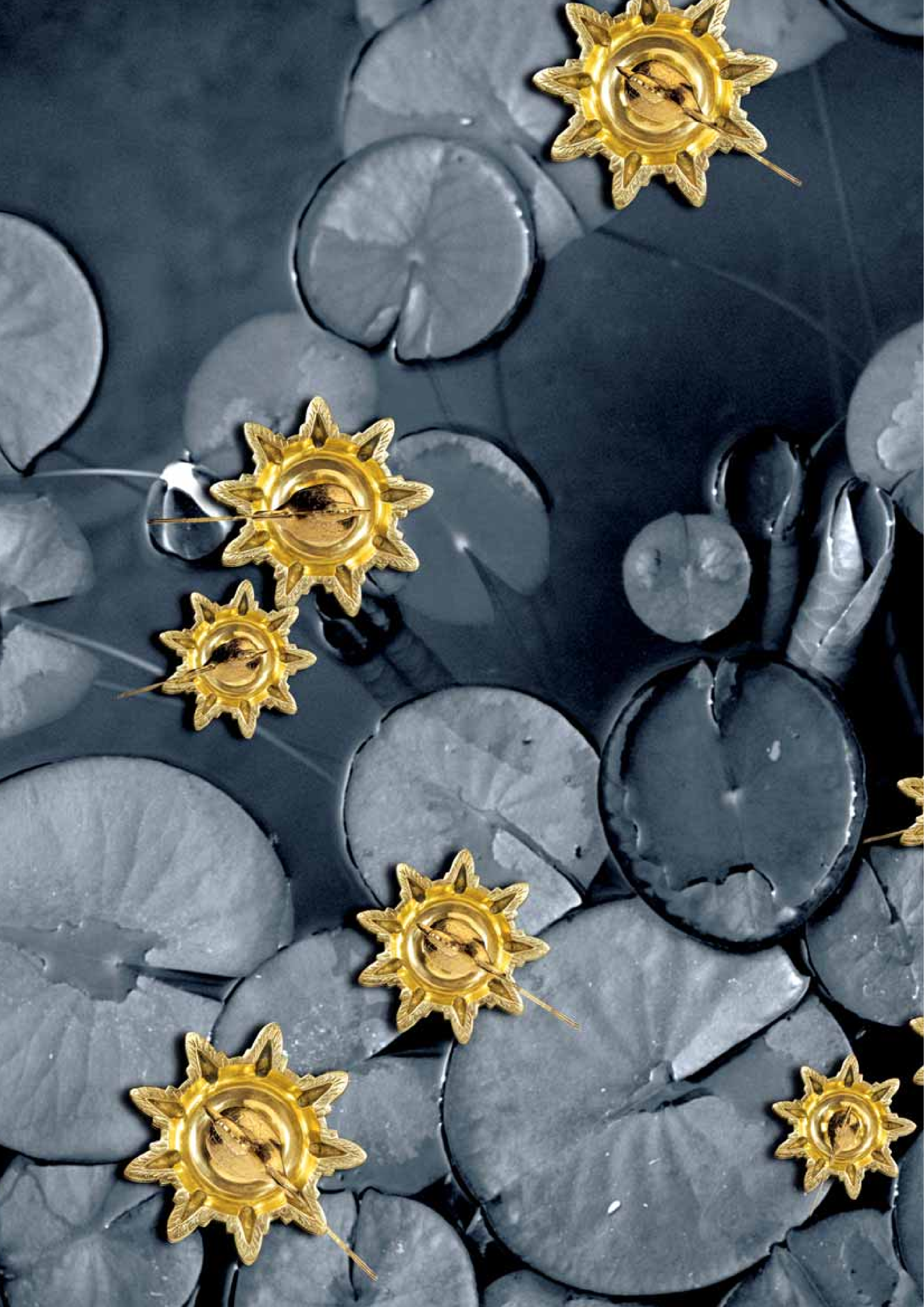
DFCC BANK

ANNUAL REPORT 2006/07

50th Anniversary
A Journey of Development



VISION

To be Sri Lanka's premier financial services group.

MISSION

To provide superior financial solutions and nurture business enterprises, adding value to our customers, shareholders, employees and the nation.

VALUES

Accountability

Be Ethical

Passion for Innovation and Excellence

Respect for the Individual

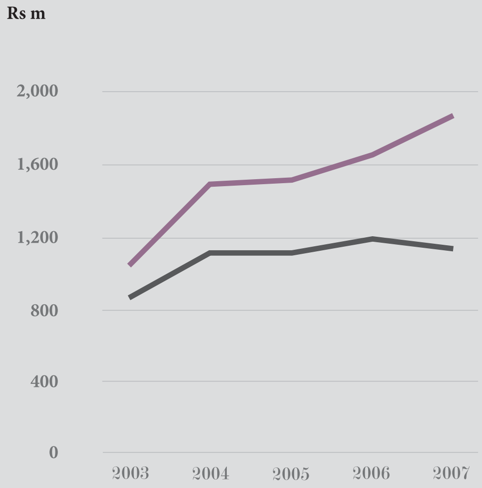
Social Responsibility

Teamwork

PROFIT

Year ended 31 March

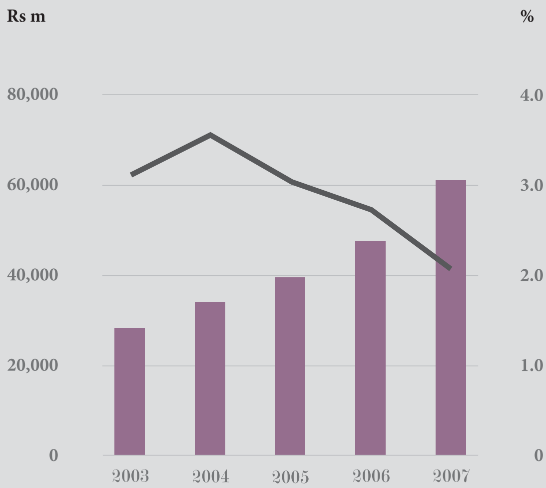
- Profit before tax (Rs)
- Profit after tax (Rs)



TOTAL ASSETS AND RETURN

Year ended 31 March

- Total assets (Rs)
- Return on total assets (%)



SHAREHOLDERS' FUNDS AND RETURN

Year ended 31 March

- Equity (Rs)
- Return on eqiity (%)

FINANCIAL HIGHLIGHTS

FOR THE YEAR ENDED 31 MARCH	2007	2006	% CHANGE
INCOME, RS M	**6,887**	5,387	28
PROFIT BEFORE TAX, RS M	**1,865**	1,652	13
PROFIT AFTER TAX, RS M	**1,125**	1,180	(5)
EARNINGS PER SHARE, BASIC, RS.	**13.01**	13.68	
DILUTED, RS.	**12.90**	13.62	
GROSS DIVIDEND, RS M	**454**	346	
RATE OF DIVIDEND, %	**50**	60	
SHAREHOLDERS' EQUITY	**9,494**	9,091	4
MEDIUM/LONG-TERM BORROWING, DEPOSITS & DEBENTURES, RS M	**47,930**	34,401	39
TOTAL ASSETS, RS M	**60,941**	47,613	28
RETURN ON AVERAGE TOTAL ASSETS, %	**2.1**	2.7	
RETURN ON AVERAGE SHAREHOLDERS' EQUITY	**12.1**	13.6	

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CHAIRMAN'S STATEMENT

"The widening of the overall tax base as opposed to excessively taxing some sectors, will be a necessary step towards placing the economy on a sounder footing and freeing the financial sector to perform its intermediary development role"

I am pleased to present the Annual Report for the financial year ended 31 March 2007 and welcome you to the Fifty First Annual General Meeting of DFCC Bank.

The year under review saw the Bank celebrating its Golden Jubilee, reminiscing its successes and achievements in a journey of fifty years through many different economic cycles. DFCC Bank can be justifiably proud of its transition from modest and obscure beginnings to one of prominence in Sri Lanka's banking industry today, as a robust, diversified financial services group. This has been made possible by a broader vision the Bank had in extending its scope of operations beyond the narrow confines of its original Charter. While the Bank's primary focus has continued to be long-term project finance, the Bank had over the years redefined itself and diversified into many other areas in response to developments in the external environment characterised by intense competition, narrowing margins and diminishing product differentiation within the banking sector.

The performance of DFCC Bank during the year under review, should be viewed in the context of the wider economic milieu. The financial year 2006/07 was an eventful one for both the Sri Lankan economy and the world economy. Fuelled by the rise of fast developing nations such as China and India, global GDP recorded another year of strong growth. Demand and speculation driven increases in commodity prices, notably the escalation of oil prices during the first half of the year in review, resulted in the emergence of inflationary trends.

The high inflation experienced in Sri Lanka during 2006, has been attributed both to these international supply-side factors and the increase in money demand due to the rapid expansion of credit to both the private sector and the Government. As a result of the Central Bank's efforts to curtail the burgeoning cost of living, policy interest rates were raised by 1.75% during the course of the financial year coupled with several other measures to tighten monetary policy, causing market interest rates to increase.

Notwithstanding the rapid increase in inflation and interest rates, the real sector of the Sri Lankan economy performed remarkably well during 2006. Real economic growth in 2006 registered 7.4%, the highest growth recorded since 1978 in the post-economic liberalisation period. All sectors of the economy contributed positively to this growth, with the services sector leading the way, while per capita GDP has increased appreciably and unemployment has reached its lowest ever level.

As we stride forward, sustaining this growth momentum will depend largely on encouraging investment. Although the Government's emphasis on countrywide infrastructure development and rural development is commendable, the deteriorating security situation is a cause for concern. Since the Ceasefire Agreement is no longer an effective deterrent to the upsurge in violence in many parts of the country and the perceived deterioration of law and order is causing international concern, confidence amongst local and foreign investors will be affected unless these adverse developments are arrested early.

In this respect, the onus is on the political leadership to set in place a stable economic environment and improved governance to facilitate sustained growth. Combating corruption, improving law and order whilst tackling terrorism and reducing the losses in state owned business undertakings, to free funds for infrastructure development will be paramount. Maintaining fiscal discipline and equitable financial policies will also be essential. In particular, the widening of the overall tax base as opposed to excessively taxing some sectors, will be a necessary step towards placing the economy on a sounder footing and freeing the financial sector to perform its intermediary development role.

Let me now comment on some aspects of DFCC Bank's financial performance during the year. Profit before Tax recorded significant growth at both Bank and Group level at 13% and 17.5% respectively. However, this growth is not translated to Profit after Tax where marginal declines were recorded due to considerably higher taxation, both on account of the financial services Value Added Tax (VAT) and the increased rate of Income Tax during the financial year 2006/07.

The subsidiary company, DFCC Vardhana Bank Limited, recorded good growth and contributed significantly to Group profits as did the associate company, Commercial Bank of Ceylon Limited, although the contribution to the Profit after Tax from the latter was somewhat lower than the previous year due to a pension plan restructuring expense.

The recent policy changes affecting ownership limits applicable to banks will require DFCC Bank to consider various options on the best way to provide the full range of banking and financial services in the longer term while preserving the value of the substantial investments in DFCC Vardhana Bank Limited and Commercial Bank of Ceylon Limited. The Board of Directors will formulate and execute appropriate strategies to accomplish these objectives.

In June 2006, a Bonus Issue of one for every two shares was made and an interim dividend of 45% was paid to shareholders in March 2007 on the enhanced capital. The Board also resolved to make a Rights Issue of one ordinary share for every four ordinary shares held at a price of Rs140/- per share and thereafter, to effect a Bonus Issue of one ordinary share for every five ordinary shares. The Board has also recommended a final dividend of 5% to be paid to shareholders on the enhanced capital.

The Rights Issue intended to raise Rs3,030 million of new capital to support the Bank's business expansion plans, Balance Sheet growth, maintain the Capital Adequacy Ratio above 12% in the light of recent and anticipated regulatory requirements and also to fund the subscription in full to the Rights Issue recently concluded by its associate company, Commercial Bank of Ceylon Limited.

The previous occasion on which the Bank sought new capital through a Rights Issue was far back in 1993. I am pleased to report that the Rights Issue was oversubscribed. The Bank also enhanced its regulatory capital by the issue of 5 to 10 year subordinated debentures amounting to Rs2,000 million.

Mr Rienzie T Wijetilleke, Chairman, Hatton National Bank Limited, who served on the Board of DFCC Bank since May 2001, did not seek re-election at the last Annual General Meeting held on 30 June 2006 in view of restrictions imposed by the amended Banking Act. We thank Mr Wijetilleke for his valuable contribution to Board deliberations with his long experience and insights in banking. I welcome to the Board Mr Gamini P Karunaratne, former Senior Deputy General Manager - Treasury of Hatton National Bank Limited, who was elected by the shareholders at the last Annual General Meeting in place of Mr Wijetilleke. I also welcome to the Board, Mr R Dalchow, Country Representative of KfW (German Development Bank), in Sri Lanka, as Alternate Director to Mr T Caglayan of German Investment Development Bank (DEG), Germany.

The Chief Executive Officer, Mr Nihal Fonseka, has once again given very able leadership to the management and staff of the Bank in coming up with a performance that is commendable when considering the context in which it was achieved. We take pride in the appointment of Mr Fonseka as the Chairman of the Colombo Stock Exchange in May 2006.

We are also very proud of our employees who have demonstrated excellent team spirit and exemplary work ethics in enabling a superior performance year after year.

As stated in the Chief Executive's Report and the Financial Review, the Bank was able to grow its total portfolio by 27% without compromising asset quality notwithstanding the high interest rates that prevailed. Thus, the Bank has succeeded in retaining its market share and competitive position though Profit after Tax has not grown due to changes to tax rates that had to be absorbed.

Once again our valuable client base has enabled us to record substantial growth in the grant of loans and leases and thereby, the outstanding portfolio. What is particularly noteworthy is a 21% growth in the number of clients in the year under review. Whilst thanking them for their business, we assure them of our commitment to improving our service standards even further.

I thank the officials of the Ministry of Finance and the Central Bank of Sri Lanka for their support and co-operation in enabling us to continue with our development banking role of assisting and nurturing business and industrial enterprises to prosper and grow.

Let me conclude by thanking you, the shareholders of the Bank, for the trust and confidence you have placed in our ability to guide and direct DFCC Bank to greater heights and in particular, for making our recent Rights Issue a success. On our part, we remain committed at all times to preserve and enhance the value of your shareholding.

JMS Brito

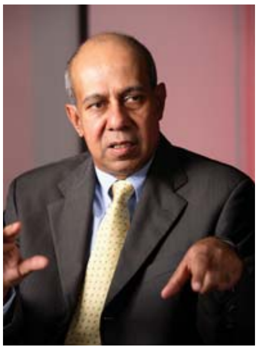
J M S BRITO

Chairman

28 May 2007

CHIEF EXECUTIVE'S REPORT

"The DFCC Bank is a significant net transferor of financial resources to underdeveloped regions in the country"



DFCC Group's performance during the financial year 2006/07 may be described as "resilience in the face of turbulence". The year under review was indeed very challenging. Given the market conditions, which were volatile for much of the year and the higher tax burden, the performance of DFCC Group was, in most respects, satisfactory.

Overall economic growth was encouraging and spurred credit demand for the financing of capital assets and working capital. However, adverse developments in the macro environment towards the latter part of the year meant that the Bank had to assume a more cautious stance during this period particularly with regard to lending. These adverse developments included the intensification of the conflict in the North and East, increased terrorist activity and unfavourable market conditions including high inflation and interest rates. The situation was compounded at times by illiquidity in the money market resulting in volatile interest rates.

OVERVIEW

Strong growth in the client base and assets, without compromising asset quality, underpinned a 33% increase in gross interest income at Bank level. Despite a significant rise in the market interest rates, pricing structures enabled the interest spread on customer advances to be maintained although the growth in net interest income did not keep pace with growth in customer advances due to a higher level of low margin treasury money market activities. The Cost/Income ratio at Bank level (excluding Value Added Tax [VAT]) was satisfactorily managed. Operating profit of the Bank before the financial services VAT and Income Tax was Rs2,238 million, up by 16% on that of the previous year after absorbing a newly mandated general provision of Rs90 million which was not deductible for Income Tax. The Bank had to bear the VAT at the higher rate of 20% for the full financial year (this rate was applicable only for the last quarter of the previous year) and also contend with an increased rate of Income Tax. This change raised the tax charge relating to the financial year under review and also the deferred tax liability brought forward from the previous year. The total of taxes amounted to 50% of the operating profit before taxes, which imposed a significant burden on the providers of equity capital and resulted in a reduction of 5% in Profit after Tax of the Bank. The trend at Group level was similar.

The bulk of credit facilities approved by the Bank continued to be for project loans. Significantly, more than half of the total approvals have been granted to the Small and Medium Enterprises (SME) sector. Whilst maintaining the diversity of the lending portfolio, the Bank implemented a strategy of expansion in the growth sectors where its exposure was limited and containment in the sectors where its exposure was high. The financing of projects that had been affected in some way by the 2004 tsunami was continued, whilst assistance was also extended to new projects that would uplift the economies of the tsunami affected districts.

As referred to earlier, the Bank was able to achieve portfolio growth whilst maintaining portfolio quality. In fact, the overall Non-Performing Asset ratio improved to 4.5% from 5.0% in the previous year. This is a noteworthy achievement since project and development financing carries inherently higher risks when compared to the typical commercial banking product portfolio. However, the recent increase in interest rates and problems faced by specific sectors such as tourism, are likely to have an adverse impact on debt service capacity of some borrowers. We expect these problems to be temporary and are proactively managing the increased risk.

On the funding side, the Bank, with the support of the Government, arranged a long-term credit line of EUR 70 million from the European Investment Bank (EIB) for post tsunami economic upliftment of affected areas. The Bank is a participating institution and also administers this line of credit. The Government and the Bank also entered into an agreement with the EIB for a EUR 50 million long-term funding line for the exclusive use of the Bank. This line is available for drawing in the financial year 2007/08. The Bank continued to administer several of the Government credit lines: The World Bank and Global Environment Facility (GEF) - assisted Renewable Energy for Rural Economic Development (RERED) project and the Asian Development Bank and Japan Bank for International Co-operation - assisted Plantation Development Project/Plantation Reform Project II are two such projects.

The Bank's emphasis on human capital and its investment in people, with special attention being paid to developing middle management remains an ongoing process of utmost priority. The Assessment & Development Centre has been implemented along with the formulation of focussed training and development programmes, for proficiency and skill enhancement of employees. Another priority area has been technology. A unified platform for core banking, across both development and commercial banking entities was commissioned and during the course of the year, the beneficial effects of greater process control, enhanced reporting, and straight-through-processing accrued to the Group. Other infrastructure projects were implemented including those achieved by enhancing the core banking platform of the Bank.

SUBSIDIARIES AND ASSOCIATES

DFCC Vardhana Bank Limited (DVB), now firmly placed on a profitable track, posted a net profit of Rs117 million in the year ended 31 December 2006 compared to the profit of Rs65 million in the previous year. As a full service commercial bank, DVB is playing an increasingly important role within the DFCC Group by enabling the provision of a wider array of banking products and services. The operating synergies between DFCC Bank and DVB means that the interface between the various functional areas of the two institutions appears increasingly integrated to customers of the DFCC Group. Such a service proposition is unique in the banking industry and going forward the Group will leverage this competitive advantage within the context of the applicable regulatory environment. DFCC Bank has also taken steps, as previously committed, to increase the equity capital of DVB and intends to further increase the Tier 1 capital of DVB to the required minimum level of Rs2,500 million by the end of 2007. Commensurate with this equity infusion, plans are underway for DVB to enter into the personal financial services market and also expand its trade finance and treasury activities while aggressively growing its deposit base.

DFCC Stockbrokers (Pvt) Limited, turned in another creditable performance despite an increasingly competitive market. The company's high standard of client service enabled it to retain its market share in the face of the entry of fresh competition. Lanka Industrial Estates Limited (LINDEL), which is the industrial estate owning and management company of the Group, posted yet another satisfactory performance. On top of the growth in its core rental income, the company's earnings were also boosted by a one-off gain from the sale of an unused plot of land to a multinational manufacturing company. The venture capital arm of the Group, Lanka Ventures Limited, continued to be profitable although earnings growth was muted due to lack of exit opportunities from investments. The company's performance was also impacted by a tax charge relating to a previous financial year. DFCC Consulting (Pvt) Limited, undertook assignments for private institutional and multilateral clients. The company is now contracted for a capacity building assignment in renewable energy development in Nepal and is looking to other foreign assignments.

Commercial Bank of Ceylon Limited (CBC), reported a Group Profit after Tax of Rs2,071 million compared to Rs2,356 million in 2005. As in the case of DFCC, the performance of CBC was impacted by a higher tax burden due to legislative changes. CBC also incurred a one-off charge on account of the restructuring of its pension scheme. National Asset Management Limited (NAMAL) is now an associate of DFCC Bank. The Company is part of the Holding Group of the Sri Lanka Insurance Corporation Limited and is beginning to play an active role in fund management, in addition to the management of Unit Trusts.

HALF A CENTURY OF DEVELOPMENT BANKING

During the year, DFCC Bank celebrated its Golden Jubilee and it is pertinent to take stock of the positioning of the Bank and the Group in the context of DFCC Bank continuing to play a significant role in development at the national level .

The Monterrey Consensus, reached at the UN International Conference on Financing for Development, held in Monterrey, Mexico in 2002 and subsequently endorsed by the United Nations, identified, a) mobilising domestic financial resources b)mobilising international financial resources including foreign direct investment c) international trade d) increasing international and technical financial cooperation e) sustainable external debt and where appropriate, debt relief, and f) addressing systemic issues such as coherence, governance and consistency of international financial, monetary and trading systems, as leading actions to be undertaken by the international community for achieving sustainable development, including the Millennium Development Goals. The national development agenda of Sri Lanka is aligned with these leading actions and the Government has unveiled an ambitious plan and a policy framework to achieve these development goals whilst also meeting certain key national development priorities such as upgrading infrastructure countrywide and reducing the regional disparities in income levels. While DFCC Bank remains strongly cognisant of and is committed to its primary role in development banking, it has also taken heed of the evolving financial landscape and the changing market dynamics. A key distinguishing feature from other banks continues to be, that DFCC Bank is a significant net transferor of financial resources to underdeveloped regions in the country. Unlike many commercial banks that use their widespread branch network for deposit mobilisation, DFCC Bank obtains its resources mainly from multilateral, bilateral and wholesale sources to lend to projects located in less developed regions. In this regard, DFCC has placed great emphasis on pursuing new funding sources, upgrading technology, developing its human capital, improving efficiency and delivery and setting up an institutional framework that would optimise and leverage on the potential of human capital and technology. The investments in staff development and process automation have enabled the Bank to maintain productivity at the highest level in the industry and absorb the asset growth and business expansion, both geographically and in scope, entailed by the commercial banking activities of DVB, in a cost effective manner.

FUTURE POSITIONING

The positioning of DFCC Bank is therefore, manifest internally through development of its human capital and externally by focusing non-core but related businesses in separate corporate entities. The continued ability to provide a full range of banking services will be a key plank for the future success of the DFCC Group. Appropriate operating strategies, within the applicable regulatory framework, will be implemented for this purpose.

The Bank has also identified Investment Banking as an area that offers medium-term potential. DFCC Bank has reached agreement in principle, with Hatton National Bank Limited, with a view to amalgamating their respective Investment Banking businesses under an equally owned joint venture company in order to leverage the complementary strengths of the two institutions and reap the benefits of scale. Subject to the required regulatory approvals, it is intended that the new enterprise will commence operations during the first half of the financial year 2007/08.

In the process of automation and migrating its systems to customised solutions, DFCC Bank was able to develop a specialised knowledge pool in information technology and project implementation skills. These attributes will be harnessed under a separate specialised entity and accordingly Synapsys (Pvt) Limited will operate as a subsidiary of the Bank to provide IT services for the DFCC Group as well as outside customers. This arrangement will enable the DFCC Group to retain the services of skilled personnel with strong financial services domain knowledge by providing them with challenging opportunities as well as remuneration schemes that are consistent with IT industry norms.

TAXATION

Many changes have been introduced, practically every year, to the overall tax regime in recent years and the fact that no additional taxes were imposed on the financial sector in respect of the year 2007/08, is a positive factor. Unfortunately, successive Governments have addressed taxation in an ad hoc manner in respect of granting tax holidays on the one hand and attempting to increase revenue generation on the other, without paying sufficient heed to the broader ramifications arising from an inequitable tax regime. While targeted tax holidays are a necessary incentive for encouraging investment, such incentives should be commensurate with deliverables and contribution to the economy and it is important to have in place mechanisms to monitor the contribution and establish that the lost revenue is justified. The measures taken in the last three years, including the re-introduction of previously abolished taxes, may have been warranted by the need to reverse the decline in tax revenue as a percentage of GDP to an unacceptably low level. However, it is hoped that the Government will now seek to evolve a comprehensive policy framework for taxation that is closely aligned with its development agenda and significantly broaden the tax base. The initiative taken by the Ministry of Finance to enter into a dialogue with the tax payer community, prior to formulating tax proposals, is commendable, but the formulation of a future medium-term tax policy should involve the participation of stakeholders through a more formal forum such as a Taxation Commission.

CAPITAL

The Bank last sought capital from shareholders in 1993. Since then the total assets of DFCC Bank have increased from Rs9 billion to Rs61 billion and the Bank has invested Rs4.6 billion in acquiring significant equity stakes in DVB and CBC (including the recently concluded Rights Issue of CBC). These investments are deducted from the regulatory capital of the Bank. The growth and investments have been supported by internally generated capital after consistently paying dividends. During the year under review, The Central Bank of Sri Lanka (CBSL) introduced new capital allocation requirements for market risk and increased the risk weight applicable to most On Balance Sheet customer loans and advances to 110% (previously 100%). CBSL has also announced the introduction of the standardised approach of the Basel II Capital Accord from January 2008 which will require the Bank to allocate additional capital for operational risks as well as for certain credit risks. These developments have prompted the Bank to seek the support of shareholders to raise additional capital of about Rs3 billion in order to strengthen the capital base for further expansion without jeopardising the AA(lka) national credit rating enjoyed by the Bank. Our shareholders have demonstrated their support by providing us with this new capital and I assure them that the management is fully committed to enhancing the value of their investment.

In conclusion, I express my sincere appreciation to the Chairman and the Board of Directors for the direction, guidance and invaluable support that I have received. My management colleagues and all staff extended their full cooperation in taking the Bank forward and I warmly acknowledge their efforts. I also thank the various agencies of the Government, our customers, local financial institutions, bilateral and multilateral lending agencies for the support and confidence placed in DFCC Bank and its subsidiaries.

NIHAL FONSEKA
Chief Executive/Director
28 May 2007

ASSOCIATE AND SUBSIDIARY COMPANIES

COMPANY	DFCC'S INTEREST	PRINCIPAL ACTIVITY	DIRECTORS	PROFIT AFTER TAX [RS MILLION] FYE 06/07	FYE 05/06	DIVIDEND PER SHARE RS FYE 06/07	FYE 05/06	ROE
SUBSIDIARY COMPANIES								
DFCC Consulting (Pvt) Limited 73/5, Galle Road Colombo 3 Tel: (011) 2442590 Incorporated: September 2004	100%	Consultancy	A N Fonseka T W de Silva D E de Mel S E de Silva	1	5	5.0	Nil	14.8%
DFCC Stockbrokers (Pvt) Limited 73, W A D Ramanayake Mawatha Colombo 2 Tel: (011) 2446021-2 Incorporated: February 2001	100%	Stockbroking	A N Fonseka M R Abeywardena (CEO) T W de Silva S Nagarajah P P S Fernando	24	34	5.55	8.00	26.8%
DFCC Vardhana Bank Limited 73, W A D Ramanayake Mawatha Colombo 2 Tel: (011) 2371371 Incorporated: August 1995 Note: Profit is FYE December 2006 and FYE December 2005	95.4%	Commercial Banking	J M S Brito (Chairman) L G Perera (Managing Director) S Nagarajah Mrs Y N Perera T K Bandaranayake Ms R A P Withana J A R E Machado	117	65	Nil	Nil	11.47%
Lanka Industrial Estates Limited Pattiwila Road, Sapugaskanda, Makola Tel: (011) 2400318 Incorporated: March 1992	50.2%	Leasing of lands and buildings to Industrial enterprises	A N Fonseka (Chairman) H A Samarakoon (CEO) V Kanagasabapathy T W de Silva Dr R M K Ratnayake A D Tudawe	150	63	8.00	4.00	58.6%
Lanka Ventures Limited 2nd Floor, Ceylon Ocean Lines Building 46/12, Navam Mawatha, Colombo 2 Tel: (011) 2439201 Incorporated: February 1992	58.34%	Venture Capital Financing	A N Fonseka (Chairman) J D N Kekulawela J M J Perera T L F W Jayasekara S E de Silva T W de Silva	64	76	*	1.50	7.5%
ASSOCIATE COMPANIES								
Commercial Bank of Ceylon Limited "Commercial House" 21, Bristol Street Colombo 1 Tel: (011) 2445010-15 Incorporated: June 1969 Note: Profit is FYE December 2006 and FYE December 2005	27% (28% voting)	Commercial Banking	M J C Amarasuriya (Chairman) B R L Fernando (Deputy Chairman) A L Gooneratne (Managing Director) Dr H S Wanasinghe A N Fonseka L J A Fernando I M Malas D S Weerakkody G Galludec (Alternate Director to I M Malas) Deshamanya K Balendra	2,071	2,356	5.00	4.50	12.7%
National Asset Management Limited 73, W A D Ramanayake Mawatha Colombo 2 Tel: (011) 2445911 Incorporated: September 1990	30%	Fund Management	H Herat (Chairman) A N Fonseka A Herat D Fernando Deshamanya A M de S Jayaratne C Jayasuriya (Alternate Director) T W de Silva (Alternate Director)	8	6	Nil	Nil	6.0%

* to be decided by the Board later

During five decades of development banking, DFCC Bank has chartered new trails and played an innovative and catalytic role without losing sight of its original Charter to infuse energy and dynamism into Sri Lanka's economy

MANAGEMENT DISCUSSION & ANALYSIS

OPERATIONS REVIEW

The Bank's revenue generating activities are mainly carried out by four strategic business units, namely, Corporate Banking, Branch Banking (SME financing), Investment Banking and Treasury. These business units, together with DFCC Vardhana Bank Limited (DVB) - the commercial banking arm of DFCC Bank - work very closely to provide 'one stop' financial solutions to customers.

The 7.4% real GDP growth in 2006 helped to create a strong demand for credit and capital asset financing throughout the year. The Bank's operations grew in tandem, recording sustained growth, profitability and further improvements in asset quality and staff productivity.

However, the Bank was compelled to adopt a more cautious approach towards the latter part of the year under review, due to certain unfavourable developments in the external environment. These included the escalation of the North-East conflict, increasing oil prices, high inflation leading to tight monetary policy and high interest rates and unfavourable liquidity position in the money market. These factors, which still persist, have been taken into account in formulating business plans for the new financial year and the management of anticipated higher credit risk that will affect segments of the existing portfolio.

Internally, the Bank continued to improve its operating structures and business processes in order to further enhance efficiency and effectiveness in customer services.

APPROVALS

DFCC Bank approved credit facilities totalling Rs26,102 million during the year under review, as against Rs24,683 million the previous year. Project loans accounted for 74% of approvals, finance leases 20% with financial guarantees and investment securities accounting for the balance. More than half the sum approved was from the Branch Banking Division, which caters to the Small and Medium Enterprises (SME) sector of the country.

Nearly two-thirds of approvals were for construction, trade and diversified businesses, financial services and property development, transportation, communication and community, social and personal services. The Bank also continued with its penetration strategy to increase its presence in some important sectors. Healthcare, construction, education and shipping are among such sectors, which are economically and socially important to the country.

The Bank continued to finance projects that had been directly or indirectly affected by the tsunami of December 2004, and also new projects that had a positive impact on the economies of tsunami-affected districts.

PORTFOLIO GROWTH

The total portfolio of the Bank (net of provisions) increased from Rs37,481 million to Rs 47,096 million, registering a growth of over 25%. This was aided by a strong growth in disbursements, up from Rs17,799 million in the previous year to Rs21,886 million in the year under review. The client base too increased, from 13,305 in the previous year to 16,038 in the year under review, a growth of 21%.

Loans accounted for 81% of the portfolio, finance leases represented 16%, and the balance, investment securities. The portfolio is well diversified to avoid excessive concentration in a particular economic sector. The following top eight sectors accounted for about 75% of the Bank's portfolio:

	2007	2006
REAL ESTATE, FINANCIAL AND BUSINESS SERVICES	17.0%	15.1%
TRADE AND DIVERSIFIED BUSINESSES	15.7%	12.7%
FOOD AND BEVERAGE	10.3%	11.4%
TRANSPORT, STORAGE AND COMMUNICATIONS	8.7%	8.5%
AGRICULTURE, FORESTRY AND FISHING	8.4%	9.7%
ELECTRICITY, GAS AND WATER INDUSTRIES	5.6%	7.3%
MANUFACTURE OF NON-METALLIC MINERAL PRODUCTS	4.9%	4.6%
CONSTRUCTION AND RELATED	4.6%	3.6%

Changes in the proportion of exposure to these sectors in relation to the previous year are an indication of the Bank's attempt at increasing its exposure to growth sectors during the year e.g. (property development, communication, transport, construction) and its prudence in decreasing its exposure to sectors where the existing exposures were considered to be high (e.g. plantations, energy).

PORTFOLIO QUALITY

Portfolio quality has shown further improvement during the year, with the Non-Performing Asset (NPA) ratio dropping further from 4.7% to 4.3% for project loans, and from 6.8% to 5.5% for finance leases. The overall NPA ratio of the Bank at the end of the year under review, was 4.5% as against 5% last year. Though the ongoing efforts to further improve the portfolio quality will continue unabated, the current NPA ratio of the Bank is satisfactory in the context of the local financial sector and more so in the context of a development banking portfolio with long tenors as opposed to short-term and revolving facilities prevalent in commercial banks. The Bank is mindful of the vulnerability of some sectors to recent economic and market factors and commenced taking steps to manage the higher risk factor.

CORPORATE BANKING

DFCC Bank's Corporate Banking portfolio grew by 22%, from Rs19,758 million to Rs24,041 million during the year under review. This represents 51% of the total credit portfolio of the Bank. The requirements of Corporate Banking customers are more complex and demanding. The Bank approved loans totalling Rs12,328 million while attracting new blue-chip companies as clients. An achievement worthy of special mention is the lead role played by the Bank's Corporate Banking team together with the Investment Banking team in successfully structuring and raising a syndicated term loan of Rs2,100 million for the country's sole manufacturer of glass bottles and containers, to relocate and set up a new plant with enhanced capacity and state-of-the-art technology.

The quality of the Corporate Banking portfolio has been maintained at very high levels, the NPA at the end of the year being around 1%.

BRANCH BANKING

By the end of the year under review, DFCC Bank had 12 branches, comprising the Colombo main branch and 11 outstation branches located in all provinces except the North and East. All the branches were integrated with DVB units offering commercial banking services. The branch network provides the required outreach and access to the development and financing of SMEs and the Bank is well positioned to provide its clients a full range of banking products. In addition, the Bank extensively uses the rapidly expanding branch network of DVB to promote and sell its products, particularly to the SMEs in the respective areas.

The Bank opened its Bandarawela branch during the year and upgraded its Kurunegala branch. The opening of the Galle and Kegalle branches had to be deferred until suitable premises were found in these towns.

SME FINANCING

DFCC Bank firmly believes that SME financing is a key thrust area in the overall economic development of the country and is therefore, committed to further develop its SME financing operations. SME financing consists of project loans, finance leases and permanent working capital facilities granted through the branch network, together with value added services offered by the Bank and commercial banking products offered by DFCC Vardhana Bank.

Credit approvals through branches amounted to Rs13,609 million (52% of total approvals) that directly benefited 4,233 SME customers, mainly in sectors such as education, construction industry, agro processing, commercial transport and passenger transport. The total SME portfolio increased from Rs16,159 million to Rs21,439 million, registering a growth of 33%. The loan and lease portfolios grew by 29% and 40% respectively.

The quality of the SME portfolio further improved, with the year end NPA ratio reaching 4.6% from the previous year's 5.2%.

DFCC Bank, with Technical Assistance from the International Finance Corporation (IFC), Washington DC, undertook an exercise during the year to find ways and means of further improving the Bank's services to the SME sector. Steps are being taken, again with assistance from IFC, to implement the recommendations shortly.

