HABIB BANK LIMITED – SRI LANKA BRANCH

FINANCIAL STATEMENTS

31 DECEMBER 2015

Building a better
working world

Ernst & Young
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INDEPENDENT AUDITOR'S REPORT
TO THE MANAGEMENT OF HABIB BANK LIMITED - SRI LANKA BRANCH

Report on the Financial Statements

We have audited the accompanying financial statements of Habib Bank Limited - Sri Lanka Branch, ("the Bank"), which comprise the statement of financial position as at 31 December 2015, 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 set out on pages 7 to 42.

Management's Responsibility for the Financial Statements

The Management is responsible for the preparation of these financial statements that give a true and fair view in accordance with Sri Lanka Accounting Standards and for such internal controls 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

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.

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 internal control relevant to the bank's preparation of the 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 Bank's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by Management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the Bank as at 31 December 2015, and of its financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

(Contd...2/-)

Report on other legal and regulatory requirements

As required by Section 163(2) of the Companies Act No. 7 of 2007, we state the following:

a) The basis of opinion, scope and limitations of the audit are as stated above.

b) In our opinion :

- We have obtained all the information and explanations that were required for the audit and, as far as appears from our examination, proper accounting records have been kept by the Bank, and
- The financial statements of the Bank, comply with the requirements of Section 151 of the Companies Act No. 07 of 2007.

30 March 2016
Colombo

Ernst & Young

Habib Bank Limited - Sri Lanka Branch

STATEMENT OF FINANCIAL POSITION

As at 31 December 2015

	Notes	2015 Rs.	2014 Rs.
Assets			
Cash and Cash Equivalents	4	4,612,748,445	2,566,022,291
Balances with Central Bank of Sri Lanka	5	1,176,890,848	861,337,327
Reverse Repurchase Agreements	6	-	260,126,857
Financial Assets - Held to Maturity	7	596,592,762	-
Other Financial Assets	8	2,551,045,789	1,934,317,040
Loans and Advances to Customers	9	3,504,586,122	3,915,219,151
Other Assets	10	78,859,870	85,679,778
Income Tax Receivable		36,558,923	22,431,330
Property, Plant and Equipment	11	256,494,140	210,034,058
Deferred Tax Assets	17	28,648,249	33,892,483
Total Assets		12,842,425,148	9,889,060,315
Liabilities			
Due to Banks	12	4,000,365,430	2,203,712,919
Due to Customers	13	1,742,246,379	1,726,347,269
Other Borrowings	14	1,502,147,628	1,454,662,000
Other Liabilities	15	40,368,957	43,212,275
Employee Benefit Liability	16	41,103,395	42,122,560
Total Liabilities		7,326,231,789	5,470,057,023
Equity			
Assigned Capital	18	4,938,390,143	3,728,549,605
Statutory Reserve Fund	19	62,317,045	62,254,472
Revaluation Reserve	20	96,622,625	96,622,625
Exchange Equalisation of Capital	21	410,762,244	225,045,049
Exchange Equalisation of Reserve	22	8,170,383	6,484,536
Retained Earnings	23	(69,081)	300,047,005
Total Equity		5,516,193,359	4,419,003,292
Total Liabilities and Equity		12,842,425,148	9,889,060,315
Contingent Liabilities and Commitments	36.2.4.1	3,268,701,622	2,200,561,355

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 07 to 42 form an integral part of these Financial Statements.

ERNST & YOUNG
Chartered Accountants
COLOMBO

30 March 2016
Colombo

Habib Bank Limited - Sri Lanka Branch

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

Year ended 31 December 2015

	Notes	2015 Rs.	2014 Rs.
Interest Income	24	391,334,534	473,140,849
Interest Expense	25	(77,668,167)	(99,522,212)
Net Interest Income		313,666,367	373,618,637
Fees and Commission Income	26	21,619,991	16,902,013
Net Trading Income		983,781	391,791
Other Operating Income	27	17,596,599	22,487,906
Total Operating Income		353,866,738	413,400,347
Impairment (Charge)/Reversal for Loans and Advances	28	4,416,747	(44,667,241)
Net Operating Income		358,283,485	368,733,106
Personnel Expenses	29	(198,040,058)	(175,082,777)
Depreciation of Property Plant and Equipment	11	(33,654,329)	(26,799,139)
Other Operating Expenses	30	(106,742,878)	(95,761,975)
Total Operating Expenses		(338,437,265)	(297,643,891)
Operating Profit Before Value Added Tax (VAT) on Financial Services		19,846,220	71,089,215
Value Added Tax (VAT) on Financial Services		(21,440,602)	(24,801,576)
Profit Before Income Tax		(1,594,382)	46,287,639
Income Tax Reversal/(Expense)	31	2,845,849	(14,195,868)
Profit for the Year		1,251,467	32,091,771
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	(1,747,187)	6,434,285
Exchange Differences on translation of Foreign Currency Capital	21	185,717,195	15,322,413
Exchange Differences on translations of Foreign Currency Reserves	22	1,685,847	85,860
Revaluation of Land and Building	20	-	21,149,721
Income Tax on Other Comprehensive Income	31	489,212	(4,328,895)
Other Comprehensive Income for the Year Net of Tax		186,145,066	38,663,384
Total Comprehensive Income for the Year		187,396,532	70,755,155

The Notes to the Financial Statements from pages 07 to 42 form an integral part of these Financial Statements.

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STATEMENT OF CHANGES IN EQUITY

Year ended 31 December 2015

	Notes	Assigned Capital Rs.	Statutory Reserve Fund Rs.	Investment Fund Account Rs.	Revaluation Reserve Rs.	Exchange Equalisation of Capital Rs.	Exchange Equalisation of Reserve Rs.	Retained Earnings Rs.	Total Rs.
As at 31 January 2014		3,728,549,605	60,649,883	94,869,421	78,000,199	209,722,636	6,398,676	170,057,717	4,348,248,137
Profit for the Year	23	-	-	-	-	-	-	32,091,771	32,091,771
Other Comprehensive Income	20/21/22/23	-	-	-	18,622,426	15,322,413	85,860	4,632,685	38,663,384
Total Comprehensive Income		-	-	-	18,622,426	15,322,413	85,860	36,724,456	70,755,155
Transfer to Investment Fund Account	23	-	-	3,535,670	-	-	-	(3,535,670)	-
Transfer from Investment Fund Account	23	-	-	(98,405,091)	-	-	-	98,405,091	-
Transfer to Statutory Reserve Fund	19/23	-	1,604,589	-	-	-	-	(1,604,589)	-
As at 31 December 2014		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 Recceived from Head Office	18	909,793,533	-	-	-	-	-	-	909,793,533
Profit for the Year	23	-	-	-	-	-	-	1,251,467	1,251,467
Other Comprehensive Income	21/22/23	-	-	-	-	185,717,195	1,685,847	(1,257,975)	186,145,067
Total Comprehensive Income		-	-	-	-	185,717,195	1,685,847	(6,508)	187,396,534
Transfer to Statutory Reserve Fund	19/23	-	62,573	-	-	-	-	(62,573)	-
Profit Capitalization during the Year	18/23	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

The Notes to the Financial Statements from pages 07 to 42 form an integral part of these Financial Statements.

