HABIB BANK LIMITED – SRI LANKA BRANCH

FINANCIAL STATEMENTS

31 DECEMBER 2013

EY
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 ("Bank") which comprise the statement of financial position as at 31 December 2013, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

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

Scope of Audit and Basis of Opinion

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

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

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

Opinion

In our opinion, so far as appears from our examination, the Bank maintained proper accounting records for the year ended 31 December 2013 and the financial statements give a true and fair view of the Bank's financial position as at 31 December 2013 and its financial performance and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

Report on Other Legal and Regulatory Requirements

These financial statements also comply with the requirements of Section 151(2) of the Companies Act No. 07 of 2007.

Ernst & Young

26 March 2014
Colombo

Habib Bank Limited - Sri Lanka Branch

STATEMENT OF FINANCIAL POSITION

As at 31 December 2013

	Notes	2013 Rs.	2012 Rs.
Assets			
Cash and Cash Equivalents	4	1,405,974,214	1,255,497,015
Balances with Central Bank of Sri Lanka	5	860,611,749	656,681,890
Reverse Repurchase Agreements	6	302,097,171	106,021,781
Financial Assets - Held to Maturity	7	-	342,899,168
Other Financial Assets	8	1,695,772,698	714,338,548
Loans and Advances to Customers	9	4,542,065,683	2,769,517,329
Other Assets	10	109,833,306	48,002,054
Property, Plant and Equipment	11	114,921,083	110,255,052
Deferred Tax Assets	17	47,463,220	1,326,421
Total Assets		9,078,739,124	6,004,539,258
Liabilities			
Due to Banks	12	1,288,249,743	936,944,484
Due to Customers	13	1,623,430,573	1,511,996,431
Other Borrowings	14	1,709,759,431	-
Current Tax Liabilities		26,889,556	8,487,559
Other Liabilities	15	35,170,723	32,457,943
Employee Benefit Liability	16	46,990,961	35,378,974
Total Liabilities		4,730,490,987	2,525,265,391
Equity			
Assigned Capital	18	3,728,549,605	2,688,353,509
Statutory Reserve Fund	19	60,649,883	56,759,560
Investment Fund Account	20	94,869,421	61,599,550
Revaluation Reserve		78,000,199	78,000,199
Exchange Equalisation of Capital	21	209,722,636	183,163,423
Exchange Equalisation of Reserve	22	6,398,676	7,599,415
Retained Earnings	23	170,057,717	403,798,211
Total Equity		4,348,248,137	3,479,273,867
Total Liabilities and Equity		9,078,739,124	6,004,539,258
Contingent Liabilities and Commitments	36.2.4.1	1,970,914,456	1,828,730,613

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

Signed for and on behalf of the management by:

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Mr. Arif M Ali
Regional General Manager
Sri Lanka and Maldives

....

Mrs. Fathima Zahara
Manager - Financial Control

The Notes to the Financial Statements from pages 6 to 38 form an integral part of these Financial Statements.

26 March 2014
Colombo

ERNST & YOUNG
Chartered Accountants
COLOMBO

STATEMENT OF COMPREHENSIVE INCOME

Year ended 31 December 2013

	Notes	2013 Rs.	2012 Rs.
Interest Income	24	517,964,852	477,470,381
Interest Expense	25	(81,280,441)	(64,993,393)
Net Interest Income		436,684,411	412,476,988
Fees and Commission Income	26	27,129,965	22,725,879
Net Trading Income		360,727	706,000
Other Operating Income	27	32,176,652	29,553,597
Total Operating Income		496,351,755	465,462,464
Impairment Charge for Loans and Advances	28	(124,474,928)	(104,959,734)
Net Operating Income		371,876,827	360,502,730
Personnel Expenses	29	(136,125,941)	(95,058,698)
Depreciation of Property Plant and Equipment	11	(14,580,675)	(12,479,934)
Other Operating Expenses	30	(71,106,037)	(68,692,667)
Total Operating Expenses		(221,812,653)	(176,231,299)
Operating Profit Before Value Added Tax (VAT) on Financial Services		150,064,174	184,271,431
Value Added Tax (VAT) on Financial Services		(29,911,557)	(28,645,125)
Profit Before Income Tax		120,152,617	155,626,306
Income Tax Expense	31	(42,346,156)	(44,901,174)
Profit for the Year		77,806,461	110,725,132
Other Comprehensive Income			
Acturial (Loss) /Gain on Retirement Benefit Obligation	16	(11,546,093)	2,700,078
Exchange Differences on translation of Foreign Currency Capital	21	26,559,213	142,610,876
Exchange Differences on translations of Foreign Currency Reserves	22	(1,200,739)	7,470,871
Income Tax on Other Comprehensive Income	31	3,232,906	(756,022)
Other Comprehensive Income for the Year Net of Tax		17,045,287	152,025,803
Total Comprehensive Income for the Year		94,851,748	262,750,935

The Notes to the Financial Statements from pages 6 to 38 form an integral part of these Financial Statements.

Habib Bank Limited - Sri Lanka Branch

STATEMENT OF CHANGES IN EQUITY

Year ended 31 December 2013

	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 01 January 2012		2,688,353,509	51,126,101	21,473,581	78,000,199	40,552,547	128,544	336,888,451	3,216,522,932
Profit for the Year	23	-	-	-	-	-	-	110,725,132	110,725,132
Other Comprehensive Income	21/22/16	-	-	-	-	142,610,876	7,470,871	1,944,056	152,025,803
Transfer to the Investment Fund Account	20	-	-	40,125,969	-	-		(40,125,969)	-
Transfer to Statutory Reserve Fund	19	-	5,633,459	-	-	-	-	(5,633,459)	-
As at 31 December 2012		2,688,353,509	56,759,560	61,599,550	78,000,199	183,163,423	7,599,415	403,798,211	3,479,273,867
Capital Funds Rececived from Head Office	18	774,122,522	-	-	-	-	-	-	774,122,522
Profit for the Year	23	-	-	-	-	-	-	77,806,461	77,806,461
Other Comprehensive Income	21/22/16	-	-	-	-	26,559,213	(1,200,739)	(8,313,187)	17,045,287
Transfer to the Investment Fund Account	20	-	-	33,269,871	-	-	-	(33,269,871)	-
Transfer to Statutory Reserve Fund	19	-	3,890,323	-	-	-	-	(3,890,323)	-
Profit Capitalization during the Year	18/23	266,073,574	-	-	-	-	-	(266,073,574)	-
As at 31 December 2013		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

The Notes to the Financial Statements from pages 6 to 38 form an integral part of these Financial Statements.

