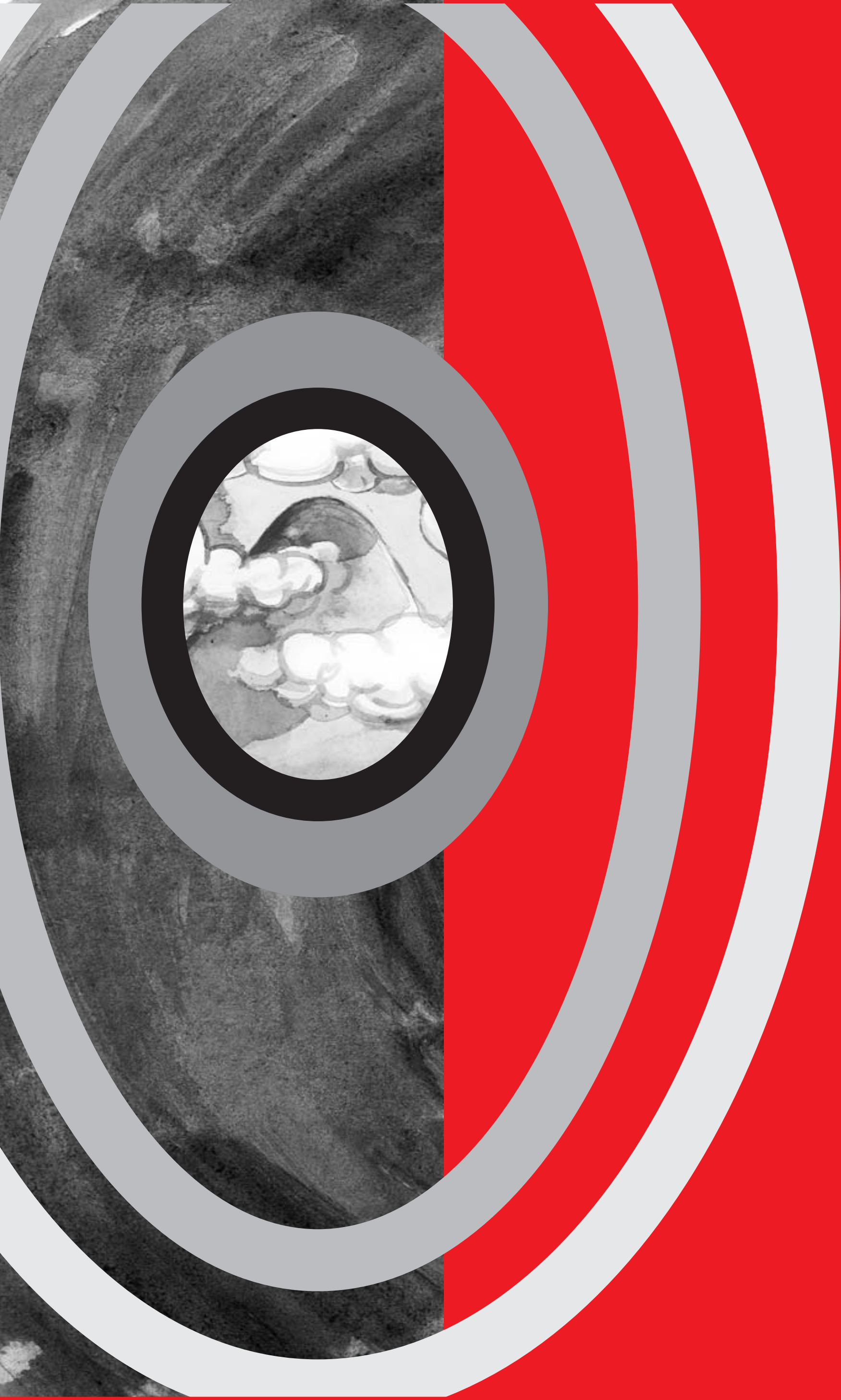
2004

DFCC BANK

ANNUAL REPORT
2003/2004



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.

CONTENTS

HIGHLIGHTS

- Acquired 94% of a licensed commercial banking operation in August 2003, re-branded and launched operations as DFCC Vardhana Bank Limited in October 2003.

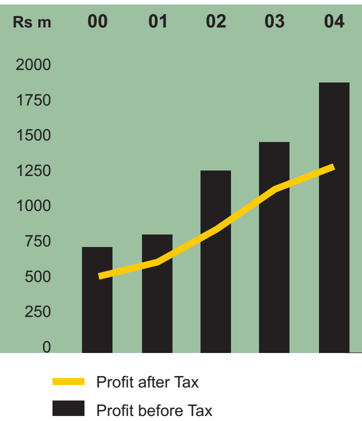
- For the first time in its history, DFCC Bank mobilised funds for lending in foreign currency. A US dollar equivalent of Euro 5 million was raised from the European Investment Bank.

- Acted as the financial adviser to what is reportedly the single largest debt raising of US$87 million by a Sri Lankan Company.

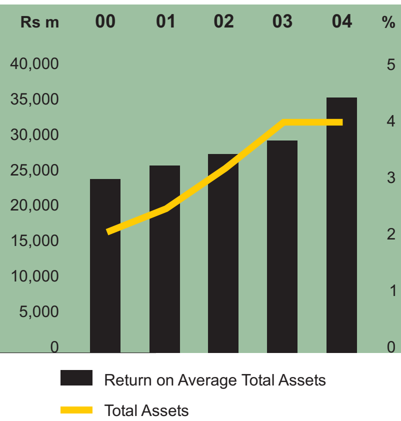
- DFCC shareholder value, as reflected by market capitalisation, more than doubled during the year.

FINANCIAL HIGHLIGHTS

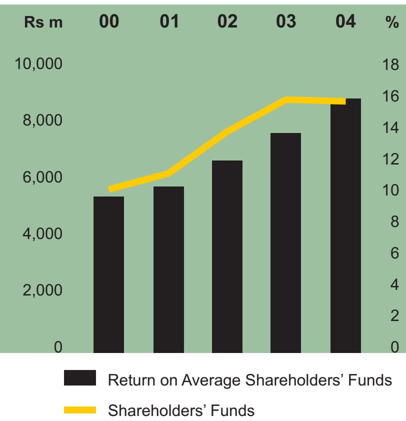
PROFIT



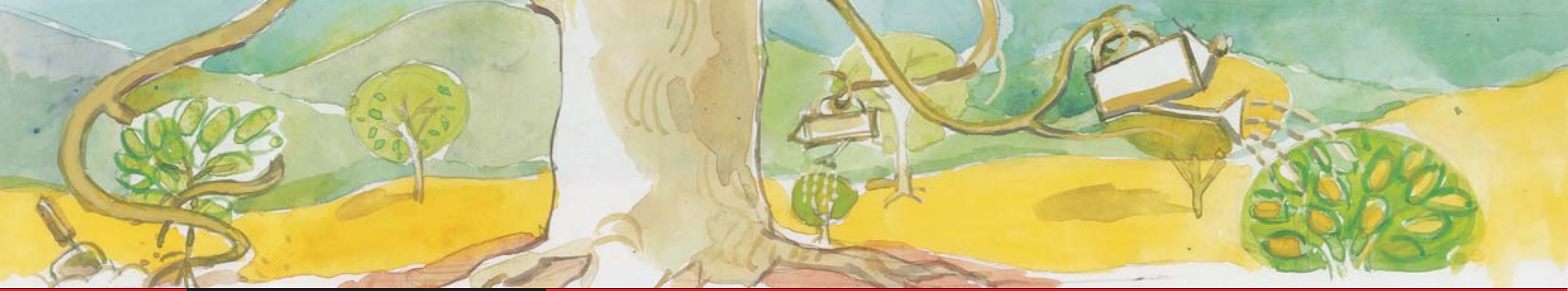
TOTAL ASSETS AND RETURN



SHAREHOLDERS' FUNDS AND RETURN



For the year ended 31 March	2004	2003	% Change
Income, Rs m	**4,444**	4,113	8
Profit before tax, Rs m	**1,874**	1,459	28
Profit after tax, Rs m	**1,293**	1,131	14
Earnings per share, Rs Basic	**22.70**	20.05	
Rs Diluted	**22.39**	19.99	
Gross dividend, Rs m	**314**	233	35
Rate of dividend, %	**55**	55	
Shareholders' funds (capital & reserves), Rs m	**8,814**	7,627	16
Medium/long-term borrowing,			
deposits & debentures, Rs m	**24,514**	19,643	25
Total assets, Rs m	**35,362**	29,427	20
Return on average total assets, %	**4.0**	4.0	
Return on average shareholders' funds, %	**15.7**	15.8	



Michael Mack - CHAIRMAN

Dear Shareholder,

It is with pleasure that I welcome you to the Forty Eighth Annual General Meeting of DFCC Bank and present to you the Annual Report of the Bank for the Financial Year Ended (FYE) 31 March 2004.

You would be pleased that the DFCC Group has performed well posting a 14% growth in post tax profits for the financial year, underpinned by a strong growth of 28% in the profit after tax for the Bank's operation. Further, the return on your equity was 15.7%, which compares well with the single digit interest rates that prevailed throughout the year. More details of the Bank's performance are provided in the Chief Executive's Report and the Operations and Financial Reviews.

Sri Lanka's performance for most of FYE 2004 could be regarded as encouraging. The economy recorded a GDP growth of 5.9% in 2003, which is satisfactory considering what was achieved previously. Among the many contributory factors were the continuation of the ceasefire, prudent monetary policy, fiscal consolidation, structural reforms, improvement in the world economy and international support for the country. As was the case in 2002, the services sector, with a 7.7% growth was the main driver followed by industry and agriculture. Within services, the banking and finance sub-sector was the key contributor with a 10.6% growth. The industry sector, having recorded a growth of 5.5% compared to 1.0% in 2002, appears to be on the road to recovery. The agriculture sector meanwhile, only grew at 1.5% against 2.5% in the previous year.

The economic picture was complemented by other factors. The overall budget deficit was kept in check and although not meeting the targeted level, declined to 8.0% of GDP. This reduced pressure on interest rates and inflation, which were stable at single digit levels. The key US dollar/Rupee exchange rate, remained relatively steady within a narrow band for much of the financial year. This environment was conducive for positive corporate performance as reflected in earnings growth. Investor confidence was thus reinforced and one outcome was the stellar performance of the Colombo Stock Exchange, which set many records during the course of the year.

However, political stability is an essential ingredient for the maintenance of economic momentum. In this context, "uneasy cohabitation" was the phrase often quoted in connection with the political situation. Unfortunately, it was proved by the events of last November to be an apt description of the relationship between the legislative and executive arms of Government. While the full impact of the political developments has yet to run its course, the country witnessed a slackening in the economic momentum in the run up to the election in April 2004.

It is, however, heartening that the commitment by both sides to the peace process appears unwavering. The maintenance of the cease fire and the resumption of a dialogue would contribute to improving business confidence and shoring up the economy. It is therefore hoped that broad national interests will prevail with the emergence of a consensus among the diverse groups on both sides of Parliament on all major issues.

Looking ahead, there are many variables on the economic horizon. While its economic policies and direction have not been articulated in detail, we assume that the new administration will adopt a pragmatic approach to macroeconomic management, and re-establish the pace of economic reform and project implementation. We accordingly expect that the economy will not exhaust its momentum.

DFCC Bank's core business of development banking remains a vital financing element especially in the context of the national agenda. However, as I have mentioned, the Bank's operating environment is one of change and as such, DFCC had to explore new avenues to complement its development banking role. DFCC Bank seized the opportunity to acquire in August 2003, a licensed commercial banking operation, which was subsequently re-branded as DFCC Vardhana Bank Limited to establish its strong affiliation to DFCC Bank. I am pleased to report that Vardhana Bank is making good progress on many fronts and has filled the void in DFCC's product range. It will be a key component of the DFCC Group and will perform a critical role in DFCC Bank's endeavour to retain its position as one of Sri Lanka's leading financial services groups.

At this juncture it would be appropriate for me to comment on the status of DFCC's association with Commercial Bank of Ceylon Limited. As has been explained to you previously, the process of establishing a closer corporate structure required certain developments in the regulatory framework. For various reasons, these have yet to materialise, thereby putting on hold any action that could have been contemplated by the two institutions. Your Board will continue to monitor the various alternatives and opportunities that arise and respond appropriately.

As you would appreciate, DFCC Bank's key asset is its human capital. This has been demonstrated by its employees who have, under the able leadership of the Chief Executive Officer, Mr Nihal Fonseka, turned in a creditable performance in increasing DFCC's profitability and shareholder value. Recognising the efforts put in by the management team and the need to reward greater achievement in the future, you approved an Employee Share Option Plan in June 2002. This was contingent on the DFCC Group attaining an annual profit growth of at least 10% thereby aligning more closely, management interests with shareholder interests. I am happy to report that the scheme has achieved this objective.

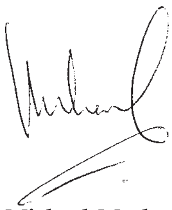
The market capitalisation of DFCC Bank more than doubled from Rs6.0 billion to Rs12.5 billion over the year. The DFCC share has thus outperformed the Colombo Stock Exchange where the All Share Price Index and the Milanka Price Index moved up by 74% and 60% respectively. This demonstrates DFCC's commitment to deliver superior returns to its shareholders.

The Board recommends the payment of a first and final dividend of 55% for the financial year. While the dividend rate is the same as last year, the payment will be on the enhanced issued share capital consequent to the bonus issue and therefore amounts to a one third increase in the distribution to shareholders.

I continue to stress that a key factor of the Bank's success is the steadfast base of clients for whom DFCC Bank is the preferred financier. I deeply appreciate their loyalty and have faith in their future support.

I extend a warm welcome to Mr D S Weerakkody who joined the Board as a Director in June 2003. I also express my thanks to my fellow Directors for their efforts and co-operation that have been valuable in steering the affairs of the Bank.

Let me conclude by thanking you, the shareholders of the Bank, for the trust placed in our ability to take DFCC forward. Be assured that in doing so, we are conscious and committed to the need to continue increasing the value of your shareholding in the Bank while meeting the just expectations of our other stakeholders and the nation.



Michael Mack
Chairman

28 May 2004

Nihal Fonseka - CHIEF EXECUTIVE / DIRECTOR

New Vistas

Stronger asset growth, continued improvement of the quality of the loan portfolio, new initiatives in resource mobilisation and the successful migration of operations to a cutting edge technology platform were the hallmarks that characterised a successful year. Profit after tax at Bank level before equity accounting for subsidiaries and associate increased by 27% to Rs1,085 million while the Group profit recorded an increase of 14% to reach Rs1,293 million.

Greater business confidence underpinned by the continuing cease-fire between the Government and LTTE and the single digit interest rate regime, was the prime facilitator of the Bank's superior performance. However, the breakdown of the state of cohabitation between the Executive Presidency and the Legislature created uncertainties that unsettled business confidence in the latter part of the financial year.

The strategic acquisition of a licensed commercial bank, re-branded DFCC Vardhana Bank Limited, will add a new dimension to the way DFCC Bank will do business in the future. This move will enable us to leverage on our core competencies in development banking to offer the full spectrum of financial services demanded by our customers, especially those small and medium sized enterprises (SMEs) we assist through our branches.

PERFORMANCE

Gross approvals of loans and leases during the year under review totalled Rs17,930 million, compared to Rs10,819 million in the previous year. Disbursements, which lag approvals, amounted to Rs12,217 million, an increase of 44% over the previous year. The finance leasing portfolio grew strongly by 56% to reach Rs3,567 million, fuelled by increased demand for this product from the SME sector. It was particularly satisfying that about 65% of new leases granted were disbursed by our branches located outside the Western province.

The Bank's continued efforts in the restructuring and rehabilitation of projects facing problems and the orderly disposal of assets belonging to some projects that had failed, coupled with credit growth, resulted in non-performing loans and finance leases decreasing from Rs2,912 million to Rs2,621 million and the ratio of non-performing loans and leases to the total, improving from 13.3% to 10.3%. Nevertheless, the Bank continued its policy of making provisions above the minimum required by regulation when warranted. Net specific provisions of Rs330 million were made for bad and doubtful debts, compared to Rs401 million in the previous year. This included the additional provisions required in terms of the 'haircuts' on collateral imposed by the Central Bank of Sri Lanka that became effective in January 2004.

The Bank's investment banking operations capitalised on the positive environment that prevailed for much of the year, and lead managed a very successful Initial Public Offering for Rs600 million. The Bank also acted as the financial adviser to the single largest debt raising of US$87 million by a Sri Lankan company in recent times.

A detailed analysis of the Bank's performance is given in the Operations and Financial Reviews contained in the Annual Report.

ASSOCIATE AND SUBSIDIARY COMPANIES

The Bank's associate and subsidiary companies contributed positively to Group results. DFCC Stock Brokers (Pvt) Limited had an excellent year and benefited from a highly motivated team that capitalised on the buoyant market conditions that prevailed. Lanka Industrial Estates Limited (LINDEL), a mature investment that manages an industrial estate, made a positive contribution. The fund management subsidiary, National Asset Management Limited (NAMAL), under-performed although it was profitable and the funds under its management fared well. Improvement of its fortunes will depend on its ability to increase the quantum of funds under its management. The venture capital subsidiary, Lanka Ventures Limited (LVL), had a good year and its performance was further boosted by a one-off refund of taxes paid previously. However, acceptable venture capital opportunities continue to be scarce and the governance structure of many enterprises that seek such capital makes venture capital a difficult business.

Our associate company, Commercial Bank of Ceylon Limited had yet another successful year, reporting a group profit after tax of Rs1,536 million, higher than the previous year. However, its contribution to DFCC Group profit under equity accounting declined due to adjustments on consolidation as explained in the Financial Review. During the year, DFCC Bank invested Rs542 million in a rights issue to support Commercial Bank's expansion. Commercial Bank is now expanding its operations in the region.

DFCC Vardhana Bank, in which a total investment of Rs541 million was made by DFCC Bank during the year under review, merits special attention. It is discussed below.

DFCC VARDHANA BANK LIMITED

The acquisition of a 94% stake in National Mercantile Bank Limited which was re-branded DFCC Vardhana Bank Limited is an important milestone in the evolution of DFCC Bank. Such a strategic entry into commercial banking was a need discussed in my previous reports. It will supplement our somewhat narrow development banking products with complementary commercial banking products demanded by our customers. In an environment of free competition, development banks should have the freedom to balance their higher risk profiles with appropriate business strategies. These include, sourcing additional revenue streams through new products and services as well as diversification and consolidation through strategic alliances, mergers and acquisitions. DFCC Bank's new commercial banking arm, DFCC Vardhana Bank, should be viewed in this light.

DFCC Vardhana Bank made satisfactory progress in meeting its short-term goal of recording an operating profit for the month of March 2004. The next challenge will be to build up the asset base to a level where profitability can be sustained. Although legally separate, the operating model for the two banks envisages strong operational synergies. 'Vardhana Windows' are being opened in all DFCC Bank branches, whereby DFCC Bank is now in a position to offer its clients a full range of commercial banking services to complement traditional project loans and leases. More details on DFCC Vardhana Bank are given in the Operations Review of this Annual Report.

DEVELOPMENT BANKING

Development banking is not confined to providing long-term loans. The impact on society at large, is as important as the outcome measured in pure financial terms and this necessarily means involvement in capacity building, generating employment and being a business facilitator. For instance, DFCC Bank has received wide acclaim for its role in developing the renewable energy sector in Sri Lanka. It has also proved its capability in successfully implementing donor funded national projects that traditionally have been plagued by low disbursements.

DFCC Bank was the largest user of the SAHANYA credit line made available by the ADB through the Government for on-lending to the SME sector. The Bank provides training to small businesses in the provinces and our executives involve themselves in activities that benefit the SME community. In keeping with our mission of nurturing enterprises, the Bank built on its provincial outreach by scaling up the operations of the eight branches and two window offices. In addition, the Bank opened Window Offices of DFCC Vardhana Bank in five of its branches and the Head Office, thus providing our SME customers a full range of banking services.

A new project supported by the Bank won an award in 2003 from the Association of Development Finance Institutions in Asia and the Pacific (ADFIAP). This is the third successive year that DFCC Bank has won an ADFIAP award for its development banking achievements after competing with entries submitted by other development banks in the region.

RESOURCE MOBILISATION

Strides were made on the resource mobilisation front in securing both domestic savings and international long-term funds. DFCC Bank successfully negotiated medium-term credit lines totalling Rs3,500 million from local institutional investors to supplement its customer deposits which have a shorter maturity profile. Going forward, the much wider range of deposit products that DFCC Vardhana Bank can offer will be a key contributor to the Group resource base. The Bank continued to make good use of credit lines obtained with the support of the Government from bilateral and multilateral sources such as the World Bank, Asian Development Bank, Kreditanstalt fur Wiederaufbau (KfW) and European Investment Bank, thus enabling it to serve key sectors of the economy. The relaxation of exchange control impediments enabled the Bank to disburse its first ever foreign currency loan with matching funds drawn under a credit line.

FINANCIAL SECTOR REFORMS

The Government made some progress on financial sector reforms. Two important bills to amend the 'closed economy era' Banking Act and to replace the five decade old Exchange Control Act were presented to the previous Parliament, but failed to make it to the statute books. It is hoped that the present Parliament will enact these laws as a matter of urgency. A new comprehensive Banking Act remains an urgent requirement to enable banking in Sri Lanka to benefit from global trends on consolidation and convergence in the financial services while ensuring competition, as well as to strengthen the hand of regulators to enforce compliance and deal with governance issues in banks. Despite the criticisms levelled at banks, much of it unjustified, they will remain by far the most significant and important financial intermediaries in Sri Lanka in the foreseeable future. Therefore, it is important to ensure that economic development does not bring with it problems in the banking sector similar to those that fuelled the East Asian crisis in the late 1990s.

OUTLOOK

Looking ahead, the country's economic prospects look promising although the continuing high petroleum prices and its effect on Sri Lanka and its global trading partners pose a threat. Continuation of the cease-fire and tangible progress on structural reforms will also play a significant role in realising the potential.

DFCC Bank sees opportunities in the financing of infrastructure projects and services, particularly in areas such as power generation, information and communication technology and leisure as well as assisting high value adding enterprises in exports and agriculture. The Bank will continue to play an active role in SME development and, if the peace process makes progress, in the reconstruction and rehabilitation efforts in the North and East.

As a socially responsible organisation, we have and will, continue to invest for the benefit of the community. In 2006, DFCC Bank will celebrate 50 years of a mutually beneficial partnership with the nation. The Bank intends to celebrate this milestone with a fitting gift to the community.

The initiatives that I mentioned last year regarding enhancing our IT capability, strengthening the management of non-performing loans and refining our credit rating system to adopt a risk based pricing mechanism have borne fruit. Our state-of-the-art IT platform, offering a comprehensive banking solution, is being rolled out to our regional branches and implementation will be completed by September 2004, culminating in a total investment of Rs300 million made over a period of 28 months. The integration of the operating platforms of DFCC Bank and DFCC Vardhana Bank is also on the agenda to be completed in 2006.

DFCC Bank is further enhancing its credit risk management techniques. During the next 18 months the Bank will implement processes that will enable it to have a more sophisticated risk rating system for its lending activities, and more importantly start building up a database that will enable the Bank to measure aspects such as "Probability of Default" and "Loss Given Default". These measures will help the Bank to improve its capital efficiency when the new capital accord of the Bank for International Settlements, which is under development, commonly referred to as Basle II, enters the Sri Lankan regulatory landscape within a few years.