Habib Bank Limited - Sri Lanka Branch

CASH FLOW STATEMENT

Year ended 31 December 2015

	Note	2015 Rs.	2014 Rs.
Cash Flows from Operating Activities			
Receipts of Interest Income		344,079,395	545,476,340
Receipts of Fees and Commission Income		21,093,799	16,900,320
Payments of Interest Expense		(76,799,940)	(95,137,731)
Exchange Gain for the Year		8,506,929	10,508,967
Receipts from Other Operating Income		9,562,702	9,672,229
Gratuity Payments Made	16	(3,809,890)	(6,083,726)
Payments for Operating Expenses		(320,646,235)	(286,305,584)
Net Cash Flow from Operating Activities Before Income Tax (A)		(18,013,240)	195,030,815
Income Tax Paid		(3,626,937)	(51,164,612)
Operating Profit Before Changes in Operating Assets and Liabilities			
(Increase)/Decrease in Operating Assets	32.1	(495,703,196)	275,780,883
Decrease in Operating Liabilities	32.2	(40,090,147)	(171,397,200)
Net Cash Flow from Operating Activities		(557,433,520)	248,249,886
Cash Flows from Investing Activities			
Purchase of Property Plant and Equipment	11.5	(70,402,405)	(42,247,744)
Dividends Received	27	510,750	366,750
Proceeds from Sale of Property Plant and Equipment		-	2,349,218
		(69,891,655)	(39,531,776)
Cash flow from Financing Activities			
Funds Received from Head Office	18	909,793,533	-
		909,793,533	-
Exchange Differences on translations of Foreign Currency Capital and Reserves	21/22	187,403,042	15,408,273
Net Increase in Cash and Cash Equivalents		469,871,400	224,126,382
Cash and Cash Equivalents at the beginning of the Year		1,382,982,088	1,158,855,706
Cash and Cash Equivalents at the end of the Year		1,852,853,488	1,382,982,088
Reconciliation of Cash and Cash Equivalents			
Cash in Hand	4	106,280,397	54,058,351
Balances with Banks	4	4,068,734,582	2,200,913,076
Money at Call and Short Notice	4	437,733,466	311,050,864
Statutory Deposit with Central Bank of Sri Lanka	5	51,811,647	50,277,192
Money held at Central Bank of Sri Lanka - Foreign Currency	5	1,125,079,201	811,060,135
Due to Banks	12	(3,936,785,805)	(2,044,377,530)
		1,852,853,488	1,382,982,088
A. RECONCILIATION OF OPERATING PROFIT			
Profit/(Loss) Before Tax		(1,594,382)	46,287,639
Gain on disposal of Property, Plant and Equipment		-	(2,331,750)
Depreciation of Property Plant and Equipments	11	33,654,329	26,799,139
Provision for Gratuity	16	6,191,456	7,649,610
Impairement Charge/(Reversal) for Loans and Advances	28	(4,416,747)	44,667,241
Decrease/(Increase) in Interest Receivable		(45,333,780)	75,445,790
Increase in Interest Payable		868,224	4,384,482
Decrease in Accrued Expenses		(614,150)	1,691,131
(Decrease) in Financial Guarantee Liabilities		(526,192)	(1,692)
Gratuity Payments Made	16	(3,809,890)	(6,083,726)
Other Non Cash Items (Notional Tax Credit on Government Securities Interest)		(1,921,359)	(3,110,299)
Dividend income	27	(510,750)	(366,750)
		(18,013,241)	195,030,815

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The Notes to the Financial Statements from pages 07 to 42 form an integral part of these Financial Statements.

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 2015 were authorized for issue by the local management on 30 March 2016.

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 measured at fair value.

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 34 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.

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 Profit or Loss and Other 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 Profit or Loss. 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 9 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 16 to the financial statements.

2.2.3 Fair Value of Property Plant and Equipment

The freehold land and buildings of the Bank are reflected at fair value. 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 11 to the financial statements.

2.2.4 Going Concern

The Bank's management has made an assessment on the Bank's ability to continue as a going concern and is satisfied that it has the resources to continue in business for the foreseeable future. Furthermore, management is not aware of any material uncertainties that may cast significant doubt upon the Bank's ability to continue as a going concern. Therefore, the Financial Statements continue to be prepared on the going concern basis.

2.2.5 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 35.

2.2.6 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. Management has considered the strategic business plan for 2016 – 2020 in assessing the future taxable profits.

The details of the deferred tax asset are described in more detail in Note 2.3.12 and Note 17 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 Profit or Loss. 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.

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

The assets, liabilities and assigned capital of Foreign Currency Banking Unit operations are translated in 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 rate.

Foreign currency differences on the translation of Foreign Currency Banking Unit operations 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 the Note 35 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, described as follows,

Level 1 - Quoted (unadjusted) market prices in active markets for identical assets or liabilities
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 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 fair value measurement and for non- recurring measurement.

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.

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 their 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 Statement of Profit or Loss.

(iv) Financial Assets - Subsequent measurement

The subsequent measurement of financial assets depends on their classification and the Bank’s financial assets comprise of Held to Maturity Financial Assets, 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 amortised cost using the Effective interest Rate (EIR), less impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the EIR. The amortisation is included in “Interest Income” in the Statement of Profit or Loss.

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 amortised cost using the effective interest rate, less allowance for impairment. Amortised cost is calculated taking in to account any fees and costs that are integral part of the EIR. The amortisation is included in the "Interest Income" in the Statement of Profit or Loss. The losses arising from impairment are recognized in the Statement of Profit or Loss in "Impairment Charge".

(v) Financial Liabilities - Subsequent measurement

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

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

Due to Customers

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

Other Borrowings

After initial measurement, Other Borrowings 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 is 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 Profit or Loss.

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 write-off is later recovered, the recovery is recognised in the Other Operating Income in the Statement of Profit or Loss.

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 9 to the financial statements for details of impairment losses on loans and advances 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 Equipments

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.

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 statement of profit or loss, in which case the increase is recognised in the statement of profit or loss. 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 11 and 35 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 Profit or Loss 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 Statement of Profit or Loss, and the best estimate of expenditure required to settle any financial obligation arising as a result of guarantee.

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

2.3.10 Employee Benefit Liability

(i) 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 2015 carried out by Messrs Actuarial and Management Consultants (Private) Limited, actuaries. Refer Note 16 to the financial statements for details on Gratuity.

The gratuity liability is not externally funded.

(ii) 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 Profit or Loss.

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%.

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 11% VAT on financial services as per Section 25A of the Value Added Tax Act No. 14 of 2002 and amendments there to. (2014- 12%)

Nation Building Tax on Value Added Tax (VAT) on Financial Services

The business of Banking or Finance is liable for Nation Building Tax with effect from 01.01.2014 and 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 at 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.

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.

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

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

Other Income
Other income is recognised on an accrual basis.

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.

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 "Direct 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 issued but not yet effective

The standards that are issued but not yet effective up to the date of issuance of the Bank's financial statements are disclosed below. The Bank intends to adopt these standards, if applicable, when they become effective.

