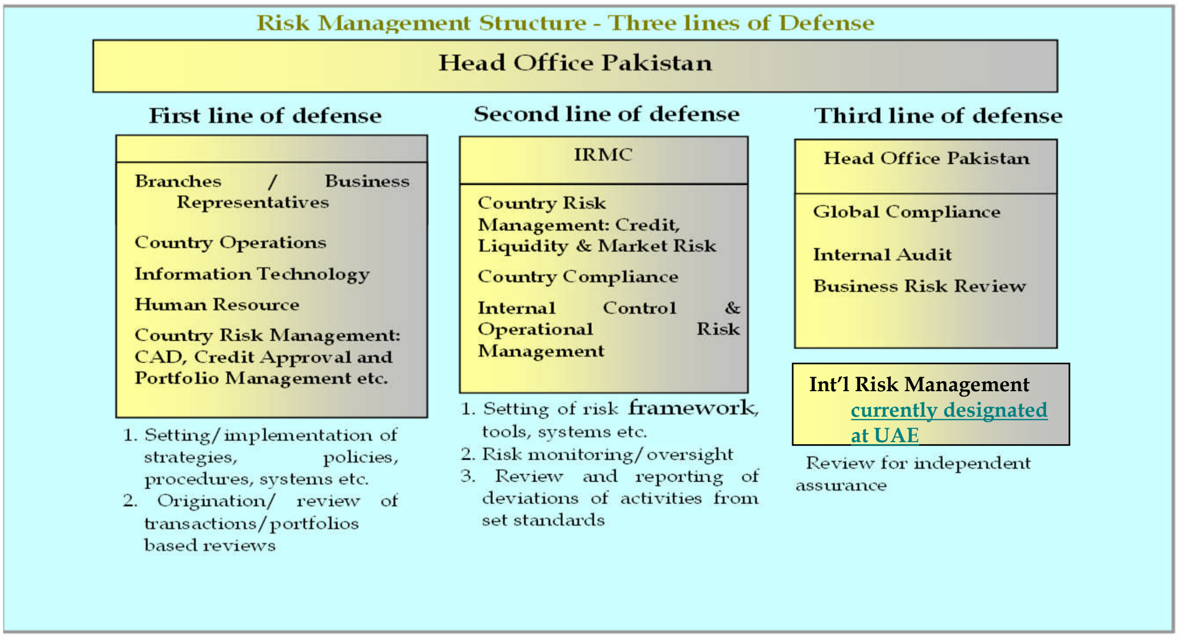
37.1 Risk management framework

Risk taking is central to banking activity. Success in any venture in general and the banking business in particular is dependent on how well an institution manages its risk. The main goal is to minimize risk and be proactive in efficiently identifying, assessing, measuring (as far as possible), monitoring and controlling risks to an organization's strategic advantage.

As Bank plans to continue diversifying its business and ensuring sustained growth and profitability amidst increasing competitiveness and challenges in the banking industry and works to implement the comprehensive risk management, capital adequacy and internal control standards enforced by the Central Bank of Sri Lanka . To this end, the Bank has a well-defined Risk Management Framework comprising of an effective risk management strategy, risk management structure and a policy framework.

Risk Management Structure

The Bank's risk management approach is underpinned by an appropriate risk management structure. This structure shall be represented by three lines of defense in order to ensure that the risks are managed effectively on an entity level.



The following is the description of the Bank's risk management structure describing the relationships and reporting responsibilities:

HABIB BANK LIMITED - SRI LANKA BRANCH

Notes to the financial statements (contd)
(all amounts in Sri Lanka Rupees)

37. Risk management

37.1 Risk management framework (contd)

Country Manager (CM) / Regional General Manager (RGM)

The CM / RGM is ultimately responsible for any financial loss or reductions in Capital suffered by the Bank. Therefore, it is the duty of the CM/RGM to recognize all the significant/ material risks to which the Bank is/ may be exposed and to ensure that the required human resource, culture, practices and systems are in place to address such risks.

Integrated Risk Management Committee (IRMC)

IRMC is the highest level oversight committee and supervising body for all types of risks faced by the bank, notably credit, market, liquidity and operational risks.

As per CBSL Guidelines, the Committee should comprise of at least three non-executive directors, chief executive officer and key management personnel supervising broad risk categories i.e. credit, market, liquidity, operational and strategic risks.

Keeping in view the structure of HBL Sri Lanka, it comprises of Country Manager/ Regional General Manager, Country Operations Manager, Country Risk Manager, Financial Controller, Compliance Manager and Manager Internal Control & Operational Risk. The Country Risk Manager is the Secretary of the Committee.

Country Risk Manager (CRM)

Country Risk Manager manages the Country Risk Management which operates within HBL Sri Lanka, independent from the other business units and support functions and plays a pivotal role in monitoring the risks associated with all the activities of the HBL Sri Lanka. The function is headed by a designated Country Risk Manager (CRM) reporting to the GM- International Risk with a dotted reporting line to Regional General Manager/ Country Manager so as to enable independent reporting of all material risk issues and matters, particularly in relation to exceptional circumstances where there may be a conflict/ disagreement with the Country Manager/ Regional General Manager.