Managing costs is essential for the Bank to remain competitive and successful. One key area that is receiving attention is the cost relating to the defined benefit pension scheme. As a responsible employer, the well-being of our employees who retire is a matter that we need to address. However, the cost benefit equation of the present scheme to both employees and the Bank is questionable. New recruits to the Bank are not entitled to this benefit and the Bank will explore the possibility of mitigating the future risks relating to the existing schemes.

DFCC Bank continues to be an institution driven by high calibre staff displaying a strong sense of integrity, commitment and motivation. The Bank is a meritocracy and its performance linked reward system has become an accepted process for creating value for shareholders and other stakeholders. The Bank's recruitment and remuneration policies as well as the investment in enhancing human capital through training and development will be targeted to preserve the Bank's position as an employer of choice.

In conclusion, I wish to express my deep appreciation of the support and guidance that I received from the Chairman and Board of Directors and the excellent co-operation extended to me by my senior management colleagues and staff at all levels. I also thank our numerous customers for their continued patronage and confidence placed in DFCC Bank and its subsidiaries.

Nihal Fonseka
Chief Executive/Director

28 May 2004

ASSOCIATE AND SUBSIDIARY COMPANIES

COMPANY	BANK'S INTEREST	PRINCIPAL ACTIVITY	DIRECTORS	PROFIT/(LOSS) AFTER TAX Rs m FYE 31 March 2004	2003	DIVIDEND RATE % FYE 31 March 2004	2003
Commercial Bank "Commercial House" 21 Bristol Street Colombo 1 Tel: 2445010-15 2328193-5 Incorporated: June 1969 *Note: Profit is for FYE December 2003 and December 2002*	28%	Commercial Banking	M J C Amarasuriya *(Chairman)* J S Mather *(Deputy Chairman)* A L Gooneratne *(Managing Director)* B R L Fernando L J A Fernando A N Fonseka M L Mack D Tsitsiragos Dr H S Wanasinghe	**1,535.6**	1,310.6	**50.0**	50.0
DFCC Stock Brokers (Pvt) Limited 3rd Floor, 73 W A D Ramanayake Mawatha Colombo 2 Tel: 2446021-2 2446031-4 Incorporated: February 1990 *Note: Profit is for FYE December 2003 and December 2002*	100%	Securities Broking	A N Fonseka *(Chairman)* M R Abeywardena *(CEO)* J H D B Abeyratna D E De Mel T W De Silva P P S Fernando S Nagarajah	**46.6**	14.6	**100.0**	25.0
DFCC Vardhana Bank Limited 371 R A De Mel Mawatha Colombo 3 Tel: 2371371 Incorporated: August 1995 *Note: Only the post acquisition loss for five months to 31 December 2003 is included*	94.16%	Commercial Banking	Dr T N Jinasena *(Chairman)* L G Perera *(ManagingDirector/CEO)* S Nagarajah J H D B Abeyarathna Ms R A P Withana Mrs Y N Perera L H A L Silva *(Chief Operating Officer)*	**(48.4)**	–	**Nil**	N/A
Lanka Industrial Estates Limited (LINDEL) Pattiwila Road Sapugaskanda Makola Tel: 2400318 Incorporated: March 1992	50%	Leasing of Land and Buildings for Industrial Enterprises	A N Fonseka *(Chairman)* Ms K C S Abeyesundere E G P Kalpage L A Mahendran W A Mendis M R Prelis A Tudawe Dr R M K Ratnayake	**50.3**	50.5	**20.0**	20.0
Lanka Ventures Limited 2nd Floor Ceylon Ocean Lines Building 46/12 Navam Mawatha Colombo 2 Tel: 2439201 Incorporated: February 1992	56%	Venture Capital Financing	A N Fonseka *(Chairman)* Ms K C S Abeyesundere J D N Kekulawela M R Prelis J M J Perera T L F W Jayasekera S E de Silva	**205.8**	58.4	**12.5**	10.0
National Asset Management Limited 2nd Floor 73 W A D Ramanayake Mawatha Colombo 2 Tel: 2445911 Incorporated: September 1990	80%	Fund Management	A N Fonseka *(Chairman)* D E De Mel Ms K C S Abeyesundere P S R Casie Chitty *(resigned with effect from 07. 04. 04)*	**9.5**	13.2	–	28.0

N/A – Not Applicable

Management Discussion & Analysis

TELECOMMUNICATIONS

A GROWING SERVICES SECTOR

Today, Sri Lanka's Services sector generates more than 50% of GDP, providing employment for three million people or 43% of the total employed. In comparison, the Industry and Agriculture sectors contribute 27% and 19% respectively and together have generated four million jobs.

In 2003, the Services sector grew by 7.7% contributing 70% of overall growth. Value added in the transport, storage and communication sector increased by 10.2% compared to 7.6% in 2002. The increase was largely due to a 24.5% expansion in the telecommunication sub-sector.

REFORMS AND A REVOLUTION

The telecommunications industry is one of the fastest growing in the world. In the last decade or so, deregulation, the Internet and technology advancement have pushed the industry into high gear.

Over the past decade, sweeping reforms have transformed the telecom landscape in Sri Lanka. The level of fixed phone access multiplied almost fivefold. The fixed line teledensity (phones per 100 people), rose from 0.7 in 1991, at the start of serious reforms, to 5.6 in 2003. Mobile phone teledensity increased from 0.01 in 1991 to approximately 7.3 by end 2003. These levels are low compared with a country such as Singapore, where there are 46 fixed phones and 79 mobile phones for every 100 people. But for a developing country like Sri Lanka these changes represent a communications revolution. And compared with neighbouring India for example, Sri Lanka is doing well. At the end of 2003, India had around four fixed phones and three mobile phones per 100 people.

In 2003, further deregulation resulted in new frequencies being auctioned to mobile operators and new inter-connection rules being introduced, thereby ending the international call monopoly of the privatised Sri Lanka Telecom Limited (SLT). This set the stage for open competition.

COMPETITION WHERE IT MATTERS

Professor Samarajeewa, one-time chief of Sri Lanka's Telecommunications Regulatory Commission of Sri Lanka (TRCSL) wrote, "If ever there was need for an example of how reform can improve performance, then Sri Lanka has to be it. This country's experiences in telecom reform show that competition is above all else, the key to improving telecom access".

Phones literally mean business in the e-commerce age, but in developing countries just getting a connection can be a trying experience. In Sri Lanka, all that was to change dramatically in 1996 when the Government introduced direct competition to its monopolistic state provider, by granting two wireless fixed-line access licences. This was competition where it mattered most, even if the new operators were able to install only a small number of lines. In August 1997, the Government sold 35% of SLT to Nippon Telegraph and Telephone Corporation (NTT), for US$225 million and signed a management agreement with them. A further 3.5% stake went to SLT's employees with another 12% stake divested through a public offering in 2002. SLT underwent organisational reform that enabled greater efficiencies and a boost in the supply of new lines.

The unprecedented growth in the telecommunication sector in 2003 was mainly driven by a 54% expansion in mobile phone usage. Sri Lanka's first private operating licence was granted in 1989 to a mobile operator and by 1995, four mobile operators were engaged in vigorous competition. Mobile congestion eased with 1,800MHz service being made available. More importantly it reached new subscribers including those in the North and East where at least 115,000 new mobile subscribers were added by December 2003. In the country as a whole, 940,000 fixed lines and 1,393,000 mobile connections had been established by 2003. Internet users benefited from the introduction of ADSL while rates on international calls were dramatically lowered.

INVESTING IN THE FUTURE

The objective of any reforms is improvement of services to the people. In telecommunications, it is getting more people connected to the network, more value for money and greater choice. The essential pre requisite for achieving all of these is increased investment, which would not of course deliver immediate results, but will gradually achieve the intended objectives.

The combined investment by the telecommunications industry in 2003 was a staggering US$363 million, nearly Rs36 billion. Most of the investment was by mobile operators whose growth rates have followed world trends. SLT announced a US$200 million funding for their fully owned subsidiary Mobitel to convert to a GSM network. The initial phase was completed in 2003 at a cost of US$87 million. The wireless fixed phone operator Suntel is planning a US$20 million expansion programme. Almost all mobile operators have announced major capital investments towards capacity enhancements in 2004.

MONEY AND MUCH MORE

DFCC Bank's record of achievement and involvement in Sri Lanka's telecomminication sector extends back well over a decade. The Bank has acted as financier or adviser to fixed wire, wireless local loop and cellular operators and played a key role or participated in virtually every major telecom transaction to date.

DFCC Bank's first significant telecom transaction was in 1987, when the Bank provided project finance to Celltel Lanka, the pioneering cellular telecom operator. Other roles followed and in 1994, The Bank was a financial adviser to SLT in its 150k line roll-out project. The highlight was in 1996, when DFCC was the domestic partner in the consortium that advised the Government on the SLT privatisation. Its success led to other roles and in 1998/2000, the Bank was lead arranger and participant in a Rs5.7 billion syndicated term loan to SLT, at that time the largest domestic capital raising by a corporate. Other landmark transactions followed. In 2000, DFCC Bank was the manager of the Rs1.5 billion debenture issue by SLT, the first rated debt security issue listed on the Colombo Stock Exchange (CSE). In 2002, the Bank managed SLT's Rs3.25 billion Initial Public Offering, the largest ever share offering on the CSE.

DFCC Bank has also been involved with funding other telecom players in cellular and wireless local loop operations. A significant assignment in 2003 was when the Bank advised Mobitel on the procurement of financing for the Company's US$ 87 million GSM project. DFCC Bank also participated in the loan syndicated for this purpose. The transaction is reportedly the single largest debt raising by a corporate to date.

PLANTATIONS

STILL A MAJOR PLAYER

The Plantation sector, with a history of well over 100 years, still plays a vital role in Sri Lanka's economy. Its importance is even more highlighted by the fact that it remains the country's single largest employer providing jobs directly and indirectly to over a million people.

Export earnings from agricultural products increased by 3% in 2003 largely owing to the plantation crop exports. The three plantation crops contributed 84% to agricultural exports - tea 71%, coconut 9% and rubber 4%.

Within the plantation crops, earnings from tea increased by 4% in 2003 but total tea production dipped slightly with an output of 303.2 million kg. Mid-year floods and earthslips followed by a dry spell caused a decline of 2.2% from the record output of 310 million kg in 2002.

Even though export earnings from rubber increased by 46% in 2003, the volume of exports declined due to the growing domestic consumption, which absorbed about 62% of total production. Rubber production in 2003 increased only marginally by 1.7%. Motivated by rising rubber prices, which went up by about 49% in the Colombo auctions, producers brought even marginal cultivations under tapping but adverse weather limited the output.

Export earnings from the three major coconut products, namely desiccated coconut, copra and coconut oil improved from a mere 1% in 2002 to 16% in 2003. Lower domestic demand from the coconut oil industry prompted the increase in export volumes of desiccated coconut and copra. Coconut production recorded a 7.1% growth in 2003 reversing the decline of the last three years.

FUTURE CHALLENGES

Regional Plantation Companies (RPCs) hold about 40% of tea and rubber land and 2% of coconut land. The balance is with smallholders. The economic, labour and social implications of the plantation industry have come sharply to the fore of late due to the near crisis situation to which the industry has been brought by issues analysed later in this review.

The Plantation sector still faces the problem of low productivity. The average yield of tea which is around 1,500 kg/ha is much lower than that of other tea producing countries such as India (1,700 kg/ha) and Kenya (2,200 kg/ha). Likewise, the average yield of rubber remained low at around 911 kg/ha compared with yields in other major producing countries such as Thailand (1,531 kg/ha) and Malaysia (1,047 kg/ha).

Over the next five years, increasing the national yield of tea to 2,000 kg/ha, rubber to 1,500 kg/ha and 10,000 nuts/ha of coconut is seen as the foremost objective of research and development, productivity improvements, value addition and cost control.

FUNDS WHEN NEEDED

To address some of the infrastructure development issues faced by RPCs, the Asian Development Bank (ADB) together with the Japan Bank for International Cooporation (JBIC) launched the Plantation Reform Project (PRP). Under this scheme, loans at concessionary interest rates with repayment periods extending up to 15 years were given to carry out field development work, machinery upgrades and purchase of field vehicles.

The second phase of this scheme, Plantation Development Project (PDP) and PRP II, once again assisted by ADB and JBIC, became effective in 2003. The US dollar 13 million loan scheme will provide further long-term financing to meet investment needs of RPCs for field development and mechanisation in core activities of tea, rubber and coconut, crop and non-crop diversification, factory consolidation and process automation, palm oil processing, effluent treatment and rehabilitation of mini hydro stations and vertical integration through marketing ventures. A special feature of this project is that it will address perennial issues relating to estate workers poor working, living and social conditions through a social and environmental component in the credit scheme.

DFCC Bank is the Apex Body that administers the PDP and PRP II credit lines together with the revolving fund of the PRP. In addition, the Bank is also a Participatory Financial Institution under the above scheme. DFCC's long time involvement with the plantation sector has resulted in extending financial and advisory assistance to the tune of Rs2.6 billion of which around Rs1.8 billion was under the ADB/JBIC funded scheme.

PLANTATION BLUES

Regional Plantation Companies are riddled with a number of other issues that affect their growth. On the one hand they need to battle uncontrollable factors such as erratic weather patterns and volatility in tea prices. On the other hand are issues related to increasing cost of labour and other expenses, higher management fees payable to parent companies, lack of diversification and lack of skilled labour coupled with low production efficiencies. All put together, Sri Lanka has become a relatively high cost producer of both tea and rubber.

In 2003, despite tea prices picking up in the latter half of the year, the cost of tea production increased by about 9.3% reducing the margins which were already low to about 15%. Labour accounts for approximately 55% of the cost of production. A situation of concern has been the rising cost of labour without a proportionate increase in productivity. For instance, green leaf intake per plucker in Sri Lanka is the lowest when compared with India and Kenya.

An increase in the out migration of estate labour, particularly the youth, is also raising the alarm of a looming labour shortage. Even though low wages in the Plantation sector are compensated by housing and other benefits, the living standards in the Estate sector are lower than other sectors resulting in youth preferring to work elsewhere.

Labour problems and trade union demands fuelled by political as much as economic reasons are brought up at crucial times to the plantation industry.

Enterprise diversification and the reduction of dependence on one or two crops have been proposed as solutions to the RPCs vulnerability to fluctuations in international prices of tea and rubber. However, the plantation sector has traditionally been reluctant to consider these as viable options perhaps for reasons that they may undermine the importance of tea.

To ease the heavy financial burden of RPCs who pay high management fees to parent companies, an agreement was reached in 2003 with ten managing agents who have controlling interests in 13 RPCs, to reduce the management fees. The lower fee structure follows a formula based on the percentage of profit before the payment of interest, tax, depreciation and amortisation.

In conclusion, given the importance of the Plantation sector in the economy of Sri Lanka, it is expected that the proper implementation of the funding schemes to improve infrastructure and the acceleration of research and development to increase yield will contribute towards improving the performance of the plantation industry, thereby ensuring its long term sustainability. However, on a final note it is imperative to draw and implement a plan to resolve labour related issues that threaten the well-being of the industry.

SMALL AND MEDIUM ENTERPRISES

NO SMALL MEASURE

Small and Medium Enterprises are the lifeblood of many a developing economy. In Sri Lanka, for several years, Small and Medium Enterprises (SMEs) have been recognised as an important strategic sector with potential to create more employment at lower investment cost, reduce inequality in income distribution, alleviate poverty, assist in diversifying the production base and developing the regions.

Like with any other growing sector, Sri Lanka's SMEs have had their own set of problems. Systemic constraints such as limited access to institutional credit and to modern technology, scarce managerial resources, obsolete machinery and equipment, poor marketing and weaknesses in the Government support programmes to compensate for these bottlenecks, have contained the growth of SMEs.

ACCESS TO CREDIT

Since the late 1970s external assistance for the SME sub-sector was received from the International Development Association (IDA) and the Asian Development Bank (ADB). Funds from four IDA credit lines and two ADB credit lines have already been channelled to the sector. The primary objective of the assistance was to provide the required resources for term financing of viable SME projects in the private sector with special emphasis on new export oriented ventures and on expansion, modernisation and replacement requirements of existing enterprises. The objectives were consistent with ADB's operational strategy, which highlights the "importance of private sector development in reducing poverty, especially SME development, to create employment for the poor".

However, recent media reports have expressed that funds from these programmes have failed to empower small enterprises from the provinces and that geographic dipersion of funds was limited. The Project Performance Audit of the SME II project states," loans were largely allocated to the relatively urban areas of the Western province which accounted for educated and information technology aware sub-borrowers maintaining good accounting records". The project's outreach was concentrated in two regions, the Western and Wayamba, accounting for 70% of SMEs. The project audit also stated that "The project design did not identify sector or region-wise distribution of sub-loans for the Participating Credit Institutions (PCIs)". As a result, the PCIs selected sub-projects for financing, on the basis of their evaluation of risks and financial gains associated with the lending - a more financially sound method of selection.

SAHANYA PROJECT

The success of its first two credit programmes encouraged the ADB to extend a third facility for SME development in Sri Lanka. The credit assistance amounting to US$60 million or approximately Rs5,800 million, designated the SAHANYA project, became effective in September 2002. A special feature of this programme was the emphasis given to addressing a target group, which includes individuals with specific trade skills, small-scale entrepreneurs, self-employed women and educated youth.

Development Banking

A development bank should really be doing what an ordinary bank would only be willing to do at outrageous rates and conditions. As the pioneer development bank in Sri Lanka DFCC Bank ventured out on a risky path to direct the low interest funds of SAHANYA specifically to small enterprises and start-up projects in the provinces. Using its provincial branch network, the Bank supported these fledgling enterprises by infusing capital at a cost that would be of a competitive advantage to small businesses.

The size-wise distribution of credit facilities given by DFCC Bank under this programme is as follows:

Refinanced amounts Rs thousand	Number of projects	Percentage	Total amount financed	Percentage
Up to 1,000	443	37	240,270	8
1,000 – 2,000	421	35	601,923	21
2,000 – 10,000	264	22	1,056,726	37
10,000 – 20,000	56	5	695,697	24
20,000 – 35,000	11	1	301,000	10
Total	**1,195**	**100**	**2,895,616**	**100**

Nearly 60% of loans approved by DFCC Bank under SAHANYA were small projects of the SME sector. This is a significantly large proportion given the limited credit absorption capacity of these projects. It is also noteworthy, that out of the 1,195 projects financed under the scheme, 825 or 70% of the projects belong to the small and start-up enterprises. The Bank's utilisation of funds amounted to Rs2,950 million, which is almost half of the SAHANYA funds.

Targeting Start-Ups

To supplement the SAHANYA project, DFCC Bank launched a special scheme with the assistance of the Industrial Development Board (IDB) to identify start-up projects which would not otherwise have access to Bank assistance. The profile of eligible projects was determined to be, start-up ventures and small enterprises needing finance under Rs1.0 million with project assets not exceeding Rs2.5 million.

Entrepreneurs willing to contribute 10% of the loan component as equity, land, building and project assets included, who are able to sustain at least two employees initially, preferably using locally available resources and those who have not taken previous loans, qualify under this scheme.

Making it Simple

In keeping with the overriding objective of the credit scheme, the project appraisal process was simplified to capture only basic evaluation requirements. In case of start-ups, it was confined to checking the borrower's industry/trade knowledge and the marketability of the product. For existing projects, having a track record in producing and marketing a product or service in the immediate past, was a qualifying factor.

In addition, the borrower's personal attributes such as the standard of education, commitment, financial discipline and employment of family labour were considered as relevant. The requirement of having collateral was greatly relaxed by accepting the project's property, machinery, personal guarantees as sufficient security. Where property collateral was involved, the Bank also accepted undivided property and prescriptive title of the mortgagor. Valuations of DFCC officers or competent IDB personnel were accepted in place of professional valuations. The credit investigations were confined to Credit Information Bureau (CRIB) references and reliable personal inquiries. Environmentally friendly projects were considered a preferred area.

Sectors

DFCC Bank channelled the SAHANYA funds into all major sectors of the economy to transfer the project benefits to a wide cross-section of projects. The major sectors financed were food and beverage with 21%, hotels and tourism sector 16% and 9% to the printing and packaging industry. All these are industries with a domestic production base.

Beyond the Cities

Of the projects financed by DFCC Bank, around 60% were outside the Colombo district. The Southern and North Western provinces each attracted around 12% of the project funding whereas other provinces too absorbed not less than another 45% of the funds. This highlights the conscious attempt to bring about a greater dispersal of the project benefits across all the geographical areas of the country.

Social Impact

The incremental employment opportunities created through the project are estimated to be around 6,000. This works out to an investment cost of four hundred and eighty thousand rupees per employment opportunity generated. The relatively low cost per employment opportunity created, shows that the majority of investments have been in projects that could absorb more labour into the workforce. The fact that a bulk of this employment was created in the provinces suggests that the project's objective of income distribution and poverty reduction was achieved. Hence, the work of DFCC Bank remained consistent with the country's objective for SME development, i.e. to utilise funds from credit lines to impact on a broader socio economic scale.

APPROVALS AND DISBURSEMENTS

Overall, operations of the Bank during the period under review, measured in terms of approvals, disbursements, portfolio size, fee income etc. showed an impressive growth. Demand for credit increased due to the improved macroeconomic environment, both nationally and globally, after a period of sluggish demand. An encouraging feature was that most of the demand for long-term project finance came from new projects. However, declining interest rates on rupee loans, low interest rate on dollar loans and excess liquidity created intense competition in the banking sector and posed a number of challenges to DFCC Bank. The Bank also passed on the benefits of the low interest rates regime to clients who had borrowed on fixed interest rates earlier wherever possible, particularly where there was a corresponding decrease in the cost of refinance. DFCC Bank also effected downward revisions of the floor rates and spreads in respect of most of the clients who had borrowed on variable rates. A few corporate clients prepaid loan balances outstanding with the proceeds of either dollar loans or short-term rupee loans where interest rates were more attractive.

APPROVALS

The total approvals during the financial year ended 31 March 2004 amounted to Rs19,711 million, an increase of Rs8,012 million or 68% over the previous year.

PRODUCT-WISE ANALYSIS OF APPROVALS (RS MILLION)

Year ended 31 March	2000	2001	2002	2003	**2004**
Loans & Advances	6,931	8,146	6,803	9,087	**15,233**
Finance Leases	1,045	998	1,039	1,732	**2,697**
Investment Securities	51	641	652	601	**453**
Guarantees & Underwriting	384	396	2,611	279	**1,328**
	8,411	10,181	11,105	11,699	**19,711**

Long-term project loans accounted for Rs10,824 million out of the approved total loans and advances of Rs15,233 million while the balance represents working capital and money market facilities. Of the loans and advances, 58% was for new projects while the balance was for expansion and balancing, modernisation and relocation purposes of existing projects.

The food, beverage and tobacco sector, energy sector, trade sector, which includes major tea exporting companies and holding companies of well diversified groups, transport, storage and communication sector and financing, insurance, real estate and business services sector all contributed towards the growth of approvals, each sector contributing more than 10% of the total approvals. The average size of the approved project loan increased from Rs7 million in 2003 to Rs9 million in 2004 while the average size of the finance lease remained at the same level of Rs1.2 million.

DISBURSEMENTS

Disbursements too, increased from the previous year's Rs8,803 million to Rs12,523 million an increase of 42%. However, the rate of growth of disbursements lagged approvals of fund based products due to the longer gestation period of some large greenfield projects.

PRODUCT-WISE ANALYSIS OF DISBURSEMENTS (RS MILLION)

Year ended 31 March	2000	2001	2002	2003	**2004**
Loans & Advances	5,515	6,750	4,533	6,820	**9,671**
Finance Leases	967	798	868	1,657	**2,546**
Investment Securities	259	625	400	326	**306**
	6,741	8,172	5,801	8,803	**12,523**

The above approval and disbursement figures do not include investments in associate and subsidiary companies during the year, which amounted to Rs1,106 million.