CAPITAL MARKETS AND INVESTMENT BANKING

In general, the Colombo Stock Market recorded a satisfactory performance. The All Share Price Index gained 23% from 2,264 points in April 2006 to 2,790 by end March 2007. During this period, the market touched new highs with the index crossing the 3,000 mark and peaking at 3,016 in February. Trading volumes also kept pace - daily turnovers of over Rs one billion were frequent particularly in the latter half, while the daily average was Rs488 million.

The market was prone to fluctuations in the first half of the year under review. The escalation in hostilities and concerns over the Ceasefire Agreement created uncertainities in the minds of investors and depressed activity levels during this period. In September, some positive signals on the political front revived optimism which despite an increase in interest rates and escalation of violence in the North and East, was to spur a Bull Run that lasted until February. This period was marked by some strategic transactions in the shares of blue-chip companies which further boosted confidence. However, the market rally cooled in March due to fundamentals and also the reaction, particularly by foreign investors, to dips in regional markets.

DFCC observed a measured strategy in managing its investment portfolio of quoted and unquoted shares and holdings in unit trusts. The realised aggregate capital gain was Rs62 million while the total asset allocation to equity was contained to Rs769 million. At end March 2006, the unrealised gain was Rs180 million from quoted and unquoted shares, and Rs63 million from unit trust holdings. Besides portfolio management, the Investment Banking division was active in fee-based assignments including share issue management, loan syndication and financial advisory services.

As referred to previously, it is intended to form a new institutional structure for DFCC's Investment Banking business. Discussions are underway with Hatton National Bank Limited, to establish an equally owned joint venture investment bank that would also take over the respective stockbroking and fixed income securities companies. Among other advantages, the new entity will be able to tap clients of the two banks as well as reap synergies and the benefits of scale and rationalisation of operations. The venture would be capitalised at Rs500 million and subject to regulatory approval, will commence operations in the first half of the financial year 2007/08.

TREASURY OPERATIONS AND FUNDING

The Group Treasury primarily supports interest rate and liquidity risk management and mobilises resources through local and foreign institutions. The Treasury functions of both DFCC Bank and DFCC Vardhana Bank are centralised, which ensures that market opportunities are made full use of through the complementary positioning of the two entities.

The progressively higher interest rate environment witnessed during the year, resulted in many local investors moving towards the shorter term, which tended to curtail the overall tenor of market based borrowings for the Bank. In response, Treasury structured and successfully issued medium to long-term, redeemable, rated, subordinated, unsecured debentures on a both listed and unlisted basis. Tenors ranged from 5 to 10 years. Deposit mobilisation activities in the retail market were strengthened through the introduction of new products via DFCC Vardhana Bank.

Under Treasury's international borrowing programme a new line of credit of EUR 70 million from the European Investment Bank was finalised and disbursements commenced, while an agreement to obtain an additional line of EUR 50 million from the same lender was also executed. Both these lines of credit were supported by the Government and the Bank is not exposed to the foreign exchange rate fluctuation risk in respect of these lines of credit. This will be operational in the second quarter of 2007.

On investment activities, the Bank carried an active repurchase portfolio and now intends to obtain participatory status on the Scripless Securities Trading System to provide a better service to customers.

The upgrading of the physical infrastructure of Group Treasury has given an impetus to all trading activities and improved the market presence of the Bank, while the increase in foreign exchange activity was further assisted by enhanced counterparty limits consequent to the strengthening of the capital base of DVB.

MANAGEMENT OF CREDIT LINES

The Project Management Division manages four credit programmes of the Government of Sri Lanka.

The World Bank and Global Environment Facility (GEF)-assisted Renewable Energy for Rural Economic Development (RERED) project promotes access to electricity through off-grid renewable energy technologies to improve the quality of rural life and encourages private sector investments in on-grid power generation using renewable resources. Todate, the 11 participating credit institutions have collectively disbursed Rs8,254 million in loans, while the project has disbursed a further Rs1,083 million as grants for co-financing and technical assistance activities. The credit line is fully committed and additional financing is being considered by the World Bank to support the continued growth of the sector. The project has so far added 69 MW of capacity to the national grid, mainly through mini hydropower projects, and provided electricity to 87,449 rural homes through solar home systems and community owned village hydro schemes.

The credit component of the Asian Development Bank and Japan Bank for International Co-operation-assisted Plantation Development Project/Plantation Reform Project II provides long-term financing through seven participating financial institutions to meet the investment needs of regional plantation companies. Loans totalling Rs565 million have been disbursed to eight companies. The credit line was fully disbursed by March 2007 and refinance for loans is presently obtained from the Revolving Fund set up by the Government.

The European Investment Bank (EIB)-assisted Post-tsunami Reconstruction Project, which became effective in 2006, provides loans through eight participating financial institutions under two schemes to enterprises that were affected by the tsunami of December 2004. Under the DFCC-administered Scheme A (for those directly or indirectly affected) loans totalling Rs1,494 million were disbursed, while EIB had approved a further Rs 95 million under the Central Bank of Sri Lanka-administered Scheme B for those directly affected.

The KfW-assisted Small and Medium Enterprises Development Project in the North and East became effective in 2006, but disbursements have yet to commence.

The Pahana, a symbol of success, a start to business, an integral part of every beginning. Throughout these fifty years, DFCC Bank has helped businesses turn ideas into reality, vision to achievement, making entrepreneurship flourish and helping light lamps like these in businesses across the country

MANAGEMENT DISCUSSION & ANALYSIS

FINANCIAL REVIEW

OVERVIEW

The Profit after Tax of the Group attributable to shareholders was Rs1,586 million compared to Rs1,690 million in the previous financial year, a marginal decrease of 6.2%. Correspondingly, the return on average assets and the return on average equity of the Group decreased from the previous year's 3.3% to 2.6% and 15.5% to 13.1% respectively. The decline is primarily due to higher levels of taxation that offset the superior performance, in terms of operational gains and core business growth, of DFCC Bank and its 95%-owned subsidiary, DFCC Vardhana Bank Limited. The performance of the Group would have been significantly higher if not for the non-recurrent pension restructure cost of Rs1,654 million incurred by Commercial Bank of Ceylon Limited, an associate company. Since the financial services VAT is based on the accounting profit, the pension restructure cost net of financial services VAT was Rs1,378 million. Although, the non-recurrent pension restructure cost borne by Commercial Bank of Ceylon Limited in the year to 31 December 2006 reduced its profits generated from operations, the pension restructure is expected to yield future savings in the pension cost.

COMPOSITION OF THE GROUP PROFIT AFTER TAX [PAT] ATTRIBUTABLE TO SHAREHOLDERS OF THE BANK

YEAR TO	31 MARCH 2007 RS MILLION	%	31 MARCH 2006 RS MILLION	%
DFCC BANK	**1,013***	**64**	1,030*	61*
DFCC VARDHANA BANK LIMITED [DVB]	**111**	**7**	62	4
SUB TOTAL	**1,124**	**71**	1,092	65
ASSOCIATE COMPANIES:				
COMMERCIAL BANK OF CEYLON LIMITED [CBC]	**333**	**21**	490	29
NATIONAL ASSET MANAGEMENT LIMITED	**2**	–	4	0**
SUBSIDIARIES:				
DFCC STOCKBROKERS (PVT) LIMITED	**23**	**1**	32	2
DFCC CONSULTING (PVT) LIMITED	**1**	–	5	0**
LANKA VENTURES LIMITED	**34**	**2**	40	2
LANKA INDUSTRIAL ESTATES LIMITED	**68**	**5**	27	2
TOTAL	**1,585**	**100**	1,690	100

* *Consolidation Adjustment for dividends from subsidiaries and associate*

The revised Sri Lanka Accounting Standard on Consolidated and Separate Financial Statements which complies with International Accounting Standard 27 in all material respects, applicable from the financial year under review onwards, does not mandate presentation of separate financial statements in addition to the consolidated financial statements. DFCC Bank however, has presented separate financial statements as required by the Direction issued under the Banking Act.

The reported results and Balance Sheet of the Bank and the consolidated financial statements have taken into consideration the changes in accounting policy due to the revised Sri Lanka Accounting Standards applicable from the financial year under review onwards. A synopsis of the financial impact of these changes is described under the heading 'Recent Accounting Developments'.

DFCC BANK

The Rs2,238 million operating profit before both VAT financial services and Income Tax is a 16% increase over Rs1,922 million in the previous financial year. The main contributors to this performance were the 27% increase in the portfolio of loans and leases from Rs35,577 million on 31 March 2006 to Rs45,016 million on 31 March 2007, astute pricing of the loans and leases to maintain the interest spread and containment of portfolio infection.

The reasons for the significant variations in each item of income and expenses are explained below, followed by comments on key Balance Sheet items, and dividend appropriation.

INCOME STATEMENT

The net interest income of Rs2,480 million is an increase of 16% compared to Rs2,131million in the previous financial year. Although the rate of increase in interest income by 33% from Rs4,508 million in the previous financial year to Rs6,018 million is higher than the 27% year-on-year increase of the loans and finance leases, this gain was offset by low margins on Treasury money market activities.

INTEREST SPREAD AND MARGIN

YEAR TO	31.03.2007	31.03.2006	31.03.2005
INTEREST SPREAD	5.06%	5.07%	5.22%
INTEREST MARGIN	5.58%	5.85%	5.89%

Interest spread measures the nominal intermediation cost while interest margin measures the effective intermediation cost. Interest margin takes into account the fact that loan funds may be financed by a mix of borrowed and equity capital.

OTHER INCOME

Other income for the financial year under review was Rs869 million, a 1.2% decrease compared to Rs879 million earned in the previous year. Main contributory factors were lower gains on sale of ordinary shares and lower recovery of bad debts written off in prior years for accounting purposes.

OPERATING EXPENSES

The operating expenses of Rs1,484 million is a 9% increase over Rs1,358 million in the previous financial year. The increase in personnel cost is commensurate with inflation, performance related variable pay and increase in staff to meet business growth. Other overhead expenses include non-recurrent 50th Anniversary commemoration expenses amounting to Rs37 million. Year 2006 marked 50 years of operations of DFCC Bank, and this milestone was used as a platform to sponsor events designed to recognise customers, service providers, long service employees and launch business promotion measures designed to promote products and services and the brand of the DFCC Bank and its commercial banking subsidiary, DFCC Vardhana Bank Limited.

The non-interest cost to operating income ratio of the Bank was 32.1% in the current year compared with 30.0% in the previous year. The combined cost to income ratio of DFCC Bank and DFCC Vardhana Bank Limited was 34.6% in the financial year under review, compared to 32.8% in the previous financial year. For the purpose of this computation, non-interest cost excludes allowances for credit losses and value added tax on financial services.

PROVISION FOR LOAN LOSSES

The gross specific provision and loan/lease losses of the Bank was Rs267 million, a reduction of 24% compared to Rs352 million in the previous year reflecting an improvement in the non-performing loan and leases as a percentage of total loans and leases. The release of provision of Rs287 million was substantially higher than Rs195 million in the previous financial year.

Accumulated allowances for loan losses, both specific and general provision on 31 March 2007 was Rs946 million or 2% of loans, leases and bills of exchange outstanding on 31 March 2007. If loans written-off for accounting purposes, Rs1,441 million on 31 March 2007 is added to On Balance Sheet loans as well as to the specific provision, the provision cover ratio improves to 5%.

The Central Bank introduced a mandatory general provision effective for the quarter commencing October 2006, which amounted to Rs90 million or 0.2% of outstanding performing loans and non-performing loans with the age of arrears 3 to 6 months.

VALUE ADDED TAX ON FINANCIAL SERVICES

The rate was increased from 15% to 20% with effect from 1 January 2006, the highest VAT rate for goods and services. The higher rate was thus applicable during the entire year under review, as opposed to only the last quarter in the previous financial year.

INCOME TAX EXPENSE

This has current income tax and deferred tax components. The income tax rate was increased from 30% to 35% for the financial year under review. The combined effect of the increase in VAT on financial services and Income Tax is estimated as an additional tax expense of Rs262 million.

DFCC BANK AND DFCC VARDHANA BANK LIMITED [DVB]

Since the banking business of both DFCC Bank and its 95%-owned subsidiary DVB is managed to optimise synergy, further comments relating to the profits, credit growth and customer deposits are based on the combined results of both institutions. The combined profit before VAT and Income Tax expense was Rs2,491 million in the financial year under review, an increase of 21% over the Rs2,066 million earned in the previous year.

The combined profit after tax of both banks was Rs1,242 million compared to Rs1,245 million in the previous financial year. Thus, the operational gains of both banks were offset by higher taxation. The operational gains were achieved through growth in credit portfolio, improved portfolio quality, management of liquidity and pricing managed through close oversight by the Asset Liability Committee of the two banks.

The combined credit portfolio of DFCC Bank and DVB was Rs52,794 million on 31 March 2007 compared to Rs40,443 million on 31 March 2006, while the combined deposit liability was Rs21,385 million on 31 March 2007 compared to Rs9,081 million on 31 March 2006.

In the abovenoted combined amounts, the values used for the credit portfolio and deposits of DVB are those as at 31 December, since the Balance Sheet of DVB is consolidated with that of DFCC Bank with a three month gap.

CONTRIBUTION FROM OTHER SUBSIDIARY COMPANIES

Although the other subsidiaries continue to be profitable, their overall contribution was lower in the current financial year compared to the previous period, reflecting the state of the respective markets in which they operate.

PROFIT CONTRIBUTION BY COMMERCIAL BANK OF CEYLON LIMITED, AN ASSOCIATE COMPANY.

The apparent decline in the profit contribution is primarily due to a non-recurrent pension restructure cost. Commercial Bank has changed from a defined benefit pension scheme to a defined contribution pension scheme, together with certain measures to limit future increase in pension cost. In a defined benefit scheme, salary increases due to inflationary pressures has a disproportionate effect on the past service cost of employees closer to retirement, since such costs have to be amortised in the remaining working life of such employee. The restructure of the pension scheme resulted in a non-recurrent compensatory payment to encourage employees to accept the change, and is expected to result in future cost savings in pension cost.

BALANCE SHEET - DFCC BANK

Quality of the Credit Portfolio

ANALYSIS OF NON-PERFORMING LOANS BY AGE OF ARREARS

YEAR TO	31 MARCH 2007		31 MARCH 2006	
AGE OF ARREARS	RS MILLION	%	RS MILLION	%
LESS THAN 3 MONTHS	**125**	**7.4**	200	13.6
3 TO LESS THAN 6 MONTHS	**306**	**18.1**	305	20.7
6 TO LESS THAN 12 MONTHS	**371**	**21.9**	182	12.4
12 TO LESS THAN 18 MONTHS	**233**	**13.7**	167	11.3
OVER 18 MONTHS	**659**	**38.9**	618	42.0
TOTAL GROSS	**1,694**	**100**	1,472	100.0
LESS: SPECIFIC PROVISION	**420**	–	409	–
TOTAL [NET]	**1,274**		1,063	

Although the gross non-performing loans (NPL) amounting to Rs1,694 million is higher than Rs1,474 million a year ago, the NPL as a proportion of the total loans was only 4.5% as at 31 March 2007 compared to 4.9% as at 31 March 2006.

The NPL figure includes loans outstanding in the Textile Debt Restructure Fund (TDRF) of the Government of Sri Lanka, amounting to Rs104 million in the year under review (Rs135 million in the previous year). The TDRF loan is repaid by the Government with some delay and consequently remains classified as non-performing and is included in the 3 to 6 months time bucket in the above table.

Non-performing loans and leases net of provision and realisable value of security as disclosed in the Notes to the Financial Statements was Rs257 million on 31 March 2007 and Rs219 million on 31 March 2006. The amount of such deficit was 2.7% of equity on 31 March 2007 (2.4% on 31 March 2006). The equity is the ultimate buffer to absorb the loss of write-off.

ANALYSIS OF NON-PERFORMING LOAN PORTFOLIO AS AT 31 MARCH 2007 BY SECTOR

SECTOR	GROSS RS MILLION	SPECIFIC PROVISION RS MILLION	NET RS MILLION
TRADE	261	57	204
AGRICULTURE, FORESTRY AND FISHING	255	75	180
FINANCING, INSURANCE, REAL ESTATE AND BUSINESS SERVICES	230	10	220
MANUFACTURE OF FOOD, BEVERAGES AND TOBACCO	216	91	126
ELECTRICITY, GAS AND WATER INDUSTRY	200	17	183
SUB TOTAL	1,162	250	913
OTHERS, 16 SECTORS	532	170	361
GRAND TOTAL, 21 SECTORS	1,694	420	1,274

This distribution of infected portfolio indicates that five sectors accounted for 69% of the total. Bank management will target these exposures and sectors for effective rehabilitation measures with a view to improving the quality.

INVESTMENT IN SUBSIDIARIES AND ASSOCIATES

During the financial year ended 31 March 2007 the Bank invested Rs288 million to participate in a Rights Issue of Rs300 million by its subsidiary DFCC Vardhana Bank Limited. The subscription was at par. The Bank also invested Rs5 million in National Asset Management increasing its ownership from 26% to 30%.

CAPITAL AND LIABILITY STRUCTURE

Interest bearing liabilities accounted for 81% of the total liabilities and shareholders' funds on 31 March 2007, compared to 77% in the previous year. Deposits from customers increased from Rs4,017 million on 31 March 2006 to Rs13,573 million on 31 March 2007, an increase of 238%.

The issued and paid-up capital of the Bank increased by the Bonus Issue of one for two on 30 June 2006. Further increase was by the exercise of employee options.

The Bank is required by loan covenant of major lenders to maintain a gearing ratio of not more than eight of long-term debt to one of equity. The position as at 31 March 2007 was 3.6.

The market capitalisation of the Bank was Rs16,792 million on 31 March 2007, compared to Rs12,684 million on 31 March 2006.

FINANCIAL IMPACT OF DIRECTIONS ISSUED BY THE CENTRAL BANK OF SRI LANKA

The Central Bank issued certain Directions, which had an impact on the profitability, regulatory capital maintenance and credit expansion. Some of the key regulatory developments are described below:

a. Introduction of Mandatory General Provision on performing loans and advances including financial leases amounting to 0.1% per calendar quarter with effect from the quarter ended 31 December 2006, and increasing to a maximum of 1% by 31 December 2008.

b. Increase in the risk weights applicable to loans secured by primary mortgage over residential property and other loans from 50% to 55% and 100% to 110% respectively.

c. Inclusion of market risks in the computation of regulatory capital as in Basel 1.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents increased to Rs4,746 million on 31 March 2007 from Rs1,149 million on 31 March 2006. Funds advanced to customers during the current year net of recoveries was Rs9,429 million compared to Rs7,074 million in the previous year. The increase in the net funds advanced to customers concomitant with increase in business volume together with Rs868 million net increase in purchase of short-term securities, were financed by a combination of the foreign sourced, rupee denominated lines of credit, borrowing from domestic institutions and customer deposits. The Bank's concerted efforts to increase its customer deposits base was sucessful with an increase in customer deposits by Rs9,582 million in the year under review. The capital infusion in DFCC Vardhana Bank Limited amounting to Rs288 million was offset by cash flow from sale of investments.

As in the previous financial year, DVB adopted a different financing strategy better suited for its commercial banking products. It has financed its credit growth with significant increase in customer deposits.

DFCC Bank has adequate committed lines of credit and standby facilities to meet the cash requirements for its operational needs and new strategic initiatives.

OTHERS

Dividend Distribution

The current year dividend payment comprises an interim dividend per share of Rs4.50 paid on 30 March 2007 and the dividend of 50 cents per share proposed for approval at the Annual General Meeting. The interim dividend was paid to shareholders in March 2007 while the final dividend will be on the share capital after it is enhanced by the one for four Rights Issue followed by one for five Bonus Issue.

The total dividend pay out as a percentage of Bank's own Profit after Tax for year to 31 March 2007 is 40%. This is above the threshold below which a deemed dividend tax applies.

Recent Accounting Developments

As a result of revised accounting standards applicable from the year under review onwards, there were significant changes to the measurement of the financial results. This included change from equity method to cost method of accounting for investments in subsidiaries and associates, recognition of deferred assets arising from the tax effect of temporary difference between accounting and taxation relating to unused tax losses of DFCC Vardhana Bank Limited and the end of service employee gratuity provision. Furthermore, the reported results of Commercial Bank of Ceylon Limited, an associate company, recognised translation gains/losses of overseas operations in their equity.

The unamortised goodwill on consolidation as at 31 March 2006 is carried forward indefinitely without further annual amortisation subject to an impairment test. During the financial year under review, there was no evidence of impairment. Concurrently the unamortised negative goodwill on 31 March 2006, was de-recognised and transferred to reserves.

Introduction of the New Companies Act

The Companies Act No. 7 of 2007 came into effect on 3 May 2007. This includes provisions relating to abolition of the par value concept of share capital, introduction of solvency test prior to payment of dividend and some other provisions, which could have an impact on the presentation of future financial statements. Since DFCC Bank is not incorporated under the Companies Act, some of the provisions of the new Act will not apply to the Bank.

MANAGEMENT DISCUSSION & ANALYSIS

RISK MANAGEMENT

In keeping with its development mandate, DFCC Bank has been an innovator in lending to economically crucial but relatively higher risk projects. Therefore, effective risk management has to be an integral part of our day-to-day operations. The commentary by an independent rating agency, Fitch Ratings Lanka, that DFCC's risk management practices are above average in the local context, has been encouraging. We continue to review and upgrade our processes to be in line with Bank specific developments and regulatory requirements, including the implementation of Basel II recommendations.

ORGANISATIONAL STRUCTURE FOR RISK MANAGEMENT

The Credit Committee, Investment Committee and Asset Liability Committee (ALCO), and the supervision of the Board of Directors with special oversight by the Board Sub-committee on Audit forms a key part of the risk management structure at DFCC Bank. In addition, policy manuals, internal controls, segregation of duties, clearly demarcated authority limits and the internal credit rating model coupled with the Internal Audit process function as key risk management tools. Our human resources policies are geared towards maintaining a high level of technical skills, professionalism and ethical standards amongst the staff since the quality of staff is an underlying factor in ensuring effective risk management.

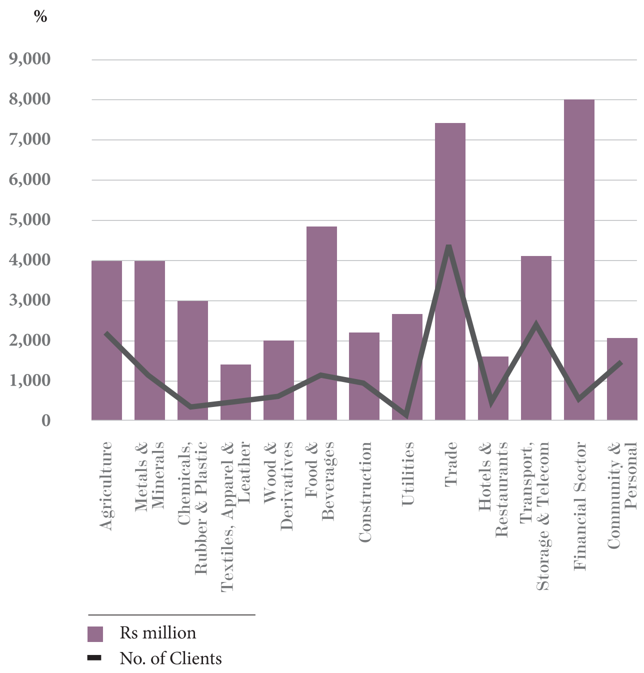
CREDIT RISK MANAGEMENT

Credit risk is the risk of losses arising due to the unwillingness or inability of counter-parties to meet their financial obligations in time and in full. The risk of potential losses in the marked-to-market value of debt securities triggered by credit events such as credit rating downgrade and credit-spread widening is also included in credit risk.

Therefore, categories of credit risk comprise default risk, settlement risk, credit rating downgrade risk, credit-spread risk, concentration risk and country risk. Credit risk can be current or potential and arise from both On Balance Sheet and Off Balance Sheet events. It is the most significant risk that the Bank is exposed to.

The risk profiling of a facility using the internal rating model provides a basis for structuring and pricing the facility. Periodic reassessment of the credit ratings of existing facilities will generate early warning signals and enable proactive measures for managing credit events. Concentration risk in terms of single borrower limits, group limits and sector limits are established and monitored, and sector-wise diversification has ensured that exposure to one particular sector does not exceed 20%. Early warning signals trigger a proactive approach for stricter monitoring on potential credit quality deterioration as well as for provisioning. A centralised collection call centre is being set up to further strengthen the collection function through effective follow up.

PORTFOLIO AND CLIENT DISTRIBUTION



MARKET RISK MANAGEMENT

Market risk refers to the risk of losses accruing to the Bank due to changes in market prices and interest rates. Market risk can be categorised into four main types, namely interest rate risk, equity prices risk, exchange rate risk and commodity prices risk. DFCC Bank is exposed to the above market risks, except commodity prices risk, through its asset-liability management activities. Supervisory monitoring, exposure limits, stop-loss limits and marking-to-market are used to manage market risks in the trading portfolio. The ALCO functions as the main forum at operational level to oversee market risk management.

INTEREST RATE RISK

Interest rate risk arises due to changes in market interest rates. The magnitude of the risk depends on the re-pricing mismatch of maturing assets and liabilities. This pricing mismatch under adverse movements in market interest rates will reduce the net interest income of the Bank. The risk of potential losses in the marked-to-market trading portfolio is also included in interest rate risk.

The Treasury and the Asset Liability Management (ALM) unit continuously assesses the Bank's asset and liability profile in terms of interest rate risks and reports to the ALCO for necessary realignments in the asset and liability structure and the pricing model. The Financial Analysis Division assists the ALCO in monitoring market interest rate scenarios and takes a proactive approach to interest rate risk management.

EQUITY PRICES RISK

Risk of losses in the marked-to-market equity investments due to the market price decline is referred to as the equity prices risk. The Bank's exposure to equity prices risk emerges from open positions in the equity market. The Investment Committee of the Bank is responsible for making investment decisions and monitoring exposure to the equity market and the level of asset allocation is approved by ALCO. A rigorous appraisal, proper market timing and exposure limits are some of the tools used in the management of equity prices risk. The Bank's long-term investment horizon for equity investments smoothens out the adverse implications of short-term volatility in the share market.

EXCHANGE RATE RISK

Exchange rate risk emerges from adverse changes in exchange rates in terms of foreign currency transactions, assets or cross-border business activities of an entity. The Bank is not exposed to exchange rate risk on its borrowings from foreign sources, as under the terms of the DFCC Act No. 35 of 1955, the Government of Sri Lanka bears the exchange risk on foreign borrowings made with its concurrence. The Bank has extended several foreign currency denominated loans to clients who have the capacity to service those loans from their foreign currency income. These loans are naturally hedged through matching foreign currency loans or deposits at the Bank.

The exchange risk of DFCC Vardhana Bank Limited, is actively managed by the Group Treasury. Single dealer limits, currency and overall exposure limits, stop-loss limits and maturity limits are used to manage the foreign currency exposure.

LIQUIDITY RISK

Liquidity risk is the risk of not having the resources to meet financial obligations in time and in full, at reasonable cost. The Bank's liquidity risk management approach includes regular analysis and monitoring of the Bank's liquidity position and the maintenance of market accessibility. Regular cash flow forecasts, liquidity ratio and dynamic maturity gap analyses are used as analytical tools and are reviewed by the ALCO. The ability to roll over long-term borrowings and the core portion of the deposits would support the liquidity position in a contingency situation. For short-term liquidity support, the Bank has access to the money market at competitive rates. As a measure to improve liquidity risk management, the Bank is in the process of defining gap limits on cash flow mismatches.

OPERATIONAL RISK

Operational risk arises from human activities, technology and natural incidents. The sources of operational risk include fraud, staff negligence, management failure, technology failure, model failure, technology obsolescence and inadequate internal control procedures. Segregation of duties with demarcated authority limits, internal and external audit, strict monitoring facilitated by the technology platform and back-up facilities for information are the fundamental tools of operational risk management. Audit findings are forwarded to the Board's Audit Sub-Committee for their examination. In addition, the high level of technical skills, professionalism and ethical conduct of our staff serve as insulators for many operational risk factors. The Bank has formulated a business recovery plan to deal with natural or other catastrophies. The loss of physical assets is mitigated through insurance.

REPUTATION RISK

Reputation risk can be defined as the risk of losing public trust or the tarnishing of the Bank's image in the public eye. Reputation risk could arise from environmental, social, regulatory or operational risk factors. Reputation risk events are closely monitored, utilising an early warning system that includes inputs from frontline staff, media reports, and internal and external market survey results. Policies and standards relating to the conduct of the Bank's business have been promulgated through internal communication and training. A culture of compliance permeates all levels of the organisation, and the Chief Compliance Officer submits quarterly compliance reports to the Board of Directors.

BUSINESS RISK

Business risk is the risk of a deterioration in earnings due to the loss of market share, changes in cost structure and adverse changes in industry or macroeconomic conditions. The Bank's medium-term strategic plan and annual business plan form a strategy road map towards continued prosperity. Diversification of business through subsidiaries and associates, continuous competitor and customer analyses, and continuous monitoring of the macroeconomic environment enable the Bank to formulate its strategies for growth and business risk management.

LEGAL RISK

Legal risk arises from unenforceable transactions in law or the failure to successfully defend legal action against the Bank. Legal risk management commences from prior analysis, and from a thorough understanding of and adherence to related legislation by the staff. Necessary precautions are taken at the designing stage of transactions to minimise legal risk exposure. In case of an emergence of a legal risk factor, immediate action is taken to rectify the situation by the Legal Department of the Bank with external legal consultation being used when required.

BASEL RECOMMENDATIONS

As per the guidelines of the Central Bank of Sri Lanka, licensed banks are required to maintain a capital charge for market risk and perform a parallel computation of capital adequacy based on the Basel II Capital Accord standardised approach, commencing from 2006. These guidelines were introduced with a view to implementing the simplest approaches of Basel II in January 2008. DFCC Bank has fully complied with these new regulatory developments, and is taking the initiative to establish an integrated risk management system in order to implement the advanced approaches specified in the Basel II Accord in the future.

MANAGEMENT DISCUSSION & ANALYSIS

CORPORATE SOCIAL RESPONSIBILITY

Corporate social responsibility is about how businesses align their values and behaviour with the expectations and needs of stakeholders. Hence, now more than ever, Corporates are alive to the fact that in a highly competitive world and in a time of depleting resources, sustainability of a business itself depends on pursuing a holistic approach of ensuring environmental, social and economic sustainability.

DFCC Bank's approach to Corporate Social Responsibility (CSR) follows a similar path. Even though economic sustainability, as opposed to economic gain, has been for sometime the focus of DFCC, and hence its successful existence for 50 years, the Bank is now on a course that encompasses social and environmental sustainability as well. Centric to the Bank's CSR programmes are its core values of being accountable and ethical, having a passion for innovation and excellence, respecting individuals and believing in teamwork.

At DFCC Bank, being a responsible citizen is now an integral part of our business model. In providing Project Finance to enterprises, which is the core function of DFCC, the Bank looks at aspects such as environmental impact, employment generation, sustainability, its importance to the country's macro environment and sector development. For instance, during the year under review, more than half of credit facilities approved have been for over 4,000 small and medium enterprises in the provinces, generating approximately 23,000 direct jobs. The Bank increased its penetration in sectors such as healthcare, construction, education and shipping which are economically and socially important to the country.

Apart from the operational model that epitomises the DFCC value system, which also forms the basis of our CSR framework, the Bank undertook other projects to deliver value across stakeholder groups.

COMMUNITY

With the objective of enabling rural youth to become beneficiaries of the global knowledge economy, DFCC Bank during the last decade or so, has been primarily focusing on projects that enhance access to education in the provinces. In that respect, during the year under review, the Bank undertook the renovation of Maha Bodhi Vidyalaya in Kadawata, a school that has been in existence for over fifty years and was in great need of funds for renovating the dilapidated buildings and getting access to related resources.

Apart from direct assistance to schools, supporting the academic community and professional bodies in the country form a key part of the Bank's ongoing CSR programme. During the year under review, the Bank sponsored the publishing of Dr. Saman Kelegama's book on "Contemporary Economic Issues: Sri Lanka in the Global Context", which was launched in May 2006 and the 50th Anniversary screening of Dr. Lester James Peiris's film 'Rekawa' (the film which marked the beginning of indigenous cinema in Sri Lanka). The Bank co-sponsored the '4th South Asian Economic Students' Annual Regional Conference' organised jointly by the Colombo University and the World Bank and the 'Business Leaders Summit' organised by the Chartered Institute of Management Accountants (CIMA).

A considerable part of the Banks' CSR budget was also spent supporting a much needed mega initiative by the Sri Lanka Tourist Board to promote Sri Lanka as a tourist and investment destination, in the United Kingdom.

Refurbishing wards 14 & 16 of the De Soysa Maternity Hospital, conducting blood donation campaigns in Badulla and Anuradhapura, completing the restoration of Tanks benefiting farmers in the North-Central Province are some of the other community development projects the Bank's branch network undertook in their respective areas.

Assisting the differently-abled has been an on-going CSR effort of the Bank. In addition to recruiting five differently-abled persons to the staff of DFCC, the Bank received the opportunity to sponsor one such recruit to take part in the first ever Asia Cup Cricket tournament for the deaf conducted in India. The Bank also continued to support the Sri Lanka Blind Association's initiative to supply White Canes to its members.

ENVIRONMENT

DFCC Bank's commitment to improve its internal and external environments brought to completion several projects in this area. Conforming to international safety standards, the Bank continued to improve health and safety at work. Installation of a Lightening Protection System, an Electrical Surge Diversion System and replacing Cooling Towers to enhance the air-conditioning capabilities and healthier air circulation at the Head Office were some of the significant investments that were made in this area.

The process that ensures our commitment to the external environment is in-built into our business model. All major projects funded by us are scrutinised and monitored for environmental impact by the Bank's Environmental Engineer. Further, the Bank offers specialised loan programmes at concessionary interest rates to encourage the installation of environmental processes and systems in industries.

EMPLOYEES

DFCC takes pride in the quality of our human capital and continue to grow their talents and strengths through various programmes and activities. The section on Human Capital in this report gives details of the Bank's HR programmes.

CUSTOMERS

Building internal managerial capabilities of SMEs form an integral part of the Bank. In this regard, DFCC continued to conduct workshops and training programmes at branch level. One such programme that delivered excellent results was a residential training programme on financial accounting, business management and marketing conducted by the Ratnapura Branch for its customers.

FUTURE

The Bank is in the process of developing a CSR Policy framework with a view to improving focus on CSR practises. In the medium-term, DFCC Bank intends to increase exposure to selected projects that will enhance access to education.

MANAGEMENT DISCUSSION & ANALYSIS

HUMAN CAPITAL

Corporate success, stability and growth, traditionally measured in financial terms, are primarily driven by the quality and strength of an organisation's human capital. With this in mind, we at DFCC Bank, have consistently focused on the development of a human resource base equipped with the requisite competencies and attributes to sustain the Bank and propel it forward.

PROMOTING A 'ONE BANK CONCEPT'

As the DFCC Group continues to evolve and grow, the continuously shifting internal dynamics within the Group, in addition to external pressures, impose further challenges on staff, especially in coming to terms with change and adapting themselves accordingly. One of the main HR initiatives in the year under review, focused on further developing the mindset of a 'one bank' concept and cohesiveness among DFCC Bank and DFCC Vardhana Bank staff. This need was addressed through a multi-pronged approach consisting of measures to enhance communications, facilitate knowledge transfer and adoption of common HR practices. Successful initiatives in this regard were two Corporate Social Responsibility projects conducted jointly by the staff of DFCC Bank and DFCC Vardhana Bank Limited (DVB).

RECRUITING THE BEST TALENT

Growth in operations is usually accompanied by the need for more staff and financial year 2006/07 was no exception. Year after year, DFCC Bank has ranked at, or near the top, in terms of profits per employee among all corporates in Sri Lanka and this is due mostly to the Bank's consistently stringent recruitment standards while maintaining a lean and highly productive team. Executive staff recruited to the Bank are required to sit for internationally adopted assessment tests including personality profiling, face multiple interviews and go through security screening. In the case of Management Trainees, group discussions and presentations on given topics are also incorporated into the selection process. During the year under review, the Bank recruited 59 staff members. As on 31 March 2007, the Bank had a staff strength of 422 with an equal gender split into 212 males and 210 females. It is noteworthy that 63% of the 223 executive staff have multi-disciplinary qualifications. The HR function of our subsidiary, DVB, continued to be centrally managed by the HR Division of DFCC Bank and during the year 2006/07, 105 new staff members were recruited to DVB increasing total staff strength to 206 as on 31 March 2007.