CRM shall be responsible for managing following significant areas;

- Risk Management Policies, Procedures and Systems
- Credit Approvals
- Credit Administration
- Portfolio Management
- Market & Liquidity Risk Management
- Implementation of CBSL guidelines on Basel-II including the annual ICAAP

Asset & Liability Committee (ALCO)

Local ALCO is the focal point for defining and leading the entire asset liability management process within the Bank. In this regard, Local ALCO also has responsibility for oversight of all market and liquidity risks. It is chaired by CM / RGM (Chairman ALCO) and other members are Head of Treasury (Secretary), Country Operations Manager, Financial Controller, Country Risk Manager and Business Heads.

Local Credit Policy Committee (CPC)

The Local CPC at the functional level, has the responsibility to translate the strategy into policies and standards for the extension of credit, and also recommending the Bank's target portfolio profile and limits to Head Office for approval.

The Credit Committee consists of a Chairman and Members comprising of at least the Country Risk Manager and one representative from Credit Administration Department. The Country Manager/ Regional General Manager is Chairman of the committee. Members of the Committee are appointed by the Chairman. The members may have the authority to approve credit transactions within the approved delegated credit authority, and recommend revision and updates in the credit policies and programs for review by the GM - International Risk.

HABIB BANK LIMITED - SRI LANKA BRANCH

Notes to the financial statements (contd)

37. Risk management

37.1 Risk management framework (contd)

GM - International Risk

The role has the following responsibilities:

- Approving loan facilities exceeding approval limits assigned to the RGM/CM/CRM.
- Overseeing implementation of risk management policies, standards and practices across the Int'l Banking Network.
- Implementing and promoting 'best practices' risk management culture in the Int'l Banking Network.
- Reviewing exceptions to the risk management policies.

Business Risk Review (BRR)

BRR working under Internal Audit function of HBL Global Network and is located at HBL's Head Office in Pakistan and provide independent assessment to the senior management of the Bank's risk management framework that includes policies, procedures, methodologies, reporting, and systems.

Business Risk Review (BRR) (contd)

It is independent of the Risk and Business functions and is entrusted with the responsibility to review each and every risk asset acquired by Business units to judge the level of risk assets quality, and the underlying credit process through which such acquisition was made, adherence to rules and regulations imposed by the Central Bank of Sri Lanka (CBSL) or by the Bank internally, loan documentation is sufficient and perfected and to see to what extent the HBL Sri Lanka (HBLSL) credit policies have been followed and implemented. Also, it is responsible for ensuring that all risk assets have been appropriately risk rated, classified, and provisioned if required, loan covenants are complied, post-sanction follow-ups are undertaken; reviewing portfolio quality and provides recommendations for improving portfolio quality. In order to have a bird's eye view of the unit, BRR also checks and assesses the credit talent available locally, and to judge whether it is sufficient or needs beefing up.

37.2 Credit risk

37.2.1 Introduction

Credit risk is the risk of loss due to the failure of a borrower to meet its credit obligations in accordance with the agreed contract terms. Credit risk makes up the largest part of the Bank's risk exposures. The Bank's credit process is guided by centrally established credit policies, rules and guidelines continuing a close to the market approach which produces a reliable and consistent return.

37.2.2 Credit strategy / policies

The credit risk strategy of HBLSL reflects tolerance for risk i.e. credit risk appetite and the level of expected profitability. This, as a minimum, reflects the statement and strategy to grant credit based on various products, economic sectors, client segments etc, target markets giving due consideration to risks specific to each target market and preferred level of diversification/ concentration and specific long term and short term business opportunities in each target market, cost of capital in granting credit and bad debts, minimum risk acceptance criteria and exclusion markets considering the business, pricing, collateralization strategies, the cyclical aspects and the resulting shifts in the composition and quality of the loan portfolio and the effect of credit risk strategy on the market, liquidity and operational risks.

Credit risk policies provide framework for the credit risk management process in the Bank and all credit policies are in line with this framework. The core credit risk Management architecture of the Bank consists of established policies, procedures and processes including a well-defined approval hierarchy which is supported by high ethical standards. The Credit Policy Manual ("CPM") is the customized form of the global Credit Policy Manual of HBL for implementation at HBLSL, it outlines the principles by which the Bank conducts its credit risk management activities.

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Notes to the financial statements (contd)

37. Risk management (contd)

37.2 Credit risk (contd)

37.2.3 Credit Risk Management

The bank follows its Credit Policy Manual and Credit Administration Procedure Manual for management of credit risks.

Credit risk arises from loans given to various corporate, SME and individual customers. It can arise from both on-balance sheet and off-balance sheet activities such as Letters of credit and Letters of guarantee.

Primary activities pertaining to credit risk management are: regulary reviewing and implementing credit risk framework comprising of policies, procedures, methodologies, tools and Management Information Systems etc., portfolio management, credit approval, work on Basel II projects, provision of necessary support in credit risk capital calculations, and credit administration etc.

Credit Risk Management Organization

The Credit Risk Management Structure of HBL Sri Lanka comprises of the following.

International Risk Management, (based in UAE)
Integrated Risk Management Committee (IRMC)
Country Risk Management
- Credit Policy
- Credit Approvals
- Credit Administration
- Portfolio Management

Credit Risk Management Process

Salient features of our credit approval process are delineated below:

- Every extension of credit to any counterparty requires approval by the personnel having credit approval authorities.
- All Business groups must apply consistent standards in arriving at their credit decisions.
- Every material change to a credit facility requires approval at the appropriate / predefined level.
- Credit approval authority is assigned to individuals according to their qualifications and experience.