PORTFOLIO

The total portfolio of the Bank (net of provisions and pre-payments) increased to Rs27,184 million from the previous year's figure of Rs22,826 million, recording a growth of 19.1%. This portfolio growth has been achieved despite substantial pre payments by a few corporate clients. The number of clients too, increased during the year by 20%, from the previous year's 9,524 to the current year's 11,425. Details of approvals during the year and the portfolio as at 31 March 2004, analysed by industry sectors and products, are given at the end of this Review.

MANAGEMENT OF NON-PERFORMING LOANS AND LEASES

Continued focus and conscious effort on achieving a better quality portfolio have resulted in a reduction of the non-performing loan ratio to 10.8% as at FYE 2004 from 13.4% in 2003. The non-performing lease ratio reduced to 8.3% from 13.1% in 2003. This improvement is comparable to the percentage reductions achieved in the previous year, and brings the Bank closer to its target of achieving single digit ratios.

Reducing the non-performing loans and leases does not necessarily mean divesting assets of sick projects, as the Bank initially makes every effort to convert them to performing assets through various actions and strategies. These varied from simple rescheduling of repayments to complex corporate restructuring including change of management. Structural changes introduced during 2002 within the Bank and the strategies adopted in addressing non-performing projects have proved to be effective as witnessed by the continuous improvement in the non-performing loan and lease ratios. Procedures were further strengthened during the year by transferring problem projects early to Special Loans Administration unit before it became too late to formulate and implement rehabilitation strategies.

Improvement of non-performing projects in the prawn farming sector continues to be slow, constrained by the fact that sector-specific problems still exist. The Bank, with the help of Wayamba University, intends to implement a Technical Assistance Scheme for bona fide prawn farmers, which will help them to revive their operations. The Bank continues to provide some relief to affected farmers who wish to settle outstanding loans and leases.

BRANCH BANKING OPERATIONS

SME Development

Credit operations of branches displayed a substantial expansion in credit approvals, credit portfolio growth as well as reduction of non-performing assets. The figures given below reflect this continued growth trend seen during the last few years, particularly in respect of the Small and Medium Enterprises (SME) sector that is served by the branches.

SME LENDING THROUGH BRANCHES (RS MILLION)

Year ended 31 March	2002	2003	**2004**
Approvals	4,250	5,354	**8,136**
Credit Portfolio	7,130	9,679	**13,257**
Deposit Products	1,562	2,092	**3,763**

Lending primarily consists of direct credit facilities to industrial, agricultural and services sector enterprises that directly contribute to provincial and rural economic development. These investment funds were channelled into start-up ventures as well as for expansion, modernisation and relocation of existing enterprises. The economic sectors that benefited include agriculture, small and medium scale plantation crop development, agro-processing of commodities, light-engineering industries, transport, tourism and trade. Branch lending accounts for about 46% of the total loan portfolio of the Bank, and the number of clients so assisted exceeds 8,000 SMEs scattered in all provinces except the North and East. The impact of such investments on rural employment creation has been very significant.

Utilisation of Credit Lines

DFCC Bank utilised almost half of the refinance funding available under the SAHANYA or Small and Medium Enterprise Sector Development Project, committing Rs2,950 million to about 1,195 SMEs. Other sources of long-term funds utilised for SME lending include Tea Smallholder, Perennial Crop Development, Southern Province Development and Renewable Energy for Rural Economic Development credit lines. These credit lines enabled the Bank to offer long repayment periods and low interest rates to a large number of end-users in the SME sector and add competitive advantage to the assisted enterprises.

Expanding the Distribution Network

Branches of DFCC Vardhana Bank were set up in five branches and in the Head Office of DFCC Bank, thus enabling existing and new customers to access a wide-range of commercial banking products that complement the development banking products already offered. The Ratnapura Branch was relocated in a more spacious location in the heart of town for better customer service. The Bank has also identified new locations for shifting of its Gampaha, Badulla, Anuradhapura and Kurunegala Branches. These changes have become necessary to accommodate the expansion of these branches, including the additional services provided by DFCC Vardhana Bank.

Branch Profitability

All branches reported profits during the year under review, including the two recently set up Window Offices. Branches as a whole have made a significant contribution to the Bank's profit reflecting the credit quality of their portfolios as well as other operational efficiencies that have been consistently maintained. Considering their present performance and future potential, the Extension Offices in Polonnaruwa and Kalutara will be upgraded into full-scale branches during the course of 2004.

FINANCE LEASING

Approvals of finance leasing amounted to Rs1,548 million during the year under review, representing 1,300 lease agreements. The leases financed passenger and goods transport vehicles, construction and earth-moving equipment, industrial machinery etc., to a large number of business undertakings. The economic sectors covered include, agricultural produce transportation, bulk handling and transportation of industrial output, commuter transportation, construction and support services for infrastructure development projects. All leases granted were exclusively for business applications and had a direct contribution to the increase in the private capital investment in the country.

TECHNOLOGY INITIATIVES

During the year under review, the Bank commenced operations of the SYMBOLS core banking system, with the Client Management, Loan Origination, Commercial Lending and Deposit Mobilisation modules. The project had a lead time of 16 months, with the system being rolled out initially at Head Office followed by the branches. It is expected to be fully deployed by September 2004. SYMBOLS has the flexibility to introduce extensive product variations through an integrated suite of business modules that can evolve to meet the changing needs of the customer. The application architecture is customer-centric and enables the Bank to manage risk at operational level. With the introduction of SYMBOLS, the Bank has replaced and consolidated several legacy sub-systems running on multiple technology platforms.

The Bank implemented the Hyperion business performance management suite, comprising Hyperion Planning, Hyperion Analyzer and Hyperion Essbase in order to support the planning, forecasting and budgeting processes of the Bank. This new system will help the Bank to proactively manage continuous change and monitor accurately the impact of changes on its business performance, while reducing overall cycle times. Information reporting and analysis will also improve, as Hyperion has the capability to link other systems such as the Oracle Financials general ledger and the SYMBOLS core banking system.

The Bank upgraded its back-end accounting platform to Oracle E-Business Suite. The new version supports all the requirements of the Bank and provides seamless integration with other core business applications, whilst gearing itself to handle commercial banking and foreign currency activities. This was an important step towards supporting the Bank's expansion.

DFCC VARDHANA BANK LIMITED

DFCC Bank purchased a 90% share in the existing equity of National Mercantile Bank Limited, also known as MERC Bank, in August 2003 for Rs60 million. MERC Bank had suffered disabilities on account of delays in the issue of a licence to act as an authorised dealer in foreign exchange, thus seriously impeding its progress as a commercial bank. The Bank, upon acquisition by DFCC Bank, was re-branded DFCC Vardhana Bank Limited to reflect the strong affiliation to DFCC Bank and to build public confidence.

DFCC Bank infused additional capital of Rs481 million through a rights issue increasing its stake to 94.2%, followed by a capital reduction exercise. The Board of the Bank was reconstituted and several senior executives of DFCC Bank were appointed as Directors and key Officers to provide direction and guidance for its revival and growth. Strategic initiatives to resurrect the Bank to a state of operational viability within a short time frame were put in place.

By 31 March 2004 nine branches were operational. Three comprised the original City Office Branch and the ones in Gangodawila and Malabe, while six more were set up within the premises of DFCC Bank's branches in Kandy, Kurunegala, Matara, Anuradhapura, Ratnapura and Head Office. This has proved to be a low-cost branch expansion strategy for DFCC Vardhana Bank, while at the same time enabling DFCC Bank to complement its development banking products to serve existing and new clients.

Approximately 30 new jobs have been created in the post acquisition period, mostly filled by new recruits with the required experience and training. The IT services are in the process of being upgraded and will be fully integrated with DFCC Bank at a future date. DFCC Bank's marketing and business promotion functions cater to the immediate business development and promotional needs of DFCC Vardhana Bank, while an integrated treasury operation has been put into place, although transactions are accounted for in the books of the respective legal entities. The centralisation of several administrative functions will be a significant cost advantage to DFCC Vardhana Bank.

The objectives of DFCC Vardhana Bank for the first six months have been achieved, and the Bank is presently on course to reporting a net profit for the financial year ending 31 December 2004. DFCC Vardhana Bank, will in the medium term, strengthen DFCC Bank's standing as a full service development bank, while both institutions reap the synergies of a fruitful relationship.

RESOURCE DEVELOPMENT

The Bank further diversified its resource base during the year under review, by accessing retail deposits and negotiating with local institutional investors for medium and long-term funding.
The main sources were credit lines from multilateral agencies, retail deposits and money and capital markets. For the first time in its history, DFCC Bank mobilised funds for lending in foreign currency. This required special approval from the Central Bank of Sri Lanka. The amount raised was the US dollar equivalent of Euro 5 million from the European Investment Bank. This will help DFCC Bank to offer its customers foreign currency loans as well.

Refinance from credit lines accounted for 27% of the term loans disbursed during the year, with the Small and Medium Enterprise Development Project (SMEDP), Renewable Energy for Rural Economic Development (RERED) project and the European Investment Bank, accounting for a major share.
The Bank continued to achieve a steady growth in establishing its retail deposit base. Deposits outstanding grew by 73% during the year and reached Rs4,965 million by 31 March 2004, which accounted for 19% of the total liabilities outstanding. A sum of Rs1,500 million was also drawn from local institutions and Rs2,000 million remains committed.

TREASURY AND MONEY MARKET

Investment income from the liquid investment portfolio grew marginally to Rs329 million despite the decline in the twelve-month treasury bill rate by 1.62 percentage points. Taking advantage of the declining long-term yields the Bank realised a capital gain of Rs62 million during the year. While actively involved in the trading of Government Securities, the Bank maintained a relatively conservative posture at lower yield levels, as a protection against possible adverse movements in interest rates. The holding of Government Securities was limited to more liquid maturities and the leverage was reduced significantly. While this, to some extent, limited up-side gains, it also hedged the Bank from the rise in yields experienced in the latter part of the year. By 31 March 2004, Government Securities and other liquid investments amounted to Rs2,246 million, of which only 11% comprised maturities more than one year. Therefore, a possible rise in interest rates is unlikely to have an adverse impact on the values of the liquid securities portfolio.

CAPITAL MARKETS AND INVESTMENT BANKING

The Colombo Stock Exchange (CSE) demonstrated an upbeat trend for most of the financial year.
A noteworthy feature was that positive fundamentals spurred both secondary and primary market activity with key indicators recording new levels. At times, daily turnovers topped Rs1.0 billion and September witnessed a monthly turnover high of Rs16.5 billion. Both indices recorded their highest levels in October with the All Share Price Index soaring to 1,423 points and the Milanka Price Index to 2,584. Particularly encouraging was the continued participation of foreign investors, who remained net buyers.

The CSE performance could be attributed to growing corporate profits and favourable economic trends such as GDP growth, easing of interest rates, relatively low inflation and stable exchange rates. However, the market was to prove its vulnerability to developments on the political front since November and the onset of political uncertainties were to negatively impact sentiment and the market's direction. Yet, the CSE was able to retain some momentum with key indicators remaining significantly above the levels that prevailed at the beginning of the financial year.

The positive market performance was conducive to investment banking activities of the Bank, which was involved in the two largest and successful primary share offerings that took place during the financial year. The most notable was the Initial Public Offering of Hemas Holdings Limited, where the Bank played the role of Lead Manager. This transaction, which generated a subscription of nearly Rs7 billion for an offering of Rs600 million, set a record for the magnitude of the public response. Among other fee-based assignments, the Bank acted as financial adviser to Mobitel in procuring a US$87 million financial package for its GSM project. This is reportedly the single largest debt raising by a Sri Lankan corporate to date.

Favourable equity market conditions also enabled the realisation of Rs81 million in capital gains from the Bank's quoted and unquoted equity portfolios.

MANAGEMENT OF CREDIT LINES

Renewable Energy Development

The Energy Services Delivery Project, concluded in 2002, has created a vibrant industry of suppliers, developers, consultants and industry associations, and introduced commercial financing to this sector through banks as well as micro credit providers. The follow-on Renewable Energy for Rural Economic Development (RERED) project, which has a World Bank credit line of US$75 million and a Global Environment Facility grant of US$8 million, became effective in October 2002. DFCC Bank functions as the Administrative Unit of this project as well. The RERED project aims to improve the quality of rural life by providing them access to electricity through off-grid renewable energy technologies, and promote private sector participation in power generation for the national grid using renewable energy resources. By 31 March 2004, a total of Rs2,009 million had been committed, with Rs1,068 million disbursed by the 10 participating credit institutions. Completed projects included five grid-connected mini hydro projects providing 7MW of capacity addition (with a further 40MW under construction), and the electrification of 1,179 rural homes through 26 off-grid village hydro schemes and 23,977 solar home systems, the latter including installations in the North and East. Several more on-grid and off-grid projects are under implementation, including a 1MW biomass plant.

Plantation Development

DFCC Bank functions as the Apex Body in the Plantation Development Project/Plantation Reform Project II, assisted by the Asian Development Bank and Japan Bank for International Co-operation. The two credit lines became effective in August 2003 and May 2003 respectively, though disbursements have yet to begin. The project will provide long-term financing to meet the investment needs of regional plantation companies through a credit component and address the estate workers poor working, living and social conditions through a social and environmental component, which inter alia includes a housing loan scheme. The refinance available for participating financial institutions under the credit component is approximately Rs3,500 million to finance regional plantation companies and approximately Rs830 million for estate workers housing loans.

SECTORAL ANALYSIS

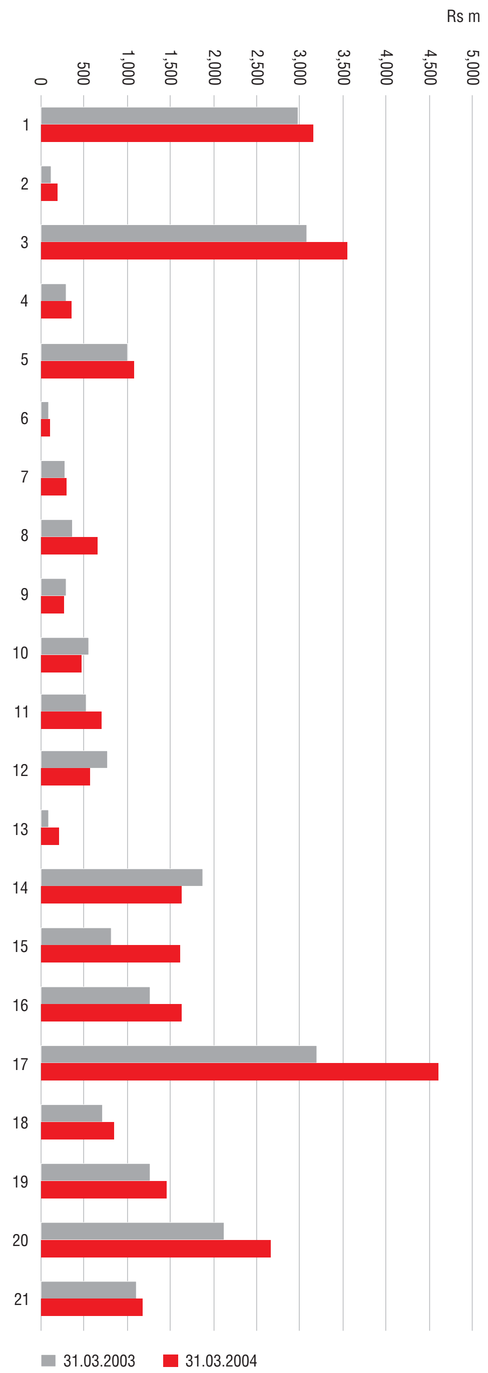
Sector: Sector groupings based on International Standard Industrial Classification	Approvals for the year ended 31 March 2004: No. of Projects	Loans	Finance Leases	Investment Securities	Bills Discounted	Guarantees & Underwriting	Total	%
	Rupees million							
1 Agriculture, forestry and fishing	588	813	212	0	0	10	1,035	5.3
2 Mining and quarrying	145	194	66	0	0	3	263	1.3
3 Manufacture of food, beverages and tobacco	332	2,223	147	0	0	102	2,472	12.5
4 Manufacture of textiles	26	117	7	0	0	1	125	0.6
5 Manufacture of wearing apparel excluding footwear	97	368	65	0	0	57	490	2.5
6 Manufacture of leather and leather products including footwear	36	132	14	0	0	0	146	0.7
7 Wood and manufacture of wood products	50	221	24	0	0	2	247	1.3
8 Manufacture of paper products, printing, publishing and packaging	77	422	66	0	0	17	505	2.6
9 Manufacture of chemicals and chemical products other than rubber and plastic products	30	148	12	0	0	40	200	1.0
10 Manufacture of rubber products	20	411	11	0	0	50	472	2.4
11 Manufacture of plastic products	29	110	6	0	0	12	128	0.6
12 Manufacture of non-metallic mineral products including pottery, china and glass	36	317	9	0	0	1	327	1.7
13 Basic metal production	25	108	7	0	0	0	115	0.6
14 Manufacture of fabricated metal products, machinery and equipment including electrical items, transport equipment and instruments	108	697	57	0	0	40	794	4.0
15 Electricity, gas and water industries	75	1,792	26	200	0	19	2,037	10.3
16 Construction industries	542	734	281	0	0	70	1,085	5.5
17 Trade	1,300	1,998	810	81	0	548	3,437	17.4
18 Hotels and restaurants	92	225	41	100	0	0	366	1.9
19 Transport, storage and communications	457	1,507	514	0	0	10	2,031	10.3
20 Financing, insurance, real estate and business services	162	2,405	56	52	0	137	2,650	13.4
21 Community, social and personal services	400	291	266	20	0	209	786	4.0
	4,627	15,233	2,697	453	0	1,328	19,711	100.0

Note: Portfolio balances are excluding loans to staff.

Portfolio as at 31 March 2004

No. of Clients	Loans	Finance Leases	Investment Securities	Bills Discounted	Total	%
Rupees million						
2,019	2,805	327	28	0	3,160	11.6
163	148	42	0	0	190	0.7
839	3,155	194	195	0	3,544	13.0
294	303	42	0	0	345	1.3
213	990	89	0	0	1,079	4.0
67	66	20	9	0	95	0.3
227	240	47	0	0	287	1.1
199	583	66	0	0	649	2.4
102	213	36	19	0	268	1.0
70	432	23	8	0	463	1.7
99	680	11	12	0	703	2.6
99	547	16	10	0	573	2.1
84	167	28	11	0	206	0.8
420	1,221	145	269	0	1,635	6.0
99	1,384	24	206	0	1,614	5.9
469	1,284	251	91	0	1,626	6.0
3,570	3,604	997	10	0	4,611	16.9
403	540	154	147	0	841	3.1
775	750	561	147	0	1,458	5.4
635	1,920	218	518	0	2,656	9.8
579	880	276	25	0	1,181	4.3
11,425	21,912	3,567	1,705	0	27,184	100.0

Portfolio



OVERVIEW

This review explains the main features of DFCC Bank's financial performance and position. The Bank accounts for its investments in associate and subsidiary companies under the equity method of accounting. Since this is a partial consolidation, under this method, the profit after tax of the Bank equals the profit attributable to the Group after deducting minority interest, and the Bank's Balance Sheet includes post acquisition reserves of associate and subsidiary companies. This review relates to the financial statements of the Bank and not the Group. The profit after tax of Rs1,293 million is a 14% increase over the Rs1,131 million achieved in the previous year.

The composition of the profit after tax is given below:

	Year to 31 March 2004		Year to 31 March 2003	
	Rs million	**%**	**Rs million**	**%**
DFCC Bank	**1,085**	**83**	856	76
Commercial Bank of Ceylon Limited	**171**	**13**	250	22
Lanka Ventures Limited	**55**	**4**	5	0 **
DFCC Stockbrokers (Pvt) Limited	**23**	**2**	10	1
Lanka Industrial Estates Limited	**9**	**1**	9	1
DFCC Vardhana Bank Limited*	**-45**	**-3**	Not applicable	Not applicable
National Asset Management Limited	**-5**	**0**	1	0 **
Total	**1,293**	**100** **	1,131	100

* *Acquired on 1 August 2003.*

** *Less than 0.5%.*

DFCC Bank's profit after tax from its own operations increased by 27% in the current financial year. However, the loss of DFCC Vardhana Bank Limited together with the goodwill write-off attributable to it and the significant reduction in contribution from Commercial Bank of Ceylon Limited, both as a proportion and in absolute amount, partly offset the favourable gains posted by DFCC Bank. The Bank posted favourable gains despite having to absorb the value added tax and income tax burden primarily due to loan and lease portfolio increases and by improving the interest margin achieved in the previous year by proactive liability management, profit on sale of investment property and efficient loan portfolio management to contain non-performing loans and recover past dues.
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

NET INTEREST INCOME, INTEREST SPREAD AND MARGIN

		Rs million	
	Year to 31.03.2004	Year to 31.03.2003	Year to 31.03.2002
1. Interest income	**3,461**	3,428	3,577
2. Interest expense	**1,819**	2,091	2,200
3. Net interest income	**1,642**	1,337	1,377
4. Interest rate on assets *(Interest income/average interest bearing assets)* x 100	**13.52%**	15.22%	16.77%
5. Borrowing rate: Method 1 *(interest expense/average interest bearing liabilities)* x 100	**7.93%**	10.29%	11.27%
6. Borrowing rate: Method 2 *(interest expense/average interest bearing assets)* x 100	**7.11%**	9.29%	10.31%
7. Interest spread (item 4 minus item 5)	**5.59%**	4.93%	5.50%
8. Interest margin (item 4 minus item 6)	**6.41%**	5.93%	6.46%

The intermediation cost of a bank inclusive of the return to equity capital providers is conventionally measured either as interest spread or margin achieved during the financial year.

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.

As depicted in the above table, the Bank was able to improve its interest margin despite sharp decreases in the on-lending rates in tandem with the low interest rate regime prevalent in the country. This was possible by proactively reducing the cost of borrowing by sourcing lines of credit at competitive rates of interest supplemented with customer deposits.

Other Income

Other income for the current year was Rs983 million, a 44% increase over Rs685 million in the previous year. Increases in dividend income and recoveries of bad debts previously written-off in full together with profit on sale of investment property contributed to this increase.

The dividend income of Rs321 million in the current year is a 28% increase over Rs251 million in the previous year. Substantial increases in dividends from our subsidiaries, DFCC Stockbrokers (Pvt) Limited and Lanka Ventures Limited together with a higher quantum of dividend from our investment in Commercial Bank of Ceylon Limited commensurate with an increase in investment through participation in the rights issue and bonus issue, contributed to this increase.

The sale of investment property located at a prime location in Colombo yielded a one-off profit of approximately Rs100 million.

Operating Expenses

The operating expenses increased by 36% to Rs851 million during the year compared to Rs625 million in the previous year. The ratio of operating expenses to operating income was 32% compared to 31% in the previous year. This was primarily due to asymmetrical value added tax expense that was introduced at the rate of 10% on 1 January 2003 and increased to 15% on 1 January 2004. Consequently, the previous year bore this expense for three months computed at a lower rate amounting to Rs29 million, while this year this expense was applicable for the entire year and also computed at the higher rate in the last quarter. The value added tax expense was Rs182 million. If the value added tax is excluded in both years, the year on year increase in the operating expenses would have been only 12%. On this basis the ratio of operating expenses to operating income was 25% in the current year compared with 29% in the previous year.