THE MANAGEMENT TRAINEE PROGRAMME

Staff intake is most concentrated in the Management Trainee grade considering that young talent is easier to train, mould and develop to suit DFCC Bank's culture and business model. With a view to attracting and retaining the best young talent, we have continually reviewed and enriched our Management Trainee programme. During the financial year 2006/07, two batches totaling 22 Management Trainees were selected from over 2,000 appllicants consequent to an exhaustive selection process. The selected trainees were initially put through an induction programme designed to familiarise them with the Group's culture and operations and provide them with an opportunity to interact with a cross-section of staff. During the training period these recruits undergo a structured development programme comprising on-the-job training with job rotation and formal training interventions. During the year under review, Management Trainees were provided with 22 man-days of classroom training comprising in-house, external and overseas programmes.

KNOWLEDGE ENHANCEMENT AND SKILL BUILDING

During financial year 2006/07, the Bank invested approximately Rs12 million on staff training and development translating to an average annual investment of Rs31,211 per employee. This included 24 overseas programmes attended by 48 executives, 130 local programmes attended by 313 participants and 33 in-house programmes attended by 714 participants. During the year under review, the Bank conducted a total of 2,084 man-days of training translating to 5.2 days of training per staff member.

Training interventions to develop technical skills, customer service, managerial competencies, personal effectiveness and IT capabilities were determined based on needs identified through the performance appraisal process as well as the recently concluded Assessment Development Centre (ADC) for managerial staff.

A focused intervention to pave the way for promising non-executives to make a transition into the executive cadre was initiated. On the basis of qualifications and potential, six non-executives were selected and individual development plans were formulated for them.

PREPARING FOR MANAGEMENT POSITIONS

Identifying and developing staff to take up managerial positions is an integral component of HR strategy. Towards this end, a group of senior project officers were put through an assessment process consisting of an in-tray exercise, a case study presentation and an interactive interview in addition to past performance on the job. Those selected through this process will be placed in a newly created special grade and will be given first preference when managerial positions need to be filled. They will also be provided with focused training and development opportunities to address skill gaps to enable them to make a faster and more effective transition to becoming managers.

The HR function of the Bank has made significant strides forward over the past several years in having in place an enviable human resource base. However, we are mindful of the need for vigilance and dynamism as traditional sources of competitive advantage are weakened by forces such as new technology and intensifying competition. In this scenario, we increasingly rely on leadership, teamwork, talent management, innovation and other organisational capabilities to create value and sustained productivity and profitability. The Bank remains committed to further developing these intangibles to harness the full potential of our human capital to be at the forefront of Sri Lanka's financial services landscape.

BOARD OF DIRECTORS

J M S BRITO - CHAIRMAN

Mr Rajan Brito is Deputy Chairman and Managing Director of Aitken Spence & Company Limited. He joined the Board of DFCC Bank in March 2005 and was appointed Chairman in September 2005.

Mr Brito is also Chairman of DFCC Vardhana Bank Limited. He is a former Chairman of SriLankan Airlines and was a member of the Strategic Enterprise Management Agency (SEMA) and the post-tsunami Presidential Task Force for Rebuilding the Nation (TAFREN).

He is a Chartered Accountant by profession. He also holds a Bachelor's Degree in Law and a Master's Degree in Business Administration. He brings with him a wealth of management expertise having served in local and international organisations such as Pricewaterhouse, British EverReady PLC, Minmetco Group, World Bank and the Public Enterprises Reform Commission (PERC).

T CAGLAYAN - DIRECTOR

Mr Turan Caglayan is Head of Portfolio Management with the German Investment Development Company - DEG, which offers a full package of services to promote private enterprise in Africa, Asia and Latin America as well as Central and Eastern Europe. He was appointed to the Board of DFCC Bank in August 1999.

Mr Caglayan started his career with Deutsche Bank, Frankfurt. In 1992, he joined DEG as an Investment Manager responsible for project management and acquisition of new projects in India, China, the Solomon Islands and Papua New Guinea. As a Senior Investment Manager, Mr Caglayan took over responsibilities for projects in several European countries as well.

Until recently, Mr Caglayan was Head of Portfolio Management Asia Department. He is now the Head of Asia Department and is responsible for new business in the region. Mr. Caglayan is based in DEG's regional office in Thailand.

MRS M A R C COORAY - GOVERNMENT DIRECTOR

Mrs Rose Cooray is an Assistant Governor of the Central Bank of Sri Lanka. She was appointed to the Board of DFCC Bank in March 2002.

Mrs Cooray served the Ministry of Finance in the capacity of a Director-General of the Department of Fiscal Policy and Economic Affairs from 1999 to 2004 on release from the Central Bank. During her period of service in the Ministry of Finance, Mrs Cooray represented the Government on the Boards of Sri Lanka Institute of Information Technology, De La Rue Lanka Currency & Security Print (Pvt) Limited, the Ceylon Electricity Board, Sri Lanka Export Development Board and Sri Lanka Telecom Limited. She also represented the Ministry of Finance on the Tariff Advisory Council. Mrs Cooray is also the Vice Chairperson of the Institute of Bankers of Sri Lanka.

She has a B.A. (Hons.) in Economics from the University of Peradeniya and a Master's Degree from the University of Strathclyde, U.K.

R DALCHOW - ALTERNATE DIRECTOR TO T CAGLAYAN

Mr Reinhard Dalchow is Director of the KfW Colombo Office. KfW Banking Group is one of the ten biggest banks in Germany with a Balance Sheet total of EUR 360 billion as at 31 December 2006. Mr Dalchow was appointed to the Board of DFCC Bank in September 2006.

Mr Dalchow joined KfW in 1987. For many years he was responsible, as Senior Project Manager, for development projects in South and East Asia. After the German re-unification, Mr Dalchow had been advisor to the former Central Bank of East Germany and assigned to the Treuhandanstalt, Berlin, an institution for the restructuring of East German public owned enterprises. He was also the Director of the KfW office in Beijing.

Mr Dalchow is a Financial Analyst, Tax Council and Certified Public Accountant. He has a Masters in Business Administration.

A N FONSEKA - CHIEF EXECUTIVE OFFICER/EX-OFFICIO DIRECTOR

Mr Nihal Fonseka is a career banker and joined the Board of DFCC Bank in January 2000 with his appointment as Chief Executive. He is the Chairman of the Colombo Stock Exchange and a Vice Chairman of the Association of Development Financing Institutions in Asia and the Pacific (ADFIAP).

Mr Fonseka is a Director of Commercial Bank of Ceylon Limited and the Credit Information Bureau of Sri Lanka. He is also a member of the Governing Board of the National Institute of Business Management (NIBM) and the Postgraduate Institute of Management, Sri Lanka. He serves as a member of the Advisory Committee on Finance and Banking of the Ceylon Chamber of Commerce and is the Chairman of the Banking, Insurance and Financial Services Committee of the National Chamber of Commerce of Sri Lanka.

He is a member of the Financial Sector, Capital Markets, Taxation and Legal Reforms Clusters of the National Council for Economic Development (NCED). He is also a member of the National Payments Council and Inter-Regulatory Institutions Council.

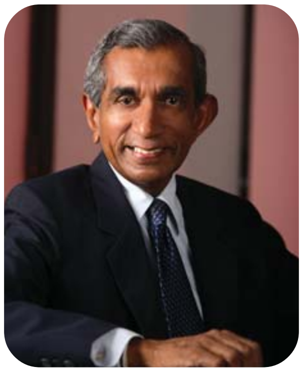
He is a Graduate of the University of Ceylon, Colombo and also a Fellow of the Chartered Institute of Bankers, UK.

DESHABANDU A M DE S JAYARATNE - DIRECTOR

Deshabandu Ajit Jayaratne retired after many years of service as Chairman of Forbes and Walker Limited. He joined the Board of Directors of DFCC Bank in September 2005.

Currently, Mr Jayaratne serves on the Boards of several public companies. Mr Jayaratne has served as Chairman of the Colombo Stock Exchange, the Ceylon Chamber of Commerce and the Finance Commission. Recently, he served as Sri Lanka's High Commissioner to Singapore.

Mr Jayaratne is a Chartered Accountant by profession and holds a Degree in Economics.



G KARUNARATNE - DIRECTOR

Mr Gamini Karunaratne is a senior banker with over 40 years experience in the industry and held the position of Senior Deputy General Manager - International and Investment Banking at Hatton National Bank Limited until his retirement in 2006. He was appointed to the Board of DFCC Bank in June 2006.

Mr Karunaratne is a former Director of HNB Securities Limited and HNB Stockbrokers (Pvt) Limited and a founder Past President of the Sri Lanka Forex Association. He served as a member of the Consultative Committee of the Central Bank of Sri Lanka on Development and Financial Markets in Sri Lanka.

Mr Karunaratne, a Fellow of the Chartered Management Institute, UK was the immediate Past President of the Sri Lanka Branch of the Chartered Management Institute, UK.

S N P PALIHENA - DIRECTOR

Mr S N P Palihena is the former General Manager of the Bank of Ceylon. He has had a distinguished banking career extending to almost 39 years at the Bank of Ceylon. He joined the Board of DFCC Bank in October 2002.

Mr Palihena has wide experience in all aspects of commercial banking, having headed important business units of the Bank of Ceylon. He has also worked at the National Development Bank of Sri Lanka for a period of two and a half years.

He is a Fellow of the Chartered Institute of Bankers, UK and a Fellow of the Institute of Bankers, Sri Lanka. He holds a Postgraduate Diploma in Business and Finance Administration.

C P R PERERA - DIRECTOR

Mr Chrisantha Perera retired as Chairman/CEO of Forbes & Walker in June 2005 after a career spanning 44 years. He was appointed to the Board of DFCC Bank in July 2005.

Mr Perera currently serves on the Committee of the Ceylon Chamber of Commerce and is a Director of the Sri Lanka Business Development Centre. He is also on the Boards of two Plantation Companies and their respective Holding Companies and is the Chairman of Avondale Tea Factories (Pvt) Limited. He is a serving Committee Member of the Hill Club, Nuwara Eliya and the Colombo Rowing Club.

Mr Perera was a former Chairman of the Bank of Ceylon, Sri Lanka Insurance Corporation Limited, Sri Lanka Tea Board and the Public Enterprises Reform Commission (PERC).

D S WEERAKKODY - DIRECTOR

Mr Dinesh Weerakkody was a former Chairman/CEO of the Employees' Trust Fund Board, Sri Lanka and Advisor to the Prime Minister of Sri Lanka from January 2003 to April 2004. He was appointed to the Board of DFCC Bank in June 2003.

Mr Weerakkody was the Director, Human Resources of GlaxoSmithKline, Sri Lanka from January 1998 to November 2005. He is currently the Managing Director of Cornucopia Sri Lanka and a Director of GlaxoSmithKline Sri Lanka and Commercial Bank of Ceylon Limited.

Mr Weerakkody is an eminent writer and a leading economic commentator who holds a Master's Degree in Business Administration from the University of Leicester, England. He is an Associate of the Chartered Institute of Management Accountants (CIMA), UK. He is also a council member of CIMA, Sri Lanka Division. He has received extensive training at the Institute of World Affairs in the USA and Matsushita Institute of Government and Management in Japan.

MANAGEMENT TEAM

Nihal Fonseka
General Manager/Director & Chief Executive Officer
BSc FCIB (UK)

LENDING

H A Ariyaratne
Executive Vice President - Lending
BSc.

Tyrone de Silva
Senior Vice President - Corporate & Investment Banking
CEI MBA

Chandana Dharmawardana
Vice President - Corporate Banking
BSc (Eng.) MIESL

Roshan Jayasekara
Vice President - Corporate Banking
ACMA

Renuka Amarasinghe
Assistant Vice President - Corporate Banking
LLB Attorney-at-Law

Ananda Kumaradasa
Vice President - Branch Credit
BSc ACMA

Bhathiya Alahakoon
Vice President - Leasing
BSc (Eng.)

Prasad Dharmaratne
Vice President /Manager (Ratnapura Branch)
BSc. (Eng.)

Samarakodi Godakanda
Vice President/Manager (Kandy Branch)
BSc. (Agri.)

Chanaka Kariyawasam
Vice President/Manager (Matara Branch)
BSc. (Pb. Admn.)

Prasanna Premaratne
Vice President/Manager (Gampaha Branch)
MSc. (Agri.) PGD in Bank Mgmt

Priyadarsana Sooriya Bandara
Vice President/Manager
(Kurunegala Branch)
BSc. (Bs. Admn.) MBA ACMA ACCA

Dharmasiri Wickramatilaka
Vice President/Manager (Colombo Office)
BSc. (Eng.) MBA ACMA

Terrence Etugala
Assistant Vice President/Manager (Badulla Branch)
BSc. (Acct.)

Kusumsiri Sathkumara
Assistant Vice President/Manager (Anuradhapura Branch)
BA (Econ.)

Champal de Costa
Assistant Vice President - Leasing (Colombo Office)
BSc. (Eng.) MBA MIESL CEng

Bandula Gamarachchi
Assistant Vice President - Accounting & Administration (Colombo Office)
ACMA

Ruwangani Jayasundera
Assistant Vice President - Credit (Colombo Office)
ACMA MBA

Stanislaus Rayen
Assistant Vice President - Credit (Colombo Office)
BSc. (Eng.) MBA MIESL

Kapila Samarasinghe
Assistant Vice President - Credit (Colombo Office)
BSc. (Eng.) MSc. (Eng.)

Neeta Sooriarachchi
Assistant Vice President - Refinance
BSc. (Est. Mgmt.) MSc. (Agri.) ACCA

INVESTMENT BANKING

Tyrone de Silva
Senior Vice President - Corporate & Investment Banking
CEI MBA

HUMAN RESOURCES & SPECIAL LOANS ADMINISTRATION

Dayantha De Mel
Executive Vice President - Human Resources & SLA
ACMA MBA

Nanediri Karunasinghe
Vice President
Restructuring & Recoveries
BSc. (Eng.) MPhil. (Eng.) ACMA

Jayani Amarasiri
Group Vice President - HR Operations & Resourcing
BA. (Econ.) MBA

Asoka Tennekoon
Group Vice President - Human Resources
BSc. (Eng.) ME (Agri.) PGD in HR

Sonali Jayasinghe
Group Assistant Vice President - Training & Talent Mgmt
BA (Bs & Econ.)

Patabendi Premaratne
Assistant Vice President – Relief Duties
BSc. (Eng.)

TREASURY

Manohari Gunawardhena
Senior Vice President - Treasury
BSc. MBA

FINANCE

S Nagarajah
Executive Vice President - Finance
FCMA FCA FACCA

Chinthika Amarasekara
Vice President - Accounting & Reporting
ACA

Suraj De Silva
Vice President - Financial Analysis & Asset/Liability Management
BCom. MBA FCMA

OPERATIONS

Anomie Withana
Senior Vice President - Operations
FCMA FCA MBA

Chaminda Gunawardana
Assistant Vice President - Transaction Processing
BSc. MBA

Chanaka Kalansuriya
Assistant Vice President - Office Management
MBA

Duleep Mahatantila
Assistant Vice President - Loan Administration
BA (Acct. & Econ.) PGD in Law Barrister of Law

Sriyani Ranatunga
Assistant Vice President - Lease Administration
FCMA MBA

INFORMATION TECHNOLOGY

Dinesh Fernandopulle
Group Chief Information Officer
BSc. MSc.

Neville Fernando
Vice President - Core Banking Project
BSc. ACMA

Guptani Gunasekera
Vice President - Network & Technical Services
BSc. DCSD (NIBM) MBCS

Channa Jasenthuliyana
Assistant Vice President - IT/Application Systems
DCSD (NIBM) MSc. (IT) MBCS

Tilak Nissanga
Assistant Vice President - Core Banking Project
DCSD (NIBM) MSc. (IT)

LEGAL AND SECRETARIAL

Thusantha Wijemanna
Senior Vice President - General Counsel
LLB LLM Attorney-at-Law

Visaka Sriskantha
Vice President - Legal
BA Attorney-at-Law

AUDIT

Mala Goonatilake
Assistant Vice President - Internal Audit
FCA

CORPORATE COMMUNICATIONS

Rosheeni Madanayake Wijesekera
Assistant Vice President - Corporate Communications
BA PGD in Bs. Admn

PROJECT MANAGEMENT

Jayantha Nagendran
Senior Vice President - Project Management
BSc. (Eng.) MBA CEng MIMechE FCMA

Kapila Subasinghe
Assistant Vice President - Project Management
BSc. (Eng.) ACMA

SECONDMENTS

Lakshman Silva
Senior Vice President on secondment to DFCC Vardhana Bank Limited as Chief Operating Officer
BCom. MBA

Palitha Gamage
Vice President on secondment to DFCC Vardhana Bank Limited as Head of Corporate Credit
BSc. (Eng.) MBA ACMA

Jayangani Perera
Assistant Vice President on secondment to Trade Finance Department, DFCC Vardhana Bank Limited
BCom

Management Team as at May 2007 with Names in alphabetical order within each grade.

CORPORATE GOVERNANCE

DFCC Bank is conscious of its responsibility to its shareholders and other stakeholders and has always practised good Corporate Governance in order to gain investor confidence and to balance the interests of all stakeholders. In deciding on the principles of good Corporate Governance, the Bank has considered the guidelines issued by the Central Bank of Sri Lanka, the Basel Committee recommendations on Corporate Governance and the listing rules issued by the Colombo Stock Exchange. The Bank is in compliance with most requirements of mandatory corporate governance rules of the Colombo Stock Exchange that become effective in April 2008 and is working towards full compliance by that time.

BOARD OF DIRECTORS

Except for the General Manager, who is the Chief Executive Officer and an Ex-Officio Director of the Bank, all the other Directors are Non-Executive Directors. Of the Non-Executive Directors other than the Government appointed Director, who is presently a senior official of the Central Bank of Sri Lanka, the other Directors are Shareholder Directors. All Shareholder Directors are elected by the shareholders. Casual vacancies arising on the Board are filled based on the recommendations of the Board Sub-committee on Nominations. Every year, the most senior elected Shareholder Director retires and if he/she is eligible can seek re-election.

When recommending the election of a Director to shareholders, the Board takes into consideration the interest of all stakeholders of the Bank and the skills required for an effective Board. Presently, there are three Directors originally proposed by shareholders who own more than 10% of the Bank's equity but subsequently elected by shareholders without dissent. The Government Director facilitates the relationship between the Bank and the Government, which issues guarantees on behalf of the Bank for borrowing from bilateral and multilateral agencies. Four Shareholder Directors represent the small shareholders of the Bank.

In addition to the Directions issued by the Central Bank of Sri Lanka with regard to granting facilities to Directors of the Bank, no Director or an entity in which he is a Director, is permitted to obtain financial facilities from the Bank unless such facility is unanimously approved by the remaining Directors. All Directors of the Bank and the Chairman, who is elected for a period of three years by the fellow Directors, have been approved by the Regulator as persons who are *fit and proper* to hold office.

BOARD SUB-COMMITTEES

The Board of Directors being conscious of their obligations to the stakeholders of the Bank and in order to focus better attention on the affairs of the Bank, in keeping with the regulatory requirements, have appointed sub-committees of the Board on the subjects of Credit, Audit, Remuneration and Nominations. When selecting members to each of these sub-committees, the Board gives consideration to the expertise of the individuals in order to harness the maximum benefit to the Bank. The Credit Sub-Committee conducts its business through circulation and tele conferencing when required. The Audit Sub-Committee of the Board meets regularly while the other two Sub-Committees meet as and when necessary. In addition to the Directors, the Bank also invites experts on the subject to participate as advisors to the sub-committees. The Chairmen and members of the Sub-Committees are Non-Executive Directors. The composition of the sub-committees are given below:

NAME OF DIRECTOR	AUDIT*	CREDIT	STAFF REMUNERATION*	NOMINATIONS
J M S BRITO			• ✓	• ✓
A N FONSEKA		✓		
T CAGLAYAN				
MRS M A R C COORAY		• ✓		
A M DE S JAYARATNE	• ✓			
G P KARUNARATNE		✓		
S N P PALIHENA	✓			
C P R PERERA			✓	✓
D S WEERAKKODY	✓		✓	✓

• *Chairperson*

* *Mr Tissa Bandaranayake, Partner, Ernst & Young, Colombo is an Advisor to the Audit Sub-Committee and Mr R T Wijetilleke, Chairman, Hatton National Bank Limited is an Advisor to the Remuneration Sub-Committee. They attend meetings by invitation.*

BOARD MEETINGS

The Directors meet at least once a month in order to attend to the regular business of the Board. In addition they also meet to approve special matters such as the Business Plan and Budget of the Bank and its key subsidiaries.

At the monthly meetings of Directors, which are scheduled at the beginning of each year, the Board discuss matters listed in the Agenda including approval of advances above the limits delegated to management. The Board Papers pertaining to the meetings are circulated at least five days prior to the meeting to enable the Directors to study them carefully before attending the meeting.

Last year the Board held 13 Board Meetings, 5 Audit Sub-Committee meetings and 2 Remuneration Sub-Committee meetings. The Credit Sub-Committee regularly transacts its business by circulation.

MANAGEMENT

The Management of the Bank is headed by the General Manger/CEO supported by a team of professional managers. The Non-Executive Directors are not involved in the day-to-day management of the Bank. They decide the policies pertaining to recruitment, reward and career advancement so that qualified and experienced staff are appointed to the management positions.

TRANSPARENCY

To ensure shareholder transparency in the functioning of the Bank, the Bank issues the annual report to shareholders annually. The quarterly financial performance is communicated to the public and to shareholders through the website of the Bank, released to the Colombo Stock Exchange and published in all three languages in the national press. The Bank maintains a detailed easy-to-access website which disseminates up-to-date information on the progress of the Bank.

COMPLIANCE

A regular quarterly Compliance Report is submitted to the Board of Directors by the Compliance Officer who is an Executive Vice President. The report provides affirmative assurance on conforming with legal and regulatory requirements and highlights any deviation. The Bank strongly supports the culture of compliance by its staff.

Prior to the recent introduction of the KYC (Know Your Customer) policy by the regulator and introduction of Anti-Money Laundering Legislation, the Bank adopted a KYC policy in order to ensure the compliance with international anti-money laundering regulations relating to terrorism.

DIRECTORS' REPORT

The Directors have pleasure in submitting their Report and audited accounts of DFCC Bank for the year ended 31 March 2007.

REVIEW OF BUSINESS AND OPERATIONS

The Chairman's Statement, the Chief Executive's Report and the Management Discussion and Analysis give a detailed description of the operations of DFCC Bank during the year under review.

PRINCIPAL ACTIVITIES

The principal activities of DFCC Bank include the business of development financing and investment banking services. There has been no significant change in the nature of DFCC Bank's principal activities during the year. The activities of the associate and subsidiary companies of DFCC Bank are given in page 62 of the Report under Associate and Subsidiary Companies.

RISK AND INTERNAL CONTROL

The Board of Directors has satisfied itself that there exists an effective and comprehensive system of internal controls to monitor, control and manage the risks to which the Bank is exposed, to carry on its business in an orderly manner, to safeguard the assets and to secure as far as possible the reliability and accuracy of the records.

PROFITS AND APPROPRIATIONS

	RS MILLION
YEAR ENDED 31.03.2007	
PROFIT BEFORE INCOME TAX (EXCLUDING SUBSIDIARIES AND ASSOCIATES)	1,865
INCOME TAX ON PROFIT	740
PROFIT AFTER INCOME TAX	1,125
APPROPRIATIONS MADE BY DIRECTORS:	
STATUTORY RESERVE FUND	60
SINKING FUND	541
AVAILABLE FOR DIVIDEND DISTRIBUTION	524
INTERIM DIVIDEND OF 45% PAID ON 20 MARCH 2007	389
FINAL DIVIDEND OF 5% PROPOSED	65
RETAINED PROFIT TO BE CARRIED FORWARD	70

CAPITAL EXPENDITURE

The total expenditure on the acquisition of property and equipment during the year amounted to Rs95 million. The details of property and equipment are shown in Note 39 to the financial statements.

RESERVES

Total reserves augmented by the annual appropriation and retained profit amounted to Rs8,628 million.

SHARE CAPITAL AND SUBORDINATED DEBENTURES

With the options exercised by the employees during this financial year, the total share capital as at 31 March 2007 is Rs865,565,370/- and it consists of 86,556,537 shares of Rs10/- each. Further information is given on page 98.

The Bank also raised Rs2 billion through the issue of Unsecured Subordinated Redeemable Debentures of Rs1,000/- each with maturities ranging from 5 to 10 years. The funds used from these debentures have been used to fund the normal business activities of the Bank. These debentures also qualify as Tier II regulatory capital with a progressive reduction in the amount that so qualifies, during the last four years left to maturity.

RIGHTS ISSUE AND BONUS ISSUE

At an Extraordinary General Meeting held on 30.06.2006 Shareholders approved a Bonus Issue of one for every two shares held which was allotted to shareholders on 21.07.2006.

At an Extraordinary General Meeting held on 27 April 2007, shareholders approval was obtained for the first time after 1993, for a Rights Issue of one share for every four shares held at Rs140/- per share and a Bonus Issue of one share for every five shares held on the enhanced capital of the Bank after the Rights Issue.

This additional Capital of about Rs3,030 million was sought to support the Bank's business expansion plans, Balance Sheet growth, maintaining the Capital Adequacy Ratio (CAR) above 12% in the light of recent and anticipated regulatory requirements, while subscribing Rs1,603 million to take up in full, the Bank's share of the Rights Issue of the Bank's associate company, Commercial Bank of Ceylon Limited (CBC). The Rights issue of DFCC Bank, which closed on 28 May 2007, was fully subscribed.

Details pertaining to the Rights Issue and Bonus Issues are included in the note on Post Balance Sheet events in page 117.

SHAREHOLDING

As at 31 March 2007 there were 7,207 registered shareholders and the distribution is indicated on page 126. The twenty largest shareholders as at 31 March 2007 are listed on page 127 of the Annual Report.

EMPLOYMENT

It is the policy of the Bank to maintain a dedicated and highly motivated team committed to the achievement of excellence in service. Having evaluated the skills required for each position, the Bank continuously invests in training and development of staff, while encouraging their participation in the business and social activities of the Bank. The Bank is an equal opportunity employer.

EMPLOYEE SHARE OPTION PLAN

Details of the Employee Share Option Plan (ESOP) and the movement in Options granted are given in Note 51.3 to the financial statements. The remaining Options were awarded during the year and the ESOP approved by shareholders was closed. The Directors intend to consider and recommend a new ESOP for the approval of shareholders at a future date.

DIRECTORS

The following were Directors of DFCC Bank during the year ended 31 March 2007:

BRITO, J M S	CHAIRMAN
CAGLAYAN, T	DIRECTOR [MR R DALCHOW APPOINTED ON 27-09-06 AS ALTERNATE DIRECTOR]
COORAY, MRS M A R C	GOVERNMENT DIRECTOR
FONSEKA, A N	EX-OFFICIO DIRECTOR
JAYARATNE, A M DE S	DIRECTOR
KARUNARATNE, G P	DIRECTOR
PALIHENA,S N P	DIRECTOR
PERERA, C P R	DIRECTOR
WEERAKKODY, D S	DIRECTOR

The Director retiring by rotation in terms of Regulation No. 85 of the DFCC Regulations is Mr D S Weerakkody who, being eligible, offers himself for re-election under the said Regulations with the unanimous support of the Directors.

DIRECTORS' INTERESTS IN SHARES AND DEBENTURES

	NO. OF SHARES* AS AT 31 MARCH 2007	NO. OF SHARES* AS AT 31 MARCH 2006
BRITO, J M S	2,250	1,500
CAGLAYAN, T	NIL	NIL
COORAY, MRS M A R C	NIL	NIL
FONSEKA, A N	16,575	10,122
JAYARATNE, A M DE S	500	NIL
KARUNARATNE, G P	8,750	–
PALIHENA, S N P	NIL	NIL
PERERA, C P R	3,000	2,000
WEERAKKODY, D S	750	500

* *Directors' shareholding includes shares held by the spouse and children under 18 years of age*

There has been no change in their interests between 31 March 2007 and the date of this Report except for allotments arising from the Rights Issue.

Ex-officio Director, Mr A N Fonseka in his capacity as Chief Executive has been awarded Options on shares under the ESOP. He held 140,781 Options as at 31 March 2007 (116,044 on 31 March 2006). He has exercised Options on 44,621 shares during the financial year 2006/07. 11,336 new Options were awarded to him during the financial year 2006/7. The other Directors do not participate in the ESOP.

No Directors directly or indirectly hold debentures of DFCC Bank.

DIRECTORS' INTERESTS IN CONTRACTS

Directors' interests in contracts with DFCC Bank, both direct and indirect, are declared in Note .. to the financial statements. These interests have been declared at Directors' meetings.

STATUTORY PAYMENTS

The Directors, to the best of their knowledge and belief are satisfied that all statutory payments due to the Government and in relation to the employees have been made in time.

COMPLIANCE WITH LAWS AND REGULATIONS

The Bank has not engaged in any activities contravening the laws and regulations. The Directors obtain quarterly confirmation from Management with regard to compliance with laws and regulations.

GOING CONCERN

The Directors are satisfied that the Bank has adequate resources to continue its operations in the foreseeable future. Accordingly, the financial statements are prepared on the going concern basis.

DIVIDEND

The Directors declared an interim dividend of 45 % (Rs4.50 per share) which was paid on 30 March 2007. The Directors have recommended to shareholders the payment of a final dividend of 5% (Rs0.50 per share) to be paid on the enlarged capital of the Bank after the conclusion of the Rights and Bonus Issues.

In recommending the payment of this dividend, the Directors unanimously declare that, in their opinion, the Bank will satisfy the solvency test stipulated in Section 57 of the Companies Act No 7 of 2007 immediately after the distribution is made and have obtained a certificate of solvency from the auditors to this effect.

CORPORATE GOVERNANCE

Systems and Procedures are in place to ensure that corporate governance is properly practised. Details in this regard are given in pages 43 to 45. Necessary steps will be taken to comply with the mandatory requirements of the Colombo Stock Exchange that come into force in April 2008.

POST BALANCE SHEET EVENTS

Subsequent to the date of the Balance Sheet no circumstances have arisen which would require adjustments to or disclosure in the accounts. Significant events, which in the opinion of Directors require disclosure, are described in Note 62 on page 117.

RE-APPOINTMENT OF AUDITORS

Messrs. KPMG Ford, Rhodes, Thornton & Company have expressed their willingness to continue in office as auditors of DFCC Bank for the year ending 31 December 2007. A Resolution pertaining to their re-appointment and authorising the Directors to determine their remuneration will be proposed at the Annual General Meeting.

By Order of the Board

T WIJEMANNA
Secretary to the Board

28 May 2007

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INTERIM REPORTS

FIRST QUARTER TO	30.06.06	:	30.08.06
SECOND QUARTER TO	30.09.06	:	24.11.06
THIRD QUARTER TO	31.12.06	:	27.02.07
ANNUAL REPORT YEAR ENDED	31.03.07	:	28.05.07

MEETINGS

50TH ANNUAL GENERAL MEETING	:	30.06.06
51ST ANNUAL GENERAL MEETING	:	29.06.07

DIVIDENDS

FIRST AND FINAL FOR YEAR ENDED 31.03.2006

APPROVED ON	:	30.06.06
EX-DIVIDEND DATE	:	20.06.06
PAYMENT	:	30.06.06

INTERIM FOR YEAR ENDED 31.03.2007

APPROVED ON	:	28.02.07
EX-DIVIDEND DATE	:	20.03.07
PAYMENT	:	30.03.07

PROPOSED FINAL FOR YEAR ENDED 31.03.2007

TO BE APPROVED ON	:	29.06.07

AUDIT COMMITTEE REPORT

The audit committee comprises of three non-executive directors of the bank with the head of internal audit functioning as the secretary. A practising chartered accountant functions as advisor to the committee. The general manager/CEO, Executive Vice President (Finance) and the external auditors attend the committee meetings by invitation.

The audit committee is empowered to examine the adequacy and effectiveness of internal control systems, review the statutory accounts and published financial statements, assess compliance with regulatory requirements, consider contents of internal audit reports and recommend appointment and remuneration of the external auditors.

During the financial year ended 31 March 2007 five audit committee meetings were held. Proceedings of the audit committee meetings are reported regularly to the Board.

Together with the other board members, the audit committee reviewed the bank's interim and annual financial statements and approved them for publication.

The audit committee met with the external auditors to review the management letter, together with management's response thereto and also met at the time of the annual audit.

With the concurrence of the board, the audit committee has enlisted the services of a firm of chartered accountants to supplement the bank's internal audit function in carrying out periodic audits at the Colombo office, Outstation branches and sub-offices. Representatives from the audit firm are invited to the audit committee meetings convened to discuss their reports.

The audit committee also provides a forum for the review of internal audit reports and consideration of findings, recommendations and corrective action taken by management to overcome the noted deficiencies, with a view to managing significant business risks and improving controls. Department/unit heads are called in when their reports are discussed.

The committee is of the view that adequate controls and procedures are in place to provide reasonable assurance that the bank's assets are safeguarded and the financial position of the bank is well monitored.

The audit committee has recommended to the board of directors that, M/s. KPMG Ford, Rhodes, Thornton & Co. be re-appointed as auditors for the year to 31 March 2008, subject to the approval of shareholders at the next annual general meeting.

Ajit Jayaratne
Chairman - Audit Committee

28 May 2007

STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RELATION TO FINANCIAL STATEMENTS

The Auditor's Report sets out the respective responsibilities of the Directors and Auditors relating to the financial statements and this statement provides additional information.

The Directors are required by relevant statutory provisions to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Bank and the Group for that period. The statutory provisions are in DFCC Bank Act No. 35 of 1955, read in conjunction with Banking Act No. 30 of 1988 and amendments thereto and Companies Act No. 17 of 1982. The Directors are satisfied that the Bank and Group have the resources to continue in business for the foreseeable future and therefore, these financial statements are prepared on a going concern basis.

The Directors consider that, these financial statements have been prepared using appropriate accounting policies, consistently applied, and supported by reasonable and prudent judgement and estimates and in compliance with applicable Sri Lanka Accounting Standards. Any change to accounting policies and reasons for such change, is disclosed in the "Notes to the Financial Statements".

The Directors are responsible for keeping proper accounting records and to take reasonable steps as far as practicable, to ensure the accuracy and reliability of accounting records, to enable the preparation of financial statements. The Directors have a general responsibility to take reasonable steps to safeguard the assets of the Bank.

In discharging this responsibility, the Directors have instituted a system of internal financial controls and a system for monitoring its effectiveness. The system of controls provide reasonable and not absolute assurance of safeguarding of Bank's assets, maintenance of proper accounting records and the reliability of financial information.

By Order of the Board

T Wijemanna
Secretary to the Board

28 May 2007

AUDITORS' REPORT

KPMG Ford, Rhodes, Thornton & Co.
(Chartered Accountants)
32A, Sir Mohamed Macan Markar Mawatha,
P. O. Box 186,
Colombo 00300,
Sri Lanka.

Tel : +94 - 11 242 6426
Fax : +94 - 11 244 5872
+94 - 11 244 6058
+94 - 11 254 1249
Internet : www.lk.kpmg.com

TO THE MEMBERS OF DFCC BANK

We have audited the balance sheet of DFCC Bank as at 31 March 2007, the consolidated balance sheet of the Bank and its subsidiaries as at that date, and the related statements of income, changes in equity and cash flows for the year then ended, together with the accounting policies and notes exhibited on pages 61 to 118 of the Annual Report.

Respective Responsibilities of Directors and Auditors

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

Basis of Opinion

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

Opinion

In our opinion, so far as appears from our examination, the Bank maintained proper books of account for the year ended 31 March 2007, and to the best of our information and according to the explanations given to us, the said balance sheet and related statements of income, changes in equity and cash flows and the accounting policies and notes thereto, which are in agreement with the said books and have been prepared and presented in accordance with the Sri Lanka Accounting Standards, provide the information required by the DFCC Bank Act No. 35 of 1955 and the Banking Act No. 30 of 1988 as amended by the Banking (Amendment) Act No. 33 of 1995 and amendments thereto, and give a true and fair view of the Bank's state of affairs as at 31 March 2007, and of its profit and cash flows for the year then ended.

In our opinion, the consolidated balance sheet and statements of income, changes in equity and cash flows and the accounting policies and notes thereto have been properly prepared and presented in accordance with the Sri Lanka Accounting Standards and the Banking Act No. 30 of 1988 as amended by the Banking (Amendment) Act No. 33 of 1995 and amedments thereto, and give a true and fair view of the state of affairs as at 31 March 2007, and the profit and cash flows for the year then ended of the Bank and its subsidiaries dealt with thereby, so far as concerns the members of the Bank.

Directors' Interests in Contracts with the Company

According to the information made available to us, the directors of the Bank were not directly or indirectly interested in contracts with the Bank during the year ended 31 March 2007, except as stated in Note 59 to these financial statements.