Before allowing a credit facility, the Bank assesses the risk profile of the customer/ transaction. This, as a minimum, include credit assessment of the borrower's industry and macro-economic factors, purpose of credit and source(s) of repayment, track record/ repayment history of borrower, assessment of repayment capacity of the borrower, future cash flows, proposed terms and conditions and covenants and adequacy and enforceability of collaterals.

The disbursement, administration and monitoring of credit facilities are managed by Credit Administration Departments (CAD) which operates under the Country Risk Manager as part of the Credit Risk Management. CAD is also responsible for collateral/ documents management.

Credit Risk Assessment and Analytics

The Bank has a credit rating system, developed by HBL (Head Office) for bank's global network for borrowers, which is based on the assessment of some quantitative and qualitative factors and also involves application of expert judgment.

The obligor ratings is assigned at the time of credit initiation and then reviewed on an annual basis or upon receipt of financial information, whichever is earlier. A more than usual frequency is also being followed for borrowers on watch list or being high risk.

Business Risk Review (BRR), which is independent of loan origination function and International Risk Management, validates the assigned ratings periodically by taking into account the information available with the relevant approval authorities at the time of the credit approval.

HABIB BANK LIMITED - SRI LANKA BRANCH

Notes to the financial statements (contd)

37. Risk management (contd)

37.2 Credit risk (contd)

37.2.3 Credit Risk Management (Contd)

Credit Risk Monitoring and Reporting

The Bank's philosophy of effective credit risk monitoring is based on a continuous close monitoring of the key credit risk indicators, behavioral and characteristics of individual credit portfolios and environmental factors that may have an impact on the Bank's credit risk profile.

Extensions of credit approved through a Credit Program is reported as specific exposures and aggregated with other credit exposures for a relationship. It is the responsibility of the Business Units / Personnel to ensure that credit risk data is reported into the independent credit risk reporting systems, and is timely, accurate and complete. On a periodic basis, the Regional General Manager/Country Manager and the Country Risk Manager reviews the outstanding portfolio to ensure ongoing adherence to aggregate program parameters and limits.

Credit Risk Mitigation

As a general policy, the Bank lends against cash flow, i.e., cash flow is the primary source of repayment. In case, cash flow becomes insufficient or unavailable, other avenues (for instance, injection of equity, additional debt from other lenders, liquidation of non-core assets, etc.) for reduction of the Bank’s credit exposure are actively pursued. When all other avenues for repayment have been exhausted, liquidation of collateral are sought to settle the residual exposure of the Bank.

As a general guideline, collateral should be available beyond the maturity date of the facility that it is securing so as to provide an appropriate cushion. Under the Basel II Standardised approach, collateral that is valid beyond the life of the facility is eligible for credit risk mitigation purposes. As such, it should be ensured that either this is the case or pricing is set to compensate for the incremental capital required.

Collateral is taken in any of a number of forms, for instance:

-first pari-passu charge (where the prior charge holders, by issuance of No Objection Certificates (NOCs), agree to share pro-rata the collateral under charge

- inferior charge
- floating charge
- lien on cash deposit
- pledge of marketable securities such as GOSL bonds, Shares etc.
- legal mortgage, i.e., any of a number of types of claims against real property or fixed assets
- standby letter of credit / bank guarantee
- corporate or personal guarantees

Collateral should match the purpose, nature and structure of the transaction; it should reflect the form and capacity of the obligor, its operations, and the business and economic environment. Collateral may include the assets acquired through the funding provided, i.e. stock, receivables, or export bills, current assets, fixed assets, specific equipment, and commercial and personal real estate.

Collateral valuation and management

Collateral Valuation is carried out periodically in line with the Credit Policies and Credit Administration Procedures of the bank.

Main Types of Guarantors

Following are three types of Guarantors the bank obtains guarantees from as a credit risk mitigant:

- Personal Guarantees of Partners / Directors
- Cross Corporate Guarantees in case of group entities
- Corporate Guarantees

Notes to the financial statements (contd)

(all amounts in Sri Lanka Rupees)

37. Risk management (contd)

37.2.4 Credit risk exposure

The total gross loans and receivables from all credit customers of the Bank stood at Rs. 5,027 Mn (2015 - Rs. 3,548 Mn) as at 31 December 2016. Please refer Note 10 for the product wise loans and advances.

37.2.4.1 Commitments and contingencies

To meet the financial needs of customers, the Bank enters in to various commitments and contingent liabilities. Even though these obligations may not be recognised on the statement of financial position, they do contain credit risk and are therefore part of the overall risk of the bank.

	2016 Rs.	2015 Rs.
Letter of credits	158,705,834	271,661,508
Guarantees	197,804,513	200,874,814
Undrawn commitments	2,059,484,000	2,796,165,300
	2,415,994,347	**3,268,701,622**

The maximum exposure to credit risk relating to a financial guarantee is the maximum amount the Bank could have to pay if the guarantee is called upon. Undrawn commitments are consists of facilities granted to customers where the Bank reserves the right to unconditionally cancel or recall the facility at it's discretion.

HABIB BANK LIMITED - SRI LANKA BRANCH

Notes to the financial statements (contd)

(all amounts in Sri Lanka Rupees)

37. Risk management (contd)

37.2.4.2 ANALYSIS OF RISK CONCENTRATION

The following table shows the risk concentration by industry for the components of the statement of financial position.