Reduced interest yield on Government Securities had an impact on the provision for staff retirement benefit. The Bank has a defined benefit non-contributory pension plan for eligible employees together with partially contributory survivor defined benefit pension plan for the spouse and dependent children who survive the retiree. Our Consultant Actuary estimated the average remaining working life of the current employee population who will retire at 55 years, as approximately 10 years. Consequently, the past service component of many of them is higher than the future service, resulting in a substantial increase in the past service cost arising from changes in actuarial assumptions necessitated by the recent reduction in interest yield of Government Securities. This cost increase is spread over the remaining working life of the employees and has thus increased the pension cost in the future. The Bank has therefore taken steps to abolish the Pension Scheme for new entrants effective from 1 May 2004 in order to mitigate the burden of maintaining a pension plan in a low interest rate regime.

Bad and Doubtful Debts

The gross specific provision for this year was Rs510 million, 5% lower than Rs536 million in the previous year. A 33% increase in recoveries of loans, leases and Bills of Exchange previously provisioned resulted in a significant improvement in the net specific provision. The net specific provision for this year was Rs330 million, 18% lower than the previous year.

The specific provision was augmented by the application of prescribed discounts to forced sale value of immovable properties held as collateral by the Bank as required by an amendment to the direction issued by the Central Bank of Sri Lanka, which became effective on 1 January 2004.

The general provision is made for Prawn Aquaculture, Brewery, Poultry and Hotel sectors and enterprises that have ceased commercial operations and are in arrears for 2 years or more. The Bank reviews continuously the scope and extent of the general provision taking into consideration enterprise specific as well as sector-specific issues. The general provision is applied as a percentage, which remained unchanged during this financial year, on the principal outstanding net of specific provision.

Profit Contribution by Commercial Bank of Ceylon Limited, an Associate Company

The financial year of this company ends on 31 December and consequently its results for the year to 31 December 2003 has been consolidated with the Bank for the year to 31 March 2004. Although the published results of Commercial Bank of Ceylon Limited (CBC), indicate a year on year increase of 17% in the profit attributable to shareholders based on its consolidated financial statements, the undistributed profit after tax included in the DFCC Bank for the current year shows a 32% decrease. The reasons for this disparity as explained in Note 10.2.1 are the consolidation adjustments. Since the Bank adopts equity method of accounting for its investments in associate and subsidiaries, which is a partial consolidation, the reported results of the Bank differ from that of CBC. The consolidation adjustments relate to differences in accounting policy on deferred taxation and the treatment of preference dividend paid by CBC and withholding tax deducted on ordinary and preference dividends paid by CBC to DFCC Bank.

Contribution from Subsidiaries

The composition of profit after tax of the Bank given on page 28 indicates the relative contributions from the subsidiaries. The profit after tax of Lanka Ventures Limited, a subsidiary in which the Bank owns 59% was substantially increased by a tax over-provision that reduced the tax charge due to the tax refund in terms of Inland Revenue (Special Provisions) Act No. 10 of 2003. This is a non-recurrent exceptional item. The tax over-provision net of current year tax charge was Rs76 million.

DFCC Stockbrokers (Pvt) Limited, a 100% owned subsidiary of the Bank, benefited from a buoyant stock market for the greater part of 2003 and its results for the year to 31 December 2003 is consolidated with the Bank.

The performance of these subsidiaries compensated for the post acquisition loss of DFCC Vardhana Bank Limited (DVB), 94.2% of which is owned by DFCC Bank. The Banks' share of post acquisition loss of Rs45 million for the period 1 August 2003 to 31 December 2003 together with the amortisation of goodwill amounting to Rs23.2 million have been included in the results of the Bank.

The provisional non-audited loss of DVB for the period 1 January 2004 to 31 March 2004 was Rs8 million and the Banks' share of 94.2% of this loss was not consolidated with the Bank as permitted by the applicable Sri Lanka Accounting Standard. The Goodwill amortisation for the period 1 January 2004 to 31 March 2004 was Rs14.1 million.

Taxation

The tax expense as a percentage of profit before tax increased to 31%, compared to 22% in the previous year. Under equity accounting the tax expense includes the tax expense on the Bank's own profit before tax and the tax expense on the undistributed profit of its associates and subsidiaries.

The tax charge on the Bank's own current year profit and the Bank's own deferred tax constitute the total tax expense on Bank's own profit before tax.

The tax charge of the Bank on its own profits including the dividends received from its subsidiaries and associates was only 15% of its profit before tax. This however, was offset by the deferred tax which neutralises the current tax saving arising from timing difference and under-provision in respect of the previous year due to the impact of amendments to the Inland Revenue Act that retrospectively changed the tax computation for the previous year. Thus the tax expense of the Bank on its own profit was 26% in the current financial year.

BALANCE SHEET ITEMS

Year on Year Change in and Quality of the Credit Portfolio

The credit portfolio comprises items included in the Balance Sheet as loans to customers excluding loans to employees, finance leases and bills of exchange discounted. The credit portfolio on 31 March 2004 amounted to Rs24,979 million an increase of 19% over the credit portfolio one year ago.

ANALYSIS OF NON-PERFORMING LOANS BY AGE OF ARREARS BEFORE SPECIFIC PROVISION

	Year to 31 March 2004		Year to 31 March 2003	
Age of arrears	**Rs m**	**%**	Rs m	%
Less than 3 months	**374**	**16.1**	324	12.4
3 to less than 6 months	**190**	**8.2**	132	5.1
6 to less than 12 months	**438**	**18.9**	502	19.2
12 to less than 18 months	**158**	**6.8**	379	14.5
Over 18 months	**1,163**	**50.0**	1,276	48.8
Total	**2,323**	**100.0**	2,613	100.0

This includes loans outstanding in the Textile Debt Restructure Fund (TDRF) of the Government of Sri Lanka of Rs197 million in the current year and Rs249 million for the previous year. The TDRF loan is repaid by the Government of Sri Lanka with some delay and consequently remains classified as non-performing.

Non-performing loans and leases net of provision and realisable value of security as disclosed in the notes to the financial statements was Rs78 million on 31 March 2004 and Rs124 million on 31 March 2003. The amount of such deficit over shareholders' funds was 0.9% on 31 March 2004 and 1.6% on 31 March 2003. The shareholders' funds are the ultimate buffer to absorb the loss of write off.

As evident from the maturity profile of the receivables and liabilities disclosed in the notes to the financial statements, there was a favourable maturity gap to cushion delays in collection and avoid liquidity risk.

Investment in Subsidiaries

The Bank paid Rs60 million to purchase 90% of the ordinary share capital in DFCC Vardhana Bank Limited (DVB). Subsequently, it participated in a rights issue of Rs500 million by DVB to replenish its capital eroded by accumulated losses. The Bank also purchased additional rights not taken up by other minority shareholders and it increased its ownership to 94.2% with a total investment of Rs541 million. This investment gave rise to a goodwill on consolidation of Rs283 million which is amortised equally over a 60 month period commencing from August 2003. As part of capital reconstruction, DVB has completed the necessary legal procedures to reduce its issued and paid-up capital by the set-off of accumulated losses. The capital reduction was by cancellation of paid up shares to the extent of set-off of accumulated losses attributable to all shareholders. The cancellation of the shares however, has no impact on the carrying value of the investment. The additional financial commitments by the Bank in respect of DVB include a composite credit facility to DVB.

This composite credit facility of Rs600 million could be utilised as a term loan and/or guarantee facility to secure the borrowing of DVB from third parties.

As at 31 March 2004, DVB utilised Rs500 million as a term loan.

Capital and Liability Structure

Interest bearing liabilities accounted for 71% of the total liabilities and shareholders' funds on 31 March 2004, compared to 71% one year ago. Deposits from customers increased from Rs2,867 million on 31 March 2003 to Rs4,944 million on 31 March 2004.

The issued and paid-up capital of the Bank was increased by a one for three bonus issue approved by the shareholders on 12 February 2004 and cash infusion by exercise of options by the eligible employees.

The capital adequacy computation given on pages 109 and 110 gives the composition of the regulatory capital and risk weighted assets. The regulatory capital of the Bank is significantly above the minimum of 10% applicable on 31 March 2004.

The market capitalisation of the Bank was Rs12,544 million on 31 March 2004 compared to Rs6,008 million on 31 March 2003.

Cash and Cash Equivalents

Cash and cash equivalents increased to Rs302 million on 31 March 2004 from Rs226 million overdraft - net on 31 March 2003. Though the Bank increased its credit portfolio, higher level of operating profits compared to the previous year and successful resource mobilisation financed such growth. The cash outflow for investing activities was to a great extent balanced by income from investments and divestments of mature investments. The cash outflow of Rs60 million to purchase the initial 90% stake in the ordinary share capital of DFCC Vardhana Bank Limited (DVB) was off-set by Rs38 million cash and cash equivalent of the DVB at the time of acquisition. These measures collectively enabled the Bank to increase the cash and cash equivalents.

OTHER

Dividend Distribution

The proposed dividend per share is Rs5.50, the same as in the previous financial year. The dividend quantum however, was augmented by the enhanced share capital from the bonus share issue and exercise of employee share options.

The dividend payout as a percentage of Bank's own profit after tax is 28.4%.

MATCHING RISK TO REWARD

DFCC Bank and its subsidiary DFCC Vardhana Bank Limited are exposed to a variety of risks arising from the transactions they enter into and the environment in which they operate. These risks are measured, monitored and managed by the DFCC Bank. Reference to "DFCC" in this section includes both DFCC Bank and DFCC Vardhana Bank Limited.

Executive Committees charged with the management of risks have carefully defined responsibilities, well-structured procedures and clearly demarcated accountabilities and form the backbone of risk management at DFCC. However, risk management is a dynamic process and accordingly the mitigation framework is continuously reviewed and improved.

The following describes the main risks and the institutional arrangements in place to implement the strategies for mitigation.

CREDIT RISK

DFCC's main exposure is to credit risk. This is the risk to earnings or capital arising from the potential of borrower default. It resides primarily in DFCC's lending portfolio. Other on-balance sheet exposures include inter-bank lending and overnight deposits. Off-balance sheet credit risk arises mainly from guarantees provided by DFCC.

Credit risk is monitored and managed by procedures and controls relating to gross positions, counter parties, credit exposure concentration, client credit rating, collection performance, non-performing assets and specific and general provisions.

The credit decision-making process is well structured with a multi-stage review and clear authority limits. A comprehensive appraisal of credit applications is undertaken by competent staff and reviewed by their supervisors, and depending on authority limits, authorised by individuals with lending authority, the Credit Committee or Board of Directors of DFCC Bank. This process brings different perspectives to the credit decision. The review process is backed by a client rating system, which enables loan pricing to match credit risk. Post disbursement project monitoring and review detects signs of distress and enables early transfer to the Special Loan Administration unit of DFCC Bank.

Lending against collateral obtained in the form of mortgage over movable/immovable assets, as well as third party guarantees, is the main risk mitigation measure. DFCC, as an approved credit institution, can enforce such security by auction of mortgaged assets, subject to legal safeguards provided in the Recovery of Loans by Banks (Special Provisions) Act No. 4 of 1990.

DFCC has commenced an initiative with the assistance of an external rating agency to improve its credit risk rating system over the next 18 months aimed at measuring "probability of default" and "loss given default". This initiative will enable DFCC to build up a database of information required to comply with and benefit from the new capital accord being formulated by the Basle Banking Committee, commonly referred to as Basle II, which is expected to be introduced in Sri Lanka in a few years.

LIQUIDITY RISK

Liquidity risk is the risk that DFCC may not be in a position to meet its financial commitments when due without incurring unacceptable losses. DFCC's liquidity management policy is in line with the Basle Committee guidelines on Banking Supervision. Risk is managed through maturity gap analyses, rolling cash flow forecasts, ratio analyses and contingency plans, which are subject to regular review. For liquidity support DFCC also has access to the short-term money market.

INTEREST RATE RISK

The potential risk of loss in net interest income arises from adverse changes in the rates of interest bearing assets relative to the changes in the rates of borrowings which finance such assets, thereby resulting in the narrowing of net interest margins.

The main sources of interest rate risk for DFCC are timing differences in the repricing of assets and liabilities, prepayment options on fixed rate loans and mismatches in the basis used for asset and liability pricing. Gap analyses are regularly carried out to quantify the interest rate risk. Such risk is mitigated through caps, floors, prepayment levies etc. Overall the DFCC Bank's fixed rate assets have been financed by fixed rate liabilities. Floating rate assets and liabilities are similarly matched. DFCC by choice, sometimes carries a basis risk on its floating rate assets and liabilities, which are calculated to enhance the net interest margin. The Asset and Liability Committee (ALCO) regularly monitors these risks, assesses the impact of rate changes on profitability and sets minimum spreads for pricing credit products. Policies for measuring and controlling interest rate risk in the treasury portfolio are also in place. The Value at Risk methodology is adopted for this purpose.

FOREIGN EXCHANGE RISK

Although DFCC Bank has borrowed from foreign sources it is not exposed to foreign exchange risks. These borrowings have been made with the concurrence of the Government of Sri Lanka. In terms of the DFCC Bank Act No. 35 of 1955, the Government bears the exchange loss or benefits from the gain. Where the DFCC Bank has assumed the risk, the liabilities are matched by same currency assets and the amounts are not significant. The product range and scale of operations of DFCC Vardhana Bank do not give rise to significant risks and appropriate controls are in place to monitor and control these risks.

PRICE RISK

Equity price risk arises from changes in the prices of the DFCC Bank's equity investments. The risk of loss arising from adverse changes in prices is managed by carrying out a detailed investment appraisal, which includes an assessment of the probability of permanent diminution in value. Risk mitigation strategies include diversifying investments to maintain the aggregate market value of the portfolio above the aggregate cost of investment. The investment portfolio is continuously monitored to determine the appropriate timing for divestment.

OPERATIONAL RISK

Operational risk arises from the potential that inadequate information systems, operational problems, breaches in internal controls, fraud or unforeseen catastrophes will result in losses.

Risks arising from errors, omissions and fraud are managed by segregation of duties, definition of authority limits and internal audit procedures. The Assistant Vice President (Internal Audit) submits the findings to the Audit Sub-Committee of the Board of Directors of DFCC Bank who examine the follow up action on internal and external audit findings. DFCC takes measures to safeguard its tangible assets as well as those taken as collateral by insuring them against identified risks.

The Bank has safeguards aimed at preventing it being used for money laundering activities and subscribes to "know your customer" requirements. It also has in place a comprehensive IT Security Policy aimed at safeguarding the privacy of its customers and the integrity of its IT systems.

LEGAL RISK

Legal risk arises from the potential that unenforceable contracts, lawsuits or adverse judgements can disrupt or negatively affect the operations or the condition of DFCC. Legal risks arising from inadequate documentation, legal or regulatory incapacity and other factors resulting in the unenforceability of contracts with counterparties are managed through the use of legal advice from in-house legal staff and where appropriate, external consultants. Risks relating to changes of regulatory environment are proactively managed and compliance with statutory requirements is monitored by the Board of Directors through a quarterly report submitted by the Compliance Officer, currently the Executive Vice President (Finance).

REPUTATION RISK

This is the risk to earnings or capital arising from the possibility that negative publicity regarding DFCC, whether true or not, will cause a decline in customer confidence, trigger costly litigation or result in revenue reductions. Such risk is mitigated by an early warning system, which includes input from frontline staff, the systematic scanning of media reports as well as other means. In addition, DFCC also conducts market surveys from time to time to ascertain its market reputation. A specialised Corporate Communications unit within DFCC coordinates the proactive management of this risk.

INSTITUTIONAL ARRANGEMENTS

ALCO is responsible for Balance Sheet planning from a risk return perspective including the strategic and tactical management of interest rates, liquidity, investment and capital risks. Its goal is to ensure an acceptable balance between profitability, growth and risk. ALCO's authority arises from a charter of authority delegated by the Board of Directors. ALCO meetings are conducted regularly and key decisions are submitted to the Board. ALCO also formulates and reviews the interest rate outlook, issues pricing guidelines for deposits and advances, decides on desired maturity profiles and the mix of incremental assets and liabilities.

The broad framework for credit decisions including the role of the Credit Committee is laid down in the Credit Policy Manual. Credit administration checks compliance with credit procedures and regularly reports salient performance indicators pertaining to the credit portfolio including significant exposures, non-performing loans, recoveries and write-offs, to the Board.

Specific and general provisions for non-performing advances over and above the regulatory minimum are determined by a Committee comprising senior executives who are not involved in lending decisions. This Committee meets quarterly and submits its recommendations to the Board.

CORPORATE SOCIAL RESPONSIBILITY

DFCC Bank recognises that Corporate Social Responsibility should be an integral part of its operations. In today's business world more and more stakeholders take an increasing interest in the activities of the bank, especially with regard to the impact our business has on the community at large. Therefore, during the year under review, the Bank, while striving to provide greater shareholder value, stepped up its activities towards supporting selected social development projects.

During the Financial Year Ended (FYE) 2003, DFCC bank took an initiative in developing the managerial capabilities of small and medium scale entrepreneurs, especially in the provinces. Encouraged by the success of the project, in FYE 2004, the Bank took an innovative step to extend its entrepreneur development activity to benefit a larger cross-section of people. In addition to those who are already involved in business activity, the Bank targeted start-up entrepreneurs, those who have a business idea and need encouragement, aspiring entrepreneurs and the general public whose knowledge is limited on banking and money related matters. We reached the target group through the most responsive medium, which is TV. The programme titled "KASIYA", was launched in October 2003.

KASIYA is a magazine style programme presented in Sinhala at 9pm every Friday on SIRASA TV. The presentation style is very different from normal business programmes and it strives to keep the viewers involved with the programme contents throughout the one hour. In the 25 programmes that the Bank conducted during the year under review, subjects varied from the prudent management of business and personal finances, to savings, investment, tax management and a series of related topics and tips for everyday living. The once weekly programme also showcased every week, a small scale entrepreneur who had a unique business idea. Viewers were given an opportunity to phone in to the programme with questions and ideas.

DFCC Bank spent almost half of its approximately rupees five million Social Responsibility budget in conducting the KASIYA programme.

The "Safe Bottle Lamp" as shown in this picture is being promoted by the Safe Bottle Lamp Foundation of the National Hospital of Sri Lanka.

In addition to the mainstream activity, DFCC Bank also supported several other projects. The Bank has committed funds to renovate several schools in the flood affected areas of Matara, Hambantota and Ratnapura. In FYE 2004 renovation work was completed in a school located in Tissamaharama. DFCC bank also donated computers to a school in the Monaragala district and will extend the project to benefit schools in the Anuradhapura, Matara, Ratnapura and Polonnaruwa districts as well.

A most deserving project that received the Bank's support during the year under review, was the "Safe Bottle Lamp Project" initiated by the Safe Bottle Lamp Foundation of the National Hospital of Sri Lanka. This is a project launched several years ago to reduce serious injury caused by the use of unsafe bottle lamps with kerosene oil. The number of people who have suffered burn injuries caused by bottle lamp related accidents is alarmingly high. Nearly one third of households in Sri Lanka do not have electricity and so have to depend on oil lamps to do their chores at night. The Bank distributed 10,000 safe bottle lamps free to homes in the Ginigathena area.

Providing much-needed support for our national heritage, the Bank supported a project to provide electricity to identified cultural sites in the country. DFCC funded the installation of a solar power system at the Somawathie Chaithya and provided electricity to the Ethugalpura Buddha statue project.

A project that regularly receives support of DFCC Bank is the Colombo Centre for Special Education. The year end greeting cards for the Bank are purchased from the Centre in support of the care of differently abled persons. The year under review, also saw the continuation of the distribution of free books obtained through the Asia Foundation to needy institutions. The Bank has been supporting this project for the past two years.

BOARD OF DIRECTORS

M L Mack
CHAIRMAN

Mr Michael Mack had a career spanning more than 42 years with Aitken Spence & Company Limited and was the Group Chairman and Managing Director for four years from 1991.

He joined the Board of DFCC Bank in June 1994, bringing with him insights gained in the service and financial sectors in fields such as tourism, transport and insurance.

Mr Mack is also a Director of Commercial Bank of Ceylon Limited, CF Venture Fund Limited, Lanka Aluminium Industries Limited, Lanka Galvanising Industries (Pvt) Limited, Acme Printing & Packaging Limited and Comark Lanka (Pvt) Limited.

M J C Amarasuriya
DIRECTOR

Mr Mahendra Amarasuriya is the Chairman of Commercial Bank of Ceylon Limited. He was appointed to the Board of DFCC Bank in June 2001.

Mr Amarasuriya, who was the former Deputy Chairman of Hayleys Limited, is currently the Chairman of United Motors Lanka Limited, Commercial Fund Management (Pvt) Limited, Equity Investments Lanka Limited, Pelwatte Sugar Industries Limited, Serendib Flour Mills (Pvt) Limited, The International Chamber of Commerce, Sri Lanka and the Regional Industry Service Committee of the North-Western Province.

He is a Graduate of the University of Ceylon with a special degree in Botany. Mr Amarasuriya has participated in many international management programmes including the advanced management course at the International Institute of Management Development, Lausanne, Switzerland.

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.

In 1999, Mr Caglayan started his duties as Head of Department for South Asia, the Philippines and Turkey. As Head of Portfolio Management he now holds responsibility for a portfolio of nearly Euro one billion.

Mrs M A R C Cooray
GOVERNMENT DIRECTOR

Mrs Rose Cooray is an Assistant to the Governor of the Central Bank of Sri Lanka. Since January 1999, she has been released to the Ministry of Finance as Director General of the Department of Fiscal Policy and Economic Affairs. She was appointed to the Board of DFCC Bank in March 2002.

Mrs Cooray has served the Central Bank for over 30 years and represents the Government on the Boards of Sri Lanka Institute of Information Technology, Thomas De La Rue (Pvt) Limited, the Ceylon Electricity Board and Sri Lanka Telecom Limited. She also represents the Government as a shareholder of the Private Sector Infrastructure Development Company and is a Member of the Tariff Advisory Council.

She has a B.A. (Honours) in Economics from the University of Peradeniya and a Masters Degree from the University of Strathclyde, U.K.

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.

Mr Fonseka is a Director of Commercial Bank of Ceylon Limited and the Colombo Stock Exchange and a member of the Financial Sector Reforms Committee. He is also the Chairman of the Finance & Banking and Exchange Control Sub-committees of the Ceylon Chamber of Commerce and the Co-Chairman of the Finance & Taxation Sub-committee of the National Chamber of Commerce of Sri Lanka. Mr Fonseka is a member of the Governing Council of the National Institute of Business Management (NIBM) and a member of the Board of Management of the Post Graduate Institute of Management (PIM).

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

Mr Gemunu Gunatilleke is the Managing Partner of Ernst & Young, Colombo Office. He received professional training at the Cranfield Institute of Management, U.K. and has been in professional practice for over 30 years. Mr Gunatilleke was appointed to the Board of DFCC Bank in 1984.

He chairs the Board Audit Sub-committee of the Bank and is a Director of several companies dealing with Secretarial Services, Management Consultancy, Information Technology and Internal Audit Services.

He is a Graduate of the University of Ceylon and a Fellow of the Institute of Chartered Accountants of Sri Lanka.

G A E Gunatilleke
ALTERNATE DIRECTOR TO T CAGLAYAN

Dr Nihal Jinasena is an eminent industrialist and is the Chairman/Managing Director of the Jinasena Group of Companies. Dr Jinasena joined the Board of DFCC Bank in December 1991.

Until recently Dr Jinasena was a Director of the Securities Exchange Commission of Sri Lanka. He is a member of the Presidential Task Force on Science and Technology and also of the Presidential Commission on Trade and Tariffs.

He has a B.Tech Degree in Mechanical Engineering and an Honorary Doctorate from Loughborough University, U.K. He is also a Chartered Engineer and a Fellow of the Institution of Engineers, Sri Lanka.