CASH FLOW STATEMENT

Year ended 31 December 2013

	Note	2013 Rs.	2012 Rs.
Cash Flows from Operating Activities			
Receipts of Interest Income		465,407,046	462,746,377
Receipts of Fees and Commission Income		27,310,583	23,274,884
Payments of Interest Expense		(76,280,328)	(72,561,832)
Exchange Gain for the Year		19,309,089	17,404,966
Receipts from Other Operating Income		9,065,398	12,643,131
Gratuity Payments Made	16	(6,387,998)	(10,227,228)
Payments for Operating Expenses		(228,171,381)	(205,795,957)
Net Cash Flow from Operating Activities Before Income Tax (A)		210,252,409	227,484,341
Income Tax Paid		(63,757,966)	(63,847,102)
Operating Profit Before Changes in Operating Assets and Liabilities			
Increase in Operating Assets	32.1	(2,743,997,185)	(750,458,333)
Increase/(Decrease) in Operating Liabilities	32.2	1,653,955,183	(241,003,561)
Net Cash Flow from Operating Activities		(943,547,559)	(827,824,656)
Cash Flows from Investing Activities			
Purchase of Property Plant and Equipment	11	(20,756,563)	(9,293,987)
Dividends Received	27	222,750	211,500
Proceeds from Sale of Property Plant and Equipment	11	5,450,000	-
		(15,083,813)	(9,082,487)
Cash flow from Financing Activities			
Funds Received from Head Office	18	774,122,522	-
		774,122,522	-
Exchange Differences on translations of Foreign Currency Capital and Reserves	21/22	25,358,472	150,081,747
Net Increase in Cash and Cash Equivalents		(159,150,378)	(686,825,395)
Cash and Cash Equivalents at the beginning of the Year		1,318,006,084	2,004,831,479
Cash and Cash Equivalents at the end of the Year		1,158,855,706	1,318,006,084
Reconciliation of Cash and Cash Equivalents			
Cash in Hand	4	46,886,044	108,016,392
Balances with Banks	4	1,159,046,527	647,345,828
Money at Call and Short Notice	4	200,041,644	500,134,795
Statutory Deposit with Central Bank of Sri Lanka	5	56,617,668	57,752,355
Money held at Central Bank of Sri Lanka - Foreign Currency	5	803,994,081	598,929,535
Due to Banks	12	(1,107,730,257)	(594,172,821)
		1,158,855,706	1,318,006,085
A. RECONCILIATION OF OPERATING PROFIT			
Profit Before Tax		120,152,617	155,626,306
(Gain)/Loss on disposal of Property, Plant and Equipment		(3,940,143)	51,000
Depreciation of Property Plant and Equipments	11	14,580,676	12,479,934
Provision for Gratuity	16	6,453,892	6,629,301
Impairement Charge for Loans and Advances		124,474,928	104,959,734
Increase in Interest Receivable		(49,467,721)	(1,581,571)
Increase/(Decrease) in Interest Payable		5,000,113	(7,568,439)
Decrease in Accrued Expenses		2,518,261	(20,079,769)
Increase in Financial Guarantee Liabilities		180,618	549,005
Gratuity Payments Made	16	(6,387,998)	(10,227,228)
Other Non Cash Items (Notional Tax Credit on Government Securities Interest)		(3,090,083)	(13,142,432)
Dividend income	27	(222,750)	(211,500)
		210,252,409	227,484,341

The Notes to the Financial Statements from pages 6 to 38 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 2013 were authorized for issue by the local management on 26 March 2014.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

2.1 Basis of preparation

The financial statements of the Bank have been prepared in accordance with Sri Lanka Accounting Standards comprising SLFRS and LKAS (hereafter "SLFRS") as issued by the Institute of Chartered Accountants of Sri Lanka.

2.1.1 Basis of measurement

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.

2.1.2 Statement of Compliance

The financial statements of the Bank have been prepared in accordance with Sri Lanka Accounting Standards ("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.

2.1.3 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 Comprehensive Income unless required or permitted by any accounting standard or interpretation.

2.1.4 Changes in Accounting Policies

The accounting policies adopted by the Bank are consistent with those used in the previous financial year except for the policy on retirement benefits obligations – gratuity.

The Bank applied revised Sri Lanka Accounting Standards (LKAS) 19 on Employee Benefits retrospectively in accordance with the transitional provisions set out in the said standard.

As per previous policy actuarial gain/loss was recognized in full in the Income Statement. As per revised LKAS 19, actuarial gain/loss is recognized in full in Other Comprehensive Income (OCI).

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

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

The impairment loss on loans and advances is disclosed in more detail in Note 2.3.7 and Note 9 to the financial statements.

2.2.2 Taxation

The Bank is subject to income tax and other taxes including VAT on financial services. Significant judgment was required to determine the total provision for current, deferred and other taxes pending the issue of tax guidelines on the treatment of the adoption of SLFRS in the Financial Statements and the taxable profit for the purpose of imposition of taxes. Uncertainties exist, with respect to the interpretation of the applicability of tax laws, at the time of the preparation of these financial statements.

The Bank recognized assets and liabilities for current, deferred and other taxes based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the income and deferred tax amounts in the period in which the determination is made.

2.2.3 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.

2.2.4 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.

2.2.5 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.

2.3 Summary of Significant Accounting Policies

2.3.1 Foreign Currency Translation

The Bank's financial statements are presented in Sri Lankan Rupees (Rs.). Transactions in foreign currencies are initially recorded at the rate of exchange prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the rate of exchange at the reporting date. All differences arising are taken in to Statement of Comprehensive Income. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the spot exchange rates as at the dates of recognition.

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

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

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 to Other Comprehensive Income.

2.3.2 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'.

(iv) Financial Assets - Subsequent measurement

The subsequent measurement of financial assets depends on their classification as described below and the Bank's financial assets comprise of Held to Maturity and Loans and Advances to Customers.

Held to Maturity Financial Assets

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 Income Statement.

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

Loans and Advances to Customers

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, "Loans and Advances to Customers" are subsequently measured at amortised cost using the EIR, 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 Income Statement. The losses arising from impairment are recognized in the Income Statement in "Impairment Charge".

(v) Financial Liabilities - Subsequent measurement

Bank's financial liabilities include due to customers, bank overdrafts, foreign currency 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 Income Statement 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.

2.3.3 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 (such as Loans and Advances to Customers as well as Held to Maturity Assets), 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 assets'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 Income Statement.

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

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 repricing date.

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

2.3.4 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.

2.3.5 Repurchase and Reverse Repurchase Agreements

Securities sold under agreements to repurchase at a specified future date are not derecognised from the statement of financial position as the Bank retains substantially all of the risks and rewards of ownership. The corresponding cash received is recognised in the statement of financial position as an asset with a corresponding obligation to return it, including accrued interest as a liability within ‘Repurchase Agreements’, reflecting the transaction’s economic substance as a loan to the bank. The difference between the sale and repurchase prices is treated as interest expense and is accrued over the life of agreement using the EIR.

Conversely, 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 EIR.