As at 31 December 2016	Agriculture and Fisheries	Financial Services	Government	Manufacturing	Construction and Housing	Traders	Other	Total
Cash and cash equivalents	-	1,247,248,959	-	-	-	-	-	1,247,248,959
Balances with Central Bank of Sri Lanka	-	-	1,306,270,622	-	-	-	-	1,306,270,622
Reverse repurchase Agreements	-	-	300,122,805	-	-	-	-	300,122,805
Placements with financial institutions	-	209,875,028	-	-	-	-	-	209,875,028
Financial assets - held to maturity	-	-	496,843,435	-	-	-	-	496,843,435
Other financial assets								
Sri Lanka Development Bonds	-	-	1,221,177,782	-	-	-	-	1,221,177,782
Trust certificates	-	835,367,805	-	-	-	-	-	835,367,805
Debentures	-	304,855,867	-	-	-	-	-	304,855,867
Unquoted investments	-	-	-	-	-	-	580,000	580,000
Total other financial assets	**-**	1,140,223,672	1,221,177,782	-	-	-	580,000	2,361,981,453
Loans and advances to customers								
Gross loans and advances	507,749,102	99,995,000	-	662,332,706	58,484,233	2,055,256,997	1,643,243,493	5,027,061,530
Allowance for Impairment losses	-	-	-	(13,817,276)	(1,108,376)	(8,087,894)	(32,810,907)	(55,824,453)
Net loans and advances	507,749,102	99,995,000	-	648,515,430	57,375,857	2,047,169,103	1,610,432,585	4,971,237,077
Total	**507,749,102**	**2,697,342,659**	**3,324,414,643**	**648,515,430**	**57,375,857**	**2,047,169,103**	**1,611,012,585**	**10,893,579,379**

As at 31 December 2015	Agriculture and Fisheries	Financial Services	Government	Manufacturing	Construction and Housing	Traders	Other	Total
Cash and Cash equivalents	-	574,284,558	-	-	-	-	-	574,284,558
Balances with Central Bank of Sri Lanka	-	-	1,176,890,848	-	-	-	-	1,176,890,848
Placements with financial institutions	-	101,678,082	-	-	-	-	-	101,678,082
Financial assets - held to maturity	-	-	596,592,762	-	-	-	-	596,592,762
Other financial assets								
Sri Lanka Development Bonds	-	-	1,458,920,210	-	-	-	-	1,458,920,210
Trust certificates	-	786,729,920	-	-	-	-	-	786,729,920
Debentures	-	260,124,176	-	-	-	-	44,691,483.00	304,815,659
Unquoted investments	-	-	-	-	-	-	580,000	580,000
Total other financial assets	-	1,046,854,096	1,458,920,210	-	-	-	45,271,483	2,551,045,789
Loans and advances to customers								
Gross loans and advances	375,639,563	333,333,333	-	1,196,442,419	9,390,652	820,257,315	812,757,926	3,547,821,208
Allowance for Impairment losses	(1,764,786)	(1,566,028)	-	(5,620,986)	(7,177)	(28,932,985)	(5,343,125)	(43,235,087)
Net loans and advances	373,874,777	331,767,305	-	1,190,821,433	9,383,475	791,324,330	807,414,801	3,504,586,121
Total	**373,874,777**	**2,054,584,041**	**3,232,403,820**	**1,190,821,433**	**9,383,475**	**791,324,330**	**852,686,284**	**8,505,078,160**

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Notes to the financial statements (contd)

(all amounts in Sri Lanka Rupees)

37. Risk management (contd)

37.2.4.3 Credit Quality of Loans and Advances to Customers

The table below shows the credit quality by class of assets for loans and advances exposed to credit risk. The amounts presented are gross of impairment allowances.

As at 31 December 2016	Neither past due nor impaired	Past due but not impaired	Individually Impaired	2016 Total
Gross loans and advances to customers				
Term loans	1,556,947,684	6,771,239	-	1,563,718,923
Overdraft	1,619,673,022	273,184,158	34,338,005	1,927,195,185
Short term loans	845,759,763	112,801,745	-	958,561,508
Trade finance loans	515,112,782	12,348,165	-	527,460,946
Staff loans	50,124,967	-	-	50,124,967
Total	**4,587,618,218**	**405,105,307**	**34,338,005**	**5,027,061,530**

As at 31 December 2015	Neither past due nor impaired	Past due but not impaired	Individually Impaired	2015 Total
Gross loans and advances to customers				
Term loans	880,692,361	112,917,504	-	993,609,865
Overdraft	690,031,660	489,475,650	26,270,473	1,205,777,783
Consumer loans	2,720,000	-	-	2,720,000
Short term loans	643,029,111	13,473,968	-	656,503,079
Trade finance loans	635,649,341	2,567,371.00	-	638,216,712
Staff loans	50,651,692	342,077	-	50,993,769
Total	**2,902,774,165**	**618,776,570**	**26,270,473**	**3,547,821,208**

Note : Past Due loans include any loan that are in arrears for more than one day.

HABIB BANK LIMITED - SRI LANKA BRANCH

Notes to the financial statements (contd)
(all amounts in Sri Lanka Rupees)

37. Risk management (contd)

37.2.4.3 Credit Quality of Loans and Advances to Customers (contd)

Aging of past due but not impaired loans and advances to customers

	Past due below 3 months but not impaired	Past due 3-12 months but not impaired	Past due more than 12 months but not impaired	Total past due but not impaired
Term loans	6,771,239	-	-	6,771,239
Overdraft	110,743,865	147,446,179	14,994,114	273,184,158
Short term loans	91,619,912	21,181,833	-	112,801,745
Trade finance loans	-	12,348,165	-	12,348,165
Total	**209,135,016**	**180,976,177**	**14,994,114**	**405,105,307**

Please refer Note 10 for the individual and collective impairment with respect to loans and advances to customers.