(i) SLFRS 9 -Financial Instruments: Classification and Measurement

SLFRS 9 replaces the existing guidance in LKAS 39 Financial Instruments: Recognition and Measurement. SLFRS 9 includes revised guidance on the classification and measurement of financial instruments, a new expected credit loss model for calculating impairment on financial assets, and new general hedge accounting requirements. It also carries forward the guidance on recognition and derecognition of financial instruments from LKAS 39.

SLFRS 9 is effective for annual reporting periods beginning on or after 1 January 2018, with early adoption permitted.

(ii) SLFRS 15 -Revenue from Contracts with Customers

SLFRS 15 establishes a comprehensive framework for determining whether, how much and when revenue is recognised. It replaces existing revenue recognition guidance, including LKAS 18 Revenue, LKAS 11 Construction Contracts and IFRIC 13 Customer Loyalty Programmes.

SLFRS 15 is effective for annual reporting periods beginning on or after 1 January 2018, with early adoption permitted.

The Bank will adopt these standards when they become effective. Pending the completion of a detailed review, the financial impact is not reasonably estimable.

3. ANALYSIS OF FINANCIAL INSTRUMENTS BY MEASUREMENT BASIS

	Loans and Receivables and Held to Maturity at Amortised Cost	
	2015	2014
Assets	Rs.	Rs.
Cash and Cash equivalents	4,612,748,445	2,566,022,291
Balances with Central Bank of Sri Lanka	1,176,890,848	861,337,327
Reverse Repurchase Agreements	-	260,126,857
Financial Assets - Held to Maturity	596,592,762	-
Other Financial Assets	2,551,045,789	1,934,317,040
Loans and Advances to Customers	3,504,586,122	3,915,219,151
Total Financial Assets	12,441,863,966	9,537,022,666

	Financial Liabilities at Amortised Cost	
	2015	2014
Liabilities	Rs.	Rs.
Due to Banks	4,000,365,430	2,203,712,919
Due to Customers	1,742,246,379	1,726,347,269
Other Borrowings	1,502,147,628	1,454,662,000
Total Financial Liabilities	7,244,759,437	5,384,722,188

4. CASH AND CASH EQUIVALENTS

	2015	2014
	Rs.	Rs.
Cash in Hand - Local Currency	101,423,274	48,055,690
Cash in Hand - Foreign Currency (United States Dollar)	4,857,123	6,002,661
Balances with Banks	4,068,734,582	2,200,913,076
Money at Call and Short Notice	437,733,466	311,050,864
	4,612,748,445	2,566,022,291

5. BALANCES WITH CENTRAL BANK OF SRI LANKA

	2015	2014
	Rs.	Rs.
Statutory Deposit with Central Bank of Sri Lanka (Note 5.1)	51,811,647	50,277,192
Money (United States Dollar) held at Central Bank of Sri Lanka (Note 5.2)	1,125,079,201	811,060,135
	1,176,890,848	861,337,327

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 2015, the minimum cash reserve requirement was 6 % (2014 -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 foriegn currency up to maximum of 50% of the new capital brought in, provided 25% of such foreign currency capital to be retained in a Reserve Fund maintained with Central Bank of Sri Lanka and balance 25% 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

	2015	2014
	Rs.	Rs.
Due from Banks	-	260,126,857
	-	260,126,857

The balance as at 31 December 2014 represents the investments in Reverse Repurchases Agreements with Central Bank of Sri Lanka.

7. FINANCIAL ASSETS - HELD TO MATURITY

	2015 Rs.	2014 Rs.
	596,592,762	-
Government Treasury Bills	596,592,762	-

8. OTHER FINANCIAL ASSETS

	2015 Rs.	2014 Rs.
Sri Lanka Development Bonds (Note 8.1)	1,458,920,210	1,003,994,708
Trust Certificates (Note 8.2)	786,729,920	634,954,072
Debentures (Note 8.3)	304,815,659	294,788,260
Unquoted Investments (Note 8.4)	580,000	580,000
	2,551,045,789	1,934,317,040

Other Financial Assets including Sri Lanka Development Bonds,Trust Certificates and Debentures are measured at amortised cost and treated as loans and receivables.

8.1 Sri Lanka Development Bonds

The investment in Sri Lanka Development Bonds amounts to USD 10 Mn and mature in year 2016.(2014 - USD 7.5 Mn and mature in year 2015 (USD 2.5 Mn) and year 2016 (USD 5 Mn)).

8.2 Trust Certificates

The above balance represents capital outstanding balance in trust certificates of Peoples Leasing Company PLC amounting to Rs. 768 Mn which mature in year 2016 (Rs. 616 Mn) and 2017 (Rs. 152 Mn) [2014 - capital outstanding balance in trust certificates of Peoples Leasing Company PLC Rs. 610 Mn and Commercial Credit Finace PLC Rs. 21.6 Mn which mature in year 2015 (Rs. 123.6 Mn), 2016 (Rs. 356 Mn) and 2017 (Rs. 152 Mn)].

8.3 Debentures

The above balance represents capital outstanding balance 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.

8.4 Unquoted Investments

	2015 Rs.	2014 Rs.
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 unqoted share investment amounts to Rs. 580,000/- and has been determined based on the cost of the investment.

9. LOANS AND ADVANCES TO CUSTOMERS

		2015 Rs.	2014 Rs.
Gross Loans and Receivables		3,547,821,208	3,965,545,140
Less:	Individual Impairment (Note 9.3.1)	(26,806,700)	(31,749,526)
	Collective Impairment (Note 9.3.2)	(16,428,386)	(18,576,463)
Net Loans and Receivables (Note 9.1)		3,504,586,122	3,915,219,151

9. LOANS AND ADVANCES TO CUSTOMERS (Contd.)

9.1 Gross Loans and Advances by Product

	2015 Rs.	2014 Rs.
Term Loans	993,609,865	1,247,358,399
Overdraft	1,205,777,783	1,602,767,210
Consumer Loans	2,720,000	-
Short Term Loans	656,503,079	291,300,739
Trade Finance Loans	638,216,712	775,919,020
	3,496,827,439	3,917,345,368
Allowance for Impairment Losses (Note 9.3)	(43,235,086)	(50,325,989)
	3,453,592,353	3,867,019,379
Staff Loans	63,189,687	62,977,018
Less : Allowance for Day 1 Difference	(12,195,918)	(14,777,246)
	50,993,769	48,199,772
	3,504,586,122	3,915,219,151

9.2 Net Loans and Advances by Currency

	2015 Rs.	2014 Rs.
Local Currency - Sri Lankan Rupees	1,569,261,232	1,837,354,997
Foreign Currency - United States Dollar	1,935,324,890	2,077,864,154
	3,504,586,122	3,915,219,151

9.3 Impairement Allowance for Loans and Advances to Customers

	2015 Rs.	2014 Rs.
Balance as at 01 January	50,325,989	248,661,559
Impairment Charge/(Reversal) during the year	(4,416,747)	44,667,241
Balance Written off during the year	(3,309,278)	(244,861,680)
Exchange Impact on revaluation of FCY Impairment	635,122	1,858,869
Balance as at 31 December	43,235,086	50,325,989

9.3.1 Movement in Individual Impairment Allowance for Loans and Advances

	2015	2014
Impairment - as at 01 January	31,749,526	227,955,749
Impairment Charge/(Reversal) during the year	(2,268,670)	46,796,588
Balance Written off during the year	(3,309,278)	(244,861,680)
Exchange Impact on revaluation of FCY Impairment	635,122	1,858,869
Impairment - as at 31 December	26,806,700	31,749,526

9.3.2 Movement in Collective Impairment Allowance for Loans and Advances

	2015	2014
Impairment - as at 01 January	18,576,463	20,705,810
Net Impairment Reversal for the year	(2,148,077)	(2,129,347)
Impairment - as at 31 December	16,428,386	18,576,463

10. OTHER ASSETS

	2015 Rs.	2014 Rs.
Deposits and Prepayments	42,631,281	39,604,788
Unamortised Staff Cost	12,195,918	14,777,245
Other Assets*	24,032,671	31,297,745
	78,859,870	85,679,778

*Inward and Outward net cheque clearing balance to be settled by the Lanka Clear (Pvt) Limited amounting to Rs. 19,068,622/- (2014- Rs. 17,769,544/-) is included in the Other Assets balance as at 31 December 2015.