2.3.6 Determination of Fair Value

The fair value of financial instruments traded in an active market at the reporting date is based on their average quoted market price or average dealer price quotations without any deduction for transaction costs. For all other financial instruments not traded in an active market, the fair value is determined by using appropriate valuation techniques such as discounted cash flow method. Refer Note 35 to the financial statements for determination of fair value and fair value hierarchy

2.3.7 Property Plant and Equipments

Property, Plant and Equipment 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 income statement, in which case the increase is recognised in the income statement. A revaluation deficit is recognised in profit or loss, except to the extent that it offsets an existing surplus on the same asset recognised in the asset revaluation reserve.

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	25 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 Income Statement in the year the asset is derecognised.

2.3.8 Impairment of Non-Financial Assets

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

2.3.9 Financial Guarantees

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

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

2.3.10 Employee Benefit Liability

(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 2013 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 is presented in the Income Statement net of any reimbursement.

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 carry forward of unused tax credits and any unused tax losses. Deferred tax assets are recognised to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry forward of unused tax credits and unused tax losses can be utilised.

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

Crop Insurance Levy

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

2.3.13 Revenue Recognition

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

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 Standards Issued but not yet Effective

The following SLFRS have been issued by the Institute of Chartered Accountants of Sri Lanka that have an effective date in the future and have not been applied in preparing these Financial Statements. Those SLFRS will have an effect on the accounting policies currently adopted by the Bank and may have an impact on the future Financial Statements.

(i) SLFRS 9 -Financial Instruments - Classification and measurement
SLFRS 9, as issued reflects the first phase of work on replacement of LKAS 39 and applies to classification and measurement of financial assets and Liabilities.

This standard was orginally effective for annual periods commencing on or after 01 January 2015. However effective date has been deferred subsequently.

(ii) SLFRS 13 -Fair Value Measurement
SLFRS 13 establishes a single source of guidance under SLFRS for all fair value measurements and provides guidance on all fair value measurements under SLFRS. This standard will be effective for the financial period beginning on or after 01 January 2014. However use of fair value measurement principles contained in this standards are currently recommended.

In addition to the above, following standards will also be effective for the annual periods commencing on after 01 January 2014.

SLFRS 10 - Consolidated Financial Statements
SLFRS 11 - Joint Arrangements
SLFRS 12 - Disclosure of Interests in Other Entities

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

3. ANALYSIS OF FINANCIAL INSTRUMENTS BY MEASUREMENT BASIS

	2013		2012		
	L & R at Amortised Cost Rs.	Total Rs.	HTM at Amortised Cost Rs.	L & R at Amortised Cost Rs.	Total Rs.
Assets					
Cash and Cash equivalents	1,405,974,214	1,405,974,214	-	1,255,497,015	1,255,497,015
Balances with Central Bank of Sri Lanka	860,611,749	860,611,749	-	656,681,890	656,681,890
Reverse Repurchase Agreements	302,097,171	302,097,171	-	106,021,781	106,021,781
Financial Assets - Held to Maturity	-	-	342,899,168	-	342,899,168
Other Financial Assets	1,695,772,698	1,695,772,698	-	714,338,548	714,338,548
Loans and Advances to Customers	4,542,065,683	4,542,065,683	-	2,769,517,329	2,769,517,329
Total Financial Assets	8,806,521,515	8,806,521,515	342,899,168	5,502,056,564	5,844,955,732

	2013		2012	
	Financial Liabilities at Amortised Cost Rs.	Total Rs.	Financial Liabilities at Amortised Cost Rs.	Total Rs.
Liabilities				
Due to Banks	1,288,249,743	1,288,249,743	936,944,484	936,944,484
Due to Customers	1,623,430,573	1,623,430,573	1,511,996,431	1,511,996,431
Other Borrowings	1,709,759,431	1,709,759,431	-	-
Total Financial Liabilities	4,621,439,747	4,621,439,747	2,448,940,916	2,448,940,916

HTM - Held to Maturity
L&R - Loans and Receivables

4. CASH AND CASH EQUIVALENTS

	2013 Rs.	2012 Rs.
Cash in Hand - Local Currency	41,281,620	105,143,367
Cash in Hand - Foreign Currency (United States Dollar)	5,604,423	2,873,025
Balances with Banks	1,159,046,527	647,345,828
Money at Call and Short Notice	200,041,644	500,134,795
	1,405,974,214	1,255,497,015

5. BALANCES WITH CENTRAL BANK OF SRI LANKA

	2013 Rs.	2012 Rs.
Statutory Deposit with Central Bank of Sri Lanka (Note 5.1)	56,617,668	57,752,355
Money (United States Dollar) held at Central Bank of Sri Lanka (Note 5.2)	803,994,081	598,929,535
	860,611,749	656,681,890

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 2013, the minimum cash reserve requirement was 6 % (2012 -8%)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 (CBSL) 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 at CBSL Reserve Fund and balance 25% to be used for lending to BOI companies. Accordingly this balance represents the 25% held at CBSL.

6. REVERSE REPURCHASE AGREEMENTS

	2013 Rs.	2012 Rs.
Due from Banks	302,097,171	106,021,781
	302,097,171	106,021,781

7. FINANCIAL ASSETS - HELD TO MATURITY

	2013 Rs.	2012 Rs.
Government Treasury Bills	-	342,899,168
	-	342,899,168

8. OTHER FINANCIAL ASSETS

	2013 Rs.	2012 Rs.
Sri Lanka Development Bonds (Note 8.1)	994,993,900	324,387,056
Trust Certificates (Note 8.2)	700,198,798	287,324,833
Commercial Papers	-	102,046,659
Unquoted Investments (Note 8.3)	580,000	580,000
	1,695,772,698	714,338,548

All other financial assets 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 7.5 Mn (2012- 2.5 Mn) and mature in year 2015 (USD 2.5 Mn) and 2016 (USD 5 Mn)

8.2 Trust Certificates

The above balance represents investment in trust certificates of Peoples Leasing Company PLC amounting to Rs. 658 Mn (2012 - Rs. 276 Mn).

8.3 Unquoted Investments

	2013 Rs.	2012 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

		2013 Rs.	2012 Rs.
Gross Loans and Receivables		4,790,727,242	2,890,755,176
Less:	Individual Impairment	(227,955,749)	(108,901,970)
	Collective Impairment	(20,705,810)	(12,335,877)
Net Loans and Receivables		4,542,065,683	2,769,517,329

9.1 Gross Loans and Advances by Product

	2013 Rs.	2012 Rs.
Term Loans	2,023,873,468	1,017,130,122
Overdraft	1,242,451,938	782,391,080
Consumer Loans	165,555	326,794
Short Term Loans	292,634,993	122,600,820
Trade Finance Loans	1,197,659,376	955,749,842
	4,756,785,330	2,878,198,658
Allowance for Impairment Losses	(248,661,559)	(121,237,847)
	4,508,123,772	2,756,960,811
Staff Loans	47,392,603	16,397,330
Less : Fair Value Adjustment	(13,450,691)	(3,840,812)
	33,941,912	12,556,518
	4,542,065,684	2,769,517,329