37.2.4.4 Collateral and Other Credit Enhancements

The amount and type of collateral required depends on an assessment of the credit risk of the counterparty.

Management monitors the market value of collateral, and requests additional collateral in accordance with the underlying agreement.

As at 31 December 2016	Maximum exposure to cedit risk	Net collateral value	Net exposure
Cash and cash equivalents	1,247,248,959	-	1,247,248,959
Balances with Central Bank of Sri Lanka	1,306,270,622	-	1,306,270,622
Reverse repurchase agreements	300,122,805	-	300,122,805
Placements with financial institutions	209,875,028		209,875,028
Other financial assets	2,361,981,453	2,361,981,453	(1)
Loans and advances to customers	4,971,237,077	4,770,861,979	200,375,098
Contingent liabilities including financial guarantees and letters of credits	356,510,347	109,636,638	246,873,709
	10,753,246,291	**7,242,480,070**	**3,510,766,221**

As at 31 December 2015	Maximum Exposure to Credit Risk	Net Collateral Value	Net Exposure
Cash and cash equivalents	574,284,558	-	574,284,558
Balances with Central Bank of Sri Lanka	1,176,890,848	-	1,176,890,848
Reverse repurchase agreements	-	-	-
Placements with financial institutions	101,678,082	-	101,678,082
Financial assets - Held to maturity	596,592,762	596,592,762	-
Other financial assets	2,551,045,789	768,100,000.00	1,782,945,789
Loans and advances to customers	3,504,586,122	2,928,656,589	575,929,533
Contingent liabilities including financial guarantees and letters of credits	472,536,323	83,009,517	389,526,806
	8,977,614,484	**4,376,358,868**	**4,601,255,616**

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Notes to the financial statements (contd)
(all amounts in Sri Lanka Rupees)

37. Risk management (contd)

37.3 Market risk

Introduction

Market risk is the risk of decrease in the value of an investment due to movement in market factors in particular, changes in interest rates, foreign exchange rates, and equity prices. Movements in interest rate is a function of broad macroeconomic activity such as level of real output in an economy and inflationary pressures. Foreign exchange risk also depends on broad fundamentals. It cannot be divorced away from interest rate risk because even an expectation of interest rate movement could cause significant movement in a currency's value.

Structure

The market risk management at HBLSL

- Local ALCO
- Country Risk Manager
- Treasury Middle Office

Market risk strategy / Policies and scope

On the books of HBLSL, Market risk arises on account of both the structural position and the treasury activities. Since the Bank's activities are mostly of commercial / retail nature, the bulk of the market risk is carried on the banking book, which emanates from structural mismatches of the assets and liabilities to take advantage of the market yield curves. A comparatively smaller portion of market risk is also carried on Treasury's investment activities in the form of fixed income transactions.

The bank only deals in products which are manageable and the risks within which are understandable. The bank has restrained itself from entering into transactions that are unmanageable due to lack of systems, accounting, data capturing, lack of market depth and product liquidity, personnel skills or other risks / limitations existing within the organization, local or international markets. Exceptions to this can be accommodated where the system is awaited if the product can be managed manually. Such exceptions would require specific recommendation of Local ALCO and approval of Market Risk Management Department, Head Office Pakistan in line with instructions of Global ALCO.

HBL Sri Lanka is allowed to take market risk through mismatches of assets and liabilities. The bank may also hold fixed income securities in line with the approved limits.

Treasury Middle Office, an integral part of Risk Management, independently evaluates and monitors transactions carried out by the Bank's Treasury from a risk perspective.

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Notes to the financial statements (contd)
(all amounts in Sri Lanka Rupees)

37. Risk management (contd)

37.3 Market risk (contd)

Market risk management

The Market Risk Management at Bank level is handled by Country Risk Management with a view to implement robust market risk management practices which are also in compliance with CBSL's Guidelines on Integrated Risk Management Framework and Basel II Framework. The Market & Liquidity Risk Analyst assumes the day to day responsibility of the Market Risk Management including Treasury Middle Office. To analyse and monitor exposures on treasury's books, Market and Liquidity Risk Analyst works closely with the Treasury.

The Market & Liquidity Risk Analyst is responsible for analysis, monitoring and reporting of market risk exposures undertaken by the bank.

Market Risk Mitigation, Monitoring and Reporting

The Local Asset Liability Committee (ALCO) manages and monitors the Bank's ALM function in accordance with the Market Risk Policy and taking into consideration the size of the Bank, its nature of activities, domestic-international mix, personnel / other resources, system capabilities and regulatory requirements. It is responsible for oversight of the asset liability management (ALM) function at HBL Sri Lanka in line with the policy parameters included in Market Risk Policy, the overall Global Market Risk Policy of HBL, Head office, Pakistan as well as instructions of Global ALCO issued from time to time.

The Bank employs conventional methodologies for the measurement of Market risk. These are preferable compared to more complex methods, due to their operational ease and simplicity. These involve the monitoring of risk by using notional (amount) based limits and sensitivity limits. These limits are compared with the treasury activity and the outstanding position on the risk measurement date.

Global ALCO or Market Risk Management Department Head Office Pakistan as per instructions of Global ALCO, as the case may be, approves market risk limits for HBL Sri Lanka.