Ford Rhodes Thornton & Co

Chartered Accountants
Colombo.
28 May 2007

INCOME STATEMENT

For the year ended 31 March	Notes	Page No.	Bank 2007 Rs 000	Bank 2006 Rs 000	Group 2007 Rs 000	Group 2006 Rs 000	*Variance Rs 000
Income	12	79	**6,886,510**	5,386,777	**8,266,523**	6,254,851	2,011,672
Interest income	13	79	**6,017,561**	4,507,591	**7,021,075**	5,075,939	1,945,136
Interest expense	14	79	**3,537,392**	2,376,297	**4,042,054**	2,640,931	1,401,123
Net interest income			**2,480,169**	2,131,294	**2,979,021**	2,435,008	544,013
Negative goodwill			**0**	0	**494**	2,096	(1,602)
Other income	15	80	**868,949**	879,186	**1,245,448**	1,178,912	66,536
Operating income			**3,349,118**	3,010,480	**4,224,963**	3,616,016	608,947
Personnel costs			**518,077**	433,692	**673,066**	558,683	114,383
Provision for staff retirement benefits	16	80	**93,584**	89,614	**93,584**	89,614	3,970
Premises, equipment and establishment expenses			**248,515**	220,075	**386,686**	329,889	56,797
Other overhead expenses			**214,726**	155,441	**306,190**	237,048	69,142
Value added tax on financial services			**372,607**	269,775	**429,039**	296,337	132,702
Goodwill written off - associate			**0**	0	**0**	2,321	(2,321)
- subsidiary			**0**	0	**0**	57,250	(57,250)
Allowances for credit losses - specific	17	82	**(20,327)**	157,001	**41,327**	154,170	(112,843)
- general	18	82	**41,963**	11,044	**41,605**	22,978	18,627
Investments - impairment losses	19	82	**14,680**	21,470	**14,665**	27,092	(12,427)
Operating expenses	20	82	**1,483,825**	1,358,112	**1,986,162**	1,775,382	210,780
Operating profit before income tax			**1,865,293**	1,652,368	**2,238,801**	1,840,634	398,167
Associate companies' profit before income tax			**0**	0	**959,350**	881,888	77,462
Profit before tax			**1,865,293**	1,652,368	**3,198,151**	2,722,522	475,629
Income tax expense	21	83	**740,332**	471,884	**1,505,387**	965,457	539,930
Profit after tax			**1,124,961**	1,180,484	**1,692,764**	1,757,065	(64,301)
Attributable to:							
Equity holders of the Bank			**1,124,961**	1,180,484	**1,585,644**	1,689,765	(104,121)
Minority interests			**0**	0	**107,120**	67,300	39,820
Profit for the year			**1,124,961**	1,180,484	**1,692,764**	1,757,065	(64,301)
Earnings per share - Basic, Rs	22	84	**13.01**	13.68	**18.34**	19.58	(1.24)
- Diluted, Rs			**12.90**	13.62	**18.19**	19.49	(1.30)
Dividend per share, Rs			**5.00**	6.00	**5.00**	6.00	(1.00)

Notes from pages 61 to 118 form part of these financial statements.

** Current year minus previous year, Group.*

BALANCE SHEET

As at 31 March	Notes	Page No.	Bank 2007 Rs 000	Bank 2006 Rs 000	Group 2007 Rs 000	Group 2006 Rs 000
Assets						
Cash and short-term funds	23	85	**4,506,177**	629,812	**5,971,176**	1,469,323
Balances with Central Bank			**0**	0	**768,018**	693,789
Treasury bills and other securities eligible for rediscounting with Central Bank	24	85	**3,429,498**	4,297,600	**3,825,547**	4,520,909
Securities purchased under resale agreements	25	85	**240,000**	519,569	**590,525**	796,959
Placements with and loans to other banks and financial institutions	26	86	**1,023,956**	737,533	**995,956**	865,533
Dealing securities	27	86	**26,072**	13,530	**26,072**	13,530
Bills of exchange discounted	28	87	**0**	0	**459,493**	70,073
Loans	29	87	**37,469,972**	30,215,430	**44,901,076**	35,090,859
Finance leases	30	88	**7,545,716**	5,361,796	**7,545,716**	5,361,796
Interest receivable	31	89	**609,887**	365,003	**587,109**	338,452
Investment securities	32	89	**1,260,439**	1,340,305	**1,758,081**	1,808,114
Investment in associate companies	33	97	**1,584,688**	1,579,603	**4,115,876**	3,749,323
Investment in subsidiary companies	34	98	**1,764,888**	1,477,310	**0**	0
Group balances receivable	35	98	**8,826**	8,139	**1,047**	516
Prepayments			**78,513**	111,673	**78,513**	111,673
Other receivables	36	98	**913,419**	461,897	**1,065,002**	615,996
Investment property	37	98	**6,500**	12,180	**131,833**	143,114
Goodwill on consolidation	38	99	**0**	0	**146,658**	146,658
Property and equipment	39	99	**392,509**	385,209	**574,171**	513,075
Intangible assets	40	100	**79,601**	95,948	**198,767**	95,948
Deferred tax asset	41	101	**0**	0	**137,490**	160,020
Total assets			**60,940,661**	47,612,537	**73,878,126**	56,565,660
Liabilities						
Deposits from customers	42	101	**13,572,571**	4,017,215	**20,816,684**	8,885,091
Borrowing - medium and long-term	43	101	**30,357,387**	28,383,769	**30,357,387**	28,383,769
- short-term	44	102	**1,539,772**	2,453,409	**2,825,102**	2,547,040
Debentures	45	102	**2,000,000**	2,000,000	**2,000,000**	2,000,000
Obligations under finance leases	46	102	**0**	393	**0**	393
Interest accrued			**847,652**	644,098	**1,012,549**	720,024
Current tax liability			**261,012**	218,758	**300,500**	268,892
Deferred tax liability	47	103	**363,842**	376,555	**363,843**	376,556
Other liabilities	48	103	**504,276**	427,481	**1,105,382**	1,202,552
Subordinated debentures	49	103	**2,000,000**	0	**2,000,000**	0
Total liabilities			**51,446,512**	38,521,678	**60,781,447**	44,384,317
Negative goodwill	50	103	**0**	0	**0**	1,263
Equity						
Share capital	51	104	**865,565**	575,908	**865,565**	575,908
Reserves	52	105				
Reserve fund			**425,000**	365,000	**548,841**	481,247
Sinking fund reserve			**3,372,664**	2,831,553	**3,372,664**	2,831,553
Share premium			**607,106**	883,376	**659,299**	935,569
Revenue reserves			**3,233,584**	3,233,584	**5,254,420**	5,172,454
Other reserves - Associate			**0**	0	**132,954**	(109,607)
Retained earnings			**990,230**	1,201,438	**1,708,205**	1,761,608
Shareholders' equity			**9,494,149**	9,090,859	**12,541,948**	11,648,732
Minority interests	53	105	**0**	0	**554,731**	531,348
Total equity			**9,494,149**	9,090,859	**13,096,679**	12,180,080
Total equity and liabilities			**60,940,661**	47,612,537	**73,878,126**	56,565,660
Commitments and contingencies	54	106	**11,229,998**	10,670,932	**16,704,913**	14,886,880
Net assets value per share, Rs			**109.69**	105.23	**144.90**	134.83

Notes from pages 61 to 118 form part of these financial statements.

For and on behalf of the Board of Directors,

JMS Brito

J M S Brito
Chairman

A N Fonseka
Director & Chief Executive

Colombo
28 May 2007

STATEMENT OF CHANGES IN EQUITY

For the year ended 31 March

	Share Capital Rs000	Reserve fund Rs000	Sinking fund Rs000	Share premium Rs000	Revenue reserve Rs000	Retained earnings Rs000	Total equity Rs000
Bank							
Balance on 31.03.2005	574,133	305,000	2,246,868	917,654	4,898,476	1,166,103	10,108,234
Changes in accounting policy (Note 8.3.1)	–	–	–	(52,193)	(1,664,892)	(184,567)	(1,901,652)
Balance on 31.03.2005 - Restated	574,133	305,000	2,246,868	865,461	3,233,584	981,536	8,206,582
Profit for the year	–	–	–	–	–	1,180,484	1,180,484
Transfers	–	60,000	584,685	–	–	(644,685)	–
First & final dividend approved on 30.06.2005	–	–	–	–	–	(315,897)	(315,897)
Issue of shares under share option scheme	1,775	–	–	17,915	–	–	19,690
Balance on 31.03.2006	575,908	365,000	2,831,553	883,376	3,233,584	1,201,438	9,090,859
Profit for the year						1,124,961	1,124,961
Transfers		60,000	541,111			(601,111)	–
First & final dividend approved on 30.06.2006						(345,574)	(345,574)
Interim dividend approved on 30.03.2007						(389,484)	(389,484)
Bonus issue of shares	287,978			(287,978)			
Issue of shares under share option scheme	1,679			11,708			13,387
Balance on 31.03.2007	**865,565**	**425,000**	**3,372,664**	**607,106**	**3,233,584**	**990,230**	**9,494,149**

	Attributable to Equity Holders of the Bank								Total	Minority interests	Total equity
						Other Reserves - Associate					
	Share Capital	Reserve fund	Sinking fund	Share premium	Revenue reserve	Capital redemption reserve	Foreign currency reserve	Retained earnings			
	Rs000	Rs000	Rs000	Rs000	Rs000	Rs000	Rs000	Rs000	Rs000	Rs000	Rs000
Group											
Balance on 31.03.2005	574,133	305,000	2,246,868	917,654	4,898,476	–	–	1,166,103	10,108,234	541,863	10,650,097
Change in accounting policy (Note 8.3.1)	–	–	–	–	–	–	–	165,819	165,819	8,361	174,180
Balance on 31.03.2005 - Restated	574,133	305,000	2,246,868	917,654	4,898,476	–	–	1,331,922	10,274,053	550,224	10,824,277
Profit for the year								1,689,765	1,689,765	67,300	1,757,065
Transfers		176,247	584,685		261,168			(1,022,100)	–	–	–
First & final dividend approved on 30.06.2005								(315,897)	(315,897)	(86,176)	(402,073)
Issue of shares under share option scheme	1,775			17,915					19,690	–	19,690
Balance on 31.03.2006	575,908	481,247	2,831,553	935,569	5,159,644	–	–	1,683,690	11,667,611	531,348	12,198,959
Change in accounting policy					12,810		(109,607)	77,918	(18,879)	–	(18,879)
Balance on 31.03.2006 - Restated	575,908	481,247	2,831,553	935,569	5,172,454	–	(109,607)	1,761,608	11,648,732	531,348	12,180,080
Derecognition of negative goodwill								1,263	1,263		1,263
Debenture issue expenses written off - associate company					(948)				(948)		(948)
Appreciation in the value of investment in Comtrust Equity Fund					32,092				32,092		32,092
- associate company									–		–
Currency translation gain/losses - Overseas operations - associate company							(3,164)		(3,164)		(3,164)
Net income recognised directly in equity	–	–	–	–	31,144	–	(3,164)	1,263	29,243	–	29,243
Profit for the year								1,585,644	1,585,644	107,120	1,692,764
Total recognised income and expenses for the period	–	–	–	–	31,144	–	(3,164)	1,586,907	1,614,887	107,120	1,722,007
Transfers		67,594	541,111		50,822	245,725		(905,252)	–		–
First & final dividends approved on 30.06.2006								(345,574)	(345,574)	(83,737)	(429,311)
Interim dividends approved on 30.03.2007								(389,484)	(389,484)	–	(389,484)
Bonus issue of shares	287,978			(287,978)					–	–	–
Issue of shares under share option scheme	1,679			11,708					13,387	–	13,387
Balance on 31.03.2007	865,565	548,841	3,372,664	659,299	5,254,420	245,725	(112,771)	1,708,205	12,541,948	554,731	13,096,679

Notes from pages 61 to 118 form part of these financial statements.

CASH FLOW STATEMENT

For the year ended 31 March	Bank		Group	
	2007	2006	**2007**	2006
	Rs 000	Rs 000	**Rs 000**	Rs 000
Cash flow from operating activities				
Interest receipts	**5,373,291**	3,945,681	**6,260,700**	4,434,077
Interest payments	**(3,333,838)**	(2,392,902)	**(3,749,529)**	(2,613,887)
Recoveries on loans previously written off	**182,639**	236,637	**182,639**	236,637
Receipts from other operating activities	**246,531**	203,008	**674,414**	501,628
Cash payments to employees and suppliers	**(971,713)**	(753,411)	**(1,255,680)**	(919,764)
Value added tax	**(306,316)**	(279,122)	**(386,013)**	(281,377)
Operating profit before changes in operating assets	**1,190,594**	959,891	**1,726,531**	1,357,314
(Increase)/decrease in operating assets:				
Short-term funds	**(1,200,060)**	687,876	**141,063**	284,592
Balances with Central Bank of Sri Lanka	**0**	0	**(74,229)**	(410,889)
Funds advanced to customers	**(9,429,184)**	(7,074,532)	**(12,136,544)**	(9,319,021)
Other short-term securities	**868,102**	(1,959,839)	**596,615**	(1,957,079)
Others	**(410,935)**	701,570	**(582,509)**	1,019,461
Increase/(decrease) in operating liabilities:				
Security deposits from customers	**(2,117)**	(6,138)	**(2,222)**	(5,135)
Deposits from customers	**9,581,623**	276,684	**11,712,983**	2,498,350
Negotiable certificates of deposit	**(26,267)**	(38,902)	**22,079**	(87,789)
Net cash flow from operating activities before income tax	**571,756**	(6,453,390)	**1,403,767**	(6,620,196)
Income tax paid	**(702,120)**	(492,605)	**(899,013)**	(524,346)
Net cash (used in)/from operating activities - (Note a)	**(130,364)**	(6,945,995)	**504,754**	(7,144,542)
Cash flow from investing activities				
Dividends received	**381,087**	251,880	**297,819**	188,115
Interest received	**379,594**	442,194	**459,511**	500,109
Proceeds from sale and redemption of securities	**231,383**	806,391	**360,485**	1,009,336
Purchase of securities	**(110,758)**	(269,001)	**(235,707)**	(415,931)
Investment in subsidiary - (DFCC Consulting (Pvt) Limited)	**0**	(5,000)	**0**	0
Disposal of subsidiary shares - (National Asset Management Limited)	**0**	68,310	**0**	68,310
Investment in additional shares of associate - National Assets Management Limited	**(5,085)**	0	**(5,085)**	0
Investment in additional shares of subsidiary - DFCC Vardhana Bank Limited	**(1,965)**	(6,619)	**0**	0
Subscription to rights issue in subsidiary - DFCC Vardhana Bank Limited	**(285,613)**	(472,259)	**0**	0
Purchase of property, equipment, intangibles and investment property	**(119,159)**	(129,929)	**(361,730)**	(182,836)
Proceeds from sale of equipment and investment property	**4,294**	7,589	**81,112**	7,822
Net cash from investing activities	**473,778**	693,556	**596,405**	1,174,925
Cash flow from financing activities				
Issue of debentures	**2,000,000**	500,000	**2,000,000**	500,000
Issue of new shares under option	**13,387**	19,690	**13,387**	19,690
Issue of new shares by subsidiary (rights issue)	**0**	0	**12,422**	21,123
Borrowing, medium and long-term	**9,626,080**	12,726,508	**9,626,080**	12,726,508
Repayment of borrowing, medium and long-term	**(7,652,462)**	(6,962,724)	**(7,652,462)**	(6,962,724)
Dividend paid	**(733,623)**	(313,993)	**(840,444)**	(385,603)
Net cash flow from financing activities	**3,253,382**	5,969,481	**3,158,983**	5,918,994
Net increase/(decrease) in cash & cash equivalents	**3,596,796**	(282,958)	**4,260,142**	(50,623)
Cash & cash equivalents/(overdraft - net) at the beginning of period (Restated)	**1,149,381**	1,432,339	**2,245,931**	2,392,809
Consolidation adjustment - National Asset Management Limited	**0**	0	**0**	(96,255)
Cash & cash equivalents at the end of period	**4,746,177**	1,149,381	**6,506,073**	2,245,931
Reconciliation of cash & cash equivalents				
Cash and short-term funds - Note 23	**4,506,177**	629,812	**5,971,176**	1,469,323
Securities purchased under resale agreements - Note 25	**240,000**	519,569	**590,525**	796,959
Borrowing, short-term - Bank overdrafts - Note 44	**0**	0	**(55,628)**	(20,351)
	4,746,177	1,149,381	**6,506,073**	2,245,931

The Cash Flow Statement of the Bank includes the results of associate/subsidiary companies only to the extent of the cash flows between Bank and respective companies as required by Sri Lanka Accounting Standards.

Comparative figures have been re-stated to conform to the period ended 31 March 2007 classification.

Notes from pages 61 to 118 or part of these financial statements.

CASH FLOW STATEMENT

Note a

Reconciliation of profit for the year to net cash (used in)/from operating activities

	Bank		Group	
For the year ended 31 March	**2007**	2006	**2007**	2006
	Rs 000	Rs 000	**Rs 000**	Rs 000
Profit for the year	**1,124,961**	1,180,484	**1,585,644**	1,689,765
Deduct: Dividend transferred to investing activities	**(373,574)**	(248,336)	**(290,306)**	(185,796)
	751,387	932,148	**1,295,338**	1,503,969
Add/(deduct) items not using (providing) cash:				
Depreciation - Property, equipment and investment property	**87,373**	78,846	**124,509**	133,779
- Intangible assets	**40,833**	40,740	**73,915**	40,740
Amortisation of negative goodwill	**–**	–	**(494)**	(2,096)
Gains on sale of investment securities	**(52,801)**	(182,112)	**(86,787)**	(219,578)
Gains from mark to market on dealing securities	**(9,500)**	(5,410)	**(9,500)**	(5,410)
Gain on sale of equipment and investment property	**(4,294)**	(3,658)	**(79,817)**	(3,878)
(Gain)/loss on deemed disposal of associate companies' shares	**–**	–	**2,389**	5,112
Notional tax credit on treasury bills and bonds	**(8,672)**	(44,216)	**(8,672)**	(44,216)
Associate companies profit before income tax	**–**	–	**(959,350)**	(881,888)
Allowances for credit losses	**21,636**	168,045	**82,932**	177,148
Investments - impairment losses	**14,680**	21,470	**14,665**	27,092
Minority interests	**0**	0	**107,120**	67,300
Increase in accounts receivables	**(635,207)**	(517,719)	**(676,076)**	(644,872)
Increase/(decrease) in accounts payables	**244,827**	(127)	**340,973**	179,084
Increase in income tax payable	**24,248**	64,588	**592,410**	585,991
Increase/(decrease) in deferred tax	**13,964**	(85,309)	**13,964**	(85,309)
Increase in operating assets	**(10,172,077)**	(7,644,925)	**(12,055,604)**	(10,382,936)
Increase/(decrease) in operating liabilities	**9,553,239**	231,644	**11,732,839**	2,405,426
Net cash (used in)/from operating activities	**(130,364)**	(6,945,995)	**504,754**	(7,144,542)

NOTES ON THE FINANCIAL STATEMENTS

1. General

1.1 Reporting Entity

DFCC Bank is a limited liability public company incorporated and domiciled in Sri Lanka. It was incorporated in 1955 under DFCC Act No. 35 of 1955. The Head Office is situated at 73/5, Galle Road, Colombo 3.

The Bank was incorporated under DFCC Act No. 35 of 1955 and therefore there was no requirement to register under the Companies Ordinance at the time of incorporation. Consequently, the address of the Head Office is not registered with the Registrar of Companies.

Ordinary shares of the Bank are listed in the Colombo Stock Exchange.

DFCC Bank's Group comprises five subsidiary companies viz., DFCC Consulting (Pvt) Limited, DFCC Stockbrokers (Pvt) Limited, DFCC Vardhana Bank Limited, Lanka Industrial Estates Limited and Lanka Ventures Limited. DFCC Bank has two associate companies viz., Commercial Bank of Ceylon Limited and National Asset Management Limited.

All subsidiary companies and associate companies have been incorporated under Companies Act No. 17 of 1982, having the following registered addresses:

Company	**Registered Address**
DFCC Consulting (Pvt) Limited (Private limited liability company)	DFCC Building 73/5, Galle Road Colombo 3
DFCC Stockbrokers (Pvt) Limited (Private limited liability company)	3rd Floor 73, W A D Ramanayake Mawatha Colombo 2
DFCC Vardhana Bank Limited (Public limited liability company)	73, W A D Ramanayake Mawatha Colombo 2
Lanka Industrial Estates Limited (Public limited liability company)	Pattiwila Road Sapugaskanda Makola
Lanka Ventures Limited (Public limited liability company) Ordinary shares listed in Colombo Stock Exchange	2nd Floor, Ceylon Ocean Lines Building 46/12, Navam Mawatha Colombo 2
Commercial Bank of Ceylon Limited (Public limited liability company) Ordinary shares listed in Colombo Stock Exchange	'Commercial House' 21, Bristol Street, Colombo 1
National Asset Management Limited (Public limited liability company)	2nd Floor, 73, W A D Ramanayake Mawatha Colombo 2

NOTES ON THE FINANCIAL STATEMENTS

1.2 Principal Activities

A summary of principal activities of DFCC Bank (the parent) its subsidiary companies and associate companies is as follows:

Company	Principal Activity
DFCC Bank	Financial products and services to industrial, agricultural and commercial enterprises in Sri Lanka.
DFCC Consulting (Pvt) Limited	Technical, financial and other professional consultancy services in Sri Lanka and abroad
DFCC Stockbrokers (Pvt) Limited	Securities broking
DFCC Vardhana Bank Limited	Commercial banking
Lanka Industrial Estates Limited	Leasing of land and buildings for industrial enterprises
Lanka Ventures Limited	Venture capital financing
Commercial Bank of Ceylon Limited	Commercial banking
National Asset Management Limited	Fund management

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

1.3 Approval of Financial Statements by Directors

The financial statements are authorised for issue by the Board of Directors on 28 May 2007.

1.4 Statement of Compliance with Sri Lanka Accounting Standards

The financial statements have been prepared in compliance with relevant Sri Lanka Accounting Standards adopted by the Institute of Chartered Accountants of Sri Lanka.

2. Consolidated and Separate Financial Statements

DFCC Bank as the parent of subsidiaries under its control is required to present only the consolidated financial statements with effect from the financial year to 31 March 2007 as per Sri Lanka Accounting Standard 26, on "Consolidated and Separate Financial Statements (Revised 2005)". In addition to the consolidated financial statements separate financial statements are also presented as per Banking Act No. 30 of 1988.

3. Basis of Preparation

The consolidated and separate financial statements of DFCC Bank are presented in Sri Lanka Rupees, the functional and presentation currency, rounded to the nearest thousand and unless otherwise stated herein have been prepared under the historical cost convention. Exceptions to the historical cost convention of accounting relate to dealing and investment securities. In the separate financial statements of the DFCC Bank, the investment in associates and subsidiaries are accounted on the basis of direct equity interest rather than on the basis of the reported results and net assets of the investees.

4. Basis of Consolidation

4.1 General

The consolidated financial statements are prepared by consistent application of consolidation procedures, which include amalgamation of the financial statements of the parent and subsidiaries and accounting for the investments in associate companies on the basis of reported results and net assets of the investee instead of the direct equity interest. Thus, the consolidated financial statements present financial information about the Group as a single economic entity.

4.2 Transactions Eliminated on Consolidation

Intra-group balances and transactions, including income, expenses and dividend are eliminated in full.

NOTES ON THE FINANCIAL STATEMENTS

4.3 Financial Statements of Subsidiaries and Associate Companies included in the Consolidated Financial Statements

Audited financial statements are used. All subsidiaries and associate companies included in the consolidation except DFCC Vardhana Bank Limited, DFCC Stockbrokers (Pvt) Limited and Commercial Bank of Ceylon Limited have financial year to 31 March in common with the Bank. The financial years of DFCC Vardhana Bank Limited, DFCC Stockbrokers (Pvt) Limited and Commercial Bank of Ceylon Limited end on 31 December and financial statements of these companies for year to 31 December 2006 have been included for consolidation and equity accounted respectively with appropriate adjustments for significant events between the two dates.

4.4 Significant Events and Transactions during the gap between date of Financial Statement of the Subsidiary/Associate Company and the date of Financial Statement of the Bank

Results of subsidiary/associate company is adjusted and disclosed for any such transactions.

4.5 Financial Statements used for Computation of Goodwill or Negative Goodwill on date of Acquisition

This is based on unaudited financial statements proximate to the date of acquisition.

4.6 Taxes on the Undistributed Earnings of Subsidiaries and Associate Companies

10% withholding tax applicable on the distribution of the undistributed earnings of the subsidiaries and associate companies have not been recognised as a tax expense in the financial statements of the Bank and the Group financial statements as such distribution is remote in the foreseeable future.

5. Scope of Consolidation

All subsidiaries have been consolidated.

Subsidiaries

Subsidiaries are those entities controlled by the Bank. Control exists when the Bank has the power, directly or indirectly, to govern the financial and operating policies of an entities so as to obtain benefits from its activities. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. Note 34 contains the financial information relating to subsidiaries.

Minority interests in subsidiaries are determined on the basis of proportionate equity in the subsidiaries owned by minority equity holders. The minority interests and the interest of the equity holders of the Bank are separately identified in the Consolidated Income Statement and Consolidated Balance Sheet.

Associate Companies

Associate companies are those enterprises in which the Bank has significant influence but not control over the financial and operating policies. The consolidated financial statements include the Bank's share of the total recognised gains and losses of the associate companies, on an equity accounted basis, from the date that significant influence commences until the date that significant influence ceases. Note 33 contains financial information relating to associate companies.

NOTES ON THE FINANCIAL STATEMENTS

6. Critical Accounting Estimates and Judgments

6.1 General

In the preparation of separate financial statements and consolidated financial statements the Bank makes judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses.

Estimates and underlying assumptions are reviewed on an ongoing basis. Changes to estimates in a subsequent financial year, if any, are normally recognised prospectively.

The following disclosures relate to judgements and future oriented estimates that have the most significant effect on the amount recognised in the financial statements.

6.2 Judgments and the Financial Impact

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

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

6.3 Accounting Estimates

6.3.1 Loan Losses

The assessment of loan loss as set out in Notes 17 and 18 involves considerable judgment and estimation. Judgment is required firstly to determine whether there are indications that a loss may already been incurred in individually significant loans and secondly to determine the recoverable amount.

For collectively assessed loans, the allowance for loan losses was 0.2% of performing and overdue loans and advances outstanding as at 31 March 2007, as per the direction issued by the Central Bank of Sri Lanka.

6.3.2 Pension Liability

The estimation of this liability determined by an independent, qualified actuary necessarily involves long-term assumptions on future changes to salaries, future income derived from pension assets, life expectancy of covered employees etc. Key assumptions are disclosed in Note 16.7.

The pension scheme is closed to new entrants recruited on or after 1 May 2004 and the basic pension and the survivor pension amount is frozen on the date of cessation of tenured employment. These risk mitigation strategies together with annual actuarial valuation and review of key assumptions tends to reduce the probability that the actual results will be significantly different from the estimate.

NOTES ON THE FINANCIAL STATEMENTS

6.3.3 Income Tax

The estimation of income tax liability includes interpretation of tax law and judgment on the allowance for losses on individually assessed loans. The estimation process by the Bank includes seeking expert advice where appropriate and the payment of the income tax liability is on self-assessment basis.

In the event an additional assessments is issued the additional income tax and deferred tax adjustment, if any, will be recognised in the period in which the assessment is issued.

6.3.4 Deferred Tax Asset arising from Unused Tax Losses

Bank's subsidiary, DFCC Vardhana Bank Limited as per Sri Lanka Accounting Standard 14 on "Income Tax (Revised 2005)", recognised for the first time the deferred tax asset arising from unused tax losses retrospectively from 1 January 2005. The recognition of tax asset arising from unused tax losses required the future estimation of the taxable profit of the subsidiary company to assess the absorption capacity for unused tax losses on 31 December 2006. In the event the future results of the subsidiary indicates the probability of a decline in taxable profits, the consequent impairment of deferred tax asset will be recognised in that period.

6.3.5 Impairment of Tangible and Intangible Assets

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

Impairment losses if any are charged to income statement immediately.

7. Recent Accounting Developments

The following Sri Lanka Accounting Standards (SLAS) have been revised and are applicable for the financial year to 31 March 2007:

SLAS Ref.	SLAS Title	Financial Impact on Accounting Policy
3	Presentation of Financial Statements	None
10	Accounting Policies, Changes to Accounting Estimates	None
12	Events after the Balance Sheet Date	None
14	Income Taxes	Change of accounting policy
18	Property, Plant & Equipment	None
19	Leases	None
21	The Effects of Changes in Foreign Exchange Rates	None
25	Business Combination	Change of accounting policy
26	Consolidated and Separate Financial Statements	Change of accounting policy
27	Accounting for Investments in Associates	Change of accounting policy
30	Related Party Disclosures	None
34	Earnings per Share	None
41	Impairment of Assets	Change of accounting policy

NOTES ON THE FINANCIAL STATEMENTS

8. Principal Accounting Policies

8.1 General

Accounting policies are the specific principles, bases, conventions, rules and practices applied consistently by the Bank in presenting and preparing the financial statements. Changes in accounting policies are made only if the Sri Lanka Accounting Standard requires such change or when a change results in providing more relevant information.

The impact of the change in accounting policy on the reported results or asset or liability and where appropriate on the earnings per share, basic and diluted have been disclosed in the notes under appropriate line item in the financial statement.

8.2 Changes in Accounting Policies

Relevant Accounting Policy	Nature of Change and Application	Reason for Change
Income taxes	Recognition of deferred asset arising from unused tax losses of subsidiaries and employee gratuity provision of the group applied retrospectively.	Revision to SLAS 14
Goodwill and negative goodwill on consolidation	No amortisation of goodwill on consolidation after 31 March 2006 and derecognition of unamortised residual goodwill on 31 March 2006 in equity. Change in policy applied prospectively.	Revision to SLAS 25 and 26
Accounting for investments in subsidiaries and associates	Change over from equity method of accounting to cost in the separate financial statements of the Bank, applied retrospectively.	Revision to SLAS 26 and 27
Impairment of assets	Recognition of impairment on investment in subsidiaries, associates, property and equipment, corporate assets, goodwill on consolidation etc. applied prospectively.	Revision to SLAS 41
Loan write off	Change over from writing off fully provided loans for accounting purposes only while retaining fully provided loans on the balance sheet until closure, applied prospectively.	Voluntary change to the option given in SLAS 23

NOTES ON THE FINANCIAL STATEMENTS

8.3 Summary Effect of Change in Accounting Policy on Financial Statements

8.3.1 Retrospective Application of Changes in Accounting Policy resulting in restatement of the earnings in prior years

	Rs000
Bank	
Reduction to previously reported reserves and retained earnings on 31 March 2005	1,849,459
Reduction in previously reported share premium on 31 March 2005	52,193
Prior year adjustment to equity as on 31 March 2005	1,901,652
Negative goodwill on 31 March 2006 transferred to equity	1,263
Reduction to previously reported profit after tax, year to 31 March 2006	523,031
Total reduction to previously reported reserves on 31 March 2006	2,425,946
Corresponding changes to asset or liability on 31 March 2006	
Reduction in carrying amount of :	
Investment in subsidiaries	237,972
Investment in associates	2,188,599
Deferred tax asset	
Recognition of deferred tax asset arising from end of service employee gratuity	(625)
	2,425,946

	Rs000
Group	
Increase in previously reported reserves and retained earnings on 31 March 2005	165,819
Reduction to previously reported reserves and retained earnings, year to 31 March 2006	(18,879)
Reduction to previously reported profit after tax attributable to equity holders of the Bank year to 31 March 2006	(13,750)
Total increase in previously reported reserves and retained earnings on 31 March 2006	133,190
Corresponding changes to asset or liability on 31 March 2006	
Reduction in carrying amount of:	
Investment in associates	(18,879)
Increase in income tax liability of subsidiary	(895)
Deferred tax: asset	
- re end of service employee gratuity	1,843
- re unused tax losses	158,802
Increase in minority interest	(7,681)
	133,190

	Basic EPS	Diluted EPS
Earnings per Share (EPS) Rs		
As previously reported in the year to 31 March 2006	29.62	29.42
Change due to restatement of profit after tax in year to 31 March 2006	(15.94)	(15.80)
Restated	13.68	13.62

8.3.2 Prospective Application of a change in Accounting Policy

8.3.2.1 The goodwill on consolidation is not amortised with effect from 1 April 2006 and is carried forward at the unamortised amount on 31 March 2006, reduced by accumulated impairment losses, if any.

8.3.2.2 The unamortised negative goodwill on 31 March 2006 is derecognised and dealt in the statement of changes in equity.

8.3.2.3 Fully provided loans remain on the balance sheet together with the full specific provision instead of being written off for accounting purposes as in prior years.

NOTES ON THE FINANCIAL STATEMENTS

8.4 Revenue and Expense Recognition

8.4.1 Interest Income

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

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

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

8.4.3 Discount or Premium on Purchase of Dated Debt Securities

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

8.4.4 Lease Income

8.4.4.1 Finance Leases

Gross earnings from leases comprising the excess of aggregate rentals receivable over the cost of leased asset are allocated over the term of the lease commencing with the month in which the lease is granted, in proportion to the declining receivable balances.

Income of finance leases in respect of lease rentals due cease to be taken to revenue after it is in arrears for three (3) months and thereafter such income is recognised on receipt basis. The interest accrued up to three months is also eliminated from the income and transferred to income suspense.

8.4.4.2 Operating Leases

Rental income is recognised on a straight-line basis over lease term.

8.4.5 Dividend Income

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

8.4.6 Discount on Bills of Exchange

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

8.4.7 Default Interest

Default charges for late payment of finance lease rentals and for delayed redemption of bills of exchange are recognised as income on receipt basis.

8.4.8 Front-end Fee Income

This arises on loan origination and the income is recognised on completion of loan documentation.

8.4.9 Consultancy and Other Professional Service Income

Recognised as income in the period in which entitlement to the consideration arises.

8.4.10 Underwriting Commission

Recognised as income in the period in which entitlement to the consideration arises.

8.4.11 Guarantee Fee

Recognised in full in the period in which guarantees are issued by the Bank.

8.4.12 Gains on sale of Property and Equipment

Recognised as income in the period in which the sale occurs.

NOTES ON THE FINANCIAL STATEMENTS

8.4.13 *Gains on Sale of Investment Property*

The difference between the net disposal proceeds and the carrying value of the property disposed of, is recognised as income. On part disposal of an investment property, the carrying value of the entire property is apportioned to the part sold, in the proportion of the net disposal proceeds to the total market value of the entire investment property at the time of disposal.

8.4.14 *Gains on Disposal of Dated Debt Securities*

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

8.4.15 *Sale and Repurchase Agreements*

Where treasury bills/bonds are sold subject to a commitment to repurchase them at a predetermined price ('Repos') the difference between sale and repurchase price is recognised as other income over the life of the agreement.

Previously the Repos volume was not significant and the treasury bill/bond income was reported as interest income and the corresponding cost included under interest expense.

8.4.16 *Premises Rental Income*

Rental income is recognised on accrual basis.

8.4.17 *Marked to Market Gains on Dealing Securities*

Gains or losses on dated dealing debt securities and listed ordinary shares that arise by adjusting the carrying value of these securities to market value on balance sheet date are recognised in the income statement.

8.4.18 *Marked to Market Gains on Forward Exchange Contracts*

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

8.4.19 *Foreign Exchange Income*

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

8.4.20 *Finance Charges on Finance Lease Payments*

Finance charges are allocated to periods during the lease terms so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period.

8.4.21 *Interest Expense*

All interest expenses are recognised in the period in which they are incurred without any amount being capitalised.

8.4.22 *Allowances for Credit Losses*

Credit losses comprise of losses against loans, finance leases, bills of exchange, commercial papers, trust certificates, promissory notes and overdrafts. The estimated losses attributable to these debts are based on a continuous review of all such debts identified as bad or doubtful.

Bank makes both general and specific provisions.

NOTES ON THE FINANCIAL STATEMENTS

8.4.22.1 Specific Provisions

Specific provisions are made for the estimated loss on doubtful loans, finance leases, bills of exchange, commercial papers, trust certificates, promissory notes and overdrafts not covered by realisable value of collateral.

Specific provision on guarantees issued are made to recognise significant impairment of the debt service capacity of the customer giving rise to a constructive obligation prior to enforcement of guarantee.