Dr T N Jinasena
DIRECTOR

Mr Shanthi Palihena is the General Manager of the Bank of Ceylon. He has had a distinguished career in banking extending over 35 years at Bank of Ceylon. He joined the Board of DFCC Bank in October 2002.

Mr Palihena has wide exposure in all aspects of commercial banking, having headed some of the key business units of the Bank. He has also worked at the National Development Bank of Sri Lanka as Manager, SMI Division.

He is a Fellow of the Chartered Institute of Bankers, U.K. and a Fellow of the Institute of Bankers, Sri Lanka. He also holds a Post Graduate Diploma in Business and Financial Administration. He has undergone extensive training in key areas of Banking and Management both in Sri Lanka and abroad.

S N P Palihena
DIRECTOR

Mr Moksevi Prelis is a Chartered Mechanical and Industrial Engineer. He switched careers to banking when he joined the Bank of Ceylon (BOC) in 1976 as the Assistant General Manager (Industrial Credit). He was appointed to the Board of DFCC Bank in 1977 as a Director representing the BOC.

In 1981 he resigned from BOC as the Deputy General Manager, Merchant Banking and Consultancy and joined the DFCC Bank as its Chief Executive. He continued in this capacity until his retirement in December 1999. Later, Mr Prelis joined the Nations Trust Bank Limited as its Chief Executive/Director and functioned in that capacity until March 2004.

Mr Prelis has a B.Sc. Engineering Degree from the University of Ceylon. As a Fulbright Scholar, he obtained a Masters Degree in Management from Purdue University, USA. He has also held the positions of Chairman of the Ceylon Electricity Board and of the Association of Development Financing Institutions in Asia and the Pacific (ADFIAP).

M R Prelis
DIRECTOR

Mr Dinesh Weerakkody is the Director- Human Resources of GlaxoSmithKline Sri Lanka. He was appointed to the Board of DFCC Bank in June 2003.

He is an eminent writer and a leading economic commentator who has published three books, presented and published many papers at national and international level and who regularly contributes to the local newspapers and business magazines. He received the “Twentieth Century Achievement Award” by IBC-USA and the international “Man of the Year” award in 2000 for researched contributions in relation to International Politics in Less Developed Countries.

Mr Weerakkody is a Graduate in Business Administration and an Associate of the Chartered Institute of Management Accountants, U.K. He also holds a Masters Degree in Business Administration from the University of Leicester, England. He was a former Chairman of the Employees Trust Fund Board.

D S Weerakkody
DIRECTOR

Mr Rienzie Wijetilleke is the Chairman/Managing Director of Hatton National Bank Limited (HNB). Mr Wijetilleke was appointed to the Board of DFCC Bank in May 2001.

He has over forty three years of experience in banking including overseas assignments. He is the Chairman of HNB Assurance Limited, HNB Stockbrokers (Pvt) Limited and HNB Securities Limited. He is also on the Boards of the Colombo Stock Exchange, People’s Merchant Bank Limited, CF Venture Fund Limited and a Director of the Asian Bankers Association.

He is both a Fellow of the Chartered Institute of Bankers, U.K. and of the Institute of Bankers, Sri Lanka.

R T Wijetilleke
DIRECTOR

HUMAN CAPITAL

The quality of Human Capital is fundamental to any institution's success and this is especially so at DFCC Bank, where its 305 employees form its most valuable asset. Such human capital has been built up, nurtured and motivated under a comprehensive development programme combined with a rigorous recruitment procedure and a progressive performance based rewards system. The upshot is that the Bank has come to be reputed as a premier employer offering equal employee opportunity and thereby being able to attract the elite of professionals to its staff.

Growth, expanding business and replacement needs have to be catered to. During the year, the Bank recruited a complement of executives as well as management trainees and invested Rs11 million in a training repertoire that included several overseas and local programmes. Forty two executives attended 19 overseas programmes while 168 employees participated at 70 local programmes. The Bank also conducted 14 in-house programmes during the year. Special attention is paid to new recruits who are put through an intensive training focussed on project appraisal, follow-up and other aspects of the Bank's operations. A unique feature of the training initiatives was a programme conducted exclusively for Bank staff by the Jawaharlal Nehru Institute for Development Banking, the training arm of the Industrial Development Bank of India. This programme has been specially tailored to meet the Bank's specific operational needs. Twenty executives have already participated in this programme, which will serve as an in-depth training for the Bank's first tier staff.

In cognisance of the changing business environment and emerging new opportunities and threats, the Bank has taken on board the need to effect periodic changes to the organisation structure to ensure operational efficiency, effectiveness and ability to be proactive. Cases in point were the structural changes effected following the Bank's acquisition of National Mercantile Bank (DFCC Vardhana Bank Limited) during the financial year. These changes comprised the amalgamation of parallel or equivalent functions under DFCC Bank staff thus improving operating efficiency, increasing coordination and thereby creating synergies between the two institutions.

Looking forward, the Bank is planning a reorganisation of mid level and senior management cadre. A key component of this process is the development of new job descriptions, job evaluations and competency mapping and thereby to equip the Bank's staff to meet a new and challenging operating environment. Accordingly, the Bank intends to procure the services of a qualified consultancy firm to carry out this important assignment. The Bank's Human Capital, which is considered its most valuable asset, will then be well positioned to take on the challenges awaiting DFCC Bank as it continues to expand and grow.

MANAGEMENT TEAM

Nihal Fonseka	–	General Manager / Director & Chief Executive Officer

Corporate Banking

H A Ariyaratne	–	Executive Vice President - Corporate Banking
Sunil De Silva	–	Vice President - Corporate Banking
Chandana Dharmawardana	–	Vice President - Corporate Banking
Renuka Amarasinghe	–	Assistant Vice President - Corporate Banking
Sonali Jayasinghe	–	Assistant Vice President - Corporate Banking
Jayangani Perera	–	Assistant Vice President - Trade Finance
Stanislaus Rayen	–	Assistant Vice President - Corporate Banking

Branch Operations and Special Loans

Kanthika Abeyesundere	–	Executive Vice President - Branch Banking & Special Loans
Asoka Mendis	–	Senior Vice President - Branch Operations
Lionel Wickramasinghe	–	Vice President - Branch Credit
Bhathiya Alahakoon	–	Vice President/Manager (Gampaha Branch)
Prasad Dharmaratne	–	Vice President/Manager (Ratnapura Branch)
Palitha Gamage	–	Vice President/Manager (Colombo Office)
Samarakodi Godakanda	–	Vice President/Manager (Kandy Branch)
Chanaka Kariyawasam	–	Vice President/Manager (Kurunegala Branch)
Ananda Kumaradasa	–	Vice President/Manager (Matara Branch)
Harsha Jayathilake	–	Assistant Vice President/Manager (Badulla Branch)
Priyadarsana Sooriya Bandara	–	Assistant Vice President/Manager (Anuradhapura Branch)
Champal de Costa	–	Assistant Vice President - Leasing (Colombo Office)
Bandula Gamarachchi	–	Assistant Vice President - Accounting & Administration (Colombo Office)
Ruwangani Jayasundera	–	Assistant Vice President - Credit (Colombo Office)
Patabendi Premaratne	–	Assistant Vice President - Kalutara Window Office
Kapila Samarasinghe	–	Assistant Vice President - Credit (Colombo Office)
Neeta Sooriarachchi	–	Assistant Vice President - Reporting (Colombo Office)
Nanediri Karunasinghe	–	Vice President - Recoveries & Acquired Assets
Dharmasiri Wickramatilaka	–	Vice President - Restructuring & Rehabilitation
Pushpa Kariyawasam	–	Assistant Vice President - Restructuring & Rehabilitation

Corporate Finance and Human Resources

Dayantha De Mel	–	Executive Vice President - Corporate Finance & Human Resources
Tyrone De Silva	–	Vice President - Financial Advisory Services
Asoka Tennekoon	–	Vice President - Human Resources
Jayani Amarasiri	–	Assistant Vice President - Training & Development

Treasury

Dheerendra Abeyaratna	–	Senior Vice President - Treasury & Resource Development

Finance

S Nagarajah	–	Executive Vice President - Finance
Suraj De Silva	–	Vice President - Financial Analysis & Asset/Liability Management
Anomie Withana	–	Vice President - Credit Administration
Chinthika Amarasekara	–	Assistant Vice President - Accounting & Reporting
Sriyani Ranatunga	–	Assistant Vice President - Lease Administration

Information Technology

Sidath Wijeratne	–	Senior Vice President - Information Technology
Neville Fernando	–	Vice President - Core Banking Project
Guptani Gunasekera	–	Vice President - Network & Technical Services
Channa Jasenthuliyana	–	Assistant Vice President - IT/Application Systems
Roshan Jayasekara	–	Assistant Vice President - Core Banking Project
Duleep Mahatantila	–	Assistant Vice President - Core Banking Project
Tilak Nissanga	–	Assistant Vice President - Core Banking Project

Legal and Secretarial

Thusantha Wijemanna	–	Senior Vice President - General Counsel and Secretary to the Board
Visaka Sriskantha	–	Vice President - Legal

Audit

Mala Goonatilake	–	Assistant Vice President - Internal Audit

Corporate Communications and Business Development

Rosheeni Madanayake Wijesekera	–	Assistant Vice President - Corporate Communications
Prasanna Premaratne	–	Assistant Vice President - Business Development

Office Management

Chanaka Kalansuriya	–	Assistant Vice President - Office Management

Project Management

Jayantha Nagendran	–	Senior Vice President - Project Management
Kapila Subasinghe	–	Assistant Vice President - Project Management

Secondments

L G Perera	–	Executive Vice President on secondment to DFCC Vardhana Bank as Chief Executive Officer
Lakshman Silva	–	Vice President on secondment to DFCC Vardhana Bank as Chief Operating Officer
H A Samarakoon	–	Assistant Vice President on secondment to Lanka Industrial Estates Limited as Chief Executive Officer

Management Team as on 28 May 2004 with names in alphabetical order within each grade.

CORPORATE GOVERNANCE

DFCC Bank believes that corporate governance is a relationship between the Bank's Management, its Board of Directors, its shareholders and other stakeholders to foster entrepreneurial drive in order to enhance its performance within an accountable system.

The Board of Directors of DFCC Bank adopted the Code of Corporate Governance issued by the Central Bank of Sri Lanka and have been regularly monitoring the compliance of the principles and guidelines enunciated in the code.

BOARD OF DIRECTORS

The Board of Directors of DFCC Bank consists of one Ex-officio Director, who is the General Manager, one Director appointed by the Government and eight Non-executive Directors. Of the present Non-executive Directors, four Directors represent major shareholders of the Bank. The remaining four Directors, while representing the other stakeholders of the Bank, are experts in various fields. All the Directors have the competency required to make formal business decisions and are fit and proper persons in terms of the code of best practice to hold office as Directors. The General Manager, being an Ex-officio Director, does not have voting rights in decision making at the Board, as he is responsible for the management of the Bank. The Government has appointed a senior official as its nominee Director to the Board. The Board meets at least once a month. During the period under review the Directors have met seventeen times.

Except for the Government Director and the General Manager, all other Directors are subject to retirement in terms of the Regulations of the DFCC Bank. Each year, the most senior Director appointed to the Board retires from office and offers himself for re-election, if the Board of Directors recommends his re-election to the shareholders. This gives the shareholders an opportunity to change the Directors if they so desire. Any recommendation received for the appointment of a Director is closely studied by the Nominations Sub-committee of the Board headed by the Chairman.

This Committee takes into consideration the skills that are required for the efficient functioning of the Board when recommending persons. The Directors who are appointed by the Board of Directors to casual vacancies during the year have to offer themselves to be elected as Directors at the following Annual General Meeting.

DFCC Bank is one of the few institutions in Sri Lanka where the remuneration paid to the Directors is decided by the shareholders at the Annual General Meeting. This is in order to ensure transparency with regard to remuneration paid to Directors. The Chairman of the Board is elected by the Board of Directors and the person elected holds office for a period of three years unless he relinquishes his duties. While the Chairman is responsible for carrying out the functions of the Board of Directors, the General Manager, as the Chief Executive Officer of the Bank, is responsible for running of the Bank on a day-to-day basis. The duties and the key functions of these two persons are clearly demarcated in the statute of the Bank.

SUB-COMMITTEES

The Board of Directors of the Bank has appointed several sub-committees in order to discharge its obligations efficiently. They are the Audit Sub-committee, the Credit Sub-committee, Nominations Sub-committee, Staff Compensation and Remuneration Sub-committee and the Sub-committee on Corporate Governance. The remuneration of the General Manager is determined by the Board and reviewed annually based on performance and recommendations made by the Sub-committee on Staff Compensation and Remuneration. When selecting members to these sub-committees the Board always takes into consideration the expertise and the experience of each member. While having these permanent sub-committees, which study in detail and make recommendations to the Board of Directors on issues referred to them, the Board also appoints ad hoc sub-committees for specific purposes. These ad hoc sub-committees mainly assist the Board on special issues on which the Board requires a detailed analysis.

Name of Director	Audit	Credit	Staff Compensation & Remuneration	Nominations	Corporate Governance
M L Mack		● ✓	● ✓	✓	
A N Fonseka		✓			
M J C Amarasuriya			✓		
Mrs M A R C Cooray		✓			
G A E Gunatilleke	● ✓		✓	✓	✓
Dr N Jinasena	✓		✓	● ✓	● ✓
S N P Palihena					
M R Prelis	✓				✓
D S Weerakkody			✓		✓
R T Wijetilleke			✓		

● *Chairman*

SECRETARY

The Board of Directors is assisted by a Secretary who possesses the required qualifications prescribed by law to function as the Secretary to the Board. The Secretary, being an Attorney-at-Law, knows the importance of the role played by him to ensure proper procedures are followed and the applicable rules and regulations are adhered to. On matters referred to the Board, accurate Board Papers are prepared and circulated among the Directors in advance to assist the Directors to study and prepare themselves for deliberations at the meeting. All decisions made at the meetings are properly minuted by the Secretary under the supervision of the Chairman, who is authorised by the Board of Directors to sign and confirm the accuracy of the minutes at the following meeting.

TRANSPARENCY

Transparency is an essential factor in effective corporate governance in the Financial sector. Enforcement of a robust financial disclosure requirement results in better management of risk, while strengthening disciplines of the market. This also provides an opportunity for stakeholders of the Bank to obtain adequate information on strengths and weaknesses of the Bank. DFCC Bank maintains its transparency with an independent Internal Audit Department reporting to the Board of Directors through the Chairman of the Audit Sub-committee. The past track record shows that DFCC Bank clearly adheres to the Sri Lanka Accounting Standards in maintaining its accounts and disclosing information pertaining to its activities. DFCC Bank has always published its quarterly accounts without delay together with a detailed analysis of its performance in order to ensure that stakeholders are kept informed of its financial position. Because of the high priority given by the Bank for compliance, the Compliance Officer of the Bank is appointed from the rank of Executive Vice President, which is only subordinate to the General Manager. He is also delegated with necessary authority and power to enforce compliance where appropriate.

MANAGEMENT

DFCC Bank has a well established hierarchical management structure with opportunities for career development. The senior management of the Bank are all professionals with over twenty years of experience in the Financial sector and are highly respected in the industry. The decisions of the Board of Directors are implemented through the Management Committee consisting of the senior management. Promotions and remuneration of the staff are performance-based. The staff of DFCC Bank are committed to excellence in service and the Bank continues to be an employer of choice. Continuous training in Sri Lanka and abroad has improved the skills of the staff of the Bank to be among the highest level in the development banking industry.

INFORMATION TECHNOLOGY

The Board of Directors is cognisant of its responsibility to improve the Bank's risk management, competitiveness and efficiency through cost effective investment in technology. During the past year, DFCC Bank introduced a new software package to meet the future needs of the Bank. In the annual business plan of the Bank, developing the skills of the staff in the use of Information Technology are given as high priority items.

The Directors have pleasure in submitting their Report and the audited accounts of DFCC Bank for the year ended 31 March 2004.

REVIEW OF THE YEAR

The Chairman's Statement and the Chief Executive's Report 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 11 of the Report under Associate and Subsidiary Companies.

PROFITS AND APPROPRIATIONS

Year ended 31.03.2004	Rs m
Profit before income tax (excluding subsidiaries and associates)	1,470
Goodwill amortisation - net	20
Income tax on profit	385
Profit after income tax	1,105
Directors have made the following appropriations:	
Statutory Reserve Fund	(60)
Sinking Fund	(361)
Available for dividend distribution	684
The Directors recommend the payment of a first and final dividend of 55% on the share capital	(314)
Retained profit carried forward	370

CAPITAL EXPENDITURE

The total expenditure on the acquisition of property and equipment during the year amounted to Rs212 million. The details of property and equipment are shown in Note 29 on page 92.

RESERVES

Total reserves augmented by the annual appropriation and retained profit amounted to Rs8,243 million.

TAXATION

It is the policy of DFCC Bank to account for deferred taxation under full liability method.

SHARE CAPITAL

With the issue of Bonus Shares approved at the Extraordinary General Meeting held on 12 February 2004 and the options exercised by the employees during this financial year, the total share capital as at 31 March 2004 is Rs571,458,230 and it consists of 57,145,823 shares of Rs10 each.

SHAREHOLDING

As at 31 March 2004 there were 6,956 registered shareholders and the distribution is indicated on page 114.

EMPLOYMENT

It is the policy of DFCC Bank to maintain a dedicated and highly motivated team committed to the achievement of excellence in service. Towards this end DFCC Bank continuously invests in training and development of staff while encouraging their participation in the business and social activities of the Bank. DFCC Bank is an equal opportunity employer.

EMPLOYEE SHARE OPTION PLAN

Details of the Employee Share Option Plan and the movement in options granted are given in Note 39.2 to the Financial Statements.

The performance of the Bank for the year ended 31 March 2004 has met the criteria for awarding options to eligible employees.

For the year ended 31 March 2004, eligible employees will be entitled to options upto a maximum of 857,187 shares at an exercise price of Rs211.55 in accordance with the scheme approved by the shareholders. The basis of allotment will be approved by the Board of Directors. These options may be exercised after a minimum period of one year and not later than five years from the date of award.

DIRECTORS

The following were Directors of DFCC Bank during the year ended 31 March 2004:

Amarasuriya, M J C	Director
Caglayan, T*	Director
Cooray, Mrs M A R C	Government Director
Fonseka, A N	Ex-officio Director
Jinasena, T N	Director
Mack, M L	Chairman
Palihena, S N P	Director
Prelis, M R	Director
Weerakkody, D S	Director (appointed on 5.6.2003)
Wijetilleke, R T	Director

** Mr G A E Gunatilleke is Alternate Director to Mr T Caglayan.*

The Director retiring by rotation in Terms of Regulation No. 85 of the DFCC Regulations is Mr M R Prelis.

Mr M R Prelis being eligible, offer himself for re-election with the unanimous support of the other Directors.

DIRECTORS' INTERESTS IN SHARES AND DEBENTURES

	No. of Shares* as at 31 March 2004	No. of Shares* as at 31 March 2003
Amarasuriya, M J C	**13,333**	10,000
Caglayan, T	**Nil**	Nil
Cooray, Mrs M A R C	**Nil**	Nil
Fonseka, A N	**8,262**	4,197
Gunatilleke, G A E	**7,229**	5,492
Jinasena, T N	**1,657**	1,243
Mack, M L	**2,488**	1,866
Palihena, S N P	**Nil**	Nil
Prelis, M R	**9,513**	17,135
Weerakkody, D S	**Nil**	Nil
Wijetilleke, R T	**Nil**	Nil

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

Ex-officio Director, Mr A N Fonseka in his capacity as General Manager has been awarded options on shares, and held 74,274 options as at 31 March 2004 after adjusting for the bonus issue (43,395 as at 31 March 2003).

During the year Mr Fonseka acquired 30,000 shares at Rs155.60 by exercising part of his options prior to the bonus issue.

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 45 on pages 103 to 106 These interests have been declared at Directors' meetings.

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 47 on page 108.

20 MAJOR SHAREHOLDERS OF THE DFCC BANK AS AT 31 MARCH 2004 ARE GIVEN BELOW:

Name of Shareholder/Company Name as at 31 March 2004

	2003/2004			2002/2003	
	No. of Shares	**%**	**Cumu lative%**	No. of Shares	%
Bank of Ceylon	**8,453,333**	**14.79**	**14.79**	6,324,900	14.95
Commercial Bank of Ceylon Limited	**7,873,678**	**13.78**	**28.57**	3,368,359	7.96
Hatton National Bank Limited A/c. No. 1	**7,054,025**	**12.34**	**40.91**	5,290,519	12.50
Sri Lanka Insurance Corporation Limited - Life Fund	**6,523,096**	**11.41**	**52.32**	4,892,322	11.56
Readywear Industries Limited	**4,996,789**	**8.74**	**61.06**	3,223,412	7.62
Distilleries Company of Sri Lanka Limited	**3,736,724**	**6.54**	**67.60**	2,852,543	6.74
HSBC Int. Nominees Limited DEG - Deutsche Investitions - Und Entwicklungsgesellschaft	**3,145,672**	**5.50**	**73.10**	3,318,508	7.84
National Savings Bank	**1,671,333**	**2.93**	**76.03**	1,333	–
HSBC Intl Nominees Limited - SSBTL - Aberdeen Far East - Emg Eco Unit Trust XCF5	**990,800**	**1.73**	**77.76**	843,100	1.99
Commercial Leasing Company Limited	**588,266**	**1.03**	**78.79**	–	–
HSBC Intl Nom Limited - SSBT - Aberdeen Global Asia Pacific Fund	**455,200**	**0.81**	**79.60**	150,465	0.36
HSBC Intl Nominees Limited - SSBTL - Aberdeen New Dawn Inv Trust XCC6	**400,000**	**0.71**	**80.31**	300,000	0.71
HSBC Intl Nominees Limited - SSBTL - Aberdeen Asia Small Co. Inv. Trust XCB9	**400,000**	**0.71**	**81.02**	300,000	0.71
Bank of Ceylon A/c. Ceybank Unit Trust	**367,414**	**0.64**	**81.66**	683,686	1.62
HSBC Intl Nom Limited - SSBTL - Aberdeen Emerg. Markets Unit Trust	**333,333**	**0.58**	**82.24**	–	–
Sri Lanka Insurance Corp. Limited - General Fund	**276,400**	**0.48**	**82.72**	207,300	0.49
Hatton National Bank Limited A/c. No.2	**229,225**	**0.40**	**83.12**	171,919	0.41
Hongkong and Shanghai Banking Corp. - Common Trust Equity Fund	**210,241**	**0.37**	**83.49**	223,681	0.53
Mr R M Nanayakkara	**159,133**	**0.28**	**83.77**	–	–
National Development Bank of Sri Lanka A/c. No. 03	**133,333**	**0.23**	**84.00**	100,000	0.24
	47,997,995	–	–	32,252,047	–
Unregistered shares*	**3,397,066**	**5.94**	**89.94**	–	–
Other shareholders	**5,570,762**	**10.06**	**100.00**	10,059,064	23.77
Total	**57,145,823**			42,311,111	100.00

* *A foreign investor purchased 2,547,800 shares in September 2003 through the Central Depository System of the Colombo Stock Exchange. Based on a communication received from the Central Bank of Sri Lanka in response to clarification sought, the Board decided not to register the shares and instructed the Secretary to*

seek and obtain adequate information from the purchaser and their representatives in order to establish the identity of the true beneficial owners of the share. This was in order to ensure that the Bank does not become a party to the violation of any statutory obligations. The information requested has not yet been provided to the satisfaction of the Board of Directors.

The Bonus Share entitlement of 849,266 on the above purchase is held in a suspense account until matters relating to the registration are resolved. The Bank's position has been conveyed to the purchaser. The purchaser through its local custodian has requested the Securities & Exchange Commission to intervene in this matter. The Bank has made its submissions to the Securities & Exchange Commission as required by the Commission.