11. PROPERTY, PLANT AND EQUIPMENT

11.1 Gross Carrying Amounts

At Cost/Revaluation	Balance As at 01.01.2015 Rs.	Additions Rs.	Disposals/ Transfers and Writeoffs Rs.	Balance As at 31.12.2015 Rs.
Freehold Land	65,200,000	-	-	65,200,000
Freehold Building	52,800,000	105,477	-	52,905,477
Motor Vehicles	23,250,000	-	-	23,250,000
Computer,Furniture and Fittings	113,153,240	56,127,251	(3,158,490)	166,122,001
	254,403,240	56,232,728	(3,158,490)	307,477,478
Leasehold Building Improvements	20,501,006	23,881,682	-	44,382,688
	20,501,006	23,881,682	-	44,382,688
Total Gross Carrying Amount	274,904,246	80,114,410	(3,158,490)	351,860,166

11.2 Accumulated Depreciation

At Cost /Revaluation	Balance As at 01.01.2015 Rs.	Charge for the year Rs.	Disposals/ Transfers and Writeoffs Rs.	Balance As at 31.12.2015 Rs.
Freehold Building	220,000	2,640,351	-	2,860,351
Motor Vehicles	7,450,000	4,650,000	-	12,100,000
Computer,Furniture and Fittings	45,043,813	21,693,450	(3,158,490)	63,578,773
	52,713,813	28,983,801	(3,158,490)	78,539,125
Leasehold Building Improvements	12,156,374	4,670,528	-	16,826,902
	12,156,374	4,670,528	-	16,826,902
	64,870,187	33,654,329	(3,158,490)	95,366,026

11.3 Net Book Values

	2015 Rs.	2014 Rs.
At Cost /Revaluation		
Freehold Land	65,200,000	65,200,000
Freehold Building	50,045,126	52,580,000
Motor Vehicles	11,150,000	15,800,000
Computer,Furniture and Fittings	102,543,228	68,109,426
	228,938,353	201,689,426
Leasehold Building Improvements	27,555,786	8,344,632
Total Carrying Amount of Property, Plant and Equipment	256,494,140	210,034,058

11. PROPERTY, PLANT AND EQUIPMENT (Contd…)

11.4 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/-. This means that valuations performed by the valuer are based on active market prices, significantly 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 values 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 35 to the financial statements.

Significant unobservable valuation input: Range

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

Significant increases(decreases) in estimated price per square metre in isolation would result in a significantly 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

11.5 During the financial year, the Bank acquired Property, Plant and Equipment to the aggregate value of Rs. 80,114,410/- (2014-Rs.100,779,861/-). Cash payments amounting to Rs.70,402,405/- (2014 - Rs.42,247,744/-) were made during the year for purchase of Property Plant and Equipments.

11.6 Property, Plant and Equipment includes fully depreciated assets having a gross carrying amount of Rs. 43,896,771/53 (2014-24,117,897/-).

12. DUE TO BANKS	**2015**	**2014**
	Rs.	**Rs.**
Bank Overdrafts	3,936,785,805	2,044,377,530
Deposits from Other Banks	63,579,625	159,335,389
	4,000,365,430	2,203,712,919

13. DUE TO CUSTOMERS

	2015	**2014**
13.1 Due to Customers - By Products	**Rs.**	**Rs.**
Demand Deposits	584,598,927	590,931,421
Savings Deposits	514,548,441	759,671,646
Time Deposits	438,921,086	211,168,890
Call Deposits	189,624,821	156,873,197
Margin Balances	14,553,104	7,702,115
	1,742,246,379	1,726,347,269

13.2 Due to Customers - By Currency

Local Currency - Sri Lankan Rupees	1,086,368,742	913,922,886
Foreign Currency- United States Dollar	646,674,901	800,800,347
Foreign Currency- Others	9,202,736	11,624,036
	1,742,246,379	1,726,347,269

14. OTHER BORROWINGS

	2015 Rs.	2014 Rs.
Short Term Loans		
Habib Bank Limited - NewYork	144,320,377	396,154,000
Habib Bank Limited - Karachchi	-	529,496,000
Indian Bank - Colombo	780,246,230	529,012,000
Habib Bank Limited - Kabul	577,581,021	-
	1,502,147,628	1,454,662,000

15. OTHER LIABILITIES

	2015 Rs.	2014 Rs.
Accrued Expenses	4,350,215	4,964,365
Bills Payable	18,720,806	30,784,658
Other Liabilities	17,297,936	7,463,252
	40,368,957	43,212,275

16. EMPLOYEE BENEFIT LIABILITY

	2015 Rs.	2014 Rs.
As at 01 January	42,122,560	46,990,961
Current Service Cost	2,400,426	2,480,605
Interest Cost	3,791,030	5,169,005
Acturial (Gain)/Loss on Retirement Benefit Obligation	1,747,187	(6,434,285)
(-) Payments during the year	(3,809,890)	(6,083,726)
(-) Gratuity payable for those who left during the Period	(5,147,918)	-
As at 31 December	41,103,395	42,122,560

16.1 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 2015, carried out by Messrs Acturial and Management Consultants (Private) Limited, actuaries.

The key assumptions used by the management include the following,

	2015	2014
Rate of Interest	10%	9%
Rate of Salary Increase	8%	8%
Retirement Age	55 Years	55 Years

Average future working life of employees is 18.5 years as at 31 December 2015 (2014- 9.54 years).