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Notes to the financial statements (contd)

(all amounts in Sri Lanka Rupees)

37. Risk management (contd)

37.3.1 Interest Rate Risk

Interest rate risk is the risk that an investment's value will change due to a change in the absolute level of interest rates i.e. the spread between two rates, in the shape of the yield curve, or in any other interest rate relationship. Substantial part of the Bank's assets and liabilities are subject to floating rates hence are re-priced simultaneously. However, the Bank is exposed to interest rate risk as a result of mismatches on a relatively small part of its assets and liabilities.

Interest Rate Risk in the Banking Book

This is the bank's structural position and is generally held for a longer tenor. Interest rate risk exposures on Banking Book arises on account of mismatches in maturity or re-pricing of assets and liabilities. The banking book includes all Rate Sensitive Assets (RSA) and Rate Sensitive Liabilities (RSL) not categorized under the treasury book. Rate Sensitive Assets and Liabilities can be defined as balance sheet items the values of which are sensitive to interest rate movements. Hence, their values can be affected favourably or adversely with changes in interest rates.

Major portion of Interest rate risk is captured under the banking book in view of the nature of activities undertaken by HBL Sri Lanka.

Interest Rate Risk Management Techniques

Interest rate risk applies to both set of books i.e. treasury and banking book, and almost similar techniques are used to analyse them considering the nature of securities i.e. investment (HTM) being classified in the treasury book.

Gap analysis measures the differences between the RSA and RSL that mature or re-price within a time period. HBLSL uses rate sensitive gap analysis as a tools for measuring sensitivity of the Bank's RSA and RSL to interest rate variations in different time bands based on the residual term to maturity (fixed rate) or residual term for their next repricing (floating rate) as shown in Note 35

37.3.1.1 Interest Rate Sensitivity Gap Analysis as at 31 December 2016

	Total Rs.	< 1 Month	1- 3 Months	3-6 Months	6 Months - 1 Year	1 Year - 2 Years	2 Years - 3 Years	3 Years - 5 Years	5 Years - 10 Years	Over 10 Years	Not exposed to interest rate risk
Financial Assets											
Cash and Cash Equivalents	1,247,248,959	48,018,487	-	-	-	-	-	-	-	-	1,199,230,473
Balances with Central Bank of Sri Lanka	1,306,270,622	-	-	-	-	-	-	-	-	-	1,306,270,622
Reverse Repurchase Agreements	300,122,805	300,122,805	-	-	-	-	-	-	-	-	-
Placements with Financial Institutions	209,875,028	-	-	-	209,875,028	-	-	-	-	-	-
Financial Assets - Held to Maturity	496,843,435	301,055,235	195,788,200	-	-	-	-	-	-	-	-
Other Financial Assets	2,361,981,453	-	1,221,177,783	54,855,866	385,122,024	450,245,780	250,000,000				580,000
Gross Loans and Advances to Customers	5,040,826,658	2,304,597,477	2,489,073,327	176,570,689	2,715,386	5,408,383	3,044,776	24,632,891	19,631,046	10,176,549	4,976,133
	10,963,168,959	2,953,794,004	3,906,039,310	231,426,555	597,712,438	455,654,163	253,044,776	24,632,891	19,631,046	10,176,549	2,511,057,228
Financial Liabilities											
Due to Banks	778,075,831	-	-	-	-	-	-	-	-	-	778,075,831
Due to Customers	3,350,124,158	1,175,958,675	312,526,395	232,019,489	1,032,686,423	-	-	-	-	-	596,933,176
Other Borrowings	1,354,453,125	1,129,453,125			225,000,000	-	-	-	-	-	-
	5,482,653,114	2,305,411,800	312,526,395	232,019,489	1,257,686,423	-	-	-	-	-	1,375,009,008
Total Interest Rate Sensitivity Gap	**5,480,515,845**	**648,382,204**	**3,593,512,916**	**(592,934)**	**(659,973,985)**	**455,654,163**	**253,044,776**	**24,632,891**	**19,631,046**	**10,176,549**	**1,136,048,220**

The following table demonstrates the sensitivity of the Bank's income statement to a reasonably possible parallel shift in the interest rate yield curve, with all other variables held constant.

Increase/ (Decrease) in Interest Rate	Sensitivity to profit before tax Rs.
+1%	(18,924,951)
-1%	19,327,431

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Notes to the financial statements (contd)

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Notes to the financial statements (contd)

(all amounts in Sri Lanka Rupees)