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 March 2005. 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 2004

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First Quarter to	30.06.2003	:	30.07.2003
Second Quarter to	30.09.2003	:	29.10.2003
Third Quarter to	31.12.2003	:	06.02.2004
Annual Report year ended	31.03.2004	:	28.05.2004

Meetings

47th Annual General Meeting	:	30.06.2003
Extraordinary General Meeting	:	12.02.2004
48th Annual General Meeting	:	30.06.2004

Dividends

First and Final for year ended 31.03.2003

Approved on	:	30.06.2003
Ex-dividend Date	:	24.06.2003
Payment	:	30.06.2003

Proposed First and Final for year ended
31.03.2004 to be approved on : 30.06.2004

AUDIT COMMITTEE REPORT

The Audit Committee comprises three Non-executive Directors of the Bank with the Head of Internal Audit functioning as the Secretary. 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, assess compliance with regulatory requirements, review the statutory accounts and published financial statements, consider contents of Internal Audit Reports, and recommend appointment and remuneration of the External Auditors.

During the Financial year ended 31 March 2004, 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.

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 Colombo Office, Outstation Branches and Sub Offices. Representatives from the 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.

The Committee is of the view that adequate controls and procedures are in place to provide reasonable, but not absolute, assurance to the Directors that the Bank's assets are safeguarded and the financial position and the results disclosed in the Accounts are free from material mis-statement.

The Audit Committee has recommended to the Board of Directors that, KPMG Ford, Rhodes, Thornton & Co be re-appointed as Auditors for the year to 31 March 2005, subject to the approval of shareholders at the Annual General Meeting.

G.A.E. Gunatilleke
Chairman - Audit Committee

28 May 2004

STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RELATION TO FINANCIAL STATEMENTS

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 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 and the Group.

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 2004

KPMG

KPMG Ford, Rhodes, Thornton & Co.
(Chartered Accountants)

32A, Sir Mohamed Macan Markar Mawatha,
P. O. Box 186,
Colombo 00300,
Sri Lanka.

Telephone : +(94-11) 242 6426
Telefax : +(94-11) 244 5872,
244 6058, 254 1249
e-Mail : frt@kpmg.lk

TO THE MEMBERS OF DFCC BANK

We have audited the balance sheet of DFCC Bank as at March 31, 2004, the consolidated balance sheet of the Bank and its subsidiaries as at that date, and the related statements of income, movement in shareholders' funds and cash flows for the year then ended, together with the accounting policies and notes exhibited on pages 58 to 108 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 March 31, 2004, and to the best of our information and according to the explanations given to us, the said balance sheet and related statements of income, movement in shareholders' funds 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 give a true and fair view of the Bank's state of affairs as at March 31, 2004 and of its profit and cash flows for the year then ended.

In our opinion, the consolidated balance sheet and statements of income, movement in shareholders' funds 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 give a true and fair view of the state of affairs as at March 31, 2004 and of its 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 Company during the year ended March 31, 2004 except as stated in Note 45 to these financial statements.

Ford Rhodes Thornton & Co

Chartered Accountants
Colombo.
28th May 2004

1 General

1.1 Constitution of legal entity

DFCC Bank is incorporated and domiciled in Sri Lanka. It was incorporated in 1955 under DFCC Act No. 35 of 1955.

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

1.2 Approval of financial statements by Directors

The financial statements are authorised for issue by the Board of Directors on 28 May 2004.

1.3 Principal activities

DFCC Bank provides a comprehensive range of financial products and services to industrial, agricultural and commercial enterprises in Sri Lanka.

1.4 Accounting convention

The financial statements are presented in Sri Lanka rupees, rounded to the nearest thousand. The balance sheet, income statement and cash flow statement, unless otherwise stated herein, are prepared under the historic cost convention in conformity with generally accepted accounting principles applied consistently and in compliance with the accounting standards prescribed by the Institute of Chartered Accountants of Sri Lanka (SLAS). Exceptions to the historic cost convention of accounting relate to dealing securities, investment securities and investment properties as described in accounting policy 2.3, 2.6 and 2.7.

1.5 Basis of consolidation

The financial statements of the subsidiaries and associate company are also prepared under the historic cost convention unless otherwise stated, with similar accounting policies for transactions and events in similar circumstances.

1.5.1 Subsidiaries

Subsidiaries are those enterprises controlled by the Bank. Control exists when the Bank has the power, directly or indirectly, to govern the financial and operating policies of an enterprise 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.

1.5.2 Associate company

Associate company is an enterprise 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 company, Commercial Bank of Ceylon Limited, on an equity accounting basis, from the date that significant influence commences until the date that significant influence ceases.

1.5.3 Transactions eliminated on consolidation

Intra group balances and transactions, and any unrealised gains arising from intra group transactions, are eliminated in preparing the consolidated financial statements. Unrealised gains arising from transactions with subsidiaries and associate company are eliminated to the extent of the Bank's interest in the enterprise.

1.5.4 Financial statements of subsidiaries and associate company included in the consolidated financial statements

Audited financial statements are used. All subsidiaries included in the consolidation except DFCC Vardhana Bank Limited and DFCC Stockbrokers (Pvt) Limited have financial year to 31 March in common with the Bank. The financial year of DFCC Vardhana Bank Limited, DFCC Stockbrokers (Pvt) Limited and

Commercial Bank of Ceylon Limited, an associate company ends on 31 December and financial statements of these companies for year to 31 December 2003 have been included for consolidation and equity accounting with appropriate adjustments for significant events between the two dates.

1.6 Foreign currency translation

1.6.1 Transactions in overseas currencies are translated to Sri Lanka currencies 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.

1.6.2 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.

1.6.3 Monetary liabilities denominated in foreign currencies subject to an exchange loss cover 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 claim arising on settlement of such monetary liabilities.

1.7 Taxation

Provision for taxation is based on the profit for the year adjusted for taxation purposes in accordance with the provisions of the Inland Revenue Act No. 38 of 2000, as amended by subsequent legislation.

1.7.1 Deferred taxation

Deferred taxation is provided using the balance sheet liability method, providing for timing differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted. A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

1.7.2 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. The initial tax rate of 10% commencing from 1 January 2003 was increased to 15% from 1 January 2004. The legislative amendment for this rate increase is pending.

1.7.3 Off set of deferred tax liability against deferred tax assets

The deferred tax liability and the related charge in the income statement of DFCC Vardhana Bank Limited has been off-set against the deferred tax asset and the related tax saving in respect of the tax losses incurred by it.

1.7.4 Withholding tax on dividends distributed by subsidiaries and associate company

Dividends distributed out of the taxable profit of the subsidiaries and associate company 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 associate company in the Group financial statements as a consolidation adjustment.

1.8 Comparative information

Where items are re-grouped, comparative information is also adjusted.

1.9 Directors' responsibility statement

The Board of Directors is responsible for the preparation and presentation of these financial statements. Details on page 56.

2 Assets and Bases of their Valuation

2.1 Dated - debt securities

Investments in treasury bill, treasury bonds issued at a discount or premium are stated at the cost of acquisition increased by amortised discount or decreased by amortised premium as appropriate.

2.2 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 underlying debt securities to the borrower at a pre-determined price. These loans are stated in the balance sheet at cost.

2.3 Dealing securities

These are marketable securities acquired and held with the intention of resale over a short period. They are stated in the balance sheet at the lower of cost and market value on an aggregate portfolio basis.

Cost includes the cost of acquisition adjusted for amortisation of premium and discounts arising on acquisition.

2.4 Loans

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

2.5 Finance leases

Assets leased to customers in terms of which the Bank does not assume substantially all the risks and rewards of ownership, are classified as financial leases and disclosed as amounts receivable. The leases are stated in the balance sheet after deduction of future income, prepaid lease rentals and provision for losses.

2.6 Investment securities

2.6.1 Investment securities excluding venture capital investments

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 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.

2.6.2 Venture capital investments

Venture capital investments in quoted and unquoted equity and debentures by Lanka Ventures Limited are stated at cost less any specific provision required for diminution in value and a general provision of 5%.

2.7 Investment property

Land and buildings that are not occupied substantially for use by or in the operations of the Bank or its subsidiaries or associate company are classified as investment property and are carried in the balance sheet at fair value determined once in five years by an external valuer. Any surplus on revaluation is credited to the equity and subsequent decreases off-set against the revaluation surplus until it is depleted and charged to revenue thereafter.

The dates of the last valuation:		
Lanka Industrial Estates Limited - Subsidiary	-	27 March 2003
The dates of the acquisition at cost:		
DFCC Bank date of acquisition at fair value	-	24 August 2001

2.8 Investment in subsidiaries and associate company

Shares in subsidiaries and associate company are accounted using the equity method. The carrying amount includes the acquisition cost, balance of goodwill or negative goodwill net of cumulative amortisation and Bank's share of undistributed post acquisition profit/(losses) in subsidiaries and associate company.

2.9 Goodwill or negative goodwill on acquisition of shares in subsidiaries and associate company

2.9.1 Goodwill arising on an acquisition represents the excess of the cost of the acquisition over the fair value of the net identifiable assets acquired. Conversely negative goodwill arising on an acquisition represents the excess of the fair value of the net identifiable assets acquired over the cost of acquisition. Goodwill or negative goodwill is amortised over a period of five years from the date of acquisition. The amount of goodwill or negative goodwill amortised in a financial year is proportionate to the number of months the subsidiary/associate company results are included in the financial statements of the Bank. The carrying amount of goodwill or negative goodwill as appropriate, is included in the carrying amount of the investment in the subsidiary or associate company.

2.9.2 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.

2.10 Property and equipment

2.10.1 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 cumulative depreciation which is provided for on the basis outlined in 2.10.2.

2.10.2 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
Office equipment, furniture, fittings and motor vehicles	20% per annum
Application software	20% per annum

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

Land and investment properties are not depreciated.

2.10.3 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 accumulated depreciation. The depreciation policy for the leased assets is consistent with that for depreciable assets, which are owned. Depreciation is accounted for in accordance with the rate and policy disclosed in 2.10.2.

3 Liabilities and Provisions

3.1 Pension and gratuity payments

3.1.1 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 except one are covered by this funded pension scheme subject to fulfillment of eligibility conditions prescribed by the Bank.

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.

3.1.2 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.

3.1.3 Unfunded pension liability

This relates to pension liability of an employee, not funded through the DFCC Bank Pension Fund and was Rs5.5m on 31 March 2004. The liability relates to the pension benefit to retiree and survivor spouse and minor children.

3.1.4 Amount recognised as expense

	Rs million
In respect of funded liability	
Current service cost	32.0
Experience adjustments	13.6
In respect of unfunded liability	
Current service cost	1.6
Experience adjustments	0.3
	47.5

3.1.5 Experience adjustments

	Rs million
In respect of funded liability	
Loss due to change in Plan assumptions at 31.3.04	92.9
Actuarial experience loss at 31.3.04	43.3
Total actuarial loss	136.2
Recognised as expense in the financial year to 31.3.04	-13.6
Balance on 31.3.04	122.6
In respect of unfunded liability	
Loss due to change in Plan assumptions at 31.3.04	1.0
Actuarial experience loss at 31.3.04	0.3
Total actuarial loss	1.3
Recognised as expense in the financial year to 31.3.04	-0.3
Balance on 31.3.04	1.0

Experience adjustments comprise loss arising from change in plan assumptions with effect from 1 April 2003 and loss due to variations between previous actuarial assumptions and actual results.

The total actuarial loss of Rs136.2m in respect of employees whose pension liabilities are funded is amortised equally over 10 year period commencing from 1 April 2003. The average remaining working life of the employees eligible for pension as at 1 April 2003 was 10 years.

The total actuarial loss of Rs1.3m in respect of an employee whose pension liability is not funded is amortised equally over 4 year period commencing from 1 April 2003. The average remaining working life of the employee eligible for pension up to the minimum 10 year qualifying period, as at 1 April 2003, is 4 years.

Change in Plan assumptions are described in 3.1.9.

3.1.6 Actuarial valuation

Date of most recent valuation is 31 March 2004.

3.1.7 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.

3.1.8 Pension assets and actuarial present value of accrued benefits

As at 31 March 2004, value of assets of the Pension Trust Fund was Rs476.3m and value of benefits that had accrued to members after allowing for expected future increases in earnings was Rs598.9m. The pension liability under discontinuance basis was Rs493.6m on 31 March 2004. The unrecognised liability of Rs122.6m in respect of the funded liability representing the unamortised balance of the experience adjustments will be amortised in 9 years at the rate of Rs.13.6m per annum.

3.1.9 *Principal actuarial assumptions*

Current 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 9.5%.

Previous assumptions

The long term annual return on investments net of tax was assumed to be 11% and the discount rate used to determine actuarial pension liability during pre-retirement period was 11% per annum reducing to 9% per annum during the post retirement period. The annual increase in total pensionable remuneration was 9.5%.

3.1.10 *Gratuity provision*

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

No provision was outstanding on 31 March 2004.

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 completed year of service commencing from the first year of service. Such provision is not externally funded.

3.2 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.

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

3.3 Securities sold under repurchase agreements

These are borrowing collateralised by sale of treasury bills or treasury bonds held by the Bank to the counter party from whom the Bank borrowed, subject to a commitment to repurchase them at a pre-determined price. Such securities remain on the balance sheet of the Bank and the liability is recorded in respect of the consideration received.

3.4 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.

3.5 Obligations under finance leasing

Obligations in respect of property and 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.

3.6 Proposed dividend

The first and final dividend proposed by the Board of Directors after the balance sheet date is not recognised as a liability and the amount of dividend is included in the profit for the year attributable to shareholders.

3.7 Commitments and contingencies

All discernible risks are accounted for in determining the amount of other liabilities. Bank's share of any contingencies and capital commitments of a subsidiary or an associate for which the Bank is also liable severally or otherwise is included with appropriate disclosures.

3.8 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 No. 47.

4. Revenue and Expense Recognition

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.

4.2 Imputation of 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 imputation credit is $1/9^{th}$ of the net income.

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.

4.4 Lease income

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.

4.4.2 Operating leases

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

4.5 Dividend income from shares is recognised in the period in which they are approved by the Board of Directors or shareholders as appropriate to the circumstances. Dividend income from unit trust is recognised in the period they are declared.

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

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

4.8 Profit on sale of investment property

On disposal, 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.

4.9 Gains/loss on disposal of dated debt securities

This represents the difference between net disposal proceeds and the carrying amount of the debt securities.

4.10 Accounting for profit of subsidiaries and associate company

4.10.1 Significant events and transactions during the gap between date of financial statement of the subsidiary/associate company and the date of financial statement of Bank

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

4.10.2 Results of subsidiaries and associate company

Profit for the current financial year and undistributed post acquisition profit of subsidiaries and associate company, attributable to the Bank, are included in the financial statements under equity method of accounting for investment in subsidiaries and associate company, with appropriate disclosures.

4.10.3 Taxes on the undistributed earnings of subsidiaries and associate

10% withholding tax applicable on the distribution of the undistributed earnings of the subsidiaries and associate 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.

4.11 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.

4.12 Interest expense

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

4.13 Bad and doubtful debts

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

Bank makes both general and specific provisions.

Specific partial provisions are made for the estimated loss on doubtful loans, finance leases, bills of exchange, commercial papers and promissory notes not covered by realisable value of collateral. When full specific provisions are required, they are treated as write-offs for accounting purposes.

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:

20% of net exposure at risk has to be provided for loans, finance leases, bills of exchange and other credit facilities which are in arrears for 6 months or more but less than 12 months. The percentage of net exposure to be provided increases to 50% when the age of arrears is 12 to 18 months and to 100% when the age of arrears is more than 18 months.

Prior to 1 January 2004, the forced sale value of immovable property was taken as equivalent to realisable value for the purpose of computing net exposure at risk. This was based on the Direction issued by Central Bank of Sri Lanka. The amendment to the aforesaid Direction effective from 1 January 2004 requires the application of prescribed discounts to the forced sale value based on age of arrears of the loans, financial leases, bills of exchange and other credit facilities as depicted hereunder.

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

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

The general provision relates to potential losses not separately identified but known from experience to exist in the portfolio of loans.

4.14 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. The management of the Bank believe that the continuously depressed condition prevailing in the Colombo Stock Exchange would not reverse in the foreseeable future, and as such the Bank would not be able to realise the initial cost of the investment of some shares. Consequently these have been partially written off.

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 official valuation of 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.

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. 21.2

5 Cash Flow

The Cash Flow has been prepared by using the "Direct Method". Cash and cash equivalents include cash and bank 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.

6 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 directly attributable to the segment 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 directly attributable to the segment 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.

For the year ended 31 March		Notes	Page No.	Bank 2004 Rs 000	Bank 2003 Rs 000	Group 2004 Rs 000	Group 2003 Rs 000	*Variance Rs 000
Income		1	(73)	**4,444,294**	4,112,756	**4,681,559**	4,338,255	343,304
Interest income		2	(73)	**3,461,424**	3,427,880	**3,563,151**	3,517,844	45,307
Interest expense		3	(73)	**1,819,389**	2,090,879	**1,838,947**	2,090,879	(251,932)
Net interest income				**1,642,035**	1,337,001	**1,724,204**	1,426,965	297,239
Amortisation of negative goodwill				**5,053**	13,565	**5,053**	13,565	(8,512)
Other income		4	(74)	**982,870**	684,876	**1,118,408**	820,411	297,997
Operating income				**2,629,958**	2,035,442	**2,847,665**	2,260,941	586,724
Personnel costs				**346,396**	282,082	**400,565**	313,874	86,691
Provision for staff retirement benefits				**47,584**	31,662	**50,975**	34,979	15,996
Premises, equipment and establishment expenses				**118,829**	124,152	**173,426**	160,143	13,283
Other overhead expenses				**313,582**	174,238	**375,289**	200,583	174,706
Goodwill written off	- associate			**1,161**	11,873	**1,161**	11,873	(10,712)
	- subsidiary			**23,911**	668	**23,911**	668	23,243
Operating expenses		5	(74)	**851,463**	624,675	**1,025,327**	722,120	303,207
Operating profit before provisions				**1,778,495**	1,410,767	**1,822,338**	1,538,821	283,517
Bad and doubtful debts	- specific	6	(75)	**329,821**	400,628	**324,018**	400,628	(76,610)
	- general			**(29,579)**	(35,892)	**(29,579)**	(35,892)	6,313
Provision for guarantee issued				**0**	2,000	**0**	2,000	(2,000)
Investment securities losses		7	(75)	**8,367**	7,260	**975**	33,873	(32,898)
Operating profit before income tax and associate/subsidiary companies' profit				**1,469,886**	1,036,771	**1,526,924**	1,138,212	388,712
Associate/subsidiary companies' profit/(losses) before income tax				**404,281**	421,861	**417,327**	384,973	32,354
Profit on ordinary activities before tax		8	(75)	**1,874,167**	1,458,632	**1,944,251**	1,523,185	421,066
Income tax on profit on ordinary activities		9	(76)	**581,354**	327,443	**542,716**	336,259	206,457
Profit on ordinary activities after tax		10	(77)	**1,292,813**	1,131,189	**1,401,535**	1,186,926	214,609
Minority interest				**0**	0	**108,722**	55,737	52,985
Profit for the year				**1,292,813**	1,131,189	**1,292,813**	1,131,189	161,624
Earnings per share, Rs	- Basic	11	(78)	**22.70**	20.05	**22.70**	20.05	
	- Diluted			**22.39**	19.99	**22.39**	19.99	

The accounting policies from pages 58 to 67 and the notes from pages 73 to 108 form part of these financial statements.

** Current year minus previous year, Group.*

STATEMENT OF RECOGNISED GAINS AND LOSSES

For the year ended 31 March	Bank		Group	
	2004	2003	**2004**	2003
	Rs 000	Rs 000	**Rs 000**	Rs 000
Reversal of temporary diminution of investment securities				
Bank	**43,723**	16,597	**43,723**	16,597
Preference share issue expenses of associate	**(2,161)**	(323)	**(2,161)**	(323)
Surplus on revaluation of investment property in subsidiary	**0**	32,371	**0**	32,371
Gains & losses not recognised in the income statement	**41,562**	48,645	**41,562**	48,645
Profit for the year	**1,292,813**	1,131,189	**1,292,813**	1,131,189
Total recognised gains & losses	**1,334,375**	1,179,834	**1,334,375**	1,179,834

STATEMENT OF MOVEMENTS IN SHAREHOLDERS' FUNDS

For the year ended 31 March	Bank		Group	
	2004	2003	**2004**	2003
	Rs 000	Rs 000	**Rs 000**	Rs 000
Total recognised gains & losses	**1,334,375**	1,179,834	**1,334,375**	1,179,834
Dividend approved during the year	**(232,711)**	(211,556)	**(232,711)**	(211,556)
Issue of shares under Employee share option plan	**5,482**	0	**5,482**	0
Increase in share premium	**79,826**	0	**79,826**	0
Net addition to shareholders' funds	**1,186,972**	968,278	**1,186,972**	968,278
Shareholders' funds at 1 April	**7,627,336**	6,659,058	**7,627,336**	6,659,058
Shareholders' funds at 31 March	**8,814,308**	7,627,336	**8,814,308**	7,627,336

As at 31 March	Notes	Page No.	Bank 2004 Rs 000	Bank 2003 Rs 000	Group 2004 Rs 000	Group 2003 Rs 000
Assets						
Cash and short-term funds	12	(79)	**408,137**	141,982	**675,915**	228,788
Balances with Central Bank			**–**	–	**50,309**	–
Treasury bills and other securities eligible for rediscounting with Central Bank	13	(79)	**2,266,605**	2,256,234	**2,439,120**	2,362,403
Securities purchased under resale agreements	14	(79)	**26,006**	47,800	**852,684**	415,152
Placements with and loans to other banks and financial institutions	15	(79)	**500,000**	0	**606,607**	69,503
Dealing securities	16	(79)	**1,314**	2,629	**1,314**	2,629
Bills of exchange discounted	17	(79)	**0**	10,015	**16,320**	10,015
Loans	18	(80)	**21,502,234**	18,739,841	**22,138,006**	18,743,514
Finance leases	19	(81)	**3,567,320**	2,283,666	**3,567,320**	2,283,666
Interest receivable	20	(81)	**204,137**	171,666	**184,977**	175,182
Investment securities	21	(82)	**1,703,799**	1,802,216	**2,219,926**	2,146,106
Investment in associate company	22	(90)	**2,520,060**	1,810,356	**2,520,060**	1,810,356
Investment in subsidiary companies	23	(91)	**1,429,795**	852,422	**0**	0
Group balances receivable	24	(92)	**19,015**	15,966	**0**	0
Prepayments			**145,474**	174,570	**145,474**	174,570
Other receivables	25	(92)	**539,801**	515,078	**638,739**	585,876
Income tax refund due	26	(92)	**0**	36,482	**4,188**	41,957
Investment property	27	(92)	**12,180**	187,199	**541,778**	715,037
Goodwill on consolidation	28	(92)	**0**	0	**261,179**	2,058
Property and equipment	29	(92)	**516,462**	378,407	**676,591**	440,896
Total assets			**35,362,339**	29,426,529	**37,540,507**	30,207,708
Liabilities						
Deposits from customers	30	(94)	**4,943,661**	2,867,665	**5,724,484**	2,867,665
Borrowing - Medium and long-term	31	(94)	**19,569,808**	16,158,402	**19,569,808**	16,158,402
- Short-term	32	(95)	**577,166**	1,142,711	**1,072,296**	1,146,907
Debentures	33	(95)	**0**	616,667	**0**	616,667
Obligations under finance leases	34	(95)	**2,767**	3,344	**2,767**	3,344
Interest accrued			**575,833**	380,661	**587,085**	380,661
Taxation	35	(95)	**52,821**	0	**70,871**	9,956
Deferred taxation	36	(96)	**470,324**	347,377	**471,074**	347,867
Other liabilities	37	(96)	**349,834**	271,496	**508,555**	358,335
			26,542,214	21,788,323	**28,006,940**	21,889,804
Negative goodwill	38	(96)	**5,817**	10,870	**5,817**	10,870
Minority interest			**0**	0	**713,442**	679,698
Shareholders' funds						
Share capital	39	(96)	**571,458**	423,111	**571,458**	423,111
Reserves	40	(97)				
Reserve fund			**245,000**	185,000	**245,000**	185,000
Sinking fund reserve			**1,786,458**	1,425,317	**1,786,458**	1,425,317
Share premium			**892,293**	955,332	**892,293**	955,332
Revenue reserves			**4,344,198**	4,144,915	**4,344,198**	4,144,915
Retained profit			**974,901**	493,661	**974,901**	493,661
			8,814,308	7,627,336	**8,814,308**	7,627,336
Total liabilities, minority interest and shareholders' funds			**35,362,339**	29,426,529	**37,540,507**	30,207,708
Commitments and contingencies	41	(99)	**6,910,684**	5,076,190	**7,852,072**	5,153,112

The accounting policies from pages 58 to 67 and the notes from pages 73 to 108 form part of these financial statements.