16.2 Net benefit expense categorised under personal expenses,

	2015 Rs.	2014 Rs.
Current Service Cost	2,400,426	2,480,605
Interest Cost	3,791,030	5,169,005
	6,191,456	7,649,610

16.3 Distribution of Present Value of Defined Benefit Obligation In Future Years

	2015 Rs.
Within the next 12 months	4,353,229
Between 1 and 2 years	16,289,599
Between 3 and 5 years	8,593,147
Beyond 5 years	11,867,420
	41,103,395

16. EMPLOYEE BENEFIT LIABILITY (Contd…)

16.4 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;

	2015 Rs.	2014 Rs.
1% increase in discount rate	(1,569,042)	(1,723,283)
1% decrease in discount rate	1,685,398	1,874,932
1% increase in Salary Escalation rate	1,791,995	1,953,290
1% decrease in Salary Escalation rate	(1,695,057)	(1,825,636)

17. DEFERRED TAX ASSET

	2015 Rs.	2014 Rs.
As at 01 January	(33,892,483)	(47,463,220)
Charge during the Year	5,244,234	13,570,737
As at 31 December	(28,648,249)	(33,892,483)

	2015 Rs.	2014 Rs.
17.1.1 Deferred Tax Liabilities		
Accelerated Depreciation Allowance for Tax Purposes - Property Plant and Equipments	9,522,962	2,119,189
Revaluation of Property Plant and equipment	12,198,299	12,198,299
	21,721,261	14,317,488
17.1.2 Deferred Tax Assets		
Employee Benefit Liability - Gratuity	(11,508,950)	(11,794,317)
Loan Impairment	(4,599,945)	(36,415,654)
Tax Losses	(34,260,615)	-
	(50,369,510)	(48,209,971)
Net Deferred Tax Asset	(28,648,249)	(33,892,483)

Deferred tax has been determined based on the effective tax rate of 28% (2014 - 28%)

18. ASSIGNED CAPITAL

	2015 Rs.	2014 Rs.
As at 01 January	3,728,549,605	3,728,549,605
Received from Head Office during the Year	909,793,533	-
Capitalisation of Retained Earnings during the year (Note 23)	300,047,005	-
As at 31 December	4,938,390,143	3,728,549,605

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

19. STATUTORY RESERVE FUND

	2015 Rs.	2014 Rs.
As at 01 January	62,254,472	60,649,883
Transfer from the profits during the year (Note 23)	62,573	1,604,589
As at 31 December	62,317,045	62,254,472

19.1 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.

20. REVALUATION RESERVE

	2015 Rs.	2014 Rs.
As at 01 January	96,622,625	78,000,199
Revaluation of land and building net of deferred tax	-	18,622,426
As at 31 December	96,622,625	96,622,625

Refer Note 11.4 to the financial statements for details of revaluation of land and buildings.

21. EXCHANGE EQUALISIATION OF CAPITAL

	2015 Rs.	2014 Rs.
As at 01 January	225,045,049	209,722,636
Exchange Differences on translations of Foreign Currency Capital	185,717,195	15,322,413
As at 31 December	410,762,244	225,045,049

Exchange Equalisation of Capital Reserve represents the net appreciation/(depreciation) of foreign currency capital maintained in Foregin Currency Banking Unit due to exchange rate fluctuations. It requires to reflect the Assigned Capital at the exchange rate prevailing 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.

22. EXCHANGE EQUALISIATION OF RESERVES

	2015 Rs.	2014 Rs.
As at 01 January	6,484,536	6,398,676
Exchange Differences on translations of Foreign Currency Reserves	1,685,847	85,860
As at 31 December	8,170,383	6,484,536

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

23. RETAINED EARNINGS

	2015 Rs.	2014 Rs.
As at 01 January	300,047,005	170,057,717
Profit for the Year	1,251,467	32,091,771
Other Comprehensive Income for the Year	(1,257,975)	4,632,685
Transfers to Investment Fund Account Reserve	-	(3,535,670)
Transfers to Investment Fund Account Reserve	-	98,405,091
Transfers to Statutory Reserve Fund (Note 19)	(62,573)	(1,604,589)
Profit capitalisation during the year (Note 18)	(300,047,005)	-
As at 31 December	(69,082)	300,047,005

24. INTEREST INCOME

	2015 Rs.	2014 Rs.
Placements with Banks	20,718,385	22,747,148
Reverse Repurchase Agreements	8,421,303	32,511,986
Financial Assets - Held to Maturity	17,004,138	-
Other Financial Assets	112,822,748	126,279,411
Loans and Advances to Customers	232,367,960	291,602,304
	391,334,534	473,140,848

Interest Income earned from Government Securities (Treasury Bills, Treasury Bonds and Reverse Repurchase Agreements) for the year 2015 amounts to Rs. 72,782,194/- (2014 - Rs. 32,511,986/-) and has been grossed up by adding notional tax receivable.

25. INTEREST EXPENSE

	2015	2014
	Rs.	Rs.
Due to Customers	50,168,662	65,509,457
Money Market and Other Borrowings	27,499,505	34,012,755
	77,668,167	99,522,212

26. FEES AND COMMISSION INCOME

	2015	2014
	Rs.	Rs.
Commisssion on Trade Finance Facilities	13,652,333	11,159,326
Commission on Guarantees	2,040,024	2,502,764
Commission on Remittances	5,927,634	3,239,923
	21,619,991	16,902,013

27. OTHER OPERATING INCOME

	2015	2014
	Rs.	Rs.
Dividend income	510,750	366,750
Foreign Exchange Gain	7,523,147	10,117,176
Other Income	9,562,702	12,003,980
	17,596,599	22,487,906

28. IMPAIRMENT CHARGE FOR LOANS AND ADVANCES

	2015	2014
	Rs.	Rs.
Impairment Charge/(Reversal) for Loans and Advances to Customers	(4,416,747)	44,667,241
	(4,416,747)	44,667,241

29. PERSONNEL EXPENSES

	2015	2014
	Rs.	Rs.
Salaries	86,046,997	73,582,925
Employee Benefits - Defined Benefit Plan (Gratuity) (Note 16.2)	6,191,456	7,649,610
Employee Benefits - Defined Contribution Plan		
Employee Provident Fund	7,468,551	6,785,581
Employee Trust Fund	1,764,370	1,583,599
Bonus	38,896,870	32,371,292
Other Allowances	54,635,964	49,959,000
Amortisation of Staff Loan Day 01 Difference	3,035,850	3,150,770
	198,040,058	175,082,777

30. OTHER OPERATING EXPENSES

		2015 Rs.	2014 Rs.
Auditors Fees and Expenses	Current year charge	1,118,880	1,058,274
	Under provision in respect of prior year	-	210,497
Non Audit Fees and Expenses		1,181,120	1,154,497
Legal Fees		866,000	1,457,900
Marketing Expenses		2,791,809	4,312,140
Transport		3,456,269	3,073,447
Other Expenses		97,328,800	84,495,220
		106,742,878	95,761,975

31. INCOME TAX EXPENSE

	2015 Rs.	2014 Rs.
Current Income Tax		
Current Income Tax on Profit for the Year	-	7,313,901
Over Provision of current taxes in respect of prior years	(8,579,295)	(2,359,875)
Deferred Income Tax	(8,579,295)	4,954,026
Deferred Tax Charge for the Year	5,733,446	9,241,842
Income Tax expense/(reversal) reported in the Statement of Profit or Loss	(2,845,849)	14,195,868
Deferred Income Tax		
Deferred Tax Charge/(Reversal) for the Year	(489,212)	4,328,895
Income Tax expense/(reversal) reported in the Statement of Other Comprehensive Income	(489,212)	4,328,895

31.1 Reconciliation of Accounting Profit and Taxable Income

	2015 Rs.	2014 Rs.
Accounting Profit/(Loss) Before Taxation	(1,594,382)	46,287,639
Add: Disallowable Expenses	94,660,246	89,694,034
Less: Allowable Expenses and Exempt Income	(116,849,728)	(109,860,597)
Taxable Income/(Tax Loss)	(23,783,864)	26,121,076
Current Income Tax on Profit for the Year @ 28%	-	7,313,901
Effective Income Tax Rate	Nil	19%

32. CASH FLOW INFORMATION

	2015 Rs.	2014 Rs.
32.1 Decrease/(Increase) in Operating Assets		
Reverse Repurchase Agreements	259,984,753	42,015,247
Financial Assets - Held to Maturity	(581,442,700)	-
Other Financial Assets	(587,965,340)	(275,759,660)
Loans and Advances to Customers	416,612,191	543,903,885
Other Assets	(2,892,100)	(34,378,591)
	(495,703,196)	275,780,881
32.2 Decrease in Operating Liabilities		
Due to Banks (Vostro)	(95,755,764)	(21,184,097)
Due to Customers	15,356,512	88,303,400
Other Borrowing	47,160,000	(249,050,000)
Other Liabilities	(6,850,895)	10,533,497
	(40,090,147)	(171,397,200)

33. 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,

33. RELATED PARTY DISCLOSURE (Contd…)

33.1 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.