9. LOANS AND ADVANCES TO CUSTOMERS (Contd..)

9.2 Gross Loans and Advances by Currency

	2013 Rs.	2012 Rs.
Local Currency - Sri Lankan Rupees	2,209,353,709	1,597,940,228
Foreign Currency - United States Dollar	2,332,711,975	1,292,814,948
	4,542,065,684	2,890,755,176

9.3 Impairement Allowance for Loans and Advances to Customers

	2013 Rs.	2012 Rs.
Balance as at 01 January	121,237,847	16,841,807
Charge for the Year	124,474,928	104,496,784
Amounts Written off	-	(100,744)
Exchange Impact on revaluation of FCY Impairment	2,948,784	-
Balance as at 31 December	248,661,559	121,237,847

9.3.1 Movement in Individual Impairment Allowance for Loans and Advances

Impairment - as at 01 January	108,901,970	8,685,323
Net Impairment Charge for the Year	116,104,994	100,216,647
Exchange Impact on revaluation of FCY Impairment	2,948,785	-
Impairment - as at 31 December	227,955,749	108,901,970

9.3.2 Movement in Collective Impairment Allowance for Loans and Advances

Impairment - as at 01 January	12,335,877	8,156,484
Net Impairment Charge for the Year	8,369,933	4,179,393
Impairment - as at 31 December	20,705,810	12,335,877

10. OTHER ASSETS

	2013 Rs.	2012 Rs.
Deposits and Prepayments	79,715,818	27,057,400
Unamortised Staff Cost	13,450,691	3,840,812
Other Assets	16,666,797	17,103,842
	109,833,306	48,002,054

11. PROPERTY, PLANT AND EQUIPMENT

11.1 Gross Carrying Amounts

At Cost/Revaluation	Balance As at 01.01.2013 Rs.	Additions/ Transfers Rs.	Disposals Rs.	Balance As at 31.12.2013 Rs.
Freehold Land*	52,975,000	-	-	52,975,000
Freehold Building*	34,727,798	-	-	34,727,798
Motor Vehicles	12,995,000	16,500,000	(9,495,000)	20,000,000
Computer,Furniture and Fittings	63,502,724	4,256,563	(500,000)	67,259,287
	164,200,522	20,756,563	(9,995,000)	174,962,085
Assets on Finance Leases				
Leasehold Building	19,320,543	-	-	19,320,543
	19,320,543	-	-	19,320,543
Total Gross Carrying Amount	183,521,065	20,756,563	(9,995,000)	194,282,628

11.2 Depreciation

At Cost /Revaluation	Balance As at 01.01.2013 Rs.	Additions/ Transfers Rs.	Disposals Rs.	Balance As at 31.12.2013 Rs.
Freehold Land	-	-	-	-
Freehold Building	9,565,852	1,061,575	-	10,627,427
Motor Vehicles	11,276,976	3,341,500	(8,093,476)	6,525,000
Computer,Furniture and Fittings	44,148,760	7,765,782	(391,667)	51,522,875
	64,991,588	12,168,857	(8,485,143)	68,675,302
Assets on Finance Leases				
Leasehold Building	8,274,425	2,411,818	-	10,686,243
	8,274,425	2,411,818	-	10,686,243
	73,266,012	14,580,676	(8,485,143)	79,361,546

11.3 Net Book Values

	2013 Rs.	2012 Rs.
At Cost /Revaluation		
Freehold Land	52,975,000	52,975,000
Freehold Building	24,100,371	25,161,946
Motor Vehicles	13,475,000	1,718,024
Computer,Furniture and Fittings	15,736,412	19,353,964
	106,286,783	99,208,934
Assets on Finance Leases		
Leasehold Building	8,634,300	11,046,118
Total Carrying Amount of Property, Plant and Equipment	114,921,083	110,255,053

* Freehold land and building situated at No 140-142, Second Cross Street, Colombo 11 was last revalued by M/s A.Y Daniel & Sons, Licentiate - Sri Lanka Institute of Valuers on 01 October 2010 at market price of Rs. 80,925,000/- and the excess over net book value has been credited to a revaluation reserve.

	Rs.
Freehold Land	52,975,000
Freehold Building	27,950,000
	80,925,000

11.4 During the financial year, the Bank acquired Property, Plant and Equipment to the aggregate value of Rs.20,756,563/- (2012- Rs 9,293,987/-). Cash payments amounting to Rs.20,756,563/- (2012 - Rs. 9,293,987/-) were made during the year for purchase of Property Plant and Equipments.

11.5 Property, Plant and Equipment includes fully depreciated assets having a gross carrying amount of Rs.29,282,005/- (2012- Rs. 29,474,740/-).

12. DUE TO BANKS

	2013 Rs.	2012 Rs.
Bank Overdrafts	1,107,730,257	594,172,821
Deposits from Other Banks	180,519,486	342,771,663
	1,288,249,743	936,944,484

13. DUE TO CUSTOMERS

13.1 Due to Customers - By Products

	2013 Rs.	2012 Rs.
Demand Deposits	783,599,078	713,534,624
Savings Deposits	632,431,054	632,046,691
Time Deposits	50,790,726	41,654,343
Call Deposits	143,607,479	118,194,320
Margin Balances	13,002,236	6,566,453
	1,623,430,573	1,511,996,431

13.2 Due to Customers - By Currency

Local Currency - Sri Lankan Rupees	1,020,832,977	964,137,456
Foreign Currency- United States Dollar	584,452,882	539,113,735
Foreign Currency- Others	18,144,714	8,745,240
	1,623,430,573	1,511,996,431

14. OTHER BORROWINGS

	2013 Rs.	2012 Rs.
Habib Bank Limited - NewYork	917,808,615	-
Habib Bank Limited - Karachchi	660,926,168	-
Habib Bank Limited - Maldives	131,024,648	-
	1,709,759,431	-

Habib Bank Limited - Sri Lanka Branch has obtained the short term borrowings amounting to Rs. 1,709,759,431/-as at 31 December 2013.

15. OTHER LIABILITIES

	2013 Rs.	2012 Rs.
Accrued Expenses	7,407,886	4,889,625
Bills Payable	22,495,407	25,094,863
Other Liabilities	5,267,430	2,473,455
	35,170,723	32,457,943

16. EMPLOYEE BENEFIT LIABILITY

	2013 Rs.	2012 Rs.
As at 01 January	35,378,974	41,676,979
Current Service Cost	2,385,310	1,836,414
Interest Cost	4,068,582	4,792,887
Acturial Losses/(Gains) on Retirement Benefit Obligation	11,546,093	(2,700,078)
(-) Payments during the year	(6,387,998)	(10,227,228)
	46,990,961	35,378,974

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 2013, carried out by Messrs Acturial and Management Consultants (Private) Limited, actuaries.