37. Risk management (contd)

37.3.1 Interest Rate Risk (contd)

Interest Rate Sensitivity Gap Analysis as at 31 December 2015

	Total Rs.	< 1 Month	1- 3 Months	3-6 Months	6 Months - 1 Year	1 Year - 2 Years	2 Years - 3 Years	3 Years - 5 Years	5 Years - 10 Years	Over 10 Years	Not exposed to interest rate risk
Financial Assets											
Cash and Cash Equivalents	574,284,558	336,095,384	-	-	-	-	-	-	-	-	238,189,174
Balances with Central Bank of Sri Lanka	1,176,890,848	-	-	-	-	-	-	-	-	-	1,176,890,848
Placements with Financial Institutions	101,678,082	101,678,082									
Financial Assets - Held to Maturity	596,592,762	396,083,895	200,508,867	-	-	-	-	-	-	-	-
Other Financial Assets	2,551,045,789	9,549,507	966,846,064	1,038,570,218	242,000,000	43,500,000	250,000,000	-	-	-	580,000
Gross Loans and Advances to Customers	3,560,017,126	2,211,402,530	540,272,895	359,720,213	50,031,243	108,402,856	118,644,367	68,650,859	37,371,870	8,837,656	56,682,637
	8,560,509,165	3,054,809,398	1,707,627,826	1,398,290,431	292,031,243	151,902,856	368,644,367	68,650,859	37,371,870	8,837,656	1,472,342,659
Financial Liabilities											
Due to Banks	63,579,625	-	-	-	-	-	-	-	-	-	63,579,625
Due to Customers	1,742,246,379	744,630,566	99,755,263	48,458,862	250,249,657	-	-	-	-	-	599,152,031
Other Borrowings	1,502,147,628	201,986,303	721,837,531	578,323,794	-	-	-	-	-	-	-
	3,307,973,632	946,616,869	821,592,794	626,782,656	250,249,657	-	-	-	-	-	662,731,656
Total Interest Rate Sensitivity Gap	**5,252,535,534**	**2,108,192,529**	**886,035,032**	**771,507,775**	**41,781,586**	**151,902,856**	**368,644,367**	**68,650,859**	**37,371,870**	**8,837,656**	**809,611,004**

The following table demonstrates the sensitivity of the Bank's income statement to a reasonably possible parallel shift in the interest rate yield curve, with all other variables held constant.

Increase/ (Decrease) in Interest Rate	Sensitivity to Profit before tax Rs.
+1%	(25,556,389)
-1%	26,496,368

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Notes to the financial statements (contd)

(all amounts in Sri Lanka Rupees)

37. Risk management (contd)

37.3.2 Foreign exchange risk

Foreign exchange risk refers to the risk that a Bank may suffer losses as a result of adverse exchange rate movements during a period in which it has an open position, either in the form of a balance sheet asset or liability account, or an off-balance sheet item. Business line managers are concerned with the consequences of potential exchange rate movements on the domestic currency equivalent value for all foreign currency positions. The goal of foreign exchange risk management is to minimize the losses that the Bank may incur due to adverse exchange rate movements of currencies in which the Bank has an open position.

Foreign exchange risk management

Foreign Exchange risk is managed by Treasury Front office. FX Risk Exposures on Banking Book arises on account of holding assets and liabilities in currencies other than the local currency. The monitoring of the Foreign Exchange Exposure Limit (FEEL) and Net Open Position are requirements of the Head Office Pakistan and Central Bank of Sri Lanka respectively, which are being complied with.

In this regard the Global ALCO specifies limits for ‘international’ operations. HBL Sri Lanka is not allowed to take speculative positions. HBL Sri Lanka is allowed a limit to manage commercial payments / receipts which may not be covered instantly due to size and timing and where nature of banking book requires a long term exposure / position.

Please refer Note 10.2 foreign currency advances and Note No 14.2 foreign currency deposits balance as at 31 December 2016.

37.4 Liquidity risk

Introduction

‘Liquidity’ is the ability of a bank to fund increases in assets and meet obligations as they become due, without incurring unacceptable losses. Liquidity Risk’ is an integral element of banking business and its management should be an essential part of a bank’s strategic management. The fundamental role of banks in the maturity transformation of short-term deposits into long-term loans makes them inherently vulnerable to liquidity risk; both of an institution specific nature and that which affects markets as a whole.

37.4.1 Liquidity risk mitigation, monitoring and reporting

Global Asset Liability Committee (Global ALCO), Head Office, Pakistan is the forum to oversee liquidity risk management in the Bank. Global ALCO has responsibility for ensuring that the ‘Liquidity Risk Policy’ is adhered to on a continuous basis. The Local ALCO at HBL Sri Lanka assumes country specific responsibilities of Global ALCO in relation to HBL Operations at Sri Lanka.

It is the policy of the Bank to maintain adequate liquidity at all times, and hence to be in a position in the normal course of business to meet all obligations to repay depositors, to fulfil commitments to lend, and to meet any other commitment it may have made. Of critical importance is the need to avoid liquidating assets or raising funds at unfavourable terms resulting in long term damage to earnings and reputation of the Bank.

Please refer Note 37.4.2 for maturity analysis of assets and liabilities as at 31 December 2016.

Bank maintains a minimum 20% ratio of liquid assets to total liabilities based on the regulations of the Central Bank of Sri Lanka as given below.

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Notes to the financial statements (contd)

(all amounts in Sri Lanka Rupees)

37. Risk management (contd)

37.4.2 Analysis of financial assets and liabilities by remaining contractual maturities

The table below summarizes the contractual maturity profile of the undiscounted cash flows of the Bank's financial assets and liabilities as at 31 December 2016. Balances due within 12 months are equal to their carrying value as the impact of discounting is not significant.