	2015 Rs.	2014 Rs.
Short Term Employee Benefits	69,189,324	60,069,183
	69,189,324	60,069,183
Deposits	25,986,112	22,906,323
	25,986,112	22,906,323
Interest Expense	514,308	491,837
	514,308	491,837

33.2 Transactions with Affiliate Branches

Items in the Statement of Financial Position	2015 Rs.	2014 Rs.
Balances due from Banks (Nostro Balances)		
Habib Bank Limited - New York	65,428,220	85,266,630
Habib Bank Limited - Karachchi	34,818,034	30,136,219
Habib Allied International Bank- UK	4,674,309	1,708,998
Habib Bank Limited - Belgium	4,170,317	16,187,925
Habib Bank Limited - Singapore	316,215	721,405
Habib Bank Limited - Bangladesh	1,786,134	2,785,306
	111,193,229	136,806,483
Balances due to Banks (Vostro Balances)		
Habib Bank Limited - Male	258,720	134,780
Habib Bank Limited - Central Branch - Oman	478,024	478,024
Habib Bank Limited - Deira Branch - Dubai	26,804	27,404
Habib Bank Limited - HO Treasury - Karachchi	33,026,361	91,139,322
	33,789,909	91,779,530
Other borrowings		
Habib Bank Limited - NewYork	144,320,377	396,154,000
Habib Bank Limited - Karachchi	-	529,496,000
Habib Bank Limited - Kabul	577,581,021	-
	721,901,398	925,650,000
Items in the Statement of Profit or Loss		
Money Market and Other Borrowings (Inter Branch Borrowing related expense)	13,970,939	32,928,471
	13,970,939	32,928,471

33.3 Transactions with Habib Bank Limited - Employee Provident Fund

	2015 Rs.	2014 Rs.
Items in the Statement of Financial Position		
Liabilities		
Saving Deposit	101,529,542	90,904,265
	101,529,542	90,904,265
Items in the Statement of Profit or Loss		
Employee Benefits - Employee Provident Fund	7,468,551	6,785,581
Interest Expense	4,396,786	6,229,586
	11,865,337	13,015,167

34. MATURITY ANALYSIS OF ASSETS AND LIABILITIES

As at 31 December Assets	Within 12 Mnoths Rs.	After 12 Months Rs.	2015 Total Rs.	Within 12 Mnoths Rs.	After 12 Months Rs.	2014 Total Rs.
Cash and Cash equivalents	4,612,748,445	-	4,612,748,445	2,566,022,291	-	2,566,022,291
Balances with Central Bank of Sri Lanka	51,811,647	1,125,079,201	1,176,890,848	50,277,193	811,060,134	861,337,327
Reverse Repurchase Agreements	-	-	-	260,126,857	-	260,126,857
Financial Assets - Held to Maturity	596,592,762	-	596,592,762	-	-	-
Other Financial Assets	2,256,965,789	294,080,000	2,551,045,789	472,237,040	1,462,080,000	1,934,317,040
Loans and Advances to Customers	2,911,011,506	593,574,548	3,504,586,122	3,109,083,627	806,135,524	3,915,219,151
Other assets	45,071,300	33,788,572	78,859,870	51,582,224	34,097,552	85,679,776
Income Tax Receivable	36,558,923	-	36,558,923	22,431,330	-	22,431,330
Property, Plant and Equipment	-	256,494,140	256,494,140	-	210,034,060	210,034,060
Deferred Tax Asset	-	28,648,249	28,648,249	-	33,892,483	33,892,483
Total Assets	10,510,760,372	2,331,664,711	12,842,425,149	6,531,760,562	3,357,299,753	9,889,060,314
Liabilities						
Due to Banks	4,000,365,430	-	4,000,365,430	2,203,712,919	-	2,203,712,919
Due to Customers	1,742,246,379	-	1,742,246,379	1,726,347,269	-	1,726,347,269
Other Borrowings	1,502,147,628	-	1,502,147,628	1,454,662,000	-	1,454,662,000
Other Liabilities	24,204,911	16,163,986	40,368,957	28,522,787	14,689,488	43,212,275
Employee Benefit Liability	-	41,103,395	41,103,395	-	42,122,560	42,122,560
Total Liabilities	7,268,964,348	57,267,381	7,326,231,789	5,413,244,976	56,812,048	5,470,057,023

35. FAIR VALUE MEASUREMENT

35.1 Fair Value Measuremnet Hierachy for Assets as at 31 December 2015

35.1.1 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 hierachy.

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 2015		Rs.	Rs.	Rs.	Rs.
Assets measured at fair value					
Land and Building					
Land (8.15 perches * Rs. 8,000,000/- per perch)	18 December 2014	65,200,000	-	-	65,200,000
Buildings (7,400 square metre at Rs. 6,000/- to Rs. 7,500/- per square metre)	18 December 2014	52,580,000	-	-	52,580,000
		117,780,000	-	-	117,780,000

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

As At 31 December 2015

Other Financial Assets	31 December 2015	2,529,143,163	-	2,529,143,163	-
Loans and Advances to Customers	31 December 2015	3,507,237,049	-	3,507,237,049	-
		6,036,380,212	-	6,036,380,212	-

35.2 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	2015 Fair Value Rs.	2015 Carrying Value Rs.	2014 Fair Value Rs.	2014 Carrying Value Rs.
Other Financial Assets	2,529,143,163	2,551,045,789	1,934,184,304	1,934,317,040
Loans and Advances to Customers	3,507,237,049	3,504,586,122	3,950,995,170	3,915,219,151
	6,036,380,212	6,055,631,911	5,885,179,474	5,849,536,191

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 for which carrying amount is a reasonable approximation of fair value as the balances are short-term in nature and repriced to current market rates periodically;

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

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 interest rates as at reporting date. 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 categorised as Level 3. Refer Note 11.4 to the financial statements for more details.