The key assumptions used by the management include the following,

	2013	2012
Rate of Interest	11%	11.5%
Rate of Salary Increase	10%	10%
Retirement Age	55 Years	55 years

16.2 Net benefit expense categorised under personal expenses,

	2013 Rs.	2012 Rs.
Current Service Cost	2,385,310	1,836,414
Interest Cost	4,068,582	4,792,887
	6,453,892	6,629,301

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

2013				2012			
Salary Escalation Rate	Discount Rate	PVDBO Rs.	PVDBO Impact Rs.	Salary Escalation Rate	Discount Rate	PVDBO Rs.	PVDBO Impact
10%	12%	45,170,662	(1,820,298)	10%	12.5%	33,894,325	(1,484,649)
10%	10%	48,952,626	1,961,665	10%	10.5%	36,982,515	1,603,541
11%	11%	49,048,883	2,057,923	11%	11.5%	37,066,818	1,687,844
9%	11%	45,049,412	(1,941,549)	9%	11.5%	33,792,800	(1,586,174)

17. DEFERRED TAX ASSET

	2013 Rs.	2012 Rs.
As at 01 January	(1,326,419)	(11,777)
Charge during the Year	(46,136,801)	(1,314,642)
As at 31 December	(47,463,220)	(1,326,419)
17.1.1 Deferred Tax Liabilities		
Accelerated Depreciation Allowance for Tax Purposes - Property Plant and Equipments	977,819	1,192,506
Revaluation of Property Plant and equipment	9,671,003	9,671,003
	10,648,822	10,863,509
17.1.2 Deferred Tax Assets		
Employee Benefit Liability - Gratuity	(13,157,469)	(9,906,113)
Loan Impairment	(44,954,573)	(2,283,816)
	(58,112,042)	(12,189,929)
Net Deferred Tax Asset	(47,463,220)	(1,326,419)

Deferred tax has been determined based on the effective tax rate of 28%.

18. ASSIGNED CAPITAL

	2013 Rs.	2012 Rs.
As at 01 January	2,688,353,509	2,688,353,509
Received from Head Office during the Year	774,122,522	-
Capitalisation of Retained Earnings during the year (Note 23)	266,073,574	-
As at 31 December	3,728,549,605	2,688,353,509

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

	2013 Rs.	2012 Rs.
As at 01 January	56,759,560	51,126,101
Transfers during the Year	3,890,323	5,633,459
As at 31 December	60,649,883	56,759,560

19.1 Five per centum of profits after tax is transferred to the 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 INVESTMENT FUND ACCOUNT (IFA RESERVE)

20.1 Investment Fund Account is established and operated based on the Guidelines on the Operations of the Investment Fund Account issued by the Central Bank of Sri Lanka on 29 April 2011 with the concurrence of the Commissioner General - Inland Revenue.

20.1.1 Tax saving on the reduction of tax rates is transferred to the Investment Fund as per the guidelines issued by the Department of Inland Revenue and Central Bank of Sri Lanka.

	2013 Rs.	2012 Rs.
As at 01 January	61,599,550	21,473,581
Transfers during the Year	33,269,871	40,125,969
As at 31 December	94,869,421	61,599,550

20.2 Utilization of Investment Fund Account (IFA Reserve)

	2013 Rs.	2012 Rs.
Total Transferred to IFA	94,869,421	61,599,550
Total Investments in Government Securities - Short Term	-	42,476,195
Loans granted to construction of hotels and for related purposes	94,869,421	-
Balance Available for Utilization	-	19,123,355

21. EXCHANGE EQUALISIATION OF CAPITAL

	2013 Rs.	2012 Rs.
As at 01 January	183,163,423	40,552,547
Exchange Differences on translations of Foreign Currency Capital	26,559,213	142,610,876
As at 31 December	209,722,636	183,163,423

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 prevailed on the date the capital was brought in, as specified by the Central Bank of Sri Lanka circular on "Request to maintain capital in foreign currency" dated 29 July 2005 and the impact due to exchange rate fluctuations is recorded in Exchange Equalisation of Capital.

22. EXCHANGE EQUALISIATION OF RESERVES

	2013 Rs.	2012 Rs.
As at 01 January	7,599,415	128,544
Exchange Differences on translations of Foreign Currency Reserves	(1,200,739)	7,470,871
As at 31 December	6,398,676	7,599,415

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

	2013 Rs.	2012 Rs.
As at 01 January	403,798,211	336,888,451
Profit for the Year	77,806,461	112,669,188
Other Comprehensive Income for the Year	(8,313,187)	-
Transfers to IFA Reserve (Note 20)	(33,269,871)	(40,125,969)
Transfers to Statutory Reserve Fund (Note 19)	(3,890,323)	(5,633,459)
Profit capitalisation during the year (Note 18)	(266,073,574)	-
As at 31 December	170,057,717	403,798,211

24. INTEREST INCOME

	2013 Rs.	2012 Rs.
Placements with Banks	55,821,746	61,202,257
Reverse Repurchase Agreements	20,713,827	4,287,162
Financial Assets - Held to Maturity	10,187,019	128,911,373
Other Financial Assets	81,179,430	25,976,152
Loans and Advances to Customers	350,062,830	257,093,437
	517,964,852	477,470,381

Interest Income earned from Government Securities (Treasury Bills, Treasury Bonds and Reverse Repurchase Agreements) for the year 2013 amounts to Rs. 30,900,845/- (2012 - Rs. 134,185,976/-) and has been grossed up by adding notional tax receivable.

25. INTEREST EXPENSE

	2013 Rs.	2012 Rs.
Repurchase Agreements	-	2,547,554
Due to Customers	68,405,544	60,776,454
Money Market Borrowings	12,874,897	1,669,385
	81,280,441	64,993,394

26. FEES AND COMMISSION INCOME

	2013 Rs.	2012 Rs.
Commisssion on Trade Finance Facilities	19,701,425	15,142,426
Commission on Guarantees	3,221,918	2,122,909
Commission on Remittances	4,206,622	5,460,544
	27,129,965	22,725,879

27. OTHER OPERATING INCOME

	2013 Rs.	2012 Rs.
Dividend income	222,750	211,500
Foreign Exchange Gain	18,948,362	16,698,966
Other Income	13,005,540	12,643,131
	32,176,652	29,553,596

28. IMPAIRMENT CHARGE FOR LOANS AND ADVANCES

	2013 Rs.	2012 Rs.
Impairment Charge for Loans and Advances to Customers	124,474,928	104,959,734
	124,474,928	104,959,734

29. PERSONNEL EXPENSES

	2013 Rs.	2012 Rs.
Salaries	64,206,926	44,337,493
Employee Benefits - Defined Benefit Plan (Gratuity)	6,453,892	6,629,301
Employee Benefits - Defined Contribution Plan		
Employee Provident Fund	6,324,146	4,874,193
Employee Trust Fund	1,558,493	1,161,061
Bonus	10,880,701	5,997,168
Other Allowances	45,217,034	31,288,274
Amortisation of Staff Loan Day 01 Difference	1,484,749	771,509
	136,125,941	95,058,999