For and on behalf of the Board of Directors,

M L Mack
Chairman

A N Fonseka
Director & Chief Executive

Colombo
28 May 2004

For the year ended 31 March	Bank		Group	
	2004	2003	2004	2003
	Rs 000	Rs 000	Rs 000	Rs 000
Cash flow from operating activities				
Interest receipts	**2,976,312**	3,011,140	**3,013,240**	3,011,140
Interest payments	**(1,624,217)**	(2,123,748)	**(1,649,526)**	(2,123,748)
Recoveries on loans previously written off	**283,695**	177,320	**283,695**	177,320
Receipts from other operating activities	**202,581**	151,452	**408,002**	309,088
Cash payments to employees and suppliers	**(515,268)**	(500,081)	**(616,081)**	(591,129)
Value added tax	**(184,118)**	(18,788)	**(185,035)**	(18,788)
Operating profit before changes in operating assets	**1,138,985**	697,295	**1,254,295**	763,883
(Increase)/decrease in operating assets				
Short-term funds	**(782,138)**	578,649	**(331,051)**	252,772
Balances with Central Bank of Sri Lanka	**0**	0	**(5,568)**	0
Funds advanced to customers	**(4,319,870)**	(2,281,854)	**(4,880,750)**	(2,281,854)
Other short-term securities	**(10,371)**	(242,910)	**(62,453)**	233,025
Others	**(45,218)**	(183,969)	**(42,002)**	(204,523)
Increase/(decrease) in operating liabilities				
Security deposits from customers	**(5,443)**	47	**(1,972)**	105
Deposits from customers	2,099,648	1,283,953	**2,386,329**	1,283,953
Negotiable certificates of deposit	**(23,652)**	21,282	**(23,841)**	21,282
Net cash flow from operating activities before income tax	**(1,948,059)**	(127,507)	**(1,707,013)**	68,643
Income tax paid	**(111,267)**	(295,347)	**(132,484)**	(307,878)
Income tax refund	**0**	0	**130,247**	0
Net cash from operating activities	**(2,059,326)**	(422,854)	**(1,709,250)**	(239,235)
Cash flow from investing activities				
Dividends received	**365,947**	257,626	**271,336**	210,024
Interest received	**385,841**	391,122	**461,143**	491,417
Proceeds from sale of securities and redemption of securities	**534,277**	740,016	**624,683**	901,392
Purchase of securities	**(305,781)**	(326,412)	**(538,342)**	(391,243)
Acquisition of subsidiary (Note a)	**(59,626)**	0	**(21,165)**	0
Acquisition of additional shares of subsidiaries	**(55,237)**	(15,000)	**(55,237)**	(15,000)
Subscription to rights issue in subsidiary and associate	**(991,941)**	0	**(541,937)**	0
Purchase of property, equipment and investment property	**(212,270)**	(193,731)	**(242,715)**	(208,670)
Proceeds from sale of equipment and investment property	**277,450**	5,813	**297,632**	6,938
Net cash from investing activities	**(61,340)**	859,434	**255,398**	994,858
Cash flow from financing activities				
Issue of new shares under option	**85,308**	0	**85,308**	0
Issue of new shares by subsidiary (Rights issue)	**0**	0	**49,996**	0
Redemption of debentures	**(616,667)**	(983,333)	**(616,667)**	(983,333)
Borrowing, medium and long-term	**5,516,266**	1,329,689	**5,516,266**	1,329,689
Repayment of borrowing, medium and long-term	**(2,104,860)**	(1,463,025)	**(2,104,860)**	(1,463,025)
Dividends paid	**(231,613)**	(210,641)	**(311,116)**	(247,263)
Net cash flow from financing activities	**2,648,434**	(1,327,310)	**2,618,927**	(1,363,932)
Effect of exchange rate changes on cash & cash equivalents	**0**	0	**17**	0
Net increase/(decrease) in cash & cash equivalents	**527,768**	(890,730)	**1,165,092**	(608,309)
Cash & cash equivalents/(overdraft - net) at the beginning of period	**(225,775)**	664,955	**226,328**	834,637
Cash & cash equivalents/(overdraft - net) at the end of period	**301,993**	(225,775)	**1,391,420**	226,328
Reconciliation of cash & cash equivalents				
Cash and short-term funds	**408,137**	141,982	**675,915**	228,788
Securities purchased under resale agreements - Refer Note 14	**26,006**	47,800	**852,684**	415,152
Borrowing, short-term - Refer Note 32	**(132,150)**	(415,557)	**(137,179)**	(417,612)
	301,993	(225,775)	**1,391,420**	226,328

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 confirm to the year ended 31 March 2004 classification.

Note a

Acquisition of subsidiary during the year ended 31 March 2004, DFCC Vardhana Bank Limited

	Rs 000
Assets	
Cash and short term funds	38,461
Balances with Central Bank	44,741
Treasury bills and other securities eligible for rediscounting with Central Bank	14,000
Placements with and loans to other banks and financial institutions	231
Bills of exchange discounted	888
Loans net of interest receivable	66,969
Investment securities	1,030
Other receivables	26,878
Property & equipment	119,958
Total assets	313,156
Liabilities	
Deposits from customers	494,331
Interest accrued	16,587
Other liabilities	27,636
Total liabilities	538,554
Net Assets	(225,398)
Minority interest	22,538
Goodwill on acquisition	262,486
Purchase consideration	59,626
Less: Cash & cash equivalents acquired	38,461
	21,165

For the year ended 31 March	Bank 2004 Rs 000	Bank 2003 Rs 000	Group 2004 Rs 000	Group 2003 Rs 000
1 Income				
Gross income	**4,444,294**	4,181,280	**4,681,559**	4,407,531
Less: Turnover based taxes	**0**	68,524	**0**	69,276
	4,444,294	4,112,756	**4,681,559**	4,338,255
Interest income	**3,461,424**	3,427,880	**3,563,151**	3,517,844
Other income	**982,870**	684,876	**1,118,408**	820,411
	4,444,294	4,112,756	**4,681,559**	4,338,255

National security levy, a turnover based tax was abolished on 31 July 2002.

	Bank 2004 Rs 000	Bank 2003 Rs 000	Group 2004 Rs 000	Group 2003 Rs 000
2 Interest Income				
Loans	**2,549,670**	2,706,637	**2,575,693**	2,706,657
Treasury bills and placements with other banks	**330,986**	360,306	**369,494**	416,506
Discount on bills of exchange	**2,002**	4,084	**2,002**	4,084
Gross earnings under finance leases	**515,420**	364,816	**515,420**	364,816
Default interest on lease rentals	**21,423**	16,204	**21,561**	16,688
Interest and discount arising from debt securities	**41,923**	43,024	**78,981**	76,284
	3,461,424	3,495,071	**3,563,151**	3,585,035
Less: National security levy	0	67,191	**0**	67,191
	3,461,424	3,427,880	**3,563,151**	3,517,844

Treasury bill and bond interest income includes Rs61m, the notional tax credit of 10% imputed to the withholding tax deducted/paid at source in respect of two financial years ended 31 March 2004. The amount relating to the previous financial year is Rs32m.

	Bank 2004 Rs 000	Bank 2003 Rs 000	Group 2004 Rs 000	Group 2003 Rs 000
3 Interest Expense				
Medium and long-term borrowing	**1,220,836**	1,585,603	**1,220,725**	1,585,603
Short-term borrowing:				
Treasury bills under repurchase agreements	**174,521**	77,693	**174,608**	77,693
Others	**537**	901	**1,276**	901
Debentures	**40,642**	171,798	**40,642**	171,798
Time deposits from customers	**382,853**	254,884	**401,696**	254,884
	1,819,389	2,090,879	**1,838,947**	2,090,879

For the year ended 31 March	Bank 2004 Rs 000	Bank 2003 Rs 000	Group 2004 Rs 000	Group 2003 Rs 000

4 Other Income

Dividend income from securities				
Quoted ordinary shares	**17,427**	10,820	**17,585**	11,249
Unquoted ordinary shares	**3,505**	2,205	**6,645**	2,205
Unquoted preference shares	**62,869**	102,153	**65,241**	102,408
Units in unit trusts	**28,869**	22,555	**33,359**	22,994
Dividend income from investments in associates/subsidiaries				
Quoted ordinary shares	**156,973**	83,710	**96,147**	55,247
Unquoted ordinary shares	**44,195**	23,354	**0**	0
Quoted preference shares	**7,479**	5,850	**7,479**	5,850
	321,317	250,647	**226,456**	199,953
Gains on sale of investment securities				
Quoted ordinary shares	**72,494**	52,428	**79,812**	52,428
Unquoted ordinary shares	**19,731**	300	**32,823**	19,119
Premium on redemption of units - Optima Fund	**0**	50,298	**0**	64,563
Others	**1,184**	125	**2,434**	125
Recovery of bad debts	**283,695**	177,320	**283,695**	177,320
Front end fee	**23,168**	14,574	**23,267**	14,706
Consultancy and other professional services	**50,185**	76,183	**50,185**	76,183
LC Commission	**3,731**	0	**5,044**	0
Underwriting commission and guarantee fees	**14,651**	8,293	**14,946**	8,293
Gain on sale of commercial paper and pro-notes	**3,360**	3,010	**3,360**	3,010
Gain on sale of treasury bills and bonds	**61,652**	12,058	**61,652**	12,058
Gain on sale of equipment	**912**	4,997	**1,443**	5,830
Exceptional gain on sale of investment property	**99,670**	0	**103,173**	0
Premises rental income	**10,772**	10,449	**70,092**	67,342
Operating lease income	**4,529**	9,504	**4,529**	9,504
Foreign exchange profit	**2**	0	**1,451**	0
Others	**11,817**	16,023	**154,046**	112,062
	982,870	686,209	**1,118,408**	822,496
Less: National security levy	**0**	1,333	**0**	2,085
	982,870	684,876	**1,118,408**	820,411

5 Operating Expenses

Operating expenses include the following:				
Chairman's emoluments - Fees	**480**	480	**480**	480
Directors' emoluments - Fees	**1,960**	1,870	**4,977**	2,513
Employers' contribution to Provident Fund	**22,812**	19,480	**25,178**	19,928
Employers' contribution to Employees' Trust Fund	**4,540**	3,907	**5,009**	3,997
Auditors' remuneration	**960**	800	**1,916**	1,269
Depreciation - operating leases	**3,213**	5,872	**3,213**	6,193
- property and equipment	**68,849**	71,713	**103,707**	83,772
Legal expenses	**4,046**	5,060	**4,796**	5,177
Special VAT on profits	**181,811**	28,961	**182,895**	28,961

For the year ended 31 March	Bank 2004 Rs 000	Bank 2003 Rs 000	Group 2004 Rs 000	Group 2003 Rs 000

6 Bad and Doubtful Debts

	Bank 2004	Bank 2003	Group 2004	Group 2003
Specific provision				
Provision for the year				
Loans	**413,090**	449,871	**411,145**	449,871
Leases	**75,602**	70,122	**75,602**	70,122
Bills of exchange	**10,015**	11,015	**10,015**	11,015
Loan/lease losses	**11,199**	4,874	**11,200**	4,874
	509,906	535,882	**507,962**	535,882
Less: Reductions in the year				
Loans	**134,113**	90,741	**137,972**	90,741
Leases	**40,868**	44,513	**40,868**	44,513
Bills	**5,104**	0	**5,104**	0
	329,821	400,628	**324,018**	400,628
General provision - loans				
Provision for the year	**1,808**	8,498	**1,808**	8,498
Less: Reduction in the year	**31,387**	44,390	**31,387**	44,390
	(29,579)	(35,892)	**(29,579)**	(35,892)
Total provision & losses	**300,242**	364,736	**294,439**	364,736

7 Investment Securities Losses

	Bank 2004	Bank 2003	Group 2004	Group 2003
Relates to diminution other than temporary in value of share investments	**8,367**	7,260	**975**	33,873

8 Profit on Ordinary Activities before Tax

	Bank 2004	Bank 2003	Group 2004	Group 2003
Bank	**1,469,886**	1,036,771	**1,364,863**	979,692
Commercial Bank of Ceylon Limited	**417,327**	384,973	**417,327**	384,973
DFCC Stock Brokers (Pvt) Limited	**46,314**	16,872	**69,376**	22,950
DFCC Vardhana Bank Limited	**(45,179)**	0	**(48,397)**	0
Lanka Industrial Estates Limited	**11,259**	11,867	**54,367**	57,569
Lanka Ventures Limited	**(21,769)**	4,965	**75,622**	59,036
National Asset Management Limited	**(3,671)**	3,184	**11,093**	18,965
Associate/subsidiary companies	**404,281**	421,861	**579,388**	543,493
Total	**1,874,167**	1,458,632	**1,944,251**	1,523,185

The profit/loss accounted in accordance with the equity method of accounting is limited to the undistributed profits/losses of the respective associate/subsidiary companies, proportionate to Bank's ownership.

9 Income Tax on Profit

9.1 Income tax on profit of the Bank has been provided at 30% on the taxable income.

9.2 In computing the liability to taxation, the Bank has:

9.2.1 Taken the full credit for savings arising from capital allowances for equipment and building and equipment leased.

9.2.2 Treated 25% of the Value Added Tax as a deductible expense.

9.3 Tax effect of undistributed earnings of associates and subsidiaries

The Bank's accounts have included its share of post acquisition profits/losses from associate and subsidiary companies. A withholding tax of 10% would be deducted if a full distribution is made and such distribution is from the taxable income of the associate and subsidiaries. However no provision for withholding tax payable on distribution of such profits has been made in the accounts of the Bank, since profits will not be distributed in full.

Cumulative total of post-acquisition undistributed profits of associate and subsidiary companies on which withholding tax is not provided is Rs1,458m. (Note 23 adjusted for share Premium and unamortised negative goodwill).

9.4 Relationship between tax expense and accounting income

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

For the year ended 31 March	**2004** **Rs 000**	2003 Rs 000
Profit before tax as per the Income Statement	**1,469,886**	1,036,771
Disallowed expenses and provisions	**201,734**	96,176
Lease rentals net of capital allowances	**270,904**	252,237
Exceptional gain on sale of investment property	**(99,670)**	–
Reported earnings under finance leases net of provision for bad & doubtful debts	**(480,686)**	(342,278)
Capital allowances on property and equipment	**(203,571)**	(171,202)
Dividend income	**(321,317)**	(249,520)
Gain on sale of investment securities	**(93,409)**	(103,151)
Goodwill	**20,019**	(1,024)
Adjustment to income for imputation credit for 31.03.2003	**(32,867)**	–
Exempt profit on government securities*	**–**	(71,865)
Taxable income	**731,023**	446,144
Normal company tax rate 30% (35%)	**219,307**	156,150
5% tax credit	**–**	(22,250)
Taxation based on profit for the year - Note 9.5	**219,307**	133,900
Tax rate on accounting profit**,%	**15**	13

* *This exemption has been removed with retrospective effect which has been adjusted for in the current year as tax under provision.*

** *Excluding associate/subsidiary companies profit.*

For the year ended 31 March	Bank 2004 Rs 000	Bank 2003 Rs 000	Group 2004 Rs 000	Group 2003 Rs 000
9.5 Tax on profit on ordinary activities				
Taxation based on profits for the year	**219,307**	133,900	**219,307**	133,900
Tax under provision	**42,325**	14,113	**42,325**	14,113
Discharge of tax liability under appeal	**0**	(22,540)	**0**	(22,540)
Transfer to deferred taxation	**122,947**	55,490	**122,947**	55,490
Bank	**384,579**	180,963	**384,579**	180,963
Commercial Bank of Ceylon Limited	**246,238**	134,584	**246,238**	134,584
DFCC Stock Brokers (Pvt) Limited	**22,756**	7,363	**25,568**	7,363
Lanka Indurtrial Estates Limited	**1,999**	2,547	**5,924**	8,190
Lanka Ventures Limited - tax over provision *	**(76,398)**	0	**(123,839)**	1,052
National Asset Management Limited	**2,180**	1,986	**4,246**	4,107
Associate/subsidiary companies' tax	**196,775**	146,480	**158,137**	155,296
Total	**581,354**	327,443	**542,716**	336,259

* *Includes a tax charge of Rs 486,000/-.*

10 Profit on Ordinary Activities after Tax

	Bank 2004 Rs 000	Bank 2003 Rs 000	Group 2004 Rs 000	Group 2003 Rs 000
Bank	**1,085,307**	855,808	**980,284**	798,729
Commercial Bank of Ceylon Limited	**171,089**	250,389	**171,089**	250,389
DFCC Stock Brokers (Pvt) Limited	**23,558**	9,509	**43,808**	15,587
DFCC Vardhana Bank Limited	**(45,179)**	0	**(48,397)**	0
Lanka Industrial Estates Limited	**9,260**	9,320	**48,443**	49,379
Lanka Ventures Limited	**54,629**	4,965	**199,461**	57,984
National Asset Management Limited	**(5,851)**	1,198	**6,847**	14,858
Associate/subsidiary companies	**207,506**	275,381	**421,251**	388,197
Total	**1,292,813**	1,131,189	**1,401,535**	1,186,926

10.1 Consolidation adjustments

10.1.1 Associate-Commercial Bank of Ceylon Limted

	2004 Rs 000	2003 Rs 000
Group profit after tax	1,537,315	1,312,547
Minority interest	1,715	1,924
Reported profit after tax	1,535,600	1,310,623
Less:		
Net preference dividend paid	170,700	106,067
Withholding tax	18,967	11,785
Deferred tax on leased assets	367,747	92,965
Profit available for ordinary shareholders	978,186	1,099,806
DFCC Bank's share @ 27.79%	271,838	305,636
Less:		
Net ordinary dividend received by Bank (included in other income - Note 4)	96,147	55,247
Withholding tax	4,602	–
	171,089	250,389

10.1.2 Subsidiaries

	DFCC Stock Brokers (Pvt) Limited Rs 000	DFCC Vardhana Bank Limited Rs 000	Lanka Industrial Estates Limited Rs 000	Lanka Ventures Limited Rs 000	National Asset Management Limited Rs 000
Reported profit/(loss) after tax	46,620	(175,495)	50,385	205,817	9,530
Percentage holding	100	94	50	59	80
DFCC Bank's share	46,620	*(45,179)	25,293	121,494	**6,339
Less: Net dividend received	20,250	–	14,091	60,826	9,854
(included in other income - Note 4)					
Withholding tax deducted at source	2,812	–	1,942	5,584	946
Intra Group Transactions					
Dividend	–	–	–	334	670
Investment security gain	–	–	–	121	720
	23,558	(45,179)	9,260	54,629	(5,851)

* *Acquisition in August 2003.*

** *Holding was increased from 60% to 80% on 28 November 2003.*

11 Earnings per Share

11.1 Basic earnings per share

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

11.2 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 number of shares issued adjusted for the effect of all dilutive potential ordinary shares.

For the year ended 31 March		Bank 2004 Rs 000	Bank 2003 Rs 000	Group 2004 Rs 000	Group 2003 Rs 000
11.3 Computation of basic and diluted earnings per share					
Profit for the year		**1,292,813**	1,131,189	**1,292,813**	1,131,189
Weighted average number of shares		**56,945,370**	42,311,111	**56,945,370**	42,311,111
Basic earnings per share, Rs		**22.70**	*20.05	**22.70**	*20.05
Number of shares that would have been issued at fair value in respect of options granted on	31.03.2002	**47,489**		**47,489**	
	31.03.2003	**290,360**		**290,360**	
	31.03.2004	**640,770**		**640,770**	
		978,619		**978,619**	
Number of shares at nil consideration (dilutive potential shares) in respect of options granted on	31.03.2002	**67,673**		**67,673**	
	31.03.2003	**518,180**		**518,180**	
	31.03.2004	**216,417**		**216,417**	
		802,270		**802,270**	
Total number of shares under option		**1,780,889**		**1,780,889**	
Weighted average ordinary shares in issue and dilutive potential shares		**57,747,640**		**57,747,640**	
Diluted earnings per share, Rs		**22.39**	*19.99	**22.39**	*19.99

* *Previously reported amounts have been restated to adjust for the bonus issue of shares.*

		Bank		Group	
		31.03.2004	31.03.2003	**31.03.2004**	31.03.2003
		Rs 000	Rs 000	**Rs 000**	Rs 000
12	**Cash and Short-Term Funds**				
	Cash and balance with banks	**175,904**	141,982	**299,027**	146,106
	Time deposits with licensed commercial banks *	**232,233**	0	**376,888**	82,682
		408,137	141,982	**675,915**	228,788

* DFCC Vardhana Bank Limited

13	**Treasury Bills and other Securities eligible for Rediscounting with Central Bank**				
	Treasury bills - short-term	**1,671,266**	267,539	**1,843,781**	353,933
	Treasury bonds - medium-term	**595,339**	1,988,695	**595,339**	2,008,470
		2,266,605	2,256,234	**2,439,120**	2,362,403

This includes investments to the value of Rs1,885m covering the amount of sinking fund created as per loan covenant in floating rate notes of US$65m and loan of US$5m from Asian Development Bank.