The specific provision has two elements:

i. A minimum statutory provision as per the direction issued by Central Bank of Sri Lanka. This is on a graduated scale based on the amount of outstanding principal net of realisable security value (net exposure at risk) as given below:

Age of arrears	Provision covered
6 months to less than 12 months	20% of net exposure at risk
12 months to 18 months	50% of net exposure at risk
More than 18 months	100% of net exposure at risk

ii. An additional provision to recognise difficulties in realisation of collateral or significant impairment of debt service capacity of the borrower.

8.4.22.2 General Provision

In the financial year to 31 March 2007, a general provision of 0.2% of the outstanding balances of performing and over due loans has been made as per the direction issued by the Central Bank of Sri Lanka on all licensed banks operating in Sri Lanka.

This mandatory general provision replaces the general provision made by the Bank in the prior years.

8.4.23 Investment Securities Losses

A temporary diminution in value is accounted for as a provision and a diminution other than temporary accounted as a partial or full write-off.

Diminution other than temporary in value of each investment security, is assessed by a combination of indicators of value including market value, investee's assets, results and the expected cash flow from the investment and the prevailing market conditions in the Colombo Stock Exchange.

Temporary diminution in value of all equity securities listed in the Colombo Stock Exchange is the amount by which the aggregate market value of such securities is lower than the aggregate cost of acquisition, reduced where appropriate by write-off for diminution other than temporary in value of each security. The market value is based on the price information on quoted securities published by the Colombo Stock Exchange.

Temporary diminution in value of all units purchased from a unit trust, is the amount by which the aggregate market value of such units, is lower than the aggregate cost of acquisition, reduced where appropriate by write-off for diminution other than temporary in value of each unit. The market value is based on the Unit Trust Manager's buying price.

Temporary diminution in value of ordinary shares listed in the Colombo Stock Exchange and units purchased from a unit trust are charged against the revenue reserves of the Bank. Any subsequent reversal of such diminution in value will be credited to the revenue reserves in the financial year in which they occur.

NOTES ON THE FINANCIAL STATEMENTS

Diminution other than temporary in value of all investment securities is charged against the earnings of the period in which they occur. Diminution other than temporary in value of shares included in investment securities is written off while that of debentures included in the investment securities is recognised as a provision.

The amount of diminution other than temporary and temporary diminution recognised in this financial year is disclosed in Note No. 19.

8.4.24 Income Tax Expense

8.4.24.1 Income Tax

i. Income tax expense for the year comprises current and deferred tax. Income tax is recognised in the income statement except to the extent it relates to items recognised directly in reserves in which case it is recognised in reserves.

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

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

8.4.24.2 Deferred Tax

i. Deferred tax is recognised on temporary differences between the carrying amount of assets and liabilities in the balance sheet and the amount attributed to such assets and liabilities for tax purposes.

   Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent it is probable that future taxable profit will be available against which deductible temporary differences can be utilised.

   Deferred tax is calculated using the tax rates that have been enacted or substantially enacted at the balance sheet date and are expected to apply in the period in which the assets will be realised or liabilities settled.

   Deferred tax assets and liabilities are not discounted.

ii. The net increase in the carrying amount of deferred tax liability net of deferred tax asset is recognised as deferred tax expense and conversely any net decrease is recognised as reversal to deferred tax expense, in the income statement.

iii. The separate financial statements of the Bank include the full recognition of deferred tax asset attributable to the gratuity provision of the Bank.

   The consolidated financial statements includes full recognition of deferred tax asset attributable to gratuity provision and unused tax losses of the group.

   The recognition of the aforesaid deferred asset is due to the new provisions of Sri Lanka Accounting Standard 14 on "Income Tax (Revised 2005)" applicable to the financial year to 31 March 2007.

NOTES ON THE FINANCIAL STATEMENTS

iv. The carrying amount of deferred tax asset is reviewed at each balance sheet date and tested against the absorption capacity of probable future taxable profit to utilise unused tax losses and adjustments made accordingly.

v. Previously, DFCC Vardhana Bank, subsidiary recognised deferred tax asset relating to unused tax losses only to the extent of deferred tax liability.

8.4.24.3 Value Added Tax

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

8.4.24.4 Withholding Tax on Dividends distributed by Subsidiaries and Associate Companies

Dividends distributed out of the taxable profit of the subsidiaries and associate companies suffers a 10% deduction at source and is not available for set off against the tax liability of the Bank. Thus, the withholding tax deducted at source is added to the tax expense of the subsidiary company and the associated company in the group financial statements as a consolidation adjustment.

8.5 Assets and Bases of their Valuation

8.5.1 Securities

8.5.1.1 Dealing Debt Securities

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

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

The marked to market adjustment to the original cost of acquisition on the balance sheet date is implemented with effect from 31 March 2006, in accordance with the direction issued by Central Bank of Sri Lanka on 'Prudential norms for classification, valuation, and operation of the Bank's investment portfolio' dated 1 March 2006.

The gains arising from marked to market adjustment on 31 March 2007 was Rs9,500,000 and is included in the income statement.

8.5.1.2 Investment Debt Securities

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

Treasury bills and other securities eligible for rediscounting with the Central Bank are included in the balance sheet at cost adjusted for the amortisation of premium or discount arising on acquisition.

8.5.1.3 Securities Purchased under Resale Agreements (Reverse Repurchase Transactions)

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

NOTES ON THE FINANCIAL STATEMENTS

8.5.1.4 Securities sold under Repurchase Agreements ('Repos')

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

8.5.1.5 Dealing Securities - Ordinary Shares

These are marketable ordinary shares listed in the Colombo Stock Exchange acquired and held with the intention of resale over a short period. These are stated in the balance sheet at market value.

8.5.1.6 Investment Securities - Shares, Debentures and Units purchased from Unit Trusts

Shares quoted in the Colombo Stock Exchange and units purchased from unit trust are stated in the balance sheet at the lower of:

i. Aggregate cost reduced by, where appropriate, the diminution in value which is other than temporary of each security; and

ii. Market value

determined on an aggregate portfolio basis.

Other shares and debentures (dated debt securities) are stated in the balance sheet at cost reduced by, where appropriate, the diminution in value, which is other than temporary of each security.

Cost determined on weighted average basis includes incidental costs of acquisition. All securities are held for yield or capital appreciation in the medium/long-term.

8.5.1.7 Investment Securities - Venture Capital Investments

Venture capital investments in quoted and unquoted ordinary shares and debentures by Lanka Ventures Limited are stated at cost less any specific provision required for diminution in value other than temporary.

8.5.2 Loans (Change in Accounting Policy)

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

Previously, the Bank adopted an accounting policy of writing off debts which are fully covered by specific provisions for accounting purposes only at each balance sheet date, while retaining such debts in the memorandum books of the Bank and continuing with the recovery efforts. The recoveries of such loans were included under other income. This policy however did not have any impact on the total on-balance sheet assets.

The Bank has changed this policy prospectively with effect from 31 March 2007; i.e. the fully provided debts and the provision remain on the balance sheet. Retrospective application is impracticable and would require costly customisation of Bank's software.

The cumulative debts fully provided and written off for accounting purposes only and retained in the memorandum books of the Bank was Rs1,441 million as at 31 March 2007.

8.5.3 Finance Leases

Assets of the Bank leased to customers by an agreement that transfers substantially all the risks and rewards of ownership to the customer without transferring the title, are classified as financial leases and disclosed as amounts receivable. The leases are stated in the balance sheet after deduction of future income and specific provision for losses.

NOTES ON THE FINANCIAL STATEMENTS

8.5.4 *Investment Property*

The investment property of the Bank is a land owned by the Bank held for capital appreciation. The investment property of the group includes land and building held by a subsidiary for capital appreciation and earns revenue by rentals.

Land classified as investment property is carried at cost reduced by accumulated impairment losses and building classified as investment property is carried at cost net of accumulated depreciation and accumulated impairment losses.

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

The rates of depreciation are as follows:

Buildings	5% per annum
Water treatment plant	10% per annum
Site improvement	10% per annum

8.5.5 *Investment in Subsidiaries and Associate Companies - The Bank (Change in Accounting Policy)*

i. The Bank's investments in subsidiaries, and associates are stated at cost less accumulated impairment losses, if any.

ii. Previously, investments in subsidiaries and associates were accounted under equity method. Under equity method the carrying amount of the investment was the proportionate share of the net assets of the investee attributable to the parent, adjusted for the unamortised goodwill/negative goodwill.

The amortisation of goodwill was included in the income statement of the Bank.

The income statement of the Bank included the proportionate share of the undistributed post-acquisition profit or loss of the associate and subsidiaries attributable to the Bank, the parent.

In accordance with Sri Lanka Accounting Standard 26 on "Consolidated and Separate Financial Statements (Revised 2005)" applicable for financial year to 31 March 2007, the Bank has accounted for the investments in associated and subsidiaries at cost less accumulated impairment losses if any.

8.5.6 *Property and Equipment*

8.5.6.1 Owned Assets

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

The assets are stated at cost less accumulated depreciation and accumulated impairment losses. The depreciation is provided for on the basis outlined in 8.5.6.2.

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

The rates of depreciation are as follows:

Buildings	5% per annum
Furniture & fittings	10% per annum
Office equipment & motor vehicles	20% per annum

NOTES ON THE FINANCIAL STATEMENTS

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

Land is not depreciated.

8.5.6.3 Leased Assets

Leases in terms of which the Bank assumes substantially all the risks and rewards of ownership are classified as finance leases. Motor vehicles acquired by way of finance lease is stated at an amount equal to the lower of its fair value and the present value of the minimum lease payments at inception of the lease, less cumulative depreciation. The depreciation policy for the leased assets is consistent with that for depreciable assets, which are owned as disclosed in 8.5.6.2.

8.5.7 Goodwill or Negative Goodwill on Consolidation (Change in Accounting Policy)

This arises on a business combination resulting in a parent-subsidiary relationship in which the acquirer is the parent and acquiree a subsidiary of the acquirer and is accounted by applying the purchase method. Goodwill arising on an acquisition of a subsidiary represents the excess of the cost of the acquisition over the fair value of the net identifiable assets acquired.

Goodwill on acquisition of associates is included in the investment cost of associate and therefore is not included in goodwill on consolidation.

Goodwill on consolidation is not amortised after 31 March 2006 in accordance with Sri Lanka Accounting Standard 25 on "Business Combinations (Revised 2004)" applicable from the financial year to 31 March 2007.

Goodwill is tested for impairment annually by comparing the present value of the expected cash flows from the subsidiary and associate with the carrying value of its net assets including attributable goodwill.

Unamortised negative goodwill on 31 March 2006 is derecognised with the corresponding adjustment to the retained profit on 31 March 2006.

The carrying amount of goodwill on consolidation is at cost reduced by accumulated impairment loss, if any. This change to the accounting policy relating to consolidated financial statements is applied prospectively from the beginning of the financial year to 31 March 2007. Consequently, the comparative amount in the consolidated income statement relating to amortisation of goodwill for the year to 31 March 2006 is not restated.

8.5.8 Intangible Assets - Computer Application Software

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

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

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

NOTES ON THE FINANCIAL STATEMENTS

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

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

8.5.9 Foreign Currency Translation

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

8.5.9.2 Monetary liabilities denominated in foreign currencies subject to an exchange loss covered by the Government of Sri Lanka as provided in the DFCC Act No. 35 of 1955 are not translated at the exchange rates ruling on the balance sheet date. Government of Sri Lanka bears the exchange loss and is entitled to any exchange gain arising on settlement of such monetary liabilities.

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

8.5.9.4 As at the balance sheet date, the assets and liabilities of the overseas branch operations of the associate company - Commercial Bank of Ceylon Limited are translated into the presentation currency of the Bank as at the rate of exchange ruling at the balance sheet date and their Income statement is translated at the weighted average exchange rate for the year. The exchange differences arising on the translation are taken directly to a separate component of equity. On disposal of a foreign operation the deferred cumulative amount recognised in equity relating to that particular foreign operation is recognised in the Income statement.

8.5.10 Comparative Information

Note 8.3.1 gives restatement of comparative information due to change in accounting policy. Where items are regrouped, comparative information is also adjusted.

'Repos' income net of interest expense amounting to Rs15,746,000 is reclassified as other income.

Previously 'Repos' income of Rs97,244,796 was included under interest income while the corresponding interest expense was Rs81,498,796.

Other than the above all other items remain unaltered.

8.6 Liabilities and Provisions

8.6.1 Pension and Gratuity Payments

8.6.1.1 Description of the Plan and Employee Groups Covered

The Bank established a Trust Fund in May 1989, which operates an approved pension scheme for payment of pension. The fund of the scheme is managed by trustees appointed by the Bank and is separate from the Bank. The scheme provides for payment of pension to retirees, spouse and minor children of deceased retirees. All members of the permanent staff who joined prior to 1 May 2004 except one are covered by this funded pension scheme subject to fulfillment of eligibility conditions prescribed by the Bank.

NOTES ON THE FINANCIAL STATEMENTS

The scheme was amended on 31 August 1998 and the amended plan will apply to all members of the permanent staff who joined the Bank on or after this date. The amendment reduced the scope of the benefit in the interest of long-term sustainability of the pension plan as advised by the independent actuary.

8.6.1.2 Funding Arrangement

The Bank's contributions to the Trust Fund are made annually based on a percentage of gross emoluments excluding certain allowances and bonus. The percentage required was determined by an independent actuary. No contributions are made by the employees in respect of the basic pension benefit. Eligible employees who desire to provide for the payment of pension to spouse and minor children, who survive them are however, required to contribute monthly, an amount based on a percentage of gross emoluments, excluding bonus, if they joined the Bank on or after 31 August 1998.

8.6.1.3 Recognition of Past Service Cost, Experience Adjustments and the Effects of Changes in Actuarial Assumptions

These costs and surpluses are recognised over the remaining working life of existing employees.

8.6.1.4 Gratuity Provision

Bank provides for the gratuity payable under the Payment of Gratuity Act No. 12 of 1983 for all employees who do not qualify under the Pension Scheme.

The subsidiary companies, which do not have a non-contributory pension scheme provide for the gratuity payable under the Payment of Gratuity Act No. 12 of 1983 for all employees.

The computation of the provision is based on half month's qualifying salary at the end of the financial year, for each year of service commencing from the first year of service. This method of determining the gratuity liability is an allowed alternative under Sri Lanka Accounting Standard 16, 'Retirement Benefit Cost', while the benchmark treatment for the calculation of gratuity is the actuarial valuation method. The amount provided for gratuity liability is not externally funded.

8.6.2 Defined Contribution Plans

All employees of the Bank are members of the Mercantile Service Provident Society and the Employees' Trust Fund to which the Bank contributes 15% and 3% respectively of such employee's basic or consolidated salary and cost of living allowance.

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

8.6.3 Provisions for Liabilities

A provision is recognised in the balance sheet when the Bank has a legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation.

8.6.4 Obligations under Finance Leasing

Obligations in respect of equipment acquired under a finance leasing arrangement are stated at the present value of total of minimum lease payments at the balance sheet date. The present value is computed by discounting the total of minimum lease payments on the balance sheet date by the interest rate implicit in the lease.

8.6.5 Off Setting

Deferred and current tax asset of each taxable entity is set off against deferred and current tax liability of the same taxable entity operating in Sri Lanka and liable by revenue authority in Sri Lanka.

NOTES ON THE FINANCIAL STATEMENTS

8.6.6 Commitments and Contingencies

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

8.6.7 Events after Balance Sheet date

All material and important events which occur between the balance sheet date and the date on which the financial statements are authorised for issue, and the financial impact on the condition of assets and liabilities are disclosed in Note 62.

9. Cash Flow

The Cash Flow has been prepared by using the 'Direct Method'. Cash and cash equivalents include cash balances, time deposits and treasury bills of three months maturity at the time of issue. For the purpose of Cash Flow Statement, cash and cash equivalents are presented net of bank overdrafts.

10. Business Segment Reporting

A business segment is a distinguishable component of an enterprise that is engaged in providing an individual product or service or a group of related products or services that is subject to risk and returns that are different from those of other business segments. The accounting policies adopted for segment reporting are the same accounting policies adopted for preparing the financial statements of the group.

Segment revenue is the revenue reported in the income statement that is directly attributable to a segment.

Segment expense includes the relevant portion of interest expense and operating expenses allocated to the segment on a reasonable basis.

Segment assets are those operating assets that are employed by a segment in its operating activities and are directly attributed or allocated to the segment on a reasonable basis.

Segment liabilities are those operating liabilities that result from the operating activities of a segment and are directly attributed or allocated to the segment on a reasonable basis.

Inter-segment transfers are accounted for at competitive market prices charged to unaffiliated customers for similar services. Such transfers are eliminated on consolidation.

11. Directors' Responsibility Statement

Directors' acknowledge the responsibility for true and fair presentation of the financial statements in accordance with the books of account and Sri Lanka Accounting Standards. Further elaboration of the Directors' Responsibility is on page 54.

NOTES ON THE FINANCIAL STATEMENTS

For the year ended 31 March	Bank		Group	
	2007	2006	**2007**	2006
	Rs 000	Rs 000	**Rs 000**	Rs 000
12 Income				
Gross income	**6,886,510**	5,386,777	**8,266,523**	6,254,851
Interest income	**6,017,561**	4,507,591	**7,021,075**	5,075,939
Other income	**868,949**	879,186	**1,245,448**	1,178,912
	6,886,510	5,386,777	**8,266,523**	6,254,851
13 Interest Income				
Loans	**4,577,395**	3,321,816	**5,444,656**	3,773,650
Treasury bills and placements with other banks	**467,009**	468,142	**586,235**	556,955
Interest on overdue bills	**0**	391	**0**	7,129
Gross earnings under finance leases	**938,056**	671,914	**938,056**	671,914
Default interest on lease rentals	**35,101**	29,797	**35,441**	29,945
Interest and discount arising from debt securities	**0**	15,531	**16,687**	36,346
	6,017,561	4,507,591	**7,021,075**	5,075,939

Treasury bill and bond income includes Rs41 million notional tax credit of 10% imputed for the withholding tax deducted/paid at source in respect of the financial year ended 31 March 2007. The amount related to the previous financial year is Rs44 million. The reversal of notional tax credit of Rs32 million recognised in prior years is also included in the treasury bill income.

	Bank 2007	Bank 2006	Group 2007	Group 2006
14 Interest Expense				
Medium and long-term borrowing	**1,528,182**	1,222,752	**1,528,182**	1,222,752
Short-term borrowing:				
Interest on overdrafts and revolving facilities	**977,040**	565,030	**1,014,829**	579,820
Debentures	**363,288**	208,398	**363,288**	208,398
Time deposits from customers	**668,882**	380,117	**1,135,755**	629,961
	3,537,392	2,376,297	**4,042,054**	2,640,931

NOTES ON THE FINANCIAL STATEMENTS

For the year ended 31 March	Bank 2007 Rs 000	Bank 2006 Rs 000	Group 2007 Rs 000	Group 2006 Rs 000
15 Other Income				
Dividend income from securities				
Quoted ordinary shares	**15,797**	16,086	**19,845**	20,106
Unquoted ordinary shares	**1,930**	3,147	**14,435**	9,721
Unquoted preference shares	**48,247**	59,012	**54,087**	66,421
Units in unit trusts	**26,351**	20,064	**31,079**	24,130
Dividend income from investments in associates/subsidiaries				
Quoted ordinary shares	**202,107**	94,733	**161,582**	54,506
Unquoted ordinary shares	**69,864**	44,382	**0**	0
Quoted preference shares	**9,278**	10,912	**9,278**	10,912
	373,574	248,336	**290,306**	185,796
Gain on sale of investment securities				
Quoted ordinary shares	**25,745**	141,411	**48,469**	167,545
Unquoted ordinary shares	**1,297**	5,619	**2,547**	12,876
Others	**25,759**	35,082	**35,771**	39,157
Gains from marked to market on dealing securities	**9,500**	5,410	**9,500**	5,410
Recovery of bad debts	**182,639**	236,637	**182,639**	236,637
Front end fee	**25,367**	27,559	**37,258**	44,704
Consultancy and other professional services	**88,514**	60,130	**95,657**	75,061
LC commission	**1,127**	2,430	**26,048**	19,673
Underwriting commission and guarantee fees	**17,468**	27,622	**41,487**	44,083
Net gain on repurchase transactions	**15,746**	13,992	**20,965**	18,750
Gain on sale of commercial paper and pro-notes	**1,595**	2,551	**1,595**	2,551
Loss on sale of treasury bills and bonds	**(13,515)**	(1,952)	**(13,510)**	(1,944)
Gain on sale of equipment	**4,294**	3,658	**4,585**	3,878
Gain on sale of investment property	**0**	0	**75,232**	0
Unrealised gain on treasury bills and bonds	**0**	16	**0**	16
Premises rental income	**28,406**	21,656	**106,011***	87,506*
Operating lease income	**0**	333	**0**	333
Foreign exchange profit	**11,920**	2,129	**72,706**	43,012
Loss on deemed disposal of associate/subsidiary companies' ordinary shares	**0**	0	**(2,389)**	(5,112)
Others	**69,513**	46,567	**210,571**	198,980
	868,949	879,186	**1,245,448**	1,178,912
* Investment property rental			**110,631**	97,408

The group amounts are with consolidation adjustment.

	Bank 2007 Rs 000	Bank 2006 Rs 000	Group 2007 Rs 000	Group 2006 Rs 000
16 Provision for Staff Retirement Benefits				
16.1 Amount Recognised as Expense				
In Respect of Funded Liability				
Current service cost	**65,791**	69,450	**65,791**	69,450
Experience adjustments	**22,898**	16,371	**22,898**	16,371
	88,689	85,821	**88,689**	85,821
In Respect of Unfunded Liability				
Current service cost	**3,645**	2,967	**3,645**	2,967
Experience adjustments	**1,250**	826	**1,250**	826
	93,584	89,614	**93,584**	89,614

NOTES ON THE FINANCIAL STATEMENTS

16.2 Amortisation of Experience Adjustments

	Bank		Group	
For the year ended 31 March	**2007** **Rs 000**	2006 Rs 000	**2007** **Rs 000**	2006 Rs 000
In Respect of Funded Liability				
Balance on 31 March	**176,128**	133,753	**176,128**	133,753
Recognition during the financial year:				
Actuarial experience loss/(gain)	**(6,129)**	39,929	**(6,129)**	39,929
Change in plan assumptions	**0**	18,817	**0**	18,817
	169,999	192,499	**169,999**	192,499
Amortisation	**(22,898)**	(16,371)	**(22,898)**	(16,371)
	147,101	176,128	**147,101**	176,128
In Respect of Unfunded Liability				
Balance on March	**1,748**	1,726	**1,748**	1,726
Recognition during financial year:				
Actuarial experience loss	**823**	666	**823**	666
Change in plan assumptions	**0**	182	**0**	182
	2,571	2,574	**2,571**	2,574
Amortisation	**(1,250)**	(826)	**(1,250)**	(826)
	1,321	1,748	**1,321**	1,748

The total remaining actuarial loss of Rs147 million in respect of employees whose pension liabilities are funded is amortised equally over the average remaining working life of the employees eligible for pensions.

The total remaining actuarial loss of Rs1.3 million in respect of an employee whose pension liability is not funded is amortised equally over the average remaining working life of the employee eligible for pension.

16.3 Unfunded Pension Liability

This relates to pension liability of an employee, not funded through the DFCC Bank Pension Fund and was Rs16.9 million on 31 March 2007. The liability relates to the pension benefit to retiree and survivor spouse and minor children.

16.4 Actuarial Valuation

Date of most recent valuation is 31 March 2007.

16.5 Actuarial Valuation Method

Projected unit credit actuarial cost method was used to allocate the actuarial present value of projected benefits earned by employees to date of valuation.

16.6 Pension Assets and Actuarial Present Value of Accrued Benefits

As at 31 March 2007, value of assets of the Pension Trust Fund was Rs805 million and value of benefits that had accrued to members after allowing for expected future increases in earnings was Rs952 million. The difference between the actuarially determined value of benefits accrued, Rs952 million and the value of the assets of the pension fund Rs805 million is the unrecognised liability of Rs147 million in respect of the funded liability. This amount representing the unamortised balance of the experience adjustments will be amortised over the remaining working life of employees entitled for pension, at the rate of Rs22.9 million per annum. The pension liability under discontinuance basis was Rs749 million on 31 March 2007.

16.7 Principal Actuarial Assumptions

Over the long term, the annual rate of return on investments net of tax would be 9%. The discount rate used to determine actuarial pension liability during pre-retirement period was 9% per annum reducing to 8% per annum during the post retirement period, while the annual increase in total pensionable remuneration would be 11%.

Assumptions relating to the mortality rates and rates of resignations prior to retirement have been adopted consistently.

NOTES ON THE FINANCIAL STATEMENTS

For the year ended 31 March	Bank		Group	
	2007	2006	**2007**	2006
	Rs 000	Rs 000	**Rs 000**	Rs 000
17 Allowances for Credit Losses - Specific				
Provision for the year				
Loans	**192,597**	283,481	**300,604**	314,021
Leases	**65,799**	52,875	**65,799**	52,875
Dues on terminated leases	**2,977**	487	**2,977**	487
Bills of exchange	**0**	0	**74**	41
Others	**940**	4,336	**940**	4,336
Loan/lease losses	**4,470**	11,211	**4,475**	12,025
	266,783	352,390	**374,869**	383,785
Less: Reductions in the year				
Loans	**234,334**	135,767	**280,766**	169,993
Leases	**51,530**	50,429	**51,530**	50,429
Dues on terminated leases	**496**	2,348	**496**	2,348
Bills of exchange	**750**	6,252	**750**	6,252
Others	**0**	593	**0**	593
	(20,327)	157,001	**41,327**	154,170
18 Allowances for Credit Losses - General				
Provision for the year				
Loans	**78,024**	35,824	**85,050**	35,824
Leases	**14,913**	0	**14,913**	0
Bills of exchange	**0**	0	**460**	0
overdraft	**0**	0	**0**	20,235
	92,937	35,824	**100,423**	56,059
Less: Reductions in the year				
Loans	**50,974**	24,780	**58,818**	33,081
	41,963	11,044	**41,605**	22,978
19 Investment - Impairment Losses				
Investment securities	**9,000**	21,470	**8,985**	27,092
Investment properties	**5,680**	0	**5,680**	0
	14,680	21,470	**14,665**	27,092
20 Operating Expenses				
Operating expenses include the following:				
Chairman's emoluments - fees	**480**	480	**780**	480
Directors' emoluments - fees	**3,432**	1,785	**8,958**	8,103
Employers' contribution to Provident Fund	**36,705**	31,285	**48,244**	40,359
Employers' contribution to Employees' Trust Fund	**7,340**	6,257	**10,675**	8,176
End of service gratuity	**4,342**	2,194	**5,618**	3,742
Auditors' remuneration	**1,419**	1,232	**2,683**	2,407
Depreciation - investment property	**0**	0	**5,860**	5,610
- property and equipment	**87,373**	78,846	**118,649**	128,169
- intangible assets	**40,833**	40,740	**73,915**	40,740
Expenses on litigation	**5,077**	995	**8,674**	4,289

NOTES ON THE FINANCIAL STATEMENTS

21 Income Tax Expense

21.1 Income tax on profit of the Bank has been provided at 35% on the taxable income.

21.2 Relationship between Tax Expense and Accounting Income

Tax charge is based on taxable profit which differs from profit for financial reporting purposes. These differences are explained in the following reconciliation statement:

	Bank	
For the year ended 31 March	**2007**	2006
	Rs 000	Rs 000
Profit before tax as per the income statement	**1,865,293**	1,652,368
Disallowed expenses and provisions	**692,209**	502,292
Lease rentals net of capital allowances	**962,204**	806,241
Reported earnings under finance leases net of provision for bad & doubtful debts	**(929,039)**	(673,442)
Capital allowances on property and equipment	**(59,085)**	(35,518)
Dividend income	**(373,574)**	(247,836)*
Impairment loss on investment property	**5,680**	0
Gain on sale of investment securities	**(52,801)**	(177,607)
Taxable income	**2,110,887**	1,826,498
Normal company tax rate 35% (2006 - 30%)	**738,810**	547,949
Tax rate on accounting profit, %	**40**	33

* *Exclude Rs500,000 dividend on which withholding tax 10% was not deducted.*

21.3 Tax on profit on Ordinary Activities

	Bank		Group	
For the year ended 31 March	**2007**	2006	**2007**	2006
	Rs 000	Rs 000	**Rs 000**	Rs 000
Taxation based on profits for the year	**738,810**	547,949	**738,810**	547,949
Tax under provision	**14,235**	9,244	**14,236**	9,244
Transfer from deferred taxation	**(12,713)**	(85,309)	**(12,714)**	(85,309)
Bank	**740,332**	471,884	**740,332**	471,884
Commercial Bank of Ceylon Limited	**0**	0	**622,124**	391,707
DFCC Consulting (Pvt) Limited	**0**	0	**484**	1,837
DFCC Stock Brokers (Pvt) Limited	0	0	**15,553**	20,367
DFCC Vardhana Bank Limited	**0**	0	**80,105**	53,484
Lanka Indurtrial Estates Limited	0	0	**15,241**	9,478
Lanka Ventures Limited	**0**	0	**30,198**	13,844
National Asset Management Limited	**0**	0	**1,350**	2,856
Associate/subsidiary companies' tax	**0**	0	**765,055**	493,573
Total	**740,332**	471,884	**1,505,387**	965,457

NOTES ON THE FINANCIAL STATEMENTS

21.4 Summary

For the year ended 31 March	Group **2007** **Rs 000**	 2006 Rs 000
Bank	**740,332**	471,884
Subsidiaries		
- current tax	**119,051**	85,014
- deferred tax	**22,530**	13,996
	141,581	99,010
Associates		
- current tax	**620,959**	401,138
- deferred tax	**2,515**	(6,575)
	623,474	394,563
	1,505,387	965,457

21.5 Reconciliation Subsidiaries

Transferred from deferred tax asset - Note 41	**22,530**	14,159
Transferred to/from deferred tax liabilities - Note 47	**0**	(163)
	22,530	13,996

The tax expense of associates are included in the carrying amount of equity accounted investments in associates.

22 Earnings per Share

22.1 Basic Earnings per Share

Basic earnings per share of the Bank has been calculated by dividing the profit after income tax by the weighted average number of shares in issue during the financial year.

Basic group earnings per share has been calculated by dividing the profit after income tax less minority interest by the weighted average number of shares in issue during the financial year.

22.2 Diluted Earnings per Share

Diluted earnings per share of the Bank and the group has been calculated using the profit after tax of the Bank and the group profit after tax less minority interest respectively divided by the weighted average number of shares issued adjusted for the effect of all dilutive potential ordinary shares.

NOTES ON THE FINANCIAL STATEMENTS

For the year ended 31 March		Bank		Group	
		2007	2006	**2007**	2006
		Rs 000	Rs 000	**Rs 000**	Rs 000
22.3 Computation of Basic and Diluted Earnings per Share					
Profit for the year		**1,124,961**	1,180,484	**1,585,644**	1,689,765
Weighted average number of shares		**86,461,809**	86,317,088	**86,461,809**	86,317,088
Basic earnings per share, Rs		**13.01**	13.68	**18.34**	19.58
Number of shares that would have been issued at fair value in respect of options granted on					
	31.03.2002	**13,356**	10,592	**13,356**	10,592
	31.03.2003	**198,805**	190,056	**198,805**	190,056
	31.03.2004	**926,156**	749,918	**926,156**	749,918
	31.03.2006	**105,741**	83,873	**105,741**	83,873
		1,244,058	1,034,439	**1,244,058**	1,034,439
Number of shares at nil consideration (dilutive potential shares) in respect of options granted on	31.03.2002	**19,182**	11,100	**19,182**	11,100
	31.03.2003	**357,386**	256,893	**357,386**	256,893
	31.03.2004	**318,584**	97,306	**318,584**	97,306
	31.03.2006	**27,919**	5,246	**27,919**	5,246
		723,071	370,545	**723,071**	370,545
Total number of shares under option		**1,967,129**	1,404,984	**1,967,129**	1,404,984
Ordinary shares in issue and dilutive potential shares		**87,184,880**	86,687,633	**87,184,880**	86,687,633
Diluted earnings per share, Rs		**12.90**	13.62	**18.19**	19.49

	Bank		Group	
	31.03.2007	31.03.2006	**31.03.2007**	31.03.2006
	Rs 000	Rs 000	**Rs 000**	Rs 000
23 Cash and Short-Term Funds				
Cash and balance with banks	**337,509**	191,445	**966,320**	894,462
Call deposits				
DFCC Vardhana Bank Limited	**1,090,771**	130,117	**714,591**	4,986
Others	**3,077,897**	308,250	**3,734,591**	349,644
Time deposits with licensed commercial banks	**0**	0	**555,674**	220,231
	4,506,177	629,812	**5,971,176**	1,469,323
24 Treasury Bills and other Securities eligible for Rediscounting with Central Bank				
Treasury bills and bonds held for trading	**269,420**	1,642,315	**269,420**	1,642,315
Treasury bills and bonds held to maturity	**3,160,078**	2,655,285	**3,556,127**	2,878,594
	3,429,498	4,297,600	**3,825,547**	4,520,909

Investments held to maturity is the amount of sinking fund created as per loan covenant in the floating rate notes of US$ 65 million and loan of US$ 5 million from Asian Development Bank.

25 Securities purchased under Resale Agreements

These are loans collaterised by the purchase of treasury bills and/or guaranteed commercial papers from the counter-party to whom the loans are granted. The sale by the counter-party is subject to a commitment by the Bank to sell back the underline debt securities to the borrower at a pre-determined price. These loans are stated at the Balance Sheet at cost.

NOTES ON THE FINANCIAL STATEMENTS

	Bank		Group	
	31.03.2007	31.03.2006	**31.03.2007**	31.03.2006
	Rs 000	Rs 000	**Rs 000**	Rs 000
26 Placements with and Loans to other Banks and Financial Institutions				
Placements	**0**	0	**59,000**	250,000
Loans to banks	**1,023,956**	737,533	**936,956**	615,533
	1,023,956	737,533	**995,956**	865,533
26.1 Placements				
Banks	**0**	0	**59,000**	250,000
	0	0	**59,000**	250,000
26.2 Loans to Banks and Financial Institutions				
DFCC Vardhana Bank Limited - Subordinated loan	**122,000**	122,000	**0**	0
Other loans	**500,000**	500,000	**535,000**	500,000
Refinance loans - Plantation development project *	**401,956**	115,533	**401,956**	115,533
	1,023,956	737,533	**936,956**	615,533

* *Refinanced by Asian Development Bank/Government of Sri Lanka line of credit.*

	Bank 31.03.2007			Bank 31.03.2006		
	Number of Ordinary shares of Rs10 each	Cost Rs 000	Market Value Rs 000	Number of Ordinary shares of Rs10 each	Cost Rs 000	Market Value Rs 000
27 Dealing Securities						
27.1 Composition: Bank						
Quoted ordinary shares						
Asiri Surgical Limited	**500,000**	**500**	**5,500**	0	0	0
Dialog Telecom Limited *	**49,900**	**998**	**1,272**	49,900	599	998
John Keells Holdings Limited	**124,515**	**15,074**	**19,300**	79,444	7,521	12,532
		16,572	**26,072**		8,120	13,530
Marked to market adjustment		**9,500**			5,410	
Market value		**26,072**			13,530	

* *Par value Rs1/- each*

No dealing securities in subsidiaries.

NOTES ON THE FINANCIAL STATEMENTS

	Bank 31.03.2007 Rs 000	Bank 31.03.2006 Rs 000	Group 31.03.2007 Rs 000	Group 31.03.2006 Rs 000
28 Bills of Exchange Discounted				
28.1 Balance on 31 March				
Local bills	**5,640**	6,390	**5,640**	6,390
Export bills	**0**	0	**347,128**	63,874
Import bills	**0**	0	**112,940**	6,240
Less: Provision for bills of exchange overdue	**5,640**	6,390	**6,215**	6,431
	0	0	**459,493**	70,073
28.2 Movement in Provision				
Balance on 31 March	**6,390**		**6,431**	
Add : Provision for the year	**0**		**534**	
Less : Reduction in the year	**750**		**750**	
	5,640		**6,215***	

* Includes a general provision of Rs460,000.