30. OTHER OPERATING EXPENSES

	2013 Rs.	2012 Rs.
Auditors Fees - for audit services	1,275,625	1,030,061
- for non audit services	359,000	-
Legal Fees	2,019,749	7,817,000
Marketing Expenses	2,039,842	1,232,716
Transport	1,480,359	9,142,470
Other Expenses	63,931,463	49,470,420
	71,106,037	68,692,667

31. INCOME TAX EXPENSE

	2013 Rs.	2012 Rs.
Current Income Tax		
Current Income Tax on Profit for the Year	58,344,654	45,464,674
Under Provision of current taxes in respect of prior years	26,905,396	1,507,165
Deferred Income Tax	85,250,050	46,971,839
Deferred Tax Reversal for the Year	(42,903,894)	(2,070,664)
Income Tax expense reported in the Income Statement	42,346,156	44,901,175
Deferred Income Tax		
Deferred Tax Charge/(Reversal) for the Year	(3,232,906)	756,022
Income Tax expense reported in the Statement of Comprehensive Income	(3,232,906)	756,022

31.1 Reconciliation of Accounting Profit and Taxable Income

	2013	2012
Accountig Profit Before Taxation	120,152,617	158,326,384
Add: Disallowable Expenses	149,765,952	52,110,615
Less: Allowable Expenses and Exempt Income	(61,544,775)	(48,063,164)
Taxable Income	208,373,794	162,373,835
Current Income Tax on Profit for the Year @ 28%	58,344,662	45,464,674
Effectiuve Income Tax Rate	33%	29%

32. CASH FLOW INFORMATION

	2013 Rs.	2012 Rs.
32.1 Increase in Operating Assets		
Reverse Repurchase Agreements	(196,075,390)	(47,000,000)
Placement with Banks	-	233,956,493
Financial Assets - Held to Maturity	324,497,495	769,044,035
Other Financial Assets	(942,799,611)	(696,499,999)
Loans and Advances to Customers	(1,867,788,426)	(983,869,025)
Other assets	(61,831,253)	(26,089,837)
	(2,743,997,185)	(750,458,333)

32. CASH FLOW INFORMATION (Contd..)

32.2 (Decrease) /Increase in Operating Liabilities

Due to Banks (Vostro)	(162,252,177)	40,649,252
Repurchase Agreements	-	(127,992,949)
Due to Customers	115,143,460	(158,693,789)
Other Borrowing	1,701,050,000	-
Other Liabilities	13,902	5,033,925
	1,653,955,184	(241,003,561)

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,

33.1 Transactions with Key Management Personnel

Key Management Personnel (KMP) include the key management of the bank, having authority and responsibility for planning, directing and controlling the activities of the entity directly and indirectly.

	2013 Rs.	2012 Rs.
Short Term Employee Benefits	29,451,201	12,111,339
	29,451,201	12,111,339

33.2 Transactions with Affiliate Branches

Items in the Statement of Financial Position	**2013 Rs.**	**2012 Rs.**
Balances due from/(to) Banks (Nostro Balances)		
Habib Bank Limited - New York	(57,995,498)	(1,196,871)
Habib Bank Limited - Karachchi	22,224,463	2,963,639
Habib Allied International Bank- UK	1,674,992	1,351,019
Habib Bank Limited - Belgium	22,923,412	9,489,885
Habib Bank Limited - Singapore	746,457	576,700
Habib Bank Limited - Bangladesh	2,761,040	7,192,123
	(7,665,134)	20,376,494
Balances due to Banks (Vostro Balances)		
Habib Bank Limited - Male	375,726	64,831
Habib Bank Limited - Central Branch - Oman	478,024	478,024
Habib Bank Limited - Deira Branch - Dubai	32,315	34,200
Habib Bank Limited - HO Treasury - Karachchi	46,858,284	35,491,569
	47,744,349	36,068,624
Other borrowings		
Habib Bank Limited - NewYork	917,808,615	-
Habib Bank Limited - Karachchi	660,926,168	-
Habib Bank Limited - Maldives	131,024,648	-
	1,709,759,431	-
Items in the Statement of Comprehensive Income		
Money Market Borrowings (Inter Branch Brrowing related expense)	12,695,562	644,672
	12,695,562	644,672

33.3 Transactions with Habib Bank Limited - Provident Fund

	2013 Rs.	**2012 Rs.**
Items in the Statement of Financial Position		
Liabilities		
Saving Deposit	84,001,832	76,365,430
	84,001,832	76,365,430
Items in the Statement of Comprehensive Income		
Employee Benefits - Employee Provident Fund	6,324,146	4,874,193
Interest Expense	5,600,000	6,735,845
	11,924,146	11,610,038

33.4 Head Office Expenses

Habib Bank Limited - Karachchi, Head Office of Habib Bank Limited Sri Lanka Branch has incurred an estimated expense of Rs. 14,676,075/- in the current financial year (2012 - Rs. 24,242,043/-) on behalf of Habib Bank Limited Sri Lanka Branch.

34. MATURITY ANALYSIS OF ASSETS AND LIABILITIES

As at 31 December

	Within 12 Mnoths Rs	After 12 Months Rs.	2013 Total Rs.	Within 12 Mnoths	After 12 Months Rs.	2012 Total Rs.
Assets						
Cash and Cash equivalents	1,405,974,214	-	1,405,974,214	1,255,497,015	-	1,255,497,015
Balances with Central Bank of Sri Lanka	56,617,668	803,994,081	860,611,749	57,752,355	598,929,535	656,681,890
Reverse Repurchase Agreements	302,097,171	-	302,097,171	106,021,781	-	106,021,781
Financial Assets - Held to Maturity	-	-	-	342,899,168	-	342,899,168
Other Financial Assets	289,817,698	1,405,955,000	1,695,772,698	214,403,997	499,934,551	714,338,548
Loans and Advances to Customers	3,383,658,710	1,386,141,684	4,542,065,683	1,853,998,742	915,518,586	2,769,517,329
Other assets	51,031,687	58,801,618	109,833,306	26,784,459	21,217,595	48,002,054
Property, Plant and Equipment	-	114,921,083	114,921,083	-	110,255,052	110,255,052
Deferred Tax Asset	-	47,463,220	47,463,220	-	1,326,421	1,326,421
Total Assets	5,489,197,148	3,817,276,684	9,078,739,125	3,857,357,517	2,147,181,741	6,004,539,258
Liabilities						
Due to Banks	1,288,249,743	-	1,288,249,743	936,944,484	-	936,944,484
Other Borrowings	1,709,759,431	-	1,709,759,431	-	-	-
Due to Customers	1,623,430,573	-	1,623,430,573	1,511,996,431	-	1,511,996,431
Current Tax Liabilities	26,889,556	-	26,889,556	8,487,559	-	8,487,559
Other Liabilities	35,170,723	-	35,170,723	32,457,943	-	32,457,943
Employee Benefit Liability	-	46,990,961	46,990,961	-	35,378,974	35,378,974
Total Liabilities	4,683,500,025	46,990,961	4,730,490,986	2,489,886,417	35,378,974	2,525,265,391

35. Fair Value of Financial Instruments

35.1 Determination of Fair Value and Fair Value Hierarchy

The Bank uses the following hierarchy for disclosing the fair value of financial instruments by valuation technique,
Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities
Level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly
Level 3: techniques which use inputs that have a significant effect on the recorded fair value that are not based on observable market data

35.2 Fair Value of Financial Assets and Liabilities not Carried at Fair Value

Set out below is a comparison, by class, of the carrying amounts and fair values of the Bank's financial instruments that are not carried at fair value in the Financial Statements. This table does not include the fair values of non–financial assets and non–financial liabilities.