14	**Securities purchased under Resale Agreements**				
	Treasury bills	**26,006**	47,800	**852,684**	415,152
		26,006	47,800	**852,684**	415,152
15	**Placements with and Loans to other Banks and Financial Institutions**				
	Banks - DFCC Vardhena Bank Limited	**500,000**	0	**505,717**	0
	Financial institutions	**0**	0	**100,890**	69,503
		500,000	0	**606,607**	69,503
16	**Dealing Securities**				
	Quoted debentures				
	Sri Lanka Telecom Limited - 14%	**864**	1,728	**864**	1,728
	- 14.5%	**450**	901	**450**	901
		1,314	2,629	**1,314**	2,629
	Market value	**1,576**	4,092	**1,576**	4,092
17	**Bills of Exchange Discounted**				
	Balance on 31 March				
	Local bills	**17,582**	22,686	**33,902**	22,686
	Less: Provision for bills of exchange overdue	**17,582**	12,671	**17,582**	12,671
		0	10,015	**16,320**	**10,015**

17.1 Movement in provision

Balance on 31 March	**12,671**		**12,671**	
Add : Provision for the year	**10,015**		**10,015**	
Less : Recoveries	**5,104**		**5,104**	
	17,582		**17,582**	

	Bank		Group	
	31.03.2004	31.03.2003	**31.03.2004**	31.03.2003
	Rs 000	Rs 000	**Rs 000**	Rs 000

18 Loans

18.1 Balance on 31 March

	Bank 31.03.2004 Rs 000	Bank 31.03.2003 Rs 000	Group 31.03.2004 Rs 000	Group 31.03.2003 Rs 000
Sri Lanka Rupee loans				
Direct loans	**21,190,113**	18,159,954	**21,544,974**	18,159,954
Refinance loans	**8,352**	21,066	**8,352**	21,066
Debenture loans	**957,496**	1,340,421	**957,496**	1,340,421
Overdrafts	**0**	0	**333,890**	0
Staff loans: Loans to purchase shares of the Bank	**0**	70	**0**	70
Loans for miscellaneous purposes	**90,178**	73,704	**98,479**	77,377
	22,246,139	19,595,215	**22,943,191**	19,598,888
Foreign Currency loans				
Direct loans	**378,334**	0	**378,334**	0
	22,624,473	19,595,215	**23,321,525**	19,598,888
Less : Loan loss provision - Specific	**842,991**	705,204	**904,271**	705,204
Loan loss provision - General	**40,874**	70,453	**40,874**	70,453
Prepaid loan instalments	**238,374**	79,717	**238,374**	79,717
Balance net of loan loss provision	**21,502,234**	18,739,841	**22,138,006**	18,743,514

18.2 Movement in Provision

18.2.1 Movement in specific provision

	Bank 31.03.2004 Rs 000	Group 31.03.2004 Rs 000
Balance on 31 March	**705,204**	**705,204**
Add: DFCC Vardhana Bank Limited	**0**	**67,084**
Provision for the year	**413,090**	**411,145**
Transfer from interest in suspense	**16,926**	**16,926**
Less: Recoveries in the year	**134,113**	**137,972**
Write off of loans	**158,116**	**158,116**
	842,991	**904,271**

18.2.2 Movement in general provision

	Bank 31.03.2004 Rs 000	Group 31.03.2004 Rs 000
Balance on 31 March	**70,453**	**70,453**
Add: Provision for the year	**1,808**	**1,808**
Less: Recoveries in the year	**31,387**	**31,387**
	40,874	**40,874**

	Bank		Group	
	31.03.2004	31.03.2003	**31.03.2004**	31.03.2003
	Rs 000	Rs 000	**Rs 000**	Rs 000

19 Finance Leases

19.1 Balance on 31 March

Gross investment in leases				
Lease rentals receivable				
- within one year from balance sheet date	**1,993,778**	1,477,663	**1,993,778**	1,477,663
- after one year from balance sheet date	**2,752,241**	1,733,481	**2,752,241**	1,733,481
	4,746,019	3,211,144	**4,746,019**	3,211,144
Less: Deposit of rentals	**100,680**	109,418	**100,680**	109,418
Provision for leases in default	**174,896**	160,224	**174,896**	160,224
Income in suspense	**41,022**	44,394	**41,022**	44,394
Prepaid lease rentals	**55,473**	43,923	**55,473**	43,923
Unearned income on rentals receivable				
- within one year from balance sheet date	**455,076**	328,032	**455,076**	328,032
- after one year from balance sheet date	**351,552**	241,487	**351,552**	241,487
Net investment in leases	**3,567,320**	2,283,666	**3,567,320**	2,283,666

19.2 Movement in provision

Balance on 31 March	**160,224**		**160,224**	
Add: Provision for the year	**75,602**		**75,602**	
Less: Recoveries	**40,868**		**40,868**	
Transfers*	**20,062**		**20,062**	
	174,896		**174,896**	

** To specific provision on debts on repossession, included under debtors.*

19.3 Movement in income in suspense

Balance on 31 March	**44,394**		**44,394**	
Add: Transfer during the year	**65,518**		**65,518**	
Less: Recoveries	**68,890**		**68,890**	
	41,022		**41,022**	

20 Interest Receivable

20.1 Balance on 31 March

Amount due	**577,167**	1,195,213	**577,167**	1,198,729
Amount accrued and not due	**664,148**	0	**695,067**	0
Less: Interest in suspense	**1,037,178**	1,023,547	**1,087,257**	1,023,547
	204,137	171,666	**184,977**	175,182

20.2 Movement in interest in suspense

Balance on 31 March	**1,023,547**		**1,023,547**	
Add: DFCC Vardhana Bank Limited	**0**		**14,043**	
Transfer during the year	**432,563**		**469,285**	
Less: Collections	**247,440**		**248,126**	
Transfer to loan provision	**16,926**		**16,926**	
Write-offs	**154,566**		**154,566**	
	1,037,178		**1,087,257**	

	Bank		Group	
	31.03.2004	31.03.2003	**31.03.2004**	31.03.2003
	Rs 000	Rs 000	**Rs 000**	Rs 000

21 Investment Securities

21.1 Balance on 31 March

Ordinary shares				
Quoted				
Balance on 31 March	**431,310**	352,265	**452,159**	358,533
Additions	**55,781**	113,985	**91,842**	128,566
Disposals	**(108,854)**	(36,051)	**(126,077)**	(36,051)
Transfers from unquoted shares on listing	**0**	1,112	**0**	1,112
Transfers to unquoted shares on delisting	**0**	(1)	**0**	(1)
Write-offs	**(8,145)**	0	**(8,145)**	0
	370,092	431,310	**409,779**	452,159
Unquoted				
Balance on 31 March	**105,654**	111,765	**198,046**	269,872
DFCC Vardhana Banka Limited investments	**0**	0	**1,030**	0
Additions	**0**	0	**20,000**	24,250
Disposals	**(4,602)**	0	**(19,802)**	(26,991)
Transfers to quoted shares on listing	**0**	(1,112)	**0**	(1,112)
Transfers from quoted shares on delisting	**0**	1	**0**	1
Write-offs	**0**	(5,000)	**(17,862)**	(67,974)
	101,052	105,654	**181,412**	198,046
Preference shares				
Quoted				
Balance on 31 March	**50,000**	50,000	**50,000**	50,000
Additions	**50,000**	0	**50,000**	0
	100,000	50,000	**100,000**	50,000
Unquoted				
Balance on 31 March	**703,500**	943,000	**787,550**	1,036,550
Additions	**200,000**	100,000	**276,500**	112,500
Redemptions	**(153,000)**	(339,500)	**(165,000)**	(339,500)
Write-offs	**0**	0	**0**	(22,000)
	750,500	703,500	**899,050**	787,550
Debentures				
Quoted				
Balance on 31 March	**237,410**	132,483	**257,472**	142,325
Additions	**0**	104,927	**20,000**	118,427
Redemptions	**(123,718)**	0	**(126,999)**	(3,280)
Write-offs	**(222)**	0	**(222)**	0
	113,470	237,410	**150,251**	257,472
Unquoted				
Balance on 31 March	**2,268**	2,268	**262,782**	307,651
Additions	**0**	0	**30,000**	0
Redemptions	**(2)**	0	**(21,045)**	(15,021)
Write-offs	**0**	0	**(53,075)**	(29,848)
	2,266	2,268	**218,662**	262,782

Investment Securities *(Contd.)*

	Bank		Group	
	31.03.2004	31.03.2003	**31.03.2004**	31.03.2003
	Rs 000	Rs 000	**Rs 000**	Rs 000
Investments in unit trusts				
Balance on 31 March	**318,057**	570,557	**326,946**	662,446
Additions	**0**	7,500	**50,000**	7,500
Redemptions	**(49,378)**	(260,000)	**(49,378)**	(343,000)
	268,679	318,057	**327,568**	326,946
Total	**1,706,059**	1,848,199	**2,286,722**	2,334,955
Less: Provision for diminution	**2,260**	45,983	**66,796**	188,849
	1,703,799	1,802,216	**2,219,926**	2,146,106
Aggregate market value of quoted investments				
Ordinary shares	**511,711**	406,216	**553,086**	427,298
Preference shares	**108,750**	48,750	**108,750**	48,750
Debentures	**125,564**	269,648	**166,993**	290,892
Market value of units in unit trusts	**324,122**	307,047	**383,906**	315,319

21.2 Provision for diminution

21.2.1 Movement in provision

	Bank	Group
Balance on 31 March 2003	**45,983**	**188,849**
(Decrease) in provision for diminution	**(43,723)**	**(50,945)**
Write-off against cost	**0**	**(71,108)**
	2,260	**66,796**

21.2.2 Composition

	Bank	Group
Temporary diminution	**0**	**649**
Other than temporary diminution	**2,260**	**66,147**
	2,260	**66,796**

21.3 On 31 March 2004 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.

21.4 Quoted Ordinary Shares

	31.03.2004				31.03.2003			
	Number of ordinary shares of Rs10 each	Cost* Rs 000	% of total cost	Market value Rs 000	Number of ordinary shares of Rs10 each	Cost* Rs 000	% of total cost	Market value Rs 000
Banks, Finance & Insurance								
Hatton National Bank Limited - non-voting	**165,000**	**10,500**		**7,178**	165,000	10,500		7,755
Lanka Orix Leasing Company Limited	**161,328**	**7,017**		**9,680**	66,264	5,270		4,854
Mercantile Leasing Limited	**204,200**	**3,292**		**5,513**	204,200	3,292		3,573
National Development Bank	**278,100**	**40,805**		**43,175**	278,100	40,805		23,360
Nations Trust Bank Limited	**297,760**	**4,937**		**7,518**	167,800	3,042		2,559
NDB Bank Limited	**15**	**0**		**0**	15	0		0
People's Merchant Bank Limited	**1,250,000**	**12,500**		**14,688**	1,250,000	12,500		15,313
Sampath Bank Limited	**100**	**7**		**8**	100	7		7
Seylan Bank Limited – non-voting	**50,000**	**1,141**		**1,100**	0	0		0
		80,199	**21.7**	**88,860**		75,416	17.5	57,421
Beverages, Food & Tobacco								
Ceylon Tobacco Company Limited	**142,567**	**102**		**5,845**	142,567	102		5,703
Distilleries Company of Sri Lanka Limited**	**135,000**	**3,135**		**2,970**	0	0		0
Lanka Milk Foods Limited	**311,300**	**4,734**		**7,004**	206,300	2,417		2,114
Nestle Lanka Limited	**99**	**2**		**9**	99	2		5
		7,973	**2.2**	**15,828**		2,521	0.6	7,822
Chemicals & Pharmaceuticals								
Chemical Industries (Colombo) Limited - voting	**30,312**	**1,449**		**4,001**	30,312	1,449		3,577
Haycarb Limited	**19,130**	**944**		**612**	19,130	944		684
		2,393	**0.6**	**4,613**		2,393	0.6	4,261
Construction & Engineering								
Samuel Sons & Company Limited	**458,333**	**2,292**	**0.6**	**3,667**	458,333	7,104	1.6	5,500
Diversified Holdings								
Hayleys Limited	**91,574**	**3,014**		**10,646**	82,417	2,831		10,302
Hemas Holdings Limited	**154,900**	**9,472**		**13,670**	0	0		0
James Finlay & Company (Colombo) Limited	**87,726**	**5,029**		**8,553**	162,026	9,289		6,481
John Keells Holdings Limited	**99,540**	**11,023**		**11,049**	100	7		7
		28,538	**7.7**	**43,918**		12,127	2.8	16,790
Footwear & Textiles								
Bata Shoe Company of Ceylon Limited	**0**	**0**		**0**	379,300	3,217		3,414
		0	**0.0**	**0**		3,217	0.7	3,414
Healthcare								
Ceylon Hospitals Limited - voting	**142,800**	**3,570**		**2,856**	0	0		0
Ceylon Hospitals Limited - non-voting	**483,200**	**9,664**		**7,490**	0	0		0
		13,234	**3.6**	**10,346**		0	0.0	0
Hotels & Travels								
Aitken Spence Hotel Holdings Limited	**956,279**	**52,385**		**65,027**	956,279	52,385		43,033
Mahaweli Reach Hotels Limited	**0**	**0**		**0**	1,477,704	7,389		14,777
Nuwara Eliya Hotels Company Limited	**1,078**	**50**		**377**	1,078	50		269
Pegasus Hotels of Ceylon Limited	**307,200**	**1,920**		**3,994**	307,200	1,920		2,688
Sigiriya Village Hotels Limited	**55,500**	**1,295**		**3,052**	55,500	1,295		1,720
Stafford Hotels Limited	**4,928,580**	**47,088**		**64,072**	5,383,180	51,432		34,991
The Lighthouse Hotel Limited	**1,892,145**	**18,921**		**64,333**	1,958,645	19,586		25,952
		121,659	**32.8**	**200,855**		134,057	31.1	123,430

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

** *Par Value Rs. 1 each.*

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

Quoted Ordinary Shares (contd.)

	31.03.2004				31.03.2003			
	Number of ordinary shares of Rs10 each	**Cost* Rs 000**	**% of total cost**	**Market value Rs 000**	Number of ordinary shares of Rs10 each	Cost* Rs 000	% of total cost	Market value Rs 000
Information Technology								
E-Channelling Limited	**666,600**	**6,666**	**1.8**	4,666	666,600	9,999	2.3	7,666
Investment Trusts								
Ceylon Guardian Investment Trust Limited	**10,363**	**331**		**3,021**	7,403	212		925
Ceylon Investment Company Limited	**21,780**	**639**		**3,490**	14,002	405		1,092
		970	**0.3**	**6,511**		617	0.2	2,017
Land & Property								
C T Land Development Limited	**39,195**	**312**	**0.1**	**265**	39,195	312	0.1	255
Manufacturing								
ACL Cables Limited	**133,437**	**4,832**		**4,370**	133,437	4,832		4,804
Caltex Lubricants Lanka Limited	**205,600**	**13,289**		**15,677**	47,000	3,702		4,865
Ceylon Grain Elevators Limited	**48,997**	**1,297**		**955**	63,997	1,694		1,024
Ceylon Oxygen Limited	**15,276**	**1,342**		**1,455**	15,276	1,342		1,461
Lanka Aluminium Industries Limited	**1,106,000**	**11,060**		**15,484**	1,106,000	11,060		9,954
Lanka Ceramic Limited	**208,900**	**5,223**		**3,499**	208,900	5,223		3,604
Lanka Tiles Limited	**157,280**	**5,130**		**6,291**	157,280	5,130		5,663
Metal Packaging Limited	**394,997**	**9,900**		**15,800**	394,997	9,900		10,665
Parquet (Ceylon) Limited	**0**	**0**		**0**	170,209	383		511
Royal Ceramics Lanka Limited	**0**	**0**		**0**	279,000	5,606		4,185
Samson International Limited	**110,619**	**3,830**		**3,346**	110,619	3,830		1,991
		55,903	**15.1**	**66,877**		52,702	12.2	48,727
Motors								
Associated Motorways Limited	**65,776**	**1,519**	**0.4**	**5,525**	403,776	9,326	2.2	20,189
Plantations								
Agalawatte Plantations Limited	**35,000**	**350**		**411**	35,000	350		403
Kegalle Plantations Limited	**100,000**	**1,000**		**1,325**	100,000	1,000		1,050
Metropolitan Resource Holdings Limited	**0**	**0**		**0**	1,862,319	18,623		26,072
		1,350	**0.4**	**1,736**		19,973	4.6	27,525
Telecommunications								
Sri Lanka Telecom Limited	**3,137,500**	**47,084**	**12.7**	**58,044**	6,766,600	101,546	23.5	81,199
Total quoted shares - Bank		**370,092**	**100.0**	**511,711**		431,310	100.0	406,216
Investment in quoted shares by subsidiaries		**39,687**		**41,375**		20,849		21,082
Total quoted shares - Group		**409,779**		**553,086**		452,159		427,298

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

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

21.4.1 Investment in Quoted Ordinary Shares by Subsidiaries

	31.03.2004				31.03.2003			
	Number of ordinary shares of Rs10 each	Cost* Rs 000	% of total cost	Market value Rs 000	Number of ordinary shares of Rs10 each	Cost* Rs 000	% of total cost	Market value Rs 000
Banks, Finance & Insurance								
Asian Alliance Insurance Company Limited	403,850	4,039		3,938	403,850	4,039		4,341
Central Finance Limited	4	0		1	0	0		0
		4,039	10.2	3,939		4,039	19.4	4,341
Manufacturing								
Blue Diamond Jewellery Worldwide Limited	0	0		0	22,075	229		44
Caltex Lubricants Lanka Limited	113,400	8,935		8,647	0	0		0
Dankotuwa Porcelain Limited	0	0		0	1,201,300	14,581		15,617
Metal Packaging Limited	39,800	1,990		1,592	40,000	2,000		1,080
		10,925	27.5	10,239		16,810	80.6	16,741
Diversified Holdings								
Hemas Holdings Limited	210,800	15,554		18,603	0	0		0
Heyleys Limited	69,989	9,125		8,136	0	0		0
John Keells Holdings Limited	4,125	44		458	0	0		0
		24,723	62.3	27,197		0	0.0	0
		39,687	100.0	41,375		20,849	100.0	21,082

21.5 Unquoted Ordinary Shares

	31.03.2004				31.03.2003			
	Number of shares of Rs10 each	Cost* Rs 000	% of total cost	Directors' valuation Rs 000	Number of shares of Rs10 each	Cost* Rs 000	% of total cost	Directors' valuation Rs 000
Asiri Medical Services Limited	500,000	5,000	4.9	5,000	500,000	5,000	4.7	5,000
Associated Battery Manufacturers (Ceylon) Limited	792,000	100	0.1	14,454	792,000	100	0.1	20,323
Beico Link Carbons (Pvt) Limited	328,500	2,190	2.2	2,339	219,000	2,190	2.1	2,190
Browns Dimo Industrial Products (Pvt) Limited	150,000	1,500	1.5	1,500	150,000	1,500	1.4	1,500
Ceylinco Developers Limited	250,000	2,500	2.5	10,855	250,000	2,500	2.4	4,560
Coca-Cola Beverages Sri Lanka Limited	0	0	0.0	0	90	1	0.0	3
Credit Information Bureau of Sri Lanka**	8,884	888	0.9	888	8,884	888	0.8	888
Cyprea Lanka (Pvt) Limited	1,500,000	15,000	14.8	15,000	1,500,000	15,000	14.2	15,000
Fitch Ratings Lanka Limited	62,500	625	0.6	625	62,500	625	0.6	625
Hydrotech Lanka (Dickoya) Pvt Limited	1,834,500	4,500	4.5	4,500	1,834,500	4,500	4.2	4,500
Impressions (Pvt) Limited	333,333	6,667	6.6	13,727	333,333	6,667	6.3	6,667
Link Development (Pvt) Limited	75,000	750	0.7	750	75,000	750	0.7	750
Link Natural Products (Pvt) Limited	425,000	1,350	1.3	10,625	500,000	3,969	3.8	10,655
Nedlanka Ceylon Limited	0	0	0.0	0	133,500	890	0.8	1,954
Plastipak Lanka Limited	240,000	2,400	2.4	3,060	240,000	2,400	2.3	1,982
Ranweli Resorts Limited	1,616,193	10,748	10.6	8,857	1,616,193	10,748	10.2	8,727
Sampath Centre Limited	1,000,000	10,000	9.9	11,900	1,000,000	10,000	9.5	10,000
Samson Reclaim Rubbers (Pvt) Limited	116,700	2,334	2.3	2,334	116,700	2,334	2.2	2,334
Sinwa Holdings Limited	460,000	9,200	9.1	9,200	460,000	9,200	8.7	9,080
Tan Lanka Limited	0	0	0.0	0	198,980	1,092	1.0	1,753
The Video Team (Pvt) Limited	30,000	300	0.3	316	30,000	300	0.3	495
Wayamba Plantation (Pvt) Limited	2,750,000	25,000	24.8	25,000	2,750,000	25,000	23.7	25,000
Total unquoted ordinary shares - Bank		101,052	100.0	140,930		105,654	100.0	133,986
Investments in unquoted ordinary shares by subsidiaries		80,360				92,392		
Total unquoted ordinary shares - Group		181,412				198,046		

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

** *Par value Rs100 each.*

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

21.5.1 Investments in Unquoted Ordinary Shares by Subsidiaries

	31.03.2004			31.03.2003		
	Number of shares of Rs10 each	Cost* Rs 000	% of total cost	Number of shares of Rs10 each	Cost* Rs 000	% of total cost
Asia Soft (Pvt) Limited	**500,000**	**7,500**	**9.3**	500,000	7,500	8.1
Cabland Lanka Limited	**500,000**	**5,000**	**6.2**	500,000	5,000	5.4
Compak Morison (Lanka) Limited	**8,000**	**80**	**0.1**	8,000	80	0.1
Credit Information Bureau of Sri Lanka**	**300**	**30**	**0.0**	0	0	0.0
Durdans Heart Surgical (Pvt) Limited	**3,000,000**	**29,250**	**36.4**	3,000,000	29,250	31.7
Gas Auto Lanka Limited	**0**	**0**	**0.0**	765,723	3,829	4.1
Koolair Ventures (Pvt) Limited	**648,500**	**4,000**	**5.0**	648,500	4,000	4.4
Lankaclear (Pvt) Limited	**100,000**	**1,000**	**1.3**	0	0	0.0
Lanka Fastners (Pvt) Limited	**100,000**	**1,000**	**1.3**	100,000	1,000	1.1
Lanka Internet Services Limited	**0**	**0**	**0.0**	2,045,000	20,450	22.1
Samson Reclaim Rubbers Limited	**100,000**	**2,500**	**3.1**	100,000	2,500	2.7
Samson Rajarata Tiles Limited	**3,000,000**	**30,000**	**37.4**	1,000,000	10,000	10.8
Spade Ceramics (Pvt) Limited	**840,000**	**0**	**0.0**	840,000	8,400	9.1
Surakum Limited	**38,320**	**0**	**0.0**	38,320	383	0.4
		80,360	**100.0**		92,392	100.0

21.6 Quoted Redeemable Cumulative Preference Shares

Commercial Bank of Ceylon Limited - 13%	**5,000,000**	**50,000**	50.0	5,000,000	50,000	100.0
Commercial Bank of Ceylon Limited - 11.25%	**5,000,000**	**50,000**	50.0	0	0	0.0
		100,000	**100.0**		50,000	100.0
Investments in quoted preference shares - Bank		**100,000**			50,000	

Market value of quoted preference shares - Bank Rs 108.75m

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

** *Par value Rs100 each.*

21.7 Unquoted Preference Shares

21.7.1 Unquoted Redeemable Cumulative Preference Shares

	31.03.2004			31.03.2003		
	Number of shares of Rs10 each	**Cost* Rs 000**	**% of total cost**	Number of shares of Rs10 each	Cost* Rs 000	% of total cost
Carson Cumberbatch & Company Limited	**17,500,000**	**175,000**	**23.3**	17,500,000	175,000	24.9
Ceylinco Developers Limited	**0**	**0**	**0.0**	1,000,000	7,500	1.1
Heladanavi (Pvt) Limited	**20,000,000**	**200,000**	**26.7**	0	0	0.0
Lakdhanavi (Pvt) Limited	**0**	**0**	**0.0**	600,000	6,000	0.9
Plastipak Lanka Limited	**1,000,000**	**10,000**	**1.3**	1,000,000	10,000	1.4
Holcim Lanka Limited (previously Puttalam Cement Limited)**	**2,500**	**250,000**	**33.4**	3,750	375,000	53.3
Sampath Centre Limited	**7,500,000**	**75,000**	**10.0**	7,500,000	75,000	10.7
Volanka Limited	**4,000,000**	**40,000**	**5.3**	5,000,000	50,000	7.1
Wayamba Polymers (Pvt) Limited	**0**	**0**	**0.0**	450,000	4,500	0.6
		750,000	**100.0**		703,000	100.0

21.7.2 Unquoted Irredeemable Preference