36. RISK MANAGEMENT

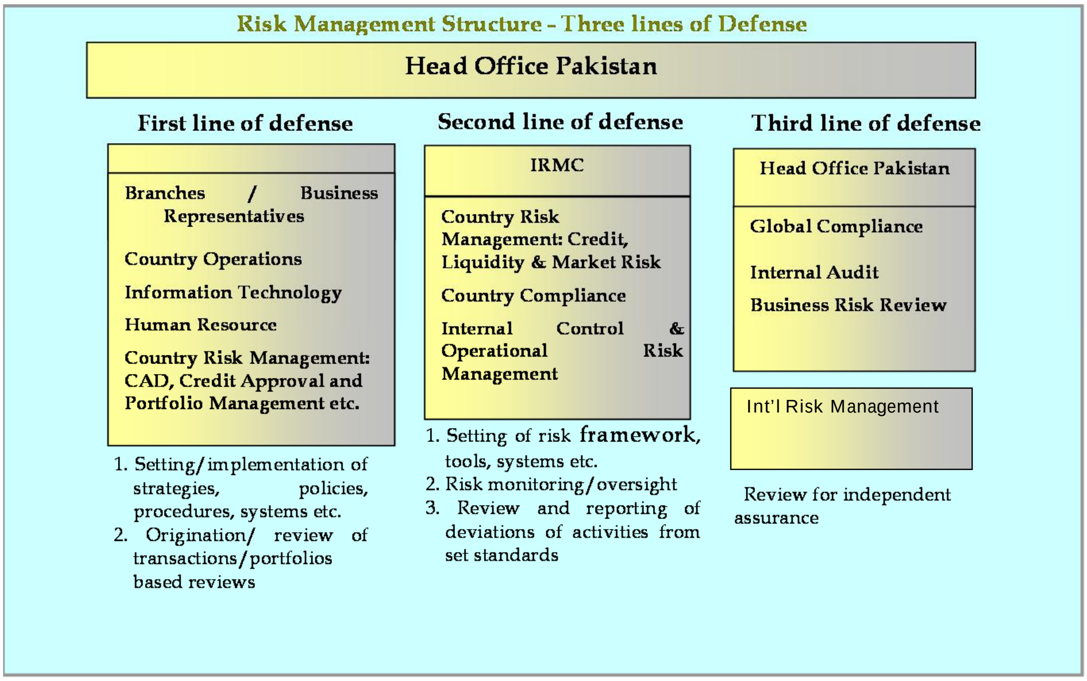
36.1 RISK MANAGEMENT FRAMEWORK

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:

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.

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.

36. RISK MANAGEMENT (Contd...)

36.1 RISK MANAGEMENT FRAMEWORK (Contd...)

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 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.

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.

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.

36. RISK MANAGEMENT (Contd...)

36.2 CREDIT RISK

36.2.1 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.

36.2.2 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.

This strategy is manifested in the Asset Underwriting Strategy ("AUS") of HBLSL.

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.

36.2.3 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 LCs/LGs.

Primary activities pertaining to credit risk management are: regulary reviewing and implementing credit risk framework comprising of policies, procedures, methodologies, tools and MIS 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, 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.

36. RISK MANAGEMENT (Contd...)

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.

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
- 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

36. RISK MANAGEMENT (Contd..)

36.2.4 CREDIT RISK EXPOSURE

The total gross loans and receivables from all credit customers of the Bank stood at Rs. 3,548 Mn (2014 - Rs. 3,966 Mn) as at 31 December 2015. Refer Note 9 for the product wise loans and advances.

36.2.4.1 COMMITMENTS AND CONTINGENCIES

To meet the financial needs of customers, the Bank enters in to various commitments and contingent liabilities. Eventhough 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.

	2015 Rs.	2014 Rs.
Letter of Credits	271,661,508	227,331,572
Guarantees	200,874,814	150,561,163
Undrawn Commitments	2,796,165,300	1,822,668,620
	3,268,701,622	2,200,561,355

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 consists of facilities granted to customers where the Bank reserves the right to unconditionally cancel or recall the facility at it's discretion.

36.2.4.2 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 2015	**Agriculture and Fisheries** **Rs.**	**Financial Services** **Rs.**	**Government** **Rs.**	**Manufacturing** **Rs.**	**Construction and Housing** **Rs.**	**Traders** **Rs.**	**Other** **Rs.**	**2015 Total** **Rs.**
Cash and Cash equivalents	-	4,612,748,445	-	-	-	-	-	4,612,748,445
Balances with Central Bank of Sri Lanka	-	-	1,176,890,848	-	-	-	-	1,176,890,848
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	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)	(43,235,086)
Net Loans and Advances	373,874,777	331,767,305	-	1,190,821,433	9,383,475	791,324,330	807,414,802	3,504,586,122
Total	373,874,777	5,991,369,846	3,232,403,820	1,190,821,433	9,383,475	791,324,330	852,686,285	12,441,863,965

As at 31 December 2014	**Agriculture and Fisheries** **Rs.**	**Financial Services** **Rs.**	**Government** **Rs.**	**Manufacturing** **Rs.**	**Construction and Housing** **Rs.**	**Traders** **Rs.**	**Other** **Rs.**	**2013 Total** **Rs.**
Cash and Cash equivalents	-	2,566,022,291	-	-	-	-	-	2,566,022,291
Balances with Central Bank of Sri Lanka	-	-	861,337,327	-	-	-	-	861,337,327
Reverse Repurchase Agreements	-	-	260,126,857	-	-	-	-	260,126,857
Other Financial Assets								
Sri Lanka Development Bonds	-	-	1,003,994,708	-	-	-	-	1,003,994,708
Trust Certificates	-	634,954,072	-	-	-	-	-	634,954,072
Debentures	-	250,109,589	-	-	-	-	44,678,671.23	294,788,260
Unquoted Investments	-	-	-	-	-	-	580,000	580,000
Total Other Financial Assets	-	885,063,661	1,003,994,708	-	-	-	45,258,671	1,934,317,040
Loans and Advances to Customers								
Gross Loans and Advances	622,735,508	48,199,772	-	1,277,205,639	4,534,312	1,050,937,748	961,932,161	3,965,545,140
Allowance for Impairment Losses	(2,953,078)	-	-	(6,056,643)	(21,502)	(35,005,830)	(6,288,936)	(50,325,989)
Net Loans and Advances	619,782,430	48,199,772	-	1,271,148,996	4,512,810	1,015,931,917	955,643,225	3,915,219,151
Total	619,782,430	3,499,285,724	2,125,458,892	1,271,148,996	4,512,810	1,015,931,917	1,000,901,896	9,537,022,666

36. RISK MANAGEMENT (Contd...)

36.2.4.3 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 2015	Neither past due nor impaired Rs.	Past due but not impaired Rs.	Individually Impaired Rs.	2015 Total Rs.
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	-	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

As at 31 December 2014	Neither past due nor impaired Rs.	Past due but not impaired Rs.	Individually Impaired Rs.	2014 Total Rs.
Gross Loans and Advances to Customers				
Term Loans	997,650,754	249,707,645	-	1,247,358,399
Overdraft	1,177,962,927	370,176,105	54,628,178	1,602,767,210
Consumer Loans	-	-	-	-
Short Term Loans	227,745,456	63,555,283	-	291,300,739
Trade Finance Loans	733,162,906	39,446,836	3,309,278	775,919,020
Staff Loans	48,150,479	49,293	-	48,199,772
Total	3,184,672,522	722,935,162	57,937,456	3,965,545,140

Note : Past Due loans include any loan that are in arrears for more than one day.
Refer Note 9.3 for the individual and collective impairement with respect to loans and advances to customers.