	2013 Carrying Value Rs.	2013 Fair Value Rs.	2012 Carrying Value Rs.	2012 Fair Value Rs.
Assets				
Cash and Cash equivalents	1,405,974,214	1,405,974,214	1,255,497,015	1,255,497,015
Balances with Central Bank of Sri Lanka	860,611,749	860,611,749	656,681,890	656,681,890
Reverse Repurchase Agreements	302,097,171	301,577,200	106,021,781	106,021,781
Financial Assets - Held to Maturity	-	-	342,899,168	342,722,750
Other Financial Assets	1,695,772,698	1,704,259,849	714,338,548	722,267,446
Loans and Advances to Customers	4,542,065,683	4,542,065,683	2,769,517,329	2,766,570,219
Total Financial Assets	8,806,521,514	8,814,488,695	5,844,955,731	5,849,761,101
Liabilities				
Due to Banks	1,288,249,743	1,288,249,743	936,944,484	936,944,484
Other Borrowings	1,709,759,431	1,709,759,431	-	-
Due to Customers	1,623,430,573	1,623,430,573	1,511,996,431	1,511,996,431
Total Financial Liabilities	4,621,439,747	4,621,439,747	2,448,940,915	2,448,940,915

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 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. This assumption is also applied to savings and demand deposits portfolio without a specific maturity and call, fixed deposits which is maturing within one year.

Loans and advances granted to customers with a variable rate are also considered to be carried at fair value in the books.

Fixed Rate Financial Instruments

In fair valuing held to maturity securities, rates published by the CBSL for similar trading securities(treasury bills and bonds) were used.
In fair valuing other financial assets, Average Weighted Primary Lending Rates rates published by the CBSL were used.

36. RISK MANAGEMENT

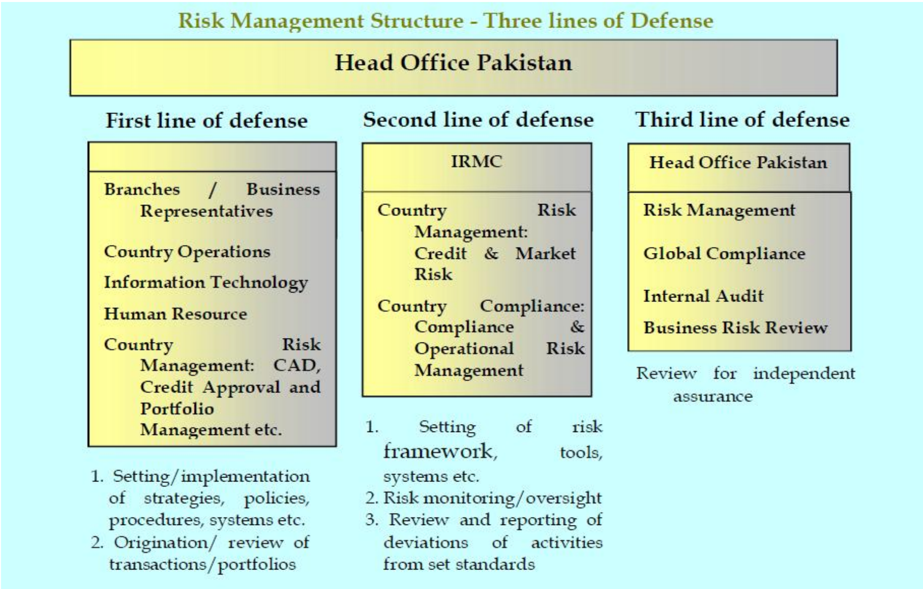
36.1 RISK MANAGEMENT FRAMEWORK

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:

Head of International Risk – Head Office Pakistan

The role has the following responsibilities:

- Implementing risk management policies, standards and practices for the approval measurement, reporting, monitoring and analysis of risk across the Int'l Banking Network.
- Ensuring integration of sound risk management system 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.

36.1 RISK MANAGEMENT FRAMEWORK (Contd.)

Integrated Risk Management Committee (IRMC)

IRMC is essentially a Board level oversight committee and is the highest risk related policy making 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. However, 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 and Compliance Manager. The Country Risk Manager is the Secretary of the Committee.

Country Risk Management (currently represented by Country Risk Manager)

Country Risk Management operates within HBL Sri Lanka, independent from the other business units and support functions and plays a pivotal role in monitoring the risks associated with all the activities of the HBL Sri Lanka. The function is headed by a designated Country Risk Manager (CRM) reporting to the Country Manager/Regional General Manager but with a dotted reporting line to International Risk Management, Head Office Pakistan so as to enable 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

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 and, Country Risk Manager.

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 HOP 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. The 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 Head of Int’l Risk Management, Head Office Pakistan (HOP).

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.

36.2 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 application at HBLSL, outline the principles by which the Bank conducts its credit risk management activities.

36.2.3 Credit Risk Management

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. This Credit Policy Manual ("CPM") is the customized form of the global Credit Policy Manual of HBL for application at HBLSL, outline the principles by which the Bank conducts its credit risk management activities.

Credit Risk Management carry out the main activities pertaining to credit risk management: formulation of 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 calculation, and credit administration etc.

Credit Risk Management Organization

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

International Risk Management, Head Office Pakistan
Integrated Risk Management Committee (IRMC)
Country Risk Management
- Credit Policy
- Credit Approvals
- Credit Administration
- Portfolio Management

Credit Risk Management Process

Salient features of our credit approval process are delineated below:

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

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

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

Credit Risk Assessment and Analytics

The Bank has an existing credit rating system developed by HBL (HOP) for bank's global network for borrowers, which is based on the assessment of some quantitative and qualitative factors applying the 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 Risk Management HOP, validates the assigned ratings periodically 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 environment 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 into the independent credit risk systems 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 is actively pursued. When all other avenues for repayment have been exhausted, liquidation of collateral should be 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 exclusive charge, senior to all other lenders
-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 (supported by the personal net worth statement of the guarantor)

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 the two 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. 4,790 Mn (2012 - Rs. 2,891 Mn) as at 31 December 2012. Please refer Note 9.1 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.