	Bank 31.03.2007 Rs 000	Bank 31.03.2006 Rs 000	Group 31.03.2007 Rs 000	Group 31.03.2006 Rs 000
29 Loans				
29.1 Balance on 31 March				
Sri Lanka Rupee Loans				
Direct loans	**35,218,831**	28,495,647	**38,965,073**	30,905,466
Refinance loans	**0**	166	**0**	166
Debenture loans	**1,234,212**	802,520	**1,234,212**	802,520
Overdrafts	**0**	0	**3,771,764**	2,510,269
Staff loans for miscellaneous purposes	**204,588**	173,673	**243,840**	194,411
	36,657,631	29,472,006	**44,214,889**	34,412,832
Foreign Currency Loans				
Direct loans	**1,542,674**	1,491,395	**1,542,674**	1,491,395
Less: Allowances for credit losses				
Loan loss provision - Specific	**655,240**	699,928	**770,278**	753,391
Loan loss provision - General	**75,093**	48,043	**86,209**	59,977
Balance net of allowances for credit losses	**37,469,972**	30,215,430	**44,901,076**	35,090,859
29.2 Movement in Provision				
29.2.1 Movement in Specific Provision				
Balance on 31 March	**699,928**		**753,391**	
Add: Provision for the year	**192,597**		**300,604**	
Transfer from interest in suspense	**15,606**		**15,606**	
Less: Reduction in the year	**234,334**		**280,766**	
Write-off of loans	**18,557**		**18,557**	
	655,240		**770,278**	
29.2.2 Movement in general provision				
Balance on 31 March	**48,043**		**59,977**	
Add: Provision for the year	**78,024**		**85,050**	
Less: Reduction in the year	**50,974**		**58,818**	
	75,093		**86,209**	

NOTES ON THE FINANCIAL STATEMENTS

	Bank		Group	
	31.03.2007 Rs 000	31.03.2006 Rs 000	**31.03.2007 Rs 000**	31.03.2006 Rs 000
30 Finance Leases				
30.1 Balance on 31 March				
Gross investment in leases				
Lease rentals receivable				
- within one year from balance sheet date	**3,736,203**	2,870,972	**3,736,203**	2,870,972
- after one year from balance sheet date	**6,101,316**	3,913,230	**6,101,316**	3,913,230
	9,837,519	6,784,202	**9,837,519**	6,784,202
Less: Deposit of rentals	**88,112**	76,278	**88,112**	76,278
Allowances for credit losses				
Specific provision for leases in default	**195,557**	183,458	**195,557**	183,458
General provision for leases in default	**14,913**	0	**14,913**	0
Income in suspense	**47,976**	43,749	**47,976**	43,749
Unearned income on rentals receivable				
- within one year from balance sheet date	**938,159**	580,241	**938,159**	580,241
- after one year from balance sheet date	**1,007,086**	538,680	**1,007,086**	538,680
Net investment in leases	**7,545,716**	5,361,796	**7,545,716**	5,361,796
30.2 Movement in Provision				
30.2.1 Movement in Specific Provision				
Balance on 31 March	**183,458**		**183,458**	
Add: Provision for the year	**65,799**		**65,799**	
Less: Reduction in the year	**51,530**		**51,530**	
Transfers *	**2,170**		**2,170**	
	195,557		**195,557**	
** To specific provision on dues on terminated leases, included under debtors.*				
30.2.2 Movement in General Provision				
Balance on 31 March	**0**		**0**	
Add: Provision for the year	**14,913**		**14,913**	
	14,913		**14,913**	
30.3 Movement in Income in Suspense				
Balance on 31 March	**43,749**		**43,749**	
Add: Transfer during the year	**108,577**		**108,577**	
Less: Recoveries	**104,350**		**104,350**	
	47,976		**47,976**	

NOTES ON THE FINANCIAL STATEMENTS

	Bank		Group	
	31.03.2007 Rs 000	31.03.2006 Rs 000	**31.03.2007 Rs 000**	31.03.2006 Rs 000
31 Interest Receivable				
31.1 Balance on 31 March				
Amount due	**715,402**	604,836	**858,613**	604,836
Amount accrued and not due	**656,217**	343,040	**656,217**	427,558
Less: Interest in suspense	**761,732**	582,873	**927,721**	693,942
	609,887	365,003	**587,109**	338,452
31.2 Movement in Interest in Suspense				
Balance on 31 March	**582,873**		**693,942**	
Add: Transfer during the year	**482,353**		**718,752**	
Less: Collections	**263,670**		**445,149**	
Transfer to loan provision	**15,606**		**15,606**	
Write-offs	**24,218**		**24,218**	
	761,732		**927,721**	

	Ordinary Shares Quoted Rs 000	Ordinary Shares Unquoted Rs 000	Preference Shares Quoted Rs 000	Preference Shares Unquoted Rs 000	Debentures Quoted Rs 000	Debentures Unquoted Rs 000	Unit Trusts Rs 000	Total 31.03.2007 Rs 000	Total 31.03.2006 Rs 000
32 Investment Securities									
32.1 Composition of Investment Securities									
Bank									
Performing investments	318,476	36,595	50,000	467,167	0	0	303,073	**1,175,311**	1,230,236
Non-performing investments	30,636	36,090	0	0	0	0	18,402	**85,128**	110,069
	349,112	72,685	50,000	467,167	0	0	321,475	**1,260,439**	1,340,305
Group									
Performing investments	419,991	95,350	50,000	644,967	43,500	40,072	353,073	**1,646,953**	1,669,047
Non-performing investments	30,636	37,090	0	43,750	0	0	18,402	**129,878**	195,317
Less: Provision for diminution other than temporary	0	0	0	18,750	0	0	0	**18,750**	56,250
	450,627	132,440	50,000	669,967	43,500	40,072	371,475	**1,758,081**	1,808,114

	Ordinary Shares Quoted Rs 000	Ordinary Shares Unquoted Rs 000	Preference Shares Quoted Rs 000	Preference Shares Unquoted Rs 000	Debentures Quoted Rs 000	Debentures Unquoted Rs 000	Unit Trusts Rs 000	Total 31.03.2007 Rs 000
32.2 Bank								
Balance on 31 March 2006	366,010	81,685	100,000	537,167	0	2	255,441	**1,340,305**
Additions for the year	22,859	0	0	0	0	0	85,357	**108,216**
Less: Disposals during the year	39,257	0	0	0	0	0	19,323	**58,580**
Redemptions during the year	0	0	50,000	70,000	0	2	0	**120,002**
Transfer to dealing securities	500	0	0	0	0	0	0	**500**
Write-offs	0	9,000	0	0	0	0	0	**9,000**
	349,112	**72,685**	**50,000**	**467,167**	**0**	**0**	**321,475**	**1,260,439**
Cost of quoted investment/units								
on 31.03.2007	**349,112**		**50,000**				**321,475**	**720,587**
on 31.03.2006	366,010		100,000				255,441	721,451
Market value of quoted investments/units								
on 31.03.2007	**516,420**		**46,250**				**384,273**	**946,942**
on 31.03.2006	412,892		92,500				319,122	824,514

NOTES ON THE FINANCIAL STATEMENTS

	Ordinary Shares		Preference Shares		Debentures		Unit Trusts	Total
	Quoted	Unquoted	Quoted	Unquoted	Quoted	Unquoted		31.03.2007
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
32.3 Group								
Balance on 31 March 2006	455,878	108,690	100,000	758,717	43,500	92,138	305,441	**1,864,364***
Additions for the year	93,558	44,250	0	0	0	10,000	85,357	**233,165**
Less: Disposals during the year	98,309	11,500	0	0	0	0	19,323	**129,132**
Redemptions during the year	0	0	50,000	70,000	0	62,066	0	**182,066**
Transfer to dealing securities	500	0	0	0	0	0	0	**500**
Write-offs	0	9,000	0	0	0	0	0	**9,000**
	450,627	132,440	50,000	688,717	43,500	40,072	371,475	**1,776,831**
Less: Provision for diminution other than temporary	0	0	0	18,750	0	0	0	**18,750**
	450,627	132,440	50,000	669,967	43,500	40,072	371,475	**1,758,081**
Cost of quoted investment/units								
on 31.03.2007	**450,627**		**50,000**		**43,500**		**371,475**	**915,602**
on 31.03.2006	455,878		100,000		43,500		305,441	**904,819**
Market value of quoted investments/units								
on 31.03.2007	**628,467**		**46,250**		**42,908**		**435,545**	**1,153,169**
on 31.03.2006	505,405		92,500		42,995		369,711	1,010,611

** Without the provision for diminution.*

	Group
	31.03.2007
	Rs 000
32.4 Provision for Diminution	
32.4.1 Movement in Provision	
Balance on 31 March	**56,250**
Less: provision relating to disposal	**(37,500)**
	18,750

32.5 On 31 March 2007 the Bank held more than 20% and less than 50% of the voting control in Hydrotech Lanka Dickoya (Pvt) Limited. This investment is classified under investment securities and not as investments in associate companies since the Bank did not have a significant influence over the operating and financial policies of this company.

NOTES ON THE FINANCIAL STATEMENTS

32.6 Quoted Ordinary Shares

	31.03.2007			31.03.2006		
	Number of Ordinary shares of Rs10 each	**Cost* Rs 000**	**Market Value Rs 000**	Number of Ordinary shares of Rs10 each	Cost* Rs 000	Market Value Rs 000
Banks, Finance & Insurance						
Hatton National Bank Limited - non-voting	**777,600**	**22,765**	**37,130**	388,800	22,765	21,384
Housing Development Finance Corporation Limited	**37,400**	**8,228**	**6,059**	37,400	8,228	6,732
Lanka Orix Leasing Company Limited	**17,828**	**780**	**1,917**	17,828	780	1,818
Sampath Bank Limited	**164,300**	**17,961**	**17,580**	164,300	17,961	14,007
Seylan Bank Limited - non-voting	**260,000**	**4,416**	**2,405**	130,000	2,791	1,755
		54,150	**65,091**		52,525	45,696
Beverages, Food & Tobacco						
Ceylon Tobacco Company Limited	**119,967**	**86**	**7,558**	119,967	86	7,078
Distilleries Company of Sri Lanka Limited **	**102,200**	**3,401**	**10,731**	102,200	3,401	4,599
		3,487	**18,289**		3,487	11,677
Chemicals & Pharmaceuticals						
Haycarb Limited	**19,130**	**944**	**670**	19,130	944	698
Diversified Holdings						
Aitken Spence & Company Limited	**48,200**	**16,512**	**18,316**	48,200	16,512	16,340
Hayleys Limited	**295,560**	**26,533**	**41,970**	295,560	26,533	29,113
		43,045	**60,286**		43,045	45,453
Health Care						
Asiri Medical Services Limited	**0**	**0**	**0**	2,493,000	2,493	7,479
Ceylon Hospitals Limited - voting	**100,000**	**2,500**	**5,625**	118,100	2,953	5,285
Ceylon Hospitals Limited - non-voting	**300,000**	**6,000**	**11,475**	343,500	6,870	9,275
		8,500	**17,100**		12,316	22,039
Hotels & Travels						
Pegasus Hotels of Ceylon Limited	**101,500**	**529**	**1,573**	128,400	669	4,526
Sigiriya Village Hotels Limited	**55,000**	**1,284**	**1,925**	55,000	1,284	2,475
Stafford Hotels Limited	**5,950,525**	**57,383**	**55,042**	6,102,525	58,848	67,128
		59,196	**58,540**		60,801	74,129
Information Technology						
E-Channelling Limited	**1,036,000**	**10,360**	**13,468**	1,111,000	11,110	15,554
Investment Trusts						
Ceylon Guardian Investment Trust Limited	**36,844**	**1,298**	**5,987**	36,844	1,298	5,149
Ceylon Investment Company Limited	**87,120**	**2,000**	**8,756**	87,120	2,000	7,079
		3,298	**14,743**		3,298	12,228

* *Cost is reduced by write-off of diminution in value other than temporary in respect of investments.*

** *Par value Rs1/- each.*

Sector classification and market value per share are based on official valuations list published by Colombo Stock Exchange.

NOTES ON THE FINANCIAL STATEMENTS

32.6 Quoted Ordinary Shares (Contd.)

	31.03.2007			31.03.2006		
	Number of Ordinary shares of Rs10 each	Cost* Rs 000	Market Value Rs 000	Number of Ordinary shares of Rs10 each	Cost* Rs 000	Market Value Rs 000
Manufacturing						
Caltex Lubricants Lanka Limited	304,700	20,301	25,900	345,000	22,986	23,029
Ceylon Grain Elevators Limited	48,997	1,297	698	48,997	1,297	686
Lanka Tiles Limited	211,587	5,809	10,368	171,608	5,088	11,626
Tokyo Cement Limited - non-voting	1,030,000	16,346	22,145	1,030,000	16,346	15,450
		43,753	59,111		45,717	50,791
Power & Energy						
Lanka Indian Oil Company Limited	600,000	18,450	18,000	857,100	26,356	25,070
Vallibel Power Erathna Limited	7,500,000	20,000	13,500	0	0	0
		38,450	31,500		26,356	25,070
Telecommunications						
Sri Lanka Telecom Limited	4,800,600	83,929	177,622	6,086,500	106,411	109,557
Total Quoted Shares - Bank		349,112	516,420		366,010	412,892
Investment in quoted shares by subsidiaries		101,515	112,047		89,868	92,513
Total Quoted Shares - Group		450,627	628,467		455,878	505,405

32.6.1 Investment in Quoted Ordinary Shares by Subsidiaries

	31.03.2007			31.03.2006		
	Number of Ordinary shares of Rs10 each	Cost* Rs 000	Market Value Rs 000	Number of Ordinary shares of Rs10 each	Cost* Rs 000	Market Value Rs 000
Banks, Finance & Insurance						
Central Finance Limited	6	0	1	6	0	2
Housing Development Finance Corporation Limited	15,500	4,726	2,511	15,500	4,726	2,790
Nation Trust Bank Limited	225,000	4,987	7,650	225,000	4,987	5,513
		9,713	10,162		9,713	8,305
Beverage & Tobacco						
Ceylon Tobacco Company Limited	0	0	0	134,100	5,417	7,912

* *Cost is reduced by write off of diminution in value other than temporary in respect of investments.*

Sector classification and market value per share are based on the list published by Colombo Stock Exchange.

NOTES ON THE FINANCIAL STATEMENTS

32.6.1 Investment in Quoted Ordinary Shares by Subsidiaries (Contd.)

	31.03.2007			31.03.2006		
	Number of Ordinary shares of Rs10 each	**Cost* Rs 000**	**Market Value Rs 000**	Number of Ordinary shares of Rs10 each	Cost* Rs 000	Market Value Rs 000
Investment Trusts						
Ceylon Gurdian Investment Trust Limited	**0**	**0**	**0**	7,110	1,035	994
Manufacturing						
ACL Cabel Limited	**0**	**0**	**0**	109,400	11,988	13,566
Caltex Lubricants Lanka Limited	**201,800**	**15,033**	**17,153**	197,100	14,634	13,156
Siera Cables Limited **	**0**	**0**	**0**	27,700	83	64
Tokyo Cement Limited	**0**	**0**	**0**	1,250,000	14,917	18,750
		15,033	**17,153**		41,622	45,536
Power & Energy						
Lanka Indian Oil Company Limited	**240,000**	**9,560**	**7,200**	240,000	9,560	7,020
Diversified Holdings						
Aitken Spence & Company Limited	**6,000**	**2,426**	**2,280**	6,000	2,426	2,034
Hayleys Limited	**90,982**	**10,182**	**12,732**	131,982	12,464	12,978
John Keells Holdings Limited	**53,396**	**9,196**	**10,243**	6,222	44	804
		21,804	**25,255**		14,934	15,816
Telecommunications						
Sri Lanka Telecom Limited	**1,412,900**	**45,405**	**52,277**	385,000	7,587	6,930
		101,515	**112,047**		89,868	92,513

* *Cost is reduced by write-off of diminution in value other than temporary in respect of investments.*

** *Par value Rs1/- each.*

Sector classification and market value per share are based on the list published by Colombo Stock Exchange.

NOTES ON THE FINANCIAL STATEMENTS

32.7 Unquoted Ordinary Shares

	31.03.2007			31.03.2006		
	Number of shares of Rs10 each	**Cost* Rs 000**	**Directors' Valuation Rs 000**	Number of shares of Rs10 each	Cost* Rs 000	Directors' Valuation Rs 000
Beico Link Carbons (Pvt) Limited	**328,500**	**2,190**	**2,190**	328,500	2,190	2,190
Browns Dimo Industrial Products (Pvt) Limited	**150,000**	**1,500**	**2,214**	150,000	1,500	3,306
Ceylinco Developers Limited	**250,000**	**2,500**	**5,160**	250,000	2,500	21,875
Credit Information Bureau of Sri Lanka **	**8,884**	**888**	**888**	8,884	888	888
Cyprea Lanka (Pvt) Limited	**1,500,000**	**15,000**	**15,000**	1,500,000	15,000	15,000
Fitch Ratings Lanka Limited	**62,500**	**625**	**625**	62,500	625	625
Hydrotech Lanka (Dickoya) (Pvt) Limited	**1,834,500**	**4,500**	**4,500**	1,834,500	4,500	4,500
Link Development (Pvt) Limited	**150,000**	**750**	**750**	150,000	750	750
Metal Packaging Limited	**0**	**0**	**0**	394,997	0	0
Plastipak Lanka Limited	**240,000**	**2,400**	**2,400**	240,000	2,400	2,400
Ranweli Resorts Limited	**1,616,193**	**10,748**	**19,073**	1,616,193	10,748	17,682
Sampath Centre Limited	**1,000,000**	**10,000**	**10,000**	1,000,000	10,000	16,906
Samson Reclaim Rubbers (Pvt) Limited	**116,700**	**2,334**	**3,363**	116,700	2,334	2,359
Sinwa Holdings Limited	**460,000**	**9,200**	**9,200**	460,000	9,200	9,200
The Video Team (Pvt) Limited	**30,000**	**300**	**300**	30,000	300	300
Wayamba Plantations (Pvt) Limited	**2,750,000**	**9,750**	**9,750**	2,750,000	18,750	18,750
Total unquoted ordinary shares - Bank		**72,685**	**85,413**		81,685	116,731
Investments in unquoted ordinary shares by subsidiaries		**59,755**			27,005	
Total unquoted ordinary shares - Group		**132,440**			108,690	

32.7.1 Investments in Unquoted Ordinary Shares by Subsidiaries

	31.03.2007		31.03.2006	
	Number of shares of Rs10 each	**Cost* Rs 000**	Number of shares of Rs10 each	Cost* Rs 000
Asia Soft (Pvt) Limited	**0**	**0**	500,000	7,500
Credit Information Bureau of Sri Lanka **	**300**	**30**	300	30
Durdans Heart Surgical (Pvt) Limited	**1,500,000**	**14,625**	1,500,000	14,475
Hayleys Hydro Energy (Pvt) Limited	**4,410,000**	**44,100**	0	0
Koolair Ventures (Pvt) Limited	**0**	**0**	648,500	4,000
Lankaclear (Pvt) Limited	**100,000**	**1,000**	100,000	1,000
		59,755		27,005

* *Cost is reduced by write-off of diminution in value other than temporary in respect of investments.*

** *Par value Rs100/- each.*

NOTES ON THE FINANCIAL STATEMENTS

32.8 Quoted Redeemable Cumulative Preference Shares

	31.03.2007 Number of shares of Rs10 each	31.03.2007 Cost* Rs 000	31.03.2006 Number of shares of Rs10 each	31.03.2006 Cost* Rs 000
Commercial Bank of Ceylon Limited - 13%	**0**	**0**	5,000,000	50,000
Commercial Bank of Ceylon Limited - 11.25%	**5,000,000**	**50,000**	5,000,000	50,000
Investments in quoted preference shares - Bank		**50,000**		100,000
Market value of quoted preference shares - Bank Rs46.25 million				
Investments in quoted preference by subsidiaries		**0**		0
Total investments in quoted preference shares - Group		**50,000**		100,000

32.9 Unquoted Preference Shares

32.9.1 Unquoted Redeemable Cumulative Preference Shares

	31.03.2007 Number of shares	31.03.2007 Cost* Rs 000	31.03.2006 Number of shares	31.03.2006 Cost* Rs 000
Carson Cumberbatch & Company Limited	**17,500,000**	**175,000**	17,500,000	175,000
Eden Hotels Lanka Limited	**6,666,667**	**66,667**	10,000,000	100,000
Heladanavi (Pvt) Limited	**15,000,001**	**150,000**	18,333,333	183,334
Plastipak Lanka Limited	**0**	**0**	333,333	3,333
Sampath Centre Limited	**7,500,000**	**75,000**	7,500,000	75,000
		466,667		536,667

32.9.2 Unquoted Irredeemable Preference Shares

	31.03.2007 Number of shares	31.03.2007 Cost* Rs 000	31.03.2006 Number of shares	31.03.2006 Cost* Rs 000
Arpico Finance Company Limited	**50,000**	**500**	50,000	500
Total investments in unquoted preference shares - Bank		**467,167**		537,167
Investments in unquoted preference shares by subsidiaries		**221,550**		221,550
Total investments in unquoted preference shares - Group		**688,717**		758,717

32.9.3 Investments in Unquoted Preference Shares by Subsidiaries

	31.03.2007 Number of shares	31.03.2007 Cost* Rs 000	31.03.2006 Number of shares	31.03.2006 Cost* Rs 000
Coco Lands Limited	**1,875,000**	**18,750**	1,875,000	18,750
E Services Limited	**2,500,000**	**25,000**	2,500,000	25,000
LVS Energy (Pvt) Limited	**5,000,000**	**50,000**	5,000,000	50,000
Nividhu (Pvt) Limited	**3,280,000**	**32,800**	3,280,000	32,800
Royal Fernwood Porcelain Limited	**2,500,000**	**30,000**	2,500,000	30,000
Tudawe Brothers Limited	**400,000**	**40,000**	400,000	40,000
Unit Energy (Pvt) Limited	**2,500,000**	**25,000**	2,500,000	25,000
		221,550		221,550

* *Cost is reduced by write-off of diminution in value other than temporary in respect of investments.*

NOTES ON THE FINANCIAL STATEMENTS

32.10 Quoted Debentures

	31.03.2007 Cost* Rs 000	31.03.2006 Cost* Rs 000
Total quoted debentures - Bank	**0**	0
Investments in quoted debentures by subsidiaries	**43,500**	43,500
Total investments in quoted debentures - Group	**43,500**	43,500

Market value of quoted debentures - Group Rs42.9 million

32.10.1 Investments in Quoted Debentures by Subsidiaries

	31.03.2007	31.03.2006
Commercial Bank of Ceylon Limited - 9.39%	**20,000**	20,000
Hatton National Bank Limited - 13.75%	**7,500**	7,500
Hatton National Bank Limited - 12% (2002/7)	**6,000**	6,000
Hatton National Bank Limited - 10%	**10,000**	10,000
	43,500	43,500

Market value of quoted debentures - Rs42.7 million

32.11 Unquoted Debentures

	31.03.2007	31.03.2006
Riverina Hotels Limited	**0**	2
Total investments in unquoted debentures - Bank	**0**	2
Investments in unquoted debentures by subsidiaries	**40,072**	92,136
Total investments in unquoted debentures - Group	**40,072**	92,138

32.11.1 Investments in Unquoted Debentures by Subsidiaries

	31.03.2007 Cost* Rs 000	31.03.2006 Cost* Rs 000
Alutec Extrusions (Pvt) Limited	**7,500**	15,000
Ceylon Hospitals Limited	**2,572**	4,536
Coco Lands Limited	**10,000**	20,000
Coco Lanka Limited	**10,000**	10,000
Koolair Ventures Power (Pvt) Limited	**0**	30,000
Lanka Transformers Limited	**0**	7,500
Laughs Holdings Limited	**0**	5,100
Unit Energy (Pvt) Limited	**10,000**	0
	40,072	92,136

* *Cost is reduced by write-off, where appropriate by the diminution in value other than temporary in respect of investments.*

NOTES ON THE FINANCIAL STATEMENTS

32.12 Investments in Unit Trusts

	31.03.2007			31.03.2006		
	Number of units	**Cost* Rs 000**	**Market value Rs 000**	Number of units	Cost Rs 000	Market value Rs 000
NAMAL Flexi Income Fund	**2,512,565**	**25,000**	**25,352**	0	0	0
NAMAL Growth Fund	**1,853,050**	**18,402**	**64,542**	2,793,050	27,736	75,915
NAMAL Income Fund	**15,644,084**	**159,500**	**161,916**	10,721,154	107,500	110,857
NAMAL Money Market Fund	**9,039,553**	**90,514**	**93,198**	8,212,385	82,157	84,013
National Equity Fund	**2,640,540**	**28,059**	**39,265**	3,580,540	38,048	48,337
Total investments in unit trusts by Bank		**321,475**	**384,273**		255,441	319,122
Investments in unit trusts by subsidiaries		**50,000**	**51,272**		50,000	50,589
Total investments in unit trusts by Group		**371,475**	**435,545**		305,441	369,711

32.12.1 Investments in Unit Trusts by Subsidiaries

NAMAL Income Fund	**4,873,740**	**50,000**	**51,272**	4,873,740	50,000	50,589
		50,000	**51,272**		50,000	50,589

* Cost is reduced by write-off, where appropriate by the dimunition in value other than temporary in respect of investments.

33 Investments in Associate Companies

	Bank		Group	
	31.03.2007 Rs 000	31.03.2006 Rs 000	**31.03.2007 Rs 000**	31.03.2006 Rs 000
Quoted				
Commercial Bank of Ceylon Limited (Ownership 27.11%-27.25% in 2006)				
Balance on 31 March	**1,549,418**	1,549,418	**3,716,885**	3,232,276
Profit after tax	**0**	0	**333,587**	520,675
Less: Goodwill written off	**0**	0	**0**	2,321
Gain/(loss) on deemed reduction in ownership	**0**	0	**(2,389)**	(3,047)
Adjustment for deferred taxation	**0**	0	**0**	(30,698)
Movements recognised in the Statement of Changes in Equity	**0**	0	**27,980**	0
Balance on 31 March	**1,549,418**	1,549,418	**4,076,063**	3,716,885
Unquoted				
National Asset Management Limited (Ownership 30%-26% in 2006)				
Balance on 31 March	**30,185**	0	**32,438**	0
Transfer from investment in subsidiaries		30,185	**0**	30,185
Profit after tax			**2,290**	85
Cost of acquisition	**5,085**	0	**5,085**	2,168
Balance on 31 March	**35,270**	30,185	**39,813**	32,438
Total	**1,584,688**	1,579,603	**4,115,876**	3,749,323
Market value of investment in Commercial Bank of Ceylon Limited (voting and non-voting ordinary shares)	**8,322,415**	5,806,315	**8,322,415**	5,806,315

The Bank increased the ownership in National Asset Management Limited from 26% to 30%.

NOTES ON THE FINANCIAL STATEMENTS

34 Investments in Subsidiary Companies

	DFCC Consulting (Pvt) Limited Ownership 100%	DFCC Stock Brokers (Pvt) Limited Ownership 100%	DFCC Vardhana Bank Limited Ownership 95%	Lanka Industrial Estates Limited Ownership 50%	Lanka Ventures Limited Ownership 58%	Bank 31.03.2007	Bank 31.03.2006
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Balance on 31 March	5,000	15,019	1,141,408	78,283	237,600	1,477,310	1,023,617
Investment in rights issue			285,613			285,613	472,259
Cost of acquisition			1,965			1,965	11,619
Transferred to investments in associate companies						0	(30,185)
Balance on 31 March	5,000	15,019	1,428,986	78,283	237,600	1,764,888	1,477,310
Market value of quoted investments					334,877	334,877	422,236

The Bank increased the ownership in DFCC Vardhana Bank Limited from 95.20% to 95.40% on 14 December 2006.

	Bank		Group	
	31.03.2007	31.03.2006	**31.03.2007**	31.03.2006
	Rs 000	Rs 000	**Rs 000**	Rs 000
35 Group Balances Receivable				
DFCC Consultancy (Pvt) Limited	**66**	64	**0**	0
DFCC Stock Brokers (Pvt) Limited	**1,051**	805	**0**	0
DFCC Vardhana Bank Limited	**6,662**	6,754	**0**	0
National Asset Management Limited	**1,047**	516	**1,047**	516
	8,826	8,139	**1,047**	516
36 Other Receivables				
Refundable deposits and advances	**107,645**	54,190	**136,440**	68,332
Dividend due	**3,865**	11,378	**3,865**	11,378
Reimbursement of exchange loss due from Government of Sri Lanka	**350,066**	101,185	**350,066**	101,185
Debtors *	**451,843**	295,144	**574,631**	435,101
	913,419	461,897	**1,065,002**	615,996

* *Debtors includes dues on terminated leases net of provision.*

37 Investment Property

37.1 Composition

	Bank 31.03.2007 Rs 000	Bank 31.03.2006 Rs 000	Group 31.03.2007 Rs 000	Group 31.03.2006 Rs 000
Balance on 31 March	**12,180**	12,180	**143,114**	143,836
Additions during the year	**0**	0	**1,871**	4,888
Less: Depreciation	**0**	0	**5,860**	5,610
Impairment loss	**5,680**	0	**5,680**	0
Disposals during the year	**0**	0	**1,612**	0
	6,500	12,180	**131,833**	143,114

NOTES ON THE FINANCIAL STATEMENTS

37.2 List of Investment Properties

	Buildings	Extent of Land	Cost	Accumulated Depreciation/ Impairment	Net Book Value	Market Value
	sq. ft.	Perches	Rs 000	Rs 000	Rs 000	Rs 000
586, Galle Road, Colombo 3	0	20	12,180	5,680	6,500	6,500
Pattiwila Road, Sapugaskanda, Makola	280,000	20,000	171,997	46,664	125,333	575,350*
			184,177	52,344	131,833	

** The fair value of investment property as at 31.03.2007 was based on market valuations carried out in 2007 by Mr P B Kalugalagedara, FIV (Sri lanka), Chartered valuer.*

38 Goodwill on Consolidation

	Group	
	31.03.2007	31.03.2006
	Rs 000	Rs 000
Balance on 31 March	**146,658**	203,809
Arising on consolidation	**0**	99
Less: Goodwill written off	**0**	57,250
	146,658	146,658

39 Property and Equipment

39.1 Composition: Bank

	Land & building	Office equipment	Furniture & fittings	Motor vehicles - owned	Motor vehicles - finance lease	Total
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
Cost on 31.03.2006	258,094	354,096	95,205	115,448	1,845	824,688
Additions for the year	2,356	72,225	20,092	0	0	94,673
Transfers *				1,845	(1,845)	0
Less: Disposals during the year			44	1,459		1,503
Cost on 31.03.2007	260,450	426,321	115,253	115,834	0	917,858
Accumulated depreciation on 31.03.2006	94,347	223,524	36,015	83,748	1,845	439,479
Charge for the year	8,626	59,056	7,386	12,305	0	87,373
Transfers *				1,845	(1,845)	0
Less: Accumulated depreciation on disposal	0	0	44	1,459	0	1,503
Accumulated depreciation on 31.03.2007	102,973	282,580	43,357	96,439	0	525,349
Net book value on 31.03.2007	**157,477**	**143,741**	**71,896**	**19,395**	**0**	**392,509**
Net book value on 31.03.2006	163,747	130,572	59,190	31,700	0	385,209

** The ownership was tranferred to the Bank.*

39.1.1 Operating Lease

	Rs 000
Cost on 31 March 2007	23,593
Less: Accumulated depreciation on 31 March 2007	23,593
Net book value on 31 March 2007	0

Included under owned motor vehicles.

NOTES ON THE FINANCIAL STATEMENTS

39.1.2 List of Freehold Land and Building

	Building sq. ft.	Extent of land perches	Cost Rs 000	Accumulated depreciation Rs 000	Net book value Rs 000
73/5, Galle Road, Colombo 3	57,200	104.45	54,510	45,406	9,104
5, Deva Veediya, Kandy	4,600	12.54	12,699	3,681	9,018
259/30, Kandy Road, Bambarakelle, Nuwara-Eliya	0	28.72	7,279	0	7,279
73, W A D Ramanayake Mw., Colombo 2	21,400	45.00	183,362	53,886	129,476
4A, 4th Cross Lane, Borupana, Ratmalana		20.00	2,600	0	2,600
			260,450	102,973	157,477

Market Value of Properties

	Rs million	Date of valuation
73/5, Galle Road, Colombo 3	396	31.03.2005
5, Deva Veediya, Kandy	32	31.03.2005
73, W A D Ramanayake Mawatha, Colombo 2	235	31.03.2005

Valued by Mr P B Kalugalagedera - Chartered Valuer

39.2 Composition: Group

	Land & building Rs 000	Plant & machinery Rs 000	Office equipment Rs 000	Furniture & fittings Rs 000	Motor vehicles - owned Rs 000	Motor vehicles - finance lease Rs 000	Total Rs 000
Cost on 31.03.2006	310,594	64,840	621,226	155,342	134,087	1,845	1,287,934
Less: Transfer to intangible assets	0	0	173,412	0	0	0	173,412
Additions for the year	2,434	10	123,146	54,802	15,088	0	195,480
Transfers*					1,845	(1,845)	0
Less: Disposals during the year	0	0	7,500	379	1,511	0	9,390
Cost on 31.03.2007	313,028	64,850	563,460	209,765	149,509	0	1,300,612
Accumulated depreciation on 31.03.2006	107,585	60,373	439,510	70,408	95,138	1,845	774,859
Less: Transfer to intangible assets	0	0	161,055	0	0	0	161,055
Charge for the year	12,841	619	76,476	12,563	16,150	0	118,649
Transfers*				–	1,845	(1,845)	
Less: Accumulated depreciation on disposal	0	0	4,132	379	1,501	0	6,012
Accumulated depreciation on 31.03.2007	120,426	60,992	350,799	82,592	116,632	0	726,441
Net book value on 31.03.2007	**192,602**	**3,858**	**212,661**	**127,173**	**37,877**	**0**	**574,171**
Net book value on 31.03.2006	203,009	4,467	181,716	84,934	38,949	0	513,075

** The ownership was transferred to the Bank.*

40 Intangible Assets
(Computer application software)

	Bank		Group	
	31.03.2007 Rs 000	31.03.2006 Rs 000	**31.03.2007 Rs 000**	31.03.2006 Rs 000
Cost on 31.03.2006	**220,440**		**220,440**	
Transferred from property and equipment		219,993	**173,412**	219,993
Additions for the year	**24,486**	447	**164,377**	447
Cost on 31.03.2007	**244,926**	220,440	**558,229**	220,440
Accumulated depreciation on 31.03.2006	**124,492**		**124,492**	
Transferred from property & equipment	**0**	83,752	**161,055**	83,752
Amortisation for the year	**40,833**	40,740	**73,915**	40,740
Accumulated amortisation on 31.03.2007	**165,325**	124,492	**359,462**	124,492
Net Book Value on 31.03.2007	**79,601**	95,948	**198,767**	95,948

NOTES ON THE FINANCIAL STATEMENTS

41 Deferred Tax Asset

	Group	
	2007 Rs 000	2006 Rs 000
Balance on 31 March	**160,020**	174,179
Reversal	**(22,530)**	(14,159)
	137,490	160,020

	Bank		Group	
	31.03.2007 Rs 000	31.03.2006 Rs 000	**31.03.2007 Rs 000**	31.03.2006 Rs 000

42 Deposits

	Bank		Group	
	31.03.2007 Rs 000	31.03.2006 Rs 000	**31.03.2007 Rs 000**	31.03.2006 Rs 000
Demand deposits	**0**	0	**533,406**	331,720
Savings deposits	**0**	0	**969,400**	511,912
Fixed deposits	**13,521,710**	3,940,087	**19,062,298**	7,884,880
Certificates of deposits	**50,861**	77,128	**123,574**	101,495
Others	**0**	0	**128,006**	55,084
	13,572,571	4,017,215	**20,816,684**	8,885,091
Deposits from banks	**691,311**	527,271	**1,896,535**	643,500
Deposits from finance companies	**1,082,199**	0	**1,108,807**	26,383
Deposits from others	**11,799,061**	3,489,944	**17,811,342**	8,215,208
	13,572,571	4,017,215	**20,816,684**	8,885,091

43 Borrowing - Medium and Long-Term

43.1 Borrowing

	Bank		Group	
	31.03.2007 Rs 000	31.03.2006 Rs 000	**31.03.2007 Rs 000**	31.03.2006 Rs 000
Government of Sri Lanka loans under:				
Government of Sri Lanka/IDA loans - credit lines	**2,007,661**	1,896,354	**2,007,661**	1,896,354
Government of Sri Lanka/ADB loans - credit lines	**3,183,374**	3,358,535	**3,183,374**	3,358,535
Government of Sri Lanka/KfW loans - credit lines	**3,454,618**	3,203,975	**3,454,618**	3,203,975
Government of Sri Lanka/ JBIC loan - credit lines	**2,256,162**	1,299,310	**2,256,162**	1,299,310
Government of Sri Lanka /IFAD loan - credit line	**28,506**	31,217	**28,506**	31,217
Government of Sri Lanka/GOI loans	**2,477**	7,226	**2,477**	7,226
European Investment Bank	**5,483,834**	5,049,697	**5,483,834**	5,049,697
Central Bank of Sri Lanka refinance loans (secured)	**1,954,132**	2,180,917	**1,954,132**	2,180,917
Direct loans	**1,146,891**	1,257,303	**1,146,891**	1,257,303
Floating rate notes	**4,339,732**	4,339,732	**4,339,732**	4,339,732
Development paper	**0**	259,503	**0**	259,503
Local borrowing	**6,500,000**	5,500,000	**6,500,000**	5,500,000
	30,357,387	28,383,769	**30,357,387**	28,383,769
Liabilities denominated in foreign currency:				
- US Dollars (US$)	**92,573**	94,159	**92,573**	94,159
- Euro Dollars (EUR)	**2,371**	3,630	**2,371**	3,630
- Japanese Yen (JPY)	**605,875**	605,875	**605,875**	605,875

NOTES ON THE FINANCIAL STATEMENTS

43.2 Supplementary Information

(As required under DFCC Act No. 35 of 1955)

Government of Sri Lanka has approved and guaranteed in terms of Section 14 of DFCC Act No. 35 of 1955 borrowing by the Bank from FMO, DEG and capital market sources.