36.2.4.4 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 2015	Maximum Exposure to Credit Risk Rs.	Net Collateral Value Rs.	Net Exposure Rs.
Cash and Cash Equivalents	4,612,748,445	-	4,612,748,445
Balances with Central Bank of Sri Lanka	1,176,890,848	-	1,176,890,848
Reverse Repurchase Agreements	-	-	-
Financial Assets - Held to Maturity	596,592,762	596,592,762	-
Other Financial Assets	2,551,045,789	768,100,000	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
	12,914,400,289	4,376,358,868	8,538,041,421

As at 31 December 2014	Maximum Exposure to Credit Risk Rs.	Net Collateral Value Rs.	Net Exposure Rs.
Cash and Cash Equivalents	2,566,022,291	-	2,566,022,291
Balances with Central Bank of Sri Lanka	861,337,327	-	861,337,327
Reverse Repurchase Agreements	260,126,857	260,126,857	-
Other Financial Assets	1,934,317,040	631,634,200	1,302,682,840
Loans and Advances to Customers	3,915,219,151	2,929,173,719	986,045,432
Contingent Liabilities including Financial Guarantees and Letters of Credits	377,892,735	83,729,517	294,163,218
	9,914,915,401	3,904,664,293	6,010,251,108

36. RISK MANAGEMENT (Contd...)

36.3 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.

Market Risk Structure

The market risk management at HBLSL comprises of,
- 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.

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 analyze 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.

36. RISK MANAGEMENT (Contd..)

36.3.1 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 favorably 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 analyze 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 36.3.1.1.

36.3.1.1 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	4,612,748,445	437,733,466	-	-	-	-	-	-	-	-	4,175,014,979
Balances with Central Bank of Sri Lanka	1,176,890,848	-	-	-	-	-	-	-	-	-	1,176,890,848
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	56,682,573
	12,497,294,969	3,054,769,398	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	5,409,168,399
Financial Liabilities											
Due to Banks	4,000,365,430	-	-	-	-	-	-	-	-	-	4,000,365,430
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	721,837,532	578,323,794	-	-	-	-	-	-	-
	7,244,759,437	946,616,869	99,755,263	48,458,862	250,249,657	-	-	-	-	-	4,599,517,461
Total Interest Rate Sensitivity Gap	5,252,535,532	2,108,152,529	1,607,872,563	1,349,831,570	41,781,586	151,902,856	368,644,367	68,650,859	37,371,870	8,837,656	809,650,938

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

36. RISK MANAGEMENT (Contd..)

Interest Rate Sensitivity Gap Analysis as at 31 December 2014

	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	2,566,022,291	311,050,864	-	-	-	-	-	-	-	-	2,254,971,427
Balances with Central Bank of Sri Lanka	861,337,327	-	-	-	-	-	-	-	-	-	861,337,327
Reverse Repurchase Agreements	260,126,857	260,126,857	-	-	-	-	-	-	-	-	-
Other Financial Assets	1,934,317,040	20,514,465	1,032,997,753	24,109,589	376,000,000	186,615,233	43,500,000	250,000,000	-	-	580,000
Gross Loans and Advances to Customers	3,980,322,387	3,551,361,227	16,706,580	19,078,672	47,728,967	103,958,448	110,235,213	72,961,493	50,866,513	2,449,142	4,976,133
	9,602,125,902	4,143,053,413	1,049,704,333	43,188,261	423,728,967	290,573,681	153,735,213	322,961,493	50,866,513	2,449,142	3,121,864,887
Financial Liabilities											
Due to Banks	2,203,712,919	-	-	-	-	-	-	-	-	-	2,203,712,919
Due to Customers	1,726,347,269	927,235,574	9,779,386	12,186,841	178,511,932	-	-	-	-	-	598,633,536
Other Borrowings	1,454,662,000	396,154,000	1,058,508,000	-	-	-	-	-	-	-	-
	5,384,722,188	1,323,389,574	9,779,386	12,186,841	178,511,932	-	-	-	-	-	2,802,346,455
Total Interest Rate Sensitivity Gap	4,217,403,713	2,819,663,839	1,039,924,947	31,001,419	245,217,035	290,573,681	153,735,213	322,961,493	50,866,513	2,449,142	319,518,432

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%	(31,293,596)
-1%	32,672,262

36. RISK MANAGEMENT (Contd...)

36.3.2 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 9.2 foreign currency advances and Note No 13.2 foreign currency deposits balance as at 31 December 2015.

36.4 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.

36.4.1 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 fulfill 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 unfavorable terms resulting in long term damage to earnings and reputation of the Bank.

Please refer Note 34 for maturity analysis of assets and liabilities as at 31 December 2015.

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.

36.4.2 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 2015.

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	Rs.	Rs.	Rs.	Rs.	Rs.
Cash and Cash equivalents	4,175,014,979	-	108,750,000	-	4,283,764,979
Balances with Central Bank of Sri Lanka	51,811,647	-	-	1,125,079,201	1,176,890,848
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	3,848,656,359
Total Financial Assets	5,678,685,266	2,335,618,670	2,271,012,326	2,283,463,946	12,568,780,208
Liabilities					
Due to Banks	4,000,365,430	-	-	-	4,000,365,430
Due to Customers	1,320,443,557	128,326,134	298,708,518	-	1,747,478,209
Other Borrowings	145,024,110	781,713,838	581,715,323	-	1,508,453,271
Total Financial Liabilities	5,465,833,097	910,039,972	880,423,841	-	7,256,296,910

36. RISK MANAGEMENT (Contd...)

As at 31 December 2014 Assets	On Demand (less than 15 Days) Rs.	15 Days to 3 Months Rs.	3 Months 12 Months Rs.	Over 1 Year Rs.	Total 2014 Rs.
Cash and Cash equivalents	2,566,022,290	-	-	-	2,566,022,290
Balances with Central Bank of Sri Lanka	50,277,192	-	-	811,060,135	861,337,327
Reverse Repurchase Agreements	260,126,857	-	-	-	260,126,857
Other Financial Assets	11,891,470	394,202,049	133,959,492	1,587,222,091	2,127,275,102
Loans and Advances to Customers	1,804,518,847	828,931,750	594,456,060	1,203,068,894	4,430,975,551
Total Financial Assets	4,692,836,656	1,223,133,799	728,415,552	3,601,351,120	10,245,737,127
Liabilities					
Due to Banks	2,203,712,919	-	-	-	2,203,712,919
Due to Customers	1,517,817,789	15,918,316	198,533,546	-	1,732,269,651
Other Borrowings	-	1,458,674,250	-	-	1,458,674,250
Total Financial Liabilities	3,721,530,708	1,474,592,566	198,533,546	-	5,394,656,820

36.4.3 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.

36.5 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-2015 to CBSL under the Exposure Draft on implementation of the Standardized Approach for calculating capital charge for Operational Risk.

37. 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 18 for the Assigned Capital.

38. 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.

Please refer Note 36.2.4.1 for the Commitments and Contingencies.

38.1 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. However the bank's legal counsel is not in the position to assess the final outcome of the case as at reporting date.

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.

39. EVENTS AFTER THE REPORTING DATE

No material events have taken place since 31 December 2015 that require disclosure or/and adjustments in these financial statements.