	2013 Rs.	2012 Rs.
Letter of Credits	47,616,881	35,790,971
Guarantees	223,729,699	83,534,030
Documentary Credits	1,363,181,416	1,149,902,452
Forward Exchange Contracts	39,225,000	31,772,500
Undrawn Commitments	297,161,460	527,730,660
	1,970,914,456	1,828,730,613

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

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 2013	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	-	1,405,974,214	-	-	-	-	-	1,405,974,214
Balances with Central Bank of Sri Lanka	-	-	860,611,749	-	-	-	-	860,611,749
Reverse Repurchase Agreements	-	-	302,097,171	-	-	-	-	302,097,171
Other Financial Assets								
Sri Lanka Development Bonds	-	-	994,993,900	-	-	-	-	994,993,900
Trust Certificates	-	700,198,798	-	-	-	-	-	700,198,798
Unquoted Investments	-	-	-	-	-	-	580,000	580,000
Total Other Financial Assets	-	700,198,798	994,993,900	-	-	-	580,000	1,695,772,698
Loans and Advances to Customers								
Gross Loans and Advances	839,358,457	782,363,481	-	1,682,573,111	5,181,485	611,042,728	870,207,981	4,790,727,242
Allowance for Impairment Losses	-	-	-	-	-	-	-	(248,661,559)
Net Loans and Advances	839,358,457	782,363,481	-	1,682,573,111	5,181,485	611,042,728	870,207,981	4,542,065,683
Total	839,358,457	2,888,536,493	2,157,702,820	1,682,573,111	5,181,485	611,042,728	870,787,981	8,806,521,514

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.

	Neither past due nor impaired Rs.	Past due but not impaired Rs.	Individually Impaired Rs.	2013 Total Rs.
Gross Loans and Advances to Customers				
Term Loans	2,022,623,858	1,249,610	-	2,023,873,468
Overdraft	1,028,617,475	150,139,009	63,695,453	1,242,451,938
Consumer Loans	165,555	-	-	165,555
Short Term Loans	292,634,994	-	-	292,634,994
Trade Finance Loans	888,081,782	-	309,577,593	1,197,659,375
Staff Loans	33,941,912	-	-	33,941,912
Total	4,266,065,576	151,388,619	373,273,047	4,790,727,242

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

Bank - 31 December 2013	Maximum Exposure to Crediit Risk Rs.	Net Collateral Value Rs.	Net Exposure Rs.
Cash and Cash Equivalents	1,405,974,214	-	1,405,974,214
Balances with Central Bank of Sri Lanka	860,611,749	-	860,611,749
Reverse Repurchase Agreements	302,097,171	302,097,171	-
Other Financial Assets	1,695,772,698	-	1,695,772,698
Loans and Advances to Customers	4,542,065,683	4,040,005,299	502,060,384
Contingent Liabilities including Financial Guarantees and Letters of Credits	1,634,527,996	377,387,029	1,257,140,967
	10,441,049,510	4,719,489,499	5,721,560,011

36.3 MARKET RISK

Introduction

Market risk is the risk of decrease in the value of an investment due to moves 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

36. RISK MANAGEMENT (Contd..)

Market Risk Strategy / Policies and Scope

On the books of HBL, SL 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 is restrain 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, if the product can be managed manually, in cases where the system is awaited. 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 shall be 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 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, Country Risk Management works closely with the Treasury.

The Market & Liquidity Risk Analyst is responsible for analysis, monitoring and reporting of market risk exposures taken 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 the formulation of overall strategy and 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 Rat 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 2013

	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**	**not exposed to interest rate risk**
Financial Assets										
Cash and Cash Equivalents	1,405,974,214	200,041,644	-	-	-	-	-	-	-	1,205,932,570
Balances with Central Bank of Sri Lanka	860,611,749	-	-	-	-	-	-	-	-	860,611,749
Reverse Repurchase Agreements	302,097,171	302,097,171	-	-	-	-	-	-	-	-
Other Financial Assets	1,695,772,698	17,039,956	45,983,044	78,490,720	148,303,979	1,083,375,000	170,000,000	152,000,000		580,000
Gross Loans and Advances to Customers	4,804,177,933	1,421,927,819	603,047,361	1,031,841,462	607,540,923	407,789,249	184,401,526	164,878,026	9,478,521	373,273,047
	9,068,633,764	1,941,106,590	649,030,405	1,110,332,182	755,844,901	1,491,164,249	354,401,526	316,878,026	9,478,521	2,067,124,319
Financial Liabilities										
Due to Banks	1,288,249,743	-	-	-	-	-	-	-	-	1,288,249,743
Due to Customers	1,623,430,573	786,093,123	17,637,543	7,316,852	28,783,976	-	-	-	-	783,599,078
Other Borrowings	1,709,759,431	1,709,759,431	-	-	-	-	-	-	-	-
	4,621,439,747	2,495,852,554	17,637,543	7,316,852	28,783,976	-	-	-	-	2,071,848,820
Total Interest Rate Sensitivity Gap	4,447,194,017	(554,745,964)	631,392,861	1,103,015,330	727,060,926	1,491,164,249	354,401,526	316,878,026	9,478,521	(4,724,502)

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%	(21,526,056)
-1%	22,252,612

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 exposures on Banking Book products such as long term investments etc. are to be excluded and managed / monitored separately. 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 is 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 2013.

36.4 LIQUIDITY RISK

Introduction

'Liquidity' is the ability of a bank to fund increases in assets and meet obligations as they come 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 2013.

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 2013	On Demand (less than 15 Days)	15 Days to 3 Months	3 Months 12 Months	Over 1 Year	Total 2013
Assets	**Rs.**	**Rs.**	**Rs.**	**Rs.**	**Rs.**
Cash and Cash equivalents	1,405,974,214	-	-	-	1,405,974,214
Balances with Central Bank of Sri Lanka	56,617,668	-	-	803,994,081	860,611,749
Reverse Repurchase Agreements	302,097,171	-	-	-	302,097,171
Other Financial Assets	-	63,022,999	226,794,699	1,405,955,000	1,695,772,698
Loans and Advances to Customers	1,844,602,789	609,192,189	929,863,733	1,386,141,684	4,769,800,393
Total Financial Assets	3,609,291,842	672,215,188	1,156,658,431	3,596,090,765	9,034,256,224
Liabilities					
Due to Banks	1,288,249,743	-	-	-	1,288,249,743
Due to Customers	-	-	1,623,430,573	-	1,623,430,573
Other Borrowings	-	1,709,759,431	-	-	1,709,759,431
Total Financial Liabilities	1,288,249,743	1,709,759,431	1,623,430,573	-	2,911,680,316

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
IHBLSL 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-2013 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.

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 company lawyers are not in the position to assess the final outcome of the case as at the balance sheet date.

39. EVENTS AFTER THE BALANCE SHEET DATE

No material events have taken place since 31 December 2013 that require disclosure or/and adjustments in these accounts.