As at 31 December 2016	On Demand (less than 15 Days)	15 Days to 3 Months	3 Months 12 Months	Over 1 Year	Total 2016
Assets	**Rs.**	**Rs.**	**Rs.**	**Rs.**	**Rs.**
Cash and cash equivalents	1,247,248,959				1,247,248,959
Balances with Central Bank of Sri Lanka	135,532,640			1,170,737,982	1,306,270,622
Reverse repurchase agreements	300,122,805				300,122,805
Placements with financial institutions			209,875,028		209,875,028
Financial Assets- Held to Maturity		301,055,235	195,788,200		496,843,435
Other financial assets		1,025,073,665	1,042,827,789	294,080,000	2,361,981,454
Loans and advances to customers	1,893,920,617	1,543,455,951	288,880,580	1,244,979,929	4,971,237,077
Total financial assets	3,576,825,022	2,869,584,851	1,737,371,596	2,709,797,911	10,893,579,379
Liabilities					
Due to banks	778,075,831			-	778,075,831
Due to customers	1,649,087,240	436,331,005	1,264,705,912	-	3,350,124,157
Other borrowings	1,129,453,125		225,000,000	-	1,354,453,125
Total financial liabilities	1,214,406,836	436,331,005	1,264,705,912	-	5,482,653,114

As at 31 December 2015	On Demand (less than 15 Days)	15 Days to 3 Months	3 Months 12 Months	Over 1 Year	Total 2015
Assets					
Cash and cash equivalents	574,284,558	-	-	-	574,284,558
Balances with Central Bank of Sri Lanka	51,811,647	-	-	1,125,079,201	1,176,890,848
Placements with financial institutions			101,678,082		101,678,082
Financial assets- held to maturity	-	600,000,000	-	-	600,000,000
Other financial assets	-	984,509,489	1,180,399,451	494,559,082	2,659,468,022
Loans and advances to customers	1,451,858,640	751,109,181	981,862,876	663,825,663	3,848,656,360
Total financial assets	**2,077,954,845**	**2,335,618,670**	**2,263,940,409**	**2,283,463,946**	**8,960,977,870**
Liabilities					
Due to banks	63,579,625	-	-	-	63,579,625
Due to customers	1,320,443,557	128,326,134	298,708,518	-	1,747,478,209
Other borrowings	145,024,110.00	781,713,838	581,715,323	-	1,508,453,271
Total financial liabilities	**1,529,047,292**	**910,039,972**	**880,423,841**	**-**	**3,319,511,105**

37.4.3 Contingency funding plan

A Contingency Funding Plan is in place for HBL Sri Lanka to evaluate magnitude of the possible liquidity crisis both specific to bank (restricted only to HBLSL) and the general crisis of the market (systemic risk). It sets out various measures in advance to deal with those situations.

37. Risk management (contd)

37.5 Operational risk management (ORM)

Operational risk is the risk of potential inability of an organisation to carry out its activities as planned. It may arise out of employee, customer or third party frauds, natural disasters, technology failures, process breakdowns, unethical business practices etc.

ORM strategy and policies

HBLSL's strategy for ORM is focused on two broad areas in coordination with HBL-HOP; 1) enhancement of ORM tools and resources, and 2) establishment of core standards for controls across the bank.

ORM at HBLSL is governed by the ORM Framework approved by HBL Head Office Pakistan for HBLSL.

ORM risk structure

The key players involved in ORM at HBLSL are:

- Chief Compliance Officer through the Operational Risk Management Division (ORMD) at HBL Head Office Pakistan
- Integrated Risk Management Committee (IRMC) at HBLSL
- Country Manager or Regional General Manager / Operational Risk Management at HBLSL
- Operational Risk Coordinators (ORCs)/Business and Support Functions at HBLSL

ORM mitigation, monitoring and reporting

The ORM Mitigation tools used by HBLSL are:
- Business Continuity Management
- Insurance
- Outsourcing

The ORM is monitored by the IRMC at HBLSL and ORMD at Head Office Pakistan. Loss Data is reported to CBSL on quarterly basis and to Head Office on monthly basis.

Use of insurance for the purpose of mitigating operational risk

HBLSL uses Insurance as a tool for Operational Risk Mitigation. Insurance companies are evaluated thoroughly and a complete due diligence is performed before formal insurance arrangement. Approvals from designated authorities are obtained before entering into formal insurance arrangements.

Outsourced Activities

HBLSL has outsourced selective IT related activities to vendors / service providers in Sri Lanka.

A complete due diligence is performed and approvals obtained for Outsourcing arrangements with Third Party Service Providers in line with Outsourcing Policy of HBLSL.

Contingency Plan Handle failure situations

HBLSL has in place a comprehensive Business Continuity and Disaster Recovery Plan to deal with contingencies. A DR Site has also been set-up to augment the Disaster Recovery Plan and ensure smooth operations subsequent to a Disaster situation.

Operational Risk Loss Data

HBL SL has not reported any loss data for FY-2016 to CBSL under the Exposure Draft on implementation of the Standardized Approach for calculating capital charge for Operational Risk.

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Notes to the financial statements (contd)

(all amounts in Sri Lanka Rupees)

38. Capital structure

HBLSL has not issued any capital instruments and capital is supported by Head office in the form of Assigned Capital.

Please refer Note 19 for the Assigned Capital.

39. Commitments and contingent liabilities

To meet the financial needs of customers, the bank enters into various irrevocable commitments and contingent liabilities. These consist of financial guarantees, letters of credit and other undrawn commitments to lend. Even though these obligations may not be recognised on the Statement of Financial Position, they do contain credit risk and are therefore part of the overall risk of the Bank.

39.1 Legal claims

Litigation is a common occurrence in the banking industry due to the nature of the business undertaken. The Bank has formal controls and policies for managing legal claims.

High Court (Civil) case No.378/2007 (MR) People's Bank Vs Habib Bank Limited was filed regarding the dispute of sum of Rs.15,520,000/- together with the interest.

In the opinion of the Management, based on the information currently available, the final outcome is not likely to have a material adverse effect to the Bank. Accordingly, no provision for any liability has been made in these financial statements.

40. Events after the reporting date

No material events have taken place since 31 December 2016 that require disclosure or/and adjustments in these accounts.