Government of Sri Lanka has guaranteed the bi-annual interest payment to floating rate note holders for the entire 10 year period.

Government of Sri Lanka has issued a counter indemnity to ADB for the principal amount of floating rate notes guaranteed by ADB.

No new guarantees have been issued during year ended 31 March 2007.

Both IDA and ADB provide credit lines denominated in Special Drawing Rights to the Government of Sri Lanka which, as the principal borrower, re-lends to the Bank to refinance direct lending operations. The Bank repays to the Government of Sri Lanka in Rupees.

43.3 Assets Pledged as Security

Nature	Amount Rs 000
Assignment in terms of Section 88A of the Monetary Law of loans refinanced by Central Bank	1,954,132

Acronyms:

ADB	-	Asian Development Bank
IDA	-	International Development Association
KfW	-	Kreditanstalt fur Wiederaufbau
JBIC	-	Japan Bank for International Cooperation Fund
GOI	-	Government of India
IFAD	-	International Fund for Agriculture Devolopment

	Bank		Group	
	31.03.2007 Rs 000	31.03.2006 Rs 000	**31.03.2007 Rs 000**	31.03.2006 Rs 000
44 Borrowing - Short-Term				
Borrowing under repurchase agreements	**614,772**	953,409	**748,198**	1,016,335
Bank overdrafts	**0**	0	**55,628**	20,351
Inter-bank borrowing	**925,000**	1,500,000	**2,021,276**	1,510,354
	1,539,772	2,453,409	**2,825,102**	2,547,040
45 Debentures				
45.1 Movement in Debentures				
Balance on 31 March	**2,000,000**	1,500,000	**2,000,000**	1,500,000
Issued during the year	**0**	500,000	**0**	500,000
	2,000,000	2,000,000	**2,000,000**	2,000,000

Unsecured debentures have been issued to provident funds. These debentures have been issued in the ordinary course of business of the Bank to supplement other financial resources.

46 Obligation under Finance Leases

	Bank 31.03.2007	Bank 31.03.2006	Group 31.03.2007	Group 31.03.2006
Total minimum lease payments outstanding		419		419
Less: Interest on lease payments		26		26
Present value		393		393

NOTES ON THE FINANCIAL STATEMENTS

	Bank		Group	
	31.03.2007 Rs 000	31.03.2006 Rs 000	**31.03.2007 Rs 000**	31.03.2006 Rs 000
47 Deferred Tax Liability				
Balace on 31 March	**376,555**	461,864	**376,556**	462,028
Impact on rate increase	**62,863**	–	**62,864**	–
Reversal	**(75,576)**	(85,309)	**(75,577)**	(85,472)
	363,842	376,555	**363,843**	376,556
48 Other Liabilities				
Accruals	**43,669**	78,964	**87,118**	120,337
Prior year dividends	**12,124**	10,689	**13,850**	11,421
Security deposit for leases	**9,729**	11,846	**52,459**	54,681
Provision	**136,945**	106,580	**161,014**	118,960
Prepaid loan instalments	**110,349**	85,388	**110,349**	85,388
Account payables	**191,460**	134,014	**680,592**	811,765
	504,276	427,481	**1,105,382**	1,202,552
48.1 Composition of Provision				
Retirement benefit - funded	**21,972**	6,752	**21,972**	6,752
- unfunded	**16,935**	12,040	**16,935**	12,040
End of service gratuity	**3,920**	1,788	**13,264**	7,858
Others	**94,118**	86,000	**108,843**	92,310
	136,945	106,580	**161,014**	118,960
48.2 Movement in Provision				
Balance on 31 March	**106,580**		**118,960**	
Add: Provision for the year	**189,834**		**208,047**	
Less: Payments	**159,469**		**165,993**	
	136,945		**161,014**	
49 Subordinated Debentures				
Listed in the Colombo Stock Exchange	**1,000,000**		**1,000,000**	
Private placement	**1,000,000**		**1,000,000**	
	2,000,000		**2,000,000**	

50 Negative Goodwill

	Group	
	31.03.2007 Rs 000	31.03.2006 Rs 000
Balance on 31 March	**1,263**	3,359
Less: Transfer to equity	**1,263**	0
Negative goodwill recognised as income	**0**	2,096
	0	1,263

Unamortised negative goodwill of Rs1,263,058 has been transferred to Statment of Changes in Equity on 1 April 2006 in accordance with SLAS 25, "Business Combinations (Revised 2006)".

NOTES ON THE FINANCIAL STATEMENTS

51 Share Capital

	Bank		Group	
	31.03.2007 Rs 000	31.03.2006 Rs 000	**31.03.2007 Rs 000**	31.03.2006 Rs 000
51.1 Authorised Share Capital				
500,000,000 ordinary shares of Rs10 each	**5,000,000**	5,000,000	**5,000,000**	5,000,000
51.2 Issued share capital				
86,556,537 ordinary shares of Rs10 each	**865,565**	575,908	**865,565**	575,908
Alloted and Fully Paid				
57,590,822 ordinary shares (57,413,283 shares in 2006)	**575,908**	574,133	**575,908**	574,133
Bonus share issue in June 2006, 1 for every 2 held, 28,797,824 ordinary shares	**287,978**	0	**287,978**	0
Issue under share option - 167,891 ordinary shares (177,539 shares in 2006)	**1,679**	1,775	**1,679**	1,775
86,556,537 ordinary shares (57,590,822 shares in 2006)	**865,565**	575,908	**865,565**	575,908

Ordinary shares held by associate on 31 March 2007
Commercial Bank of Ceylon Limited - 16,866

51.3 Employee Share Option Plan

51.3.1 Movement in Options Granted

	31.03.2007 Numbers	31.03.2006 Numbers
Options granted in respect of:		
31.3.2002	**634,631**	634,631
31.3.2003	**634,628**	634,628
Adjustment for bonus shares issue on 12.2.2004	**230,906**	230,906
31.3.2004	**857,162**	857,162
31.3.2005	**Nil**	Nil
31.3.2006	**89,119**	89,119
Adjustment for bonus shares issue on 30.6.2006	**710,036**	–
	3,156,482	2,446,446
Options lapsed year to 31.3.2003	**(28,207)**	(28,207)
Total granted as at 31.3.2007	**3,128,275**	2,418,239
Options exersised:		
During year to 31.3.2004	**(548,256)**	(548,256)
31.3.2005	**(267,460)**	(267,460)
31.3.2006	**(177,539)**	(177,539)
31.3.2007	**(167,891)**	–
Options outstanding on 31.3.2007	**1,967,129**	1,424,984

51.3.2 Composition

	2007		2006		
	Number	Exercise Price Rs	Number	Exercise Price Rs	Expiry date
Options granted in year to 31.3.2002	**32,538**	77.80	21,692	116.70	19.7.2007
31.3.2003	**556,191**	67.75	466,949	101.63	30.6.2008
31.3.2004	**1,244,740**	141.03	847,224	211.55	30.6.2009
31.3.2006	**133,660**	149.95	89,119	224.93	2.7.2011
	1,967,129		1,424,984		

NOTES ON THE FINANCIAL STATEMENTS

52 Reserve

52.1 Reserve Fund

This is a statutory reserve created as per direction issued by Central Bank of Sri Lanka under Section 76 (j) (1) of the Banking Act No. 30 of 1988 as amended by Banking (Amended) Act No. 33 of 1995.

52.2 Sinking Fund Reserve

This is a non-distributable revenue reserve augmented annually by the appropriation of profit after tax in each financial year. The equivalent amount of the reserve is invested in government securities. The annual appropriation and investment in government securities is intended to provide funds for the repayment of the liability of US$70 million in 2008 at the original rate of exchange. The difference between the rate of exchange at the time of repayment in 2008 and this fund is borne by the government of Sri Lanka.

The annual amount appropriated and the investment in government securities is in accordance with the loan covenants in respective loan agreements.

52.3 Share Premium

This is the premium paid on ordinary shares.

52.4 Revenue Reserve and Retained Earnings

52.4.1 This represents cumulative net earnings, inclusive of proposed dividend amounting to Rs65 million payable on approval by the shareholders at the Annual General Meeting on 29 June 2007. The balance is retained and reinvested in the business of the Bank.

52.4.2 Dividend Proposed

	Bank		Group	
	31.03.2007 Rs 000	31.03.2006 Rs 000	**31.03.2007 Rs 000**	31.03.2006 Rs 000
Net dividend	60,459	335,771	40,981	335,771
Tax deducted at source	4,461	9,774	2,297	9,774
Gross dividend - 5% (60%)	64,920	345,545	43,278	345,545
Dividend per share, (Rs)	0.50	6.00	0.50	6.00

52.5 Other Reserves - Associates

This includes capital redemption reserve and foreign currency translation loss.

52.5.1 Capital Redemption Reserve

This represents the nominal value of preference shares redeemed out of profits.

52.5.2 Foreign Currency Translation Reserve

This represents the loss on the translation of the financial statements of the Bangladesh operations.

53 Minority Interests

Minority interests represent the portion of equity interests that are not owned, directly or indirectly through subsidiaries, by the Bank.

NOTES ON THE FINANCIAL STATEMENTS

	Bank		Group	
	31.03.2007 Rs 000	31.03.2006 Rs 000	**31.03.2007 Rs 000**	31.03.2006 Rs 000
54 Contingent Liabilities and Commitments				
54.1 Contingent Liabilities				
Guarantees issued to:				
DFCC Vardhana Bank in respect of indebtedness of customers of the Bank	**221,500**	582,000	**0**	0
Other banks in respect of indebtedness of customers of the Bank	**118,584**	109,034	**118,584**	109,034
Companies in respect of indebtedness of customers of the bank	**732,735**	786,222	**2,746,214**	2,549,403
Principal collector of customs (duty guarantees)	**349**	0	**5,769**	23,860
Third parties as security for commerical paper issued by customers of the Bank	**358,782**	319,415	**358,782**	319,415
Documentary credits		0	**2,120,573**	1,453,411
Bills for collection	**0**	0	**165,403**	350,181
Income tax*	**0**	180,915	**235,549**	416,464
Forward exchange contracts (net)	**0**	0	**227,953**	272,886
54.2 Commitments in Ordinary Course of Business				
Commitments for unutilised credit facilities	**9,770,253**	8,667,616	**10,643,814**	9,363,985
Capital expenditure approved by the Board of Directors				
Contracted	**5,795**	13,552	**12,057**	14,863
Not contracted	**22,000**	12,178	**70,215**	13,378
	11,229,998	10,670,932	**16,704,913**	14,886,880

* *The contingent liability of Lanka Ventures Limited (LVL) was Rs235,548,863 inclusive of a penalty of Rs79,768,400 for years of assessment 1994/95 and 2001/02. The Company has lodged appeals against the assessments and initiated action in Court of Appeal seeking a writ of certiorari to quash the assessment and seek other interim reliefs. The court of appeal has issued an interim restraining order to prevent recovery of tax in default.*

55 Litigation

Litigations against the Bank

Bank has appealed to the Supreme Court to set aside an order given by the High Court confirming an award of Rs1,132,518 granted to an ex-employee by the Labour Tribunal.

Legal action has been initiated by a party in the District Court of Colombo claiming that the property mortgaged to DFCC Bank by a customer was not transferred to him by the plaintiff and that the customer was holding the property in trust in favour of the plaintiff. A Stay Order on this matter had been issued by the Court of Appeal until the final determination of the said application. On legal advice, the Bank is defending themselves as an added defendant.

Legal action was filed against the Bank and several other defendants in the District Court of Colombo praying:

(a) for a determination that the Bank's holding of voting shares in the Commercial Bank of Ceylon Limited aggregated with the other shareholders who are cited as defendants cannot exceed 10%.

(b) to reduce the said named defendants shareholding to a maximum of 10% by selling the excess shareholding; and

(c) for an Enjoining Order restricting the presence and voting by the Bank with the other named shareholders to 10%.

The District Court refused the Enjoining Order and subsequently dismissed the petition. Against initial dismissal of the petition, a revision application has been filed by the plaintiffs. When the Enjoining Order was refused by the District Court, the plaintiffs appealed to the Court of Appeal and obtained a Stay Order against the Bank. Since both these matters are inter-connected the Court of Appeal has fixed both, matters for argument from 17 to 21 September 2007.

The Bank is defending the actions on the ground that the Bank's acquisition of shares in 1997 was done with specific approval of the Monetary Board in accordance with the provisions of the Banking Act.

NOTES ON THE FINANCIAL STATEMENTS

A shareholder of Commercial Bank of Ceylon Limited has filed action against the Monetary Board and 11 others including DFCC Bank in the Court of Appeal praying for an Order in the nature of a Writ, compelling DFCC and the other defendants to reduce its shareholding in Commercial Bank of Ceylon Limited not to exceed 10% within a specific period of time.

On the legal advise received, Bank has filed its objections and will be defending the action.

56 Maturity Profile of Assets and Liabilities

56.1 Definition of Maturity

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

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

56.2 Allocation of Amounts

Amounts are allocated to respective maturity groupings based on:

a) instalments falling due as per contracts, for assets and liabilities with a contractual maturity dates; and

b) expected dates of realisation of an asset and expected dates of repayments of liabilities, for assets and liabilities with no contractual maturity dates.

The amounts allocated represent the total amount receivable or payable in each maturity grouping.

56.3 Profile

	Total	Up to 3 months		3 to 12 months		1 to 3 years		3 to 5 years		> 5 years	
	Rs 000	Rs 000	%	Rs 000	%	Rs 000	%	Rs 000	%	Rs 000	%
56.3.1 Bank											
Assets with Contractual Maturity											
(Interest bearing assets)											
Short-term funds	**4,168,668**	4,168,668	100	–	–	–	–	–	–	–	–
Treasury bills & other securities	**3,429,498**	441,063	13	859,823	25	2,084,631	61	43,981	1	–	
Securities purchased under resale agreements	**240,000**	40,000	17	200,000	83	–	–	–	–	–	–
Placements with and loans to other banks and financial institutions	**1,023,956**	1,944	0	2,687	0	201,563	20	544,429	53	273,333	27
Loans	**37,469,972**	3,052,841	8	7,164,543	19	17,248,060	46	7,772,177	21	2,232,351	6
Leases	**7,545,716**	795,705	11	1,731,948	23	3,734,888	49	1,283,175	17	–	
	53,877,810	8,500,221	16	9,959,001	18	23,269,142	43	9,643,762	18	2,505,684	5
Other Assets											
(Non-interest bearing assets)											
Cash and balance with Banks	**337,509**	337,509	100	–	–	–	–	–	–	–	–
Dealing Securities	**26,072**	26,072	100	–	–	–	–	–	–	–	–
Balances with Central Bank											
Interest receivable	**609,887**	609,887	100	–	–	–	–	–	–	–	–
Investment securities											
Ordinary shares/units	**743,272**	–	–	–	–	–	–	–	–	743,272	100
Preference shares	**517,167**	50,000	10	50,000	10	366,667	70	50,000	10	500	0
Investment in associate companies	**1,584,688**	–	–	–	–	–	–	–	–	1,584,688	100
Investment in subsidiary companies	**1,764,888**	–	–	–	–	–	–	–	–	1,764,888	100
Group balances recievable	**8,826**	8,826	100	–	–	–	–	–	–	–	–
Prepaymnets	**78,513**	2,032	3	31,127	40	37,224	47	8,130	10	–	–
Other receivables	**913,419**	913,419	100	–	–	–	–	–	–	–	–
Investment property	**6,500**	–	–	–	–	–	–	–	–	6,500	100
Property & equipment	**392,509**	–	–	–	–	–	–	–	–	392,509	100
Intangible assets	**79,601**	–	–	–	–	–	–	–	–	79,601	100
	7,062,851	1,947,745	27	81,127	1	403,891	6	58,130	1	4,571,958	65
Total assets	**60,940,661**	10,447,966	17	10,040,128	16	23,673,033	39	9,701,892	16	7,077,642	12

NOTES ON THE FINANCIAL STATEMENTS

	Total	Up to 3 months		3 to 12 months		1 to 3 years		3 to 5 years		> 5 years	
	Rs 000	Rs 000	%	Rs 000	%	Rs 000	%	Rs 000	%	Rs 000	%
Liabilities with Contractual Maturity											
(Interest bearing liabilities)											
Deposits from customers	**13,572,571**	11,236,341	83	54,214	0	2,050,958	15	231,058	2	–	–
Medium and long-term	**30,357,387**	595,493	2	5,547,095	18	11,818,613	39	4,583,015	15	7,813,171	26
Short-term	**1,539,772**	1,531,116	99	8,656	1	–	–	–	–	–	
Debentures	**2,000,000**	–	–	–	–	–	–	2,000,000	100	–	–
Subordinated debentures	**2,000,000**	–	–	–	–	–	–	1,410,000	71	590,000	29
	49,469,730	13,362,950	27	5,609,965	11	13,869,571	28	8,224,073	17	8,403,171	17
Other Liabilities											
(Non-interest bearing liabilities)											
Interest accrued	**847,652**	847,652	100	–	–	–	–	–	–	–	–
Taxation	**261,012**	261,012	100	–	–	–	–	–	–	–	–
Deferred taxation	**363,842**	–	–	–	–	–	–	363,842	100	–	–
Other liabilities	**504,276**	504,276	100	–	–	–	–	–	–	–	–
	1,976,782	1,612,940	82	–	–	–	–	363,842	18	–	–
Total liabilities	**51,446,512**	14,975,890	29	5,609,965	11	13,869,571	27	8,587,915	17	8,403,171	16

56.3.2 Group

Assets with Contractual Maturity

	Total	Up to 3 months		3 to 12 months		1 to 3 years		3 to 5 years		> 5 years	
(Interest bearing assets)											
Short-term funds	**5,004,856**	4,937,010	99	67,846	1	–	–	–	–	–	–
Treasury bills & other securities	**3,825,547**	451,874	12	859,823	22	2,469,869	65	43,981	1	–	–
Securities purchased under resale agreements	**590,525**	390,525	66	200,000	34	–	–	–	–	–	–
Placements with and loans to other banks and financial institutions	**995,956**	95,944	10	2,687	0	201,563	20	422,429	42	273,333	27
Bills of exchange	**459,493**	448,005	97	–	–	11,488	3	–	–	–	–
Loans	**44,901,076**	6,391,968	14	10,360,004	23	17,729,186	40	7,835,340	17	2,584,578	6
Leases	**7,545,716**	795,705	11	1,731,948	23	3,734,888	49	1,283,175	17	–	–
	63,323,169	13,511,031	21	13,222,308	21	24,146,994	38	9,584,925	15	2,857,911	5
Other Assets											
(Non-interest bearing assets)											
Cash and balance with Banks	**966,320**	966,320	100	–	–	–	–	–	–	–	–
Dealing securities	**26,072**	26,072	100	–	–	–	–	–	–	–	–
Balances with Central Bank	**768,018**	768,018	100	–	–	–	–	–	–	–	–
Interest receivable	**587,109**	564,129	96	11,960	2	9,041	2	1,229	0	750	0
Investment securities	**–**	–									
Ordinary shares/units	**910,443**	–	–	50,000	5	100,356	11	14,625	2	745,462	82
Preference shares	**764,067**	50,000	7	68,750	9	442,917	58	125,000	16	77,400	10
Debentures	**83,571**	4,286	5	15,357	18	10,428	12	10,000	13	43,500	52
Investment in associate companies	**4,115,876**	–	–	–	–	–	–	–	–	4,115,876	100
Group balances receivable	**1,047**	1,047	100	–	–	–	–	–	–	–	–
Prepayments	**78,513**	2,032	3	31,127	40	37,224	47	8,130	10	–	–
Other receivables	**1,065,002**	1,010,867	95	35,997	3	2,484	0	4,829	1	10,825	1
Investment property	**131,833**	–	–	–	–	–	–	–	–	131,833	100
Goodwill on consolidation	**146,658**	–	–	–	–	–	–	–	–	146,658	100
Property & equipment	**574,171**	–	–	–	–	–	–	–	–	574,171	100
Intangible assets	**198,767**	–	–	–	–	–	–	–	–	198,767	100
Deferred tax asset	**137,490**	–	–	77,302	56	60,188	44	–	–	–	–
	10,554,957	3,392,771	32	290,493	3	662,638	6	163,813	2	6,045,242	57
Total assets	**73,878,126**	16,903,802	23	13,512,801	18	24,809,632	34	9,748,738	13	8,903,153	12

NOTES ON THE FINANCIAL STATEMENTS

	Total	Up to 3 months		3 to 12 months		1 to 3 years		3 to 5 years		> 5 years	
	Rs 000	Rs 000	%	Rs 000	%	Rs 000	%	Rs 000	%	Rs 000	%
Liabilities with Contractual Maturity											
(Interest bearing liabilities)											
Deposits from customers	**20,816,684**	15,228,091	73	3,242,128	16	2,115,407	10	231,058	1	–	–
Medium and long-term	**30,357,387**	595,493	2	5,547,095	18	11,818,613	39	4,583,015	15	7,813,171	26
Short-term	**2,825,102**	2,715,770	96	109,332	4	–	–	–	–	–	–
Debentures	**2,000,000**	–	–	–	–	–	–	2,000,000	100	–	–
Subordinated debentures	**2,000,000**	–	–	–	–	–	–	1,410,000	70	590,000	30
	57,999,173	18,539,354	32	8,898,555	15	13,934,020	24	8,224,073	14	8,403,171	15
Other Liabilities											
(Non-interest bearing liabilities)											
Interest accrued	**1,012,549**	1,012,549	100	–	–	–	–	–	–	–	–
Taxation	**300,500**	300,500	100	–	–	–	–	–	–	–	–
Deferred taxation	**363,843**	–	–	–	–	–	–	363,842	100	1	0
Other liabilities	**1,105,382**	976,071	89	74,247	6	1,722	0	–	–	53,342	5
	2,782,274	2,289,120	82	74,247	3	1,722	0	363,842	13	53,343	2
Total liabilities	**60,781,447**	20,828,474	34	8,972,802	15	13,935,742	23	8,587,915	14	8,456,514	14

57 Concentration of Assets and Liabilities

57.1 Concentration in the Distribution of Assets

57.1.1 In order to minimise potential risks inherent in the realisation of assets, the Bank adhere to prudential exposure limits on customer and industry groups.

57.1.2 Industrywise Distribution of main Assets are given below:

Industry Sector	2007 %	2006 %
Agriculture, forestry and fishing	**8.4**	9.7
Mining and quarrying	**1.2**	0.9
Manufacture of food, beverages and tobacco	**10.3**	11.4
Manufacture of textiles	**1.0**	1.4
Manufacture of wearing apparel excluding footwear	**1.6**	2.3
Manufacture of leather and leather products including footwear	**0.4**	0.4
Wood and manufacture of wood products	**1.1**	1.1
Manufacture of paper products, printing, publishing and packaging	**3.1**	4.0
Manufacture of chemical and chemical products	**1.1**	1.6
Manufacture of rubber products	**3.8**	3.2
Manufacture of plastic products	**1.5**	1.7
Manufacture of non-metallic mineral products	**4.9**	4.6
Basic metal products	**0.8**	0.6
Manufacture of fabricated metal products, machinery and equipment	**1.6**	2.0
Electricity, gas and water industries	**5.6**	7.3
Construction industries	**4.6**	3.6
Trade	**15.5**	12.7
Hotels and restaurants	**3.4**	4.6
Transport, storage and communications	**8.7**	8.5
Financing, insurance, real estate and business services	**17.0**	15.1
Community, social and personal services	**4.4**	3.3
	100.0	100.0

Composition of Assets	Rsm	Rsm
Loans*	38,289	30,779
Leases	7,545	5,362
Investment securities	1,260	1,340
Dealing securities	26	13
	47,120	37,494

* *Including loans to banks & excluding staff loans*

57.2 Composition of Liabilities is given in Note 43.

NOTES ON THE FINANCIAL STATEMENTS

58 Non-Performing Loans, Leases and Bills

	Bank				Group			
	31.3.2007 Rs 000	%	31.3.2006 Rs 000	%	**31.3.2007 Rs 000**	%	31.3.2006 Rs 000	%
Loans and advances	**1,694,213**		1,473,546		**2,260,857**		1,702,936	
Finance leases	**422,920**		376,634		**422,920**		376,634	
Bills of exchange discounted	**5,640**		6,390		**17,704**		6,473	
Gross exposure	**2,122,773**	**4.5**	1,856,570	5.0	**2,701,481**	**4.9**	2,086,043	4.9
Less: Interest in suspense included in overdrafts	**0**		0		**110,561**		78,193	
Net non-performing loans, advances, leases and bills	**2,122,773**	**4.5**	1,856,570	5.0	**2,590,920**	**4.7**	2,007,850	4.7
Less: Provision for bad and doubtful debts	**612,181**		582,547		**727,334**		636,051	
Net exposure	**1,510,592**	**3.2**	1,274,023	3.5	**1,863,586**	**3.4**	1,371,799	3.3
Net of tangible securities	**257,091**		219,030		**497,951**		281,363	

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

58.1 Allowances for Credit Losses

	Bank 31.3.2007	Bank 31.3.2006	Group 31.3.2007	Group 31.3.2006
Loans and advances - Note 29.1	**655,240**	699,928	**770,278**	753,391
Finance leases - Note 30.1	**195,557**	183,458	**195,557**	183,458
Bills of exchange discounted - Note 28.1	**5,640**	6,390	**5,755**	6,431
	856,437	889,776	**971,590**	943,280
Less: Provision relating to facilities currently performing				
Loans and advances	**234,886**	291,196	**234,886**	291,196
Finance leases	**9,370**	16,033	**9,370**	16,033
	244,256	307,229	**244,256**	307,229
Provision relating to non-perfoming facilities	**612,181**	**582,547**	**727,334**	636,051

58.2 The realisable value of tangible securities is computed in accordance with the hair cut rule prescribed by the Central Bank of Sri Lanka. Effective from 1 January 2004, Central Bank of Sri Lanka requires the application of prescribed discounts given below, to the forced sale value based on age of arrears of the loans, financial leases, bills of exchange and other credit facilities for the purpose of determining the net exposure at risk.

Age of Arrears	Applicable Discount Percentage on the Forced Sale Value
6-30 months	25%
Over 30 months and below 42 months	40%
Over 42 months and below 54 months	50%
Over 54 months and below 66 months	60%
Over 66 months	At the discretion of the management

NOTES ON THE FINANCIAL STATEMENTS

59 Directors' Interest in Contracts with the Bank

59.1 Financial Facilities Contracts

The Bank has entered into contracts in the normal course of business with the following enterprises in which a Director of the Bank is also a Director and/or Shareholder.

J M S Brito	Elpitiya Plantations Limited
A N Fonseka	Merchant Bank of Sri Lanka Limited *
	National Development Bank Limited *
A M de S Jayaratne	National Development Bank Limited *
	Singer (Sri Lanka) Limited
S N P Palihena	Merchant Bank of Sri Lanka Limited

* *Only a shareholder*

Facilities approved by the Board of Directors in prior years have been disclosed in the year in which such contracts were executed.

59.2 Other Contracts

Name of Related Party	Name of Director	Amount 2007 Rs 000	Amount 2006 Rs 000	Nature of Transaction
Ace Travels and Conventions (Pvt) Limited	J M S Brito	**613**	0	Purchase of air tickets
Singer Sri Lanka Limited	A M de S Jayaratne	**1,319**	0	Staff welfare
Sri Lanka Insurance Corporation Limited	J M S Brito	**13,146**	11,012	Insurance premium
Colombo Stock Exchange	A N Fonseka	**245**	115	Listing fees & subscription
Credit information Bureau of Sri Lanka	A N Fonseka	**1,922**	1,493	Services
Elevators (Pvt) Limited	J M S Brito	**120**	774	Maintenance
Aitken Spence Printing (Pvt) Limited	J M S Brito	**1,738**	1,461	Printing
Aitken Spence Overseas Travel Services (Pvt) Limited	J M S Brito	**1,259**	239	Purchase of air tickets
National Institute of Business Management	A N Fonseka	**127**	0	Staff training

60. Related Party Transactions

60.1 Directors

The Bank carries out transactions in the ordinary course of its business with related parties, based on banks pricing policy.

The baseline benchmark for Bank's pricing policy is the cost of finance, tenor premium and other costs plus adequate return to shareholders. This baseline benchmark would be adjusted for the inherent risks of the borrower. The rates of interest on the facilities to related parties conform to the Bank's pricing policy as applicable to a non-related party without any special reduction or concession.

NOTES ON THE FINANCIAL STATEMENTS

The Companies in which a Director of the Bank has significant influence by representation on the Board of Directors without a substantial shareholding are listed below:

Party Accommodated	Name of Director/ Position	Aggregate Amount of Accommodation Approved Rs m	Outstanding as at 31.03.2007 Rs m	Nature of Transaction	Security
Ace Exports (Pvt) Limited	J M S Brito Chairman	145.00	**138.10**	Term Loan	Movable property
		145.00	**138.10**		
Ace Power Embilipitya (Pvt) Limited	J M S Brito Chairman	434.80	**347.80**	Term loan (US$)	Immovable & movable property
		434.80	**347.80**		
Ace Power Generation Horana (Pvt) Limited	J M S Brito Chairman	68.00	**40.80**	Debenture loan	Immovable & movable property
		68.00	**40.80**		
Ace Power Generation Matara (Pvt) Limited	J M S Brito Chairman	118.80	**118.80***	Guarantee	Immovable & movable property
		118.80	**118.80**		
AEN Palm Oil Processing (Pvt) Limited	J M S Brito Director	85.00	**84.23**	Term loan	Immovable & movable property
		85.00	**84.23**		
Agarapatana Plantations Limited	C P R Perera Director	173.41	**107.38**	Term loan	Immovable property
		173.41	**107.38**		
Elpitiya Plantations Limited	J M S Brito Chairman	364.29	**249.32**	Term Loan	Immovable property
		100.00	**72.00**	Term Loan	
		464.29	**321.32**		
Kotagala Plantations Limited	C P R Perera Director	200.19	**126.06**	Term loan	Immovable property
		7.47	**5.76**	Term loan	Corporate Guarantee
		207.66	**131.82**		
Merchant Bank of Sri Lanka Limited	S N P Palihena Managing Director	250.00	**250.00**	Term Loan	Lease recievables**
		250.00	**250.00**		
National Asset Management Limited	A N Fonseka Director A M de S Jayaratne Director	1.59	**0.68**	Lease	Lease assets
		1.59	**0.68**		
Nawaloka Hospitals Limited	R T Wijetilleke Director	7.00	**5.12**	Lease	Lease assets
		22.74	Not disbursed	Lease	
		29.74	**5.12**		
Palm Village Hotels Limited	J M S Brito Director	10.00	**6.75**	Term Loan	Immovable property
		10.00	**6.75**		
Singer (Sri Lanka) Limited	A M de S Jayaratne Director	700.00	**700.00**	Debenture loan	
		700.00	**700.00**		
The Lanka Hospital Corporation (Pvt) Limited	A M de S Jayaratne Director	134.50	**134.50***	Guarantee	Immovable & movable property
		134.50	**134.50**		

** Only indirect accommodation.*

*** Agreement to mortgage.*

Mr R T Wijetilleke ceased to be a Diretor of DFCC Bank on 30 June 2006.

NOTES ON THE FINANCIAL STATEMENTS

60.2 Investment in Companies where a Director of the Bank is a Director

Company	Name of Director/Position	As at 31.03.2007 Ordinary Shares Quoted Rs 000	Ordinary Shares Unquoted Rs 000	Preference Shares Quoted Rs 000
Credit Information Bureau of Sri Lanka	A N Fonseka - Director		888	
Commercial Bank of Ceylon Limited	D S Weerakkody - Director A N Fonseka - Director			50,000

60.3 Transactions with Subsidiary Companies

60.3.1 Financial Facilities

Company	Facility Type	Terms	Facility Limit Rs000	Balance on 31March 2007 Rs000
DFCC Vardhana Bank	Subordinated loan	Repayable in 5 years from the date of utilisation at the rate of 11% per annum	122,000	122,000
	Short term loan	Each tranch is repayable in 3 months after the date of utilisation and interest rate based on Interbank Rate plus a premium determined at the date of utilisation.		
	Medium term loan	Each tranch is repayable in 5 years from the date of utilisation and interest repriced quarterly based on Sri Lanka Interbank Offer Rate plus a premium	878,000	0
	Guarantee facility to secure borrowings by the Bank	Guarantee commission is 0.5% per annum		

60.3.2 Other Transactions

60.3.2.1 Payments made by Subsidiaries

	Rent Rs	Other fees Rs	Reimbursement of employee cost Rs	Reimbursement of utilities Rs
DFCC Consulting (Pvt) Limited	348,480	–	–	949,350
DFCC Stock Brokers (Pvt) Limited	2,010,690	–	–	2,917,917
DFCC Vardhana Bank Limited	11,238,679	15,369,750	8,543,569	35,114,318

60.3.2.2 Payments made to Subsidiaries

	Rent Rs
Lanka Industrial Estate Limited	1,813,249

60.3.2.3 The bank has Rs1,090 million in call deposits with DFCC Vardhana Bank Limited.

NOTES ON THE FINANCIAL STATEMENTS

60.4 Transactions with Associate Companies

60.4.1 *Payments made by Associates*

	Rent Rs	Reimbursement of Utilities Rs
National Asset Management Limited	1,237,500	1,225,985

60.4.2 *Payments made to Associates*

	Other Fees Rs
National Asset Management Limited	1,903,493

60.5 Key Management Personnel

60.5.1 Key management personnel are the Board of Directors of the Bank, Chief Executive Officer, Executive Vice Presidents and the Secretary to the Board of Directors for the purpose of Sri Lanka Accounting Standard on Related Party Disclosure. The Board of Directors or the Chief Executive, nominates Executive Vice-Presidents and Secretary to the Board of Directors for appointments as Nominee Directors of enterprises to which facilities have been granted. Their appointment is pursuant to an agreement subsequent to the grant of the initial facility. Their appointment and tenure of office is at the sole discretion of the Board of Directors or the Chief Executive. Under the circumstances these enterprises are not deemed to be related parties of the Bank.

60.5.2 *Compensation - Bank*

End of service gratuity is not applicable to employees who receive post employment pension benefit.

For the year ended 31 March	**2007 Rs000**	2006 Rs000
Directors' Fees		
Chairman	**480**	480
Other Directors	**3,432**	1,785
Remuneration	**35,621**	37,790
Post employment benefits - pension	**3,920**	8,283
Termination benefits	**4,002**	3,774
	47,455	52,112

Chief Executive Officer, who is also an Ex-officio Director does not receive any fees or remuneration in his capacity as Ex-officio Director. Cost of post employment pension is the retirement benefit expense recognised in the income statement. Cost of termination benefits is the Bank's contribution for provident fund and employees' trust fund recognised in the income statement.

60.5.3 *Share Based Payments - Bank*

Key management personnel together with other eligible employees participated in a share option plan approved by the shareholders in 2002. The final grant under this plan was made during the year ended 31 March 2007.

For the year ended 31 March	**2007 Rs 000**	2006 Rs 000
Unexercised options balance at the beginning of financial year	**312,309**	150,414
Adjustment to the unexercised options on the date of bonus issue 30 June 2006	**156,152**	–
Awarded during the year	**23,616**	188,828
Exercised during the year	**(54,621)**	(26,933)
Unexercised options balance end of financial year	**437,456**	312,309
Weighted average price of unexercised options end of the year	**119.63**	168.09
Weighted average price of exercised options	**67.75**	116.42
Weighted average price of Bank's share during the year	**189.55**	239.30

NOTES ON THE FINANCIAL STATEMENTS

60.6 DFCC Bank Pension Fund – Trust

60.6.1 DFCC Bank Pension Fund constituted as a Trust was established by the DFCC Bank to discharge defined benefit pension liability of eligible employees of the Bank. The assets of the pension fund are not invested in the business of the Bank.

The Chairman, the Chief Executive Officer together with two other employees and two pensioners (ex-employees) are trustees.

60.6.2 Transactions with DFCC Bank Pension Fund

	31.03.2007	31.03.2006
	Rs 000	Rs 000
Contributions due at the beginning of financial year	**6,752**	22,415
Contribution due for the financial year (Note 16.1)	**88,689**	85,821
Contributions paid	**(73,469)**	(101,484)
Contributions due at the end of the financial year (Note 48.2)	**21,972**	6,752

These contributions are made in accordance with the legal obligations under the Trust Deed and are made to fund the actuarially determined pension liability, based on independent advice of a qualified actuary.

60.6.3 Transactions between DFCC Bank Pension Fund and Associate

DFCC Bank Pension Fund has invested Rs65 million in the subordinated debenture issue by Commercial Bank of Ceylon Limited.

First investment amount	Rs50 million
Date of investment	16 May 2006
Repayment	16 May 2016
Interest	13.25% p.s. (fixed) payable annually
Second investment amount	Rs15 million
Date of investment	18 December 2006
Repayment	18 December 2011
Interest	1 year gross treasury bill rate + 1% p.a. (floating interest, yearly repricing) and payable annually

NOTES ON THE FINANCIAL STATEMENTS

61 Business Segment Information

	Lending	Financial Leasing	Investing in Equity	Venture Capital	Commercial Banking	Other	Unallocated	Eliminations	Total
	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000	Rs 000
For the year ended 31 March 2007									
Revenue									
Interest income	5,044,404	973,157	–	54,342	998,538	25,513	–	(74,879)	7,021,075
Amortisation of negative goodwill							494	–	494
Other income	313,988	–	435,875	61,754	190,029	272,601	81,590	(110,389)	1,245,448
Income from external customers	5,358,392	973,157	435,875	116,096	1,188,567	298,114	82,084	(185,268)	8,267,017
Inter segment income				–	–	0	37,495	(37,495)	–
Total income	**5,358,392**	**973,157**	**435,875**	**116,096**	**1,188,567**	**298,114**	**119,579**	**(222,763)**	**8,267,017**
Percentage *	65	12	5	1	14	4	2	–	100
Expense									
Segment losses	(13,346)	34,982	14,680	(15)	61,296	–	–	–	97,597
Depreciation	–	–	–	697	53,674	15,777	–	–	70,148
Other operating & interest expenses	3,546,145	643,001	–	24,493	782,723	86,801	–	(74,879)	5,008,284
Inter segment expense					37,495	–	–	(37,495)	–
	3,532,799	**677,983**	**14,680**	**25,175**	**935,188**	**102,578**	–	**(112,374)**	**5,176,029**
Result	**1,825,593**	**295,174**	**421,195**	**90,921**	**253,379**	**195,536**	–	–	**3,090,988**
Unallocated expenses									423,148
Value added tax on financial services									429,039
									2,238,801
Associate companies profit before tax									959,350
Profit before tax									**3,198,151**
Income tax expense									1,505,387
Profit after tax									**1,692,764**
Minority interests									107,120
Profit for the year									**1,585,644**
Assets	**43,497,570**	**7,560,630**	**1,260,438**	**859,984**	**11,323,430**	**543,181**	**5,407,234**	**(690,217)**	**69,762,250**
Percentage	**62**	**11**	**2**	**1**	**16**	**1**	**8**	**(1)**	**100**
Investments in associate companies									4,115,876
									73,878,126
Liabilities	**33,535,777**	**6,804,567**	**–**	**9,303**	**9,841,922**	**181,358**	**11,098,737**	**(690,217)**	**60,781,447**
Capital expenditure - additions				**345**	**89,869**	**10,594**	**94,672**		**195,480**
For the year ended 31 March 2006									
Revenue									
Interest income	3,805,880	701,711	–	49,566	533,252	24,504	–	(38,974)	5,075,939
Amortisation of negative goodwill							2,096	–	2,096
Other income	351,948	–	425,942	62,960	122,378	228,526	71,766	(84,608)	1,178,912
Income from external customers	4,157,828	701,711	425,942	112,526	655,630	253,030	73,862	(123,582)	6,256,947
Inter segment income	–	–	–	–	-	–	19,911	(19,911)	–
Total income	**4,157,828**	**701,711**	**425,942**	**112,526**	**655,630**	**253,030**	**93,773**	**(143,493)**	**6,256,947**
Percentage *	**66**	**11**	**7**	**2**	**10**	**4**	**3**	**–**	**100**
Expense									
Segment losses	167,460	585	21,470	5,383	9,103	239	–	–	204,240
Depreciation	–	–	–	643	37,851	16,439	–	–	54,933
Other operating & interest expenses	2,452,383	391,191	–	20,407	447,723	96,959	–	(38,974)	3,369,689
Inter segment expense				–	17,911	2,000	–	(19,911)	–
	2,619,843	**391,776**	**21,470**	**26,433**	**512,588**	**115,637**	**–**	**(58,885)**	**3,628,862**
Result	**1,537,985**	**309,935**	**404,472**	**86,093**	**143,042**	**137,394**			**2,628,085**
Unallocated expenses									491,114
Value added tax on financial services									296,337
									1,840,634
Associate companies profit before tax									881,888
Profit before tax									**2,722,522**
Income tax expenses									965,457
Profit after tax									**1,757,065**
Minority interests									67,300
Profit for the year									**1,689,765**
Assets	**32,275,903**	**5,361,796**	**1,340,305**	**872,735**	**7,086,615**	**526,653**	**5,720,183**	**(367,853)**	**52,816,337**
Percentage	**61**	**10**	**3**	**2**	**13**	**1**	**11**	**(1)**	**100**
Investments in associate companies									3,749,323
									56,565,660
Liabilities	**27,051,085**	**4,825,616**	**–**	**11,007**	**6,021,948**	**187,342**	**6,655,172**	**(367,853)**	**44,384,317**
Capital expenditure - additions				**422**	**42,351**	**5,249**	**129,482**		**177,504**

** Net of eliminations.*

NOTES ON THE FINANCIAL STATEMENTS

61.1 Revenue and expenses attributable to the incorporated business segments of industrial estate management, unit trust management, stockbroking and consultancy services are included in the column for other.

61.2 Revenue and expenses attributable to the business segment of DFCC Vardhana Bank is included in the column for Commercial Banking.

61.3 Property & equipment and depreciation attributable to an incorporated business segment is included in the relevant segment and the balance is unallocated.

61.4 Dealing securities losses and goodwill written off of subsidiary company are included in unallocated expenses.

61.5 Eliminations are the consolidation adjustments for inter company transactions, dividend and dividend payable attributable to minority shareholders.

62 Post Balance Sheet Events

62.1 Rights Issue

Shareholders approved on 28 April 2007, a rights issue of one share for every four shares held, at a price of Rs140 per share. The rights issue subscriptions closed on 28 May 2007 and was fully subscribed. The equity of the shareholders has increased by Rs3,030 million less share issue expenses through this subscription on 28 May 2007.

62.2 Bonus Issue

Shareholders approved on 28 April 2007, a scrip issue of one bonus share for every five shares held as at 19 June 2007, by utilising the share premium account.

62.3 Options Exercised by Employees

The employees have exercised options during the post balance sheet period. Increase in ordinary share capital corresponding to the options exercised was Rs31,530 and the increase in the share premium was Rs182,086.

62.4 Proposed Dividend

Directors have recommended the payment of a final dividend of 50 cents per share (5%) for the year ended 31 March 2007, which requires the approval of the shareholders at the Annual General Meeting to be held on 29 June 2007. The Board of Directors confirm that the Bank has satisfied the solvency test in accordance with Section 57 of the Companies Act No. 7 of 2007 and have obtained the certificate from the auditors.

The proposed final dividend together with Rs4.50 per share (45%) an interim dividend paid on 30 March 2007 exceeds the minimum distribution mandated by the Inland Revenue Act No. 10 of 2006 and therefore the 15% deemed dividend tax, will not be imposed on the Bank.

62.5 Investment in DFCC Vardhana Bank Limited

Currently the Bank owns 95.4% of the voting share capital of this subsidiary, a licensed commercial bank. Central Bank of Sri Lanka has notified DFCC Vardhana Bank Limited of a decision that the Monetary Board has directed that DFCC Bank shall dispose and/or reduce its ownership to 15% on or before 23 April 2012.

NOTES ON THE FINANCIAL STATEMENTS

62.6 The Bank has obtained the approval of Central Bank of Sri Lanka to have a subsidiary, Synapsys Limited to provide information technology services to DFCC Bank Group as well as other non-affiliated customers. The initial investment in equity capital is up to Rs20 million.

62.7 The Bank made an announcement to the Colombo Stock Exchange on 5 March 2007 stating that the formation of an equally owned joint venture investment bank with Hatton National Bank Limited, a licensed commercial bank is under active consideration. This joint venture will be the group holding company for other related entities of the two banks including stock broking. The procedural requirements are yet to be completed and it is expected that the operations will commence in the financial year ending 31 March 2008.

62.8 The Companies Act No. 7 of 2007 which replaced the Companies Act No. 17 of 1982 became effective on 3 May 2007. The applicability of this Act to matters expressly provided in the DFCC Bank Act No. 35 of 1955 is under consideration.

62.9 The Bank participated in the rights issue by Commercial Bank of Ceylon Limited by subscribing to its entitlement in full and invested Rs1,603 million.

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

63 Restatement of Comparative Figures

Comparative figures have been restated to conform to the year ended 31 March 2007 classification.

CAPITAL ADEQUACY

INTRODUCTION

This term is used to describe the adequacy of Bank's aggregate capital in relation to the risks which arise from its assets and its off balance sheet transactions and its dealing operations. The minimum risk sensitive capital required to be maintained by the Bank is prescribed by Central Bank of Sri Lanka and is consistent with the international standards of Basel Committee on Banking Capital Regulations and Supervisory Practices (Basel I). The aim is to ensure minimum capital, commensurate with risks assumed by the Bank, is maintained as a buffer to absorb foreseeable, future credit and market losses.

BASIS OF COMPUTATION

The risk weights assigned to the on and off balance sheet assets and composition of capital are prescribed by Central Bank of Sri Lanka. Effective from 31.03.2006 risk weighted assets (RWA) include, in addition to risk weighted on and off balance sheet assets, equivalent RWA capital charge for market risk. The capital charge for market risk is based on standardised measurement method. The risk weights applicable to loans secured by primary mortgage over residential property and other loans have been increased from 50% to 55% and 100% to 110% respectively as per Direction issued by Central Bank of Sri Lanka.

CAPITAL TO RISK WEIGHTED ASSETS RATIO

(Based on consolidated financial statements)

		Actual	
	Minimum Requirement	**31.03.2007**	31.03.2006
Tier 1 (%)	5.0	**17.8**	22.9
Tier 2 (%)		**3.2**	0.4
Tier 1 and Tier 2 (%)		**21.0**	23.3
Deductions (%)		**5.8**	7.4
Capital base (%)	10.0	**15.2**	15.9

DETAILS OF COMPUTATION

Capital Base	**31.03.2007**	31.03.2006
	Rs 000	Rs 000
Tier 1 : Core Capital		
Paid up ordinary shares	**865,565**	575,908
Share premium	**659,299**	935,569
Statutory reserve fund	**548,841**	481,247
Published retained profits	**1,708,205**	1,531,621
General & other reserves	**8,445,893**	7,677,052
Minority interests	**554,731**	523,667
	12,782,534	11,725,064
Less: Deductions		
Goodwill	**146,658**	146,658
Total Tier 1 capital	**12,635,876**	11,578,406
Tier 2: Supplementary Capital		
Revaluation reserve (as approved by the Central Bank of Sri Lanka)	**134,528**	134,528
Approved subordinated term debt	**2,000,000**	0
General provision	**101,582**	59,977
Tier 1 and Tier 2	**14,871,986**	11,772,911
Less: Deductions		
Investments in capital of other banks		
Commercial Bank	**3,946,445**	3,656,146
Other Banks	**96,121**	84,093
Capital base	**10,829,420**	8,032,672

CAPITAL ADEQUACY

RISK WEIGHTED ASSETS AND OFF BALANCE SHEET EXPOSURE

Balance Sheet Assets	31.03.2007 Rs 000	31.03.2006 Rs 000	Risk Weights %	Risk Weighted Balance 31.03.2007 Rs 000	Risk Weighted Balance 31.03.2006 Rs 000
Cash, treasury bills & other securities eligible for rediscounting with Central Bank	**4,123,059**	4,710,878	0	**0**	0
Securities purchased under resale agreements	**590,525**	796,959	0	**0**	0
Textile debt restructure fund	**103,539**	135,033	0	**0**	0
Balances due from Central Bank	**768,018**	693,789	0	**0**	0
Loans against cash deposits	**725,953**	659,485	0	**0**	0
Bank balances	**349,054**	230,743	20	**69,810**	46,149
Due from banks abroad	**314,234**	479,015	20	**62,847**	95,803
Placements with and loans to other banks	**5,738,708**	1,306,319	20	**1,147,742**	261,263
Cash items in process of collection	**6,410**	0	20	**1,282**	0
Loans guaranteed by SLECIC	**95**	10,000	50	**48**	5,000
Dealing securities	**26,072**	13,530	100	**26,072**	13,530
Other loans, bills of exchange, finance lease and interest receivable	**0**	40,249,864	100	**0**	40,249,864
Other loans, bills of exchage, finance lease and interest receivable	**53,026,604**	0	110	**58,329,265**	0
Other investments (excluding items deducted from total capital)	**1,963,223**	1,979,191	100	**1,963,223**	1,979,191
Property and equipment	**574,171**	513,075	100	**574,171**	513,075
Prepayments and other receivables	**1,480,819**	829,916	100	**1,480,819**	829,916
Total assets	**69,790,484**	52,607,797		**63,655,279**	43,993,791

Off Balance Sheet Exposure	Credit Conversion Factor %	31.03.2007 Rs 000	31.03.2006 Rs 000	Risk Weights %	Risk Weighted Credit Equivalent 31.03.2007 Rs 000	Risk Weighted Credit Equivalent 31.03.2006 Rs 000
General guarantee of indebtedness	100	**1,183,707**	1,313,019	100	**1,183,707**	1,313,019
Performance bonds, bid bonds and warranties	50	**1,159,049**	732,660	100	**579,525**	366,330
Shipping guarantees	20	**453,693**	568,747	100	**90,739**	113,749
Documentary letters of credit	20	**2,120,573**	1,453,411	100	**424,115**	290,682
Trade related acceptances	20	**359,538**	352,262	100	**71,908**	70,452
Others - bills on collection	20	**165,403**	350,181	100	**33,081**	70,036
Undrawn term loans	50	**9,534,804**	8,415,987	100	**4,767,402**	4,207,994
Others - undrawn lease facilities	50	**235,449**	251,629	100	**117,725**	125,815
Forward foreign exchange contracts	2	**227,953**	272,886	100	**4,559**	5,458
Undrawn overdraft facilities and others	0	**955,833**	696,369	100	**0**	0
Facilities against cash deposits	100	**73,362**	35,024	0	**0**	0
Total off balance sheet exposure		**16,469,364**	14,442,175		**7,272,761**	6,563,535
Total risk weighted assets and off balance sheet exposure for credit risk					**70,928,040**	50,557,326
Total risk weighted assets for market risk					**44,830**	95,290
Total risk weighted assets and off balance sheet exposure for credit risk and market risk					**70,972,870**	50,652,616

Reconciliation with Balance Sheet

Capital excludes revaluation reserve of Rs179 million and negative goodwill, a deferred income.

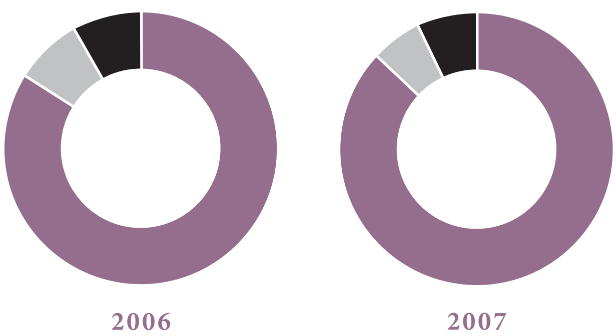
STATEMENT OF VALUE ADDED - BANK

For the year ended 31 March		**2007**			2006	
		Rs million	**%**		Rs million	%
Value Added						
Gross income		**6,887**			5,387	
Cost of borrowing and support services		**(3,872)**			(2,633)	
Provision for bad debts and investments		**(37)**			(190)	
		2,978			2,564	
Value Allocated						
To employees						
Salaries, wages and other benefits		**612**	**21**		523	20
To providers of capital						
Dividends to shareholders		**454**	**15**		346	13
To government						
Income tax on profit	**740**			472		
Value added tax on financial services	**373**	**1,113**	**37**	270	742	29
To expansion and growth						
Retained income	**671**			834		
Depreciation	**128**	**799**	**27**	119	953	38
		2,978	**100**		2,564	100

SOURCES AND DISTRIBUTION OF INCOME - BANK

For the year ended 31 March	2003	2004	2005	2006	**2007**
			Rupees million		
Sources of Income					
Interest income	3,495	3,461	3,645	4,508	**6,018**
Income from investments	354	414	521	436	**436**
Other	332	569	475	443	**433**
	4,181	4,444	4,641	5,387	**6,887**
Distribution of Income					
To employees as emoluments	313	394	438	523	**612**
To lenders as interest	2,091	1,819	1,873	2,376	**3,537**
To providers of supplies and services	192	179	230	257	**335**
To government as taxation	277	567	629	742	**1,113**
To shareholders as dividends	233	314	316	346	**454**
Retained in the business:					
Depreciation set aside	78	72	107	119	**128**
Provision for losses	374	308	256	190	**37**
Reserves	623	791	792	834	**671**
	4,181	4,444	4,641	5,387	**6,887**

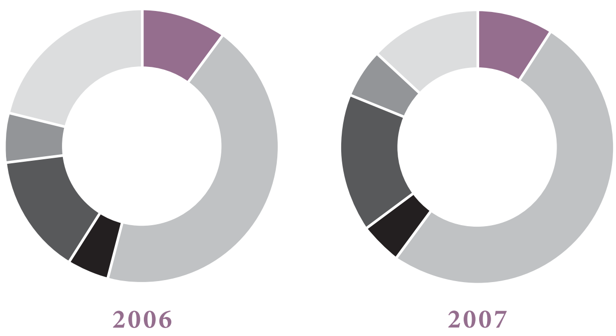
SOURCES OF INCOME



Year ended 31 March

	2006	**2007**
Interest Income	84%	**87%**
Income from Investments	8%	**7%**
Other	8%	**6%**

DISTRIBUTION OF INCOME



Year ended 31 March

	2006	**2007**
Employees	10%	**9%**
Lenders	44%	**51%**
Suppliers and Services	5%	**5%**
Government	14%	**16%**
Shareholders	6%	**7%**
Retained	21%	**12%**

TEN YEAR SUMMARY

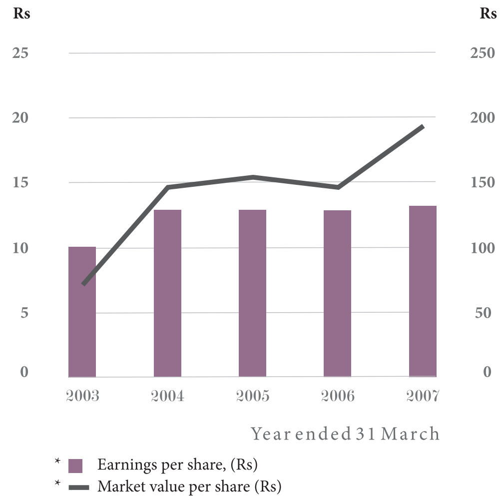
Bank

Year ended 31 March	1998	1999	2000	2001	2002	2003	2004	2005	2006	**2007**
	Rupees million									
OPERATING RESULTS										
Total income (net of TT & NSL)	2,762	2,949	3,446	3,452	4,037	4,113	4,444	4,641	5,387	**6,887**
Profit before tax	896	745	476	507	883	1,036	1,490	1,512	1,652	**1,865**
Income tax	282	173	133	132	252	181	385	404	472	**740**
Profit after tax	614	572	343	375	631	855	1,105	1,108	1,180	**1,125**
BALANCE SHEET										
Assets										
Cash, short-term funds and securities	1,164	2,877	1,631	1,394	2,359	2,398	2,675	2,778	4,928	**7,935**
Dealing securities	0	0	0	3	4	3	1	0	14	**26**
Other receivables	286	601	508	533	666	914	909	1,641	946	**1,611**
Placements with and loans to banks and financial institutions	0	1,175	651	325	0	0	500	302	738	**1,024**
Securities purchased under resale agreement	0	0	23	288	569	48	26	1,051	520	**240**
Bills of exchange discounted	161	38	23	23	23	23	18	13	6	**6**
Loans	12,426	14,877	15,989	17,878	17,982	19,515	22,386	25,270	30,963	**38,200**
Finance leases	2,039	2,066	2,009	1,932	1,859	2,445	3,742	4,348	5,545	**7,756**
Provisions	(710)	(225)	(374)	(633)	(757)	(949)	(1,077)	(995)	(937)	**(946)**
Net of provisions	13,916	16,756	17,647	19,200	19,107	21,034	25,069	28,636	35,577	**45,016**
Investment securities	2,004	1,865	1,474	1,784	2,102	1,802	1,704	1,731	1,340	**1,260**
Investment in associate/subsidiary companies	1,316	1,355	1,371	1,386	1,392	1,407	2,514	2,636	3,057	**3,350**
Investment property	0	0	0	0	187	187	12	12	12	**7**
Property, equipment and intangibles	100	265	285	277	265	378	516	475	481	**472**
	18,786	24,894	23,590	25,190	26,651	28,171	33,926	39,262	47,613	**60,941**
Liabilities										
Equity	4,456	4,703	4,973	5,054	5,723	6,382	7,383	8,207	9,091	**9,494**
Medium/long-term borrowing and debentures	12,750	17,424	17,279	17,841	17,892	16,775	19,570	24,120	30,384	**34,357**
Customer deposits	0	555	314	558	1,562	2,868	4,944	3,780	4,017	**13,573**
Short-term borrowings	0	1,140	0	796	398	1,143	577	1,387	2,453	**1,540**
	12,750	19,119	17,593	19,195	19,852	20,786	25,091	29,287	36,854	**49,470**
Other liabilities	1,580	1,072	1,024	941	1,076	1,003	1,452	1,768	1,668	**1,977**
	18,786	24,894	23,590	25,190	26,651	28,171	33,926	39,262	47,613	**60,941**
Return on equity, %	14.5	12.5	7.1	7.5	11.7	14.1	16.1	14.2	13.6	**12.1**
Return on total assets, %	3.4	2.6	1.4	1.5	2.4	3.1	3.6	3.0	2.7	**2.1**
*Earnings per share, Rs	7.64	6.69	4.02	4.38	7.39	10.01	12.86	12.86	13.68	**13.01**
*Market value per share, Rs	105.42	44.58	39.58	31.25	56.00	71.00	146.33	154.50	146.83	**194.00**
Price earnings ratio	13.8	6.7	9.9	7.1	7.6	7.1	11.4	12.00	10.7	**14.9**
Rate of dividend, %	35.0	40.0	40.0	45.0	50.0	55.0	55.0	55.0	60.0	**50.0**
Dividend cover, times	5.0	4.0	2.4	2.4	3.0	3.7	3.5	3.5	3.4	**2.5**
Gross dividend, Rsm	123.4	141.0	141.0	159.0	212.0	233.0	314.3	315.8	345.5	**454.4**
Liquid assets to liabilities *(As specified in the Banking Act No. 30 of 1988)*	–	–	–	–	–	–	28	38	48	**79**
No. of employees	249	271	277	276	289	305	305	340	374	**422**

**Adjusted for bonus issues.*

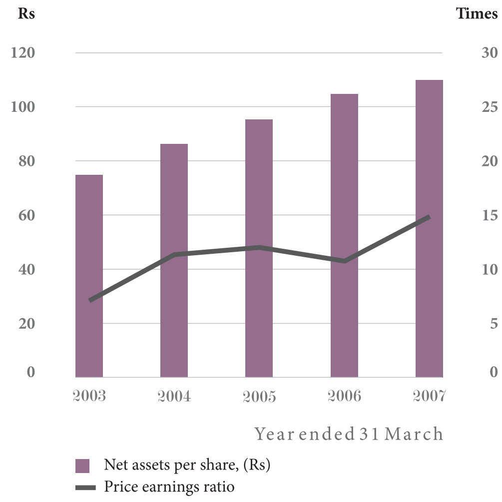
PERFORMANCE OF THE SHARE

EARNINGS AND MARKET VALUE

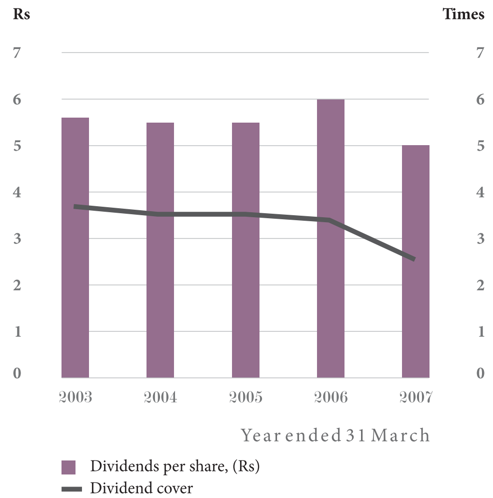


* *Adjusted for bonus issue*

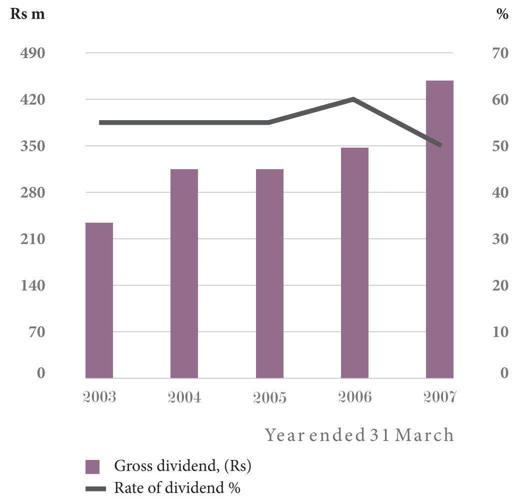
SHARE VALUE



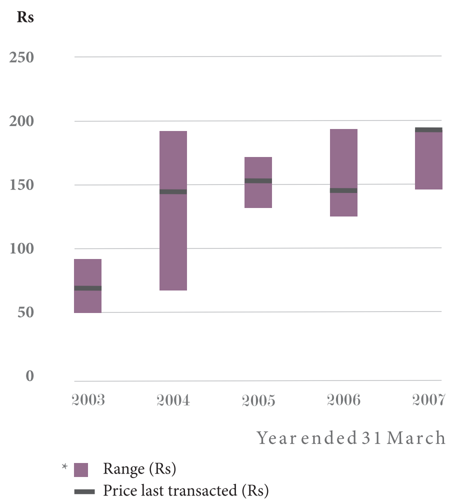
DIVIDENDS



DIVIDEND PAID



SHARE PRICE



* *Adjusted for bonus issue*

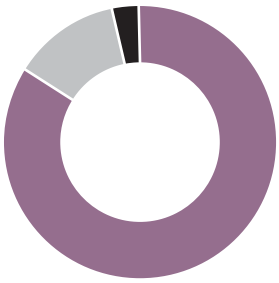
RETURN ON EQUITY

SHARE INFORMATION

Year ended 31 March	**2007**	2006
Earnings		
Earnings per share, basic, Rs	**13.01**	13.68
Price earnings ratio, times	**14.91**	10.73
Dividends		
Interim dividend paid Rs m	**389.48**	0
Final dividend, (proposed/paid) Rs m	**64.92**	345.54
Rate of dividend, %	**50.00**	60.00
Dividend per share, Rs	**5.00**	6.00
Book Value - Bank		
Net assets per share on 31 March, Rs	**109.69**	105.23
Price Indices		
CSE All Share Price Index	**2,789.80**	2,264.36
Milanka Price Index	**3,837.60**	2,877.66
Share Prices		
Lowest, Rs	**147.50 (23.08.06)**	190.00 (10.01.06)
Highest, Rs	**290.00 (05.05.06)**	292.00 (11.10.05)
Last transaction, Rs	**194.00 (29.03.07)**	220.25 (31.03.06)
Market Capitalisation		
Value, Rs m	**16,792**	12,684
% of total trade	**1.93**	1.84
Rank	**8**	9
Value of Shares Traded		
Value, Rs m	**4,502**	933
% of total trade	**3.83**	0.82
Rank	**6**	25
Days Traded		
Number of days traded	**231**	221
Total number of market days	**240**	241
% of market days traded	**96**	91.70
Frequency of Shares Traded		
Number of transactions	**4,226**	1,661
% of total frequency	**0.44**	0.16
Rank	**69**	124

SHARE INFORMATION

SHAREHOLDERS



Year ended 31 March

- 1,000 Shares or Less 84%
- 1,001 - 5,000 Shares 13%
- Greater than 5,000 Shares 3%

SHAREHOLDING

Year ended 31 March

- 1,000 Shares or Less 2%
- 1,001 - 5,000 Shares 2%
- Greater than 5,000 Shares 96%

OWNERSHIP

Year ended 31 March

- Foreign Individuals 4%
- Foreign Institutions 34%
- Sri Lankan Individuals 7%
- Sri Lankan Institutions 55%

SIZE-WISE DISTRIBUTION OF SHAREHOLDING

Number of Shares			As at 31 March 2007			As at 31 March 2006		
			No. of Holders	**Total Holding**	**%**	No. of Holders	Total Holding	%
01	-	1,000	**6,032**	**1,838,713**	**2.12**	6,102	1,546,478	2.68
1,001	-	5,000	**930**	**1,820,473**	**2.10**	512	1,034,533	1.80
5,001	-	10,000	**108**	**778,196**	**0.90**	72	496,720	0.86
10,001	-	50,000	**86**	**1,762,845**	**2.04**	54	1,081,853	1.88
50,001	-	100,000	**16**	**1,011,126**	**1.17**	8	584,680	1.02
100,001	-	500,000	**17**	**4,530,313**	**5.23**	17	4,199,965	7.29
500,001	-	1,000,000	**4**	**2,722,500**	**3.15**	1	560,000	0.97
Greater than		1,000,000	**14**	**72,092,371**	**83.29**	12	48,086,593	83.50
Total			**7,207**	**86,556,537**	**100.00**	6,778	57,590,822	100.00

OWNERSHIP

Shareholding %	As at 31 March 2007			As at 31 March 2006		
	Foreign	**Sri Lankan**	**Total**	Foreign	Sri Lankan	Total
Individuals	**4.00**	**6.44**	**10.44**	1.38	5.59	6.97
Institutions	**34.28**	**55.28**	**89.56**	18.35	74.68	93.03
Total	**38.28**	**61.72**	**100.00**	19.73	80.27	100.00

As per the Rule No. 8.7 (h) of the Colombo Stock Exchange, percentage of public holding as at 31.03.2007 was 38.21% (48.23% as at 31.03.2006).

SHARE INFORMATION

TWENTY MAJOR SHAREHOLDERS OF THE DFCC BANK AS AT 31 MARCH 2007 ARE GIVEN BELOW:

Name of Shareholder/Company Name as at 31 March 2007

	2007			2006	
	NO. OF SHARES	**%**	**CUMU-LATIVE%**	NO. OF SHARES	%
Bank of Ceylon	**12,679,999**	**14.65**	**14.65**	8,453,333	14.68
Hatton National Bank Limited A/c. No. 1	**10,581,037**	**12.22**	**26.87**	7,054,025	12.25
Sri Lanka Insurance Corporation Limited - Life Fund	**9,784,644**	**11.30**	**38.17**	6,523,096	11.33
Galleon Technology Offshore Limited	**6,482,350**	**7.49**	**45.66**	–	–
Distilleries Company of Sri Lanka Limited	**5,605,086**	**6.48**	**52.14**	3,736,724	6.49
Readywear Industries Limited	**5,388,900**	**6.23**	**58.37**	5,422,600	9.41
Seafeld International Limited	**5,095,599**	**5.89**	**64.26**	3,397,066	5.90
HSBC International Nominees Limited - BPSS LUX - Aberdeen Global Asia Pacific Fund	**4,043,749**	**4.67**	**68.93**	1,865,466	3.24
Mr M A Yaseen	**3,225,000**	**3.73**	**72.66**	560,000	0.97
HSBC International Nominees Limited - BPSS LDN Aberdeen Asia Pacific Fund	**2,250,000**	**2.60**	**75.26**	–	–
Galleon Diversified Fund Limited	**2,170,700**	**2.51**	**77.77**	–	–
Jaya Investments Limited	**1,785,199**	**2.06**	**79.83**	–	–
HSBC International Nominees Limited/DEG - Deutsche Investitions - UND Entwicklungsesellschaft	**1,500,108**	**1.73**	**81.56**	1,000,072	1.74
RBC Dexia Investor Services Trust S/A Edinburg Dragon Trust Fund	**1,500,000**	**1.73**	**83.29**	441,200	0.77
Northern Trust Co. S/A Murray Johnstone International Delaware Business Trust	**847,500**	**0.98**	**84.27**	453,300	0.79
HSBC International Nominees Limited - SSBT - Frank Russell Investments Co. Plc	**675,000**	**0.78**	**85.05**	292,100	0.51
HSBC International Nominees Limited - SSBT - Aberdeen Asia Smaller Companies	**600,000**	**0.69**	**85.74**	400,000	0.69
HSBC International Nominees Limited - SSBTL - Aberdeen New Dawn Investment Trust XCC6	**600,000**	**0.69**	**86.43**	400,000	0.69
HSBC International Nominees Limited - BPSS LDN - Aberdeen Investment Fund ICVC Aberdeen Emerging Market	**499,999**	**0.58**	**87.01**	333,333	0.58
Employees' Trust Fund Board	**468,549**	**0.54**	**87.55**	–	–
	75,783,419	–	–	40,332,315	–
Other Shareholders	**10,773,118**	**12.45**	**100.00**	17,258,507	29.96
Total	**86,556,537**	**100.00**		57,590,822	100.00

DEBENTURE INFORMATION

DFCC LISTED DEBENTURES - 2006

Debenture Categories	Interest Payable Frequency	Coupon Rate	Interest Rate of Comparable Government Security
Fixed Rate			
2006/2016 - 14.00% p.a.	Annually	14.00%	15.56%
2006/2011 - 13.75% p.a.	Annually	13.75%	15.66%
Floating Rate			
2006/2011 - 6 months TB rate (Net) + 2.00% p.a.	Semi-Annually	14.78%	15.66%
2006/2011 - 6 months TB rate (Gross) + 1.00% p.a.	Semi-Annually	15.20%	15.66%

None of these debentures have been traded during the year.

6 months TB rate (Net) - Six months weighted average Treasury Bill rate after 10% withholding (net rate) as published by the Central Bank of Sri Lanka.

6 months TB rate (Gross) - Six months weighted average Treasury Bill rate before 10% withholding (gross rate) as published by the Central Bank of Sri Lanka.

Other Ratios	**2007**	2006
Debt Equity Ratio	**3.62**	3.34
Interest Cover (Times)	**1.36**	1.63
Quick Assets Ratio (%)	**79**	48

(Same as liquid asset ratio.)

The Annual General Meeting will be held at the Cinnamon Grand, Colombo 3, on 29 June 2007. Details of the business of the meeting and other information are contained in the booklet enclosed with this Annual Report.

NAME OF COMPANY

DFCC Bank

LEGAL FORM

A quoted public company with limited liability incorporated by Development Finance Corporation of Ceylon Act No. 35 of 1955.
A licensed specialised bank under the Banking Act No. 30 of 1988.

CREDIT RATING

AA (lka) credit rating from Fitch Ratings Lanka Limited.

BOARD SECRETARY

T Wijemanna

LAWYERS

F J & G De Saram
Attorneys-at-Law

AUDITORS

KPMG Ford, Rhodes, Thornton & Co.
Chartered Accountants

BANKERS

DFCC Vardhana Bank Ltd.
Commercial Bank of Ceylon Ltd.
Bank of Ceylon

VAT REGISTRATION NO.

409000088 7000

HEAD OFFICE

DFCC Building, P O Box 1397
73/5, Galle Road, Colombo 3.
Telephone: 94-11-2442442
Fax: 94-11-2440376
E-mail: info@dfccbank.com
Website: http://www.dfccbank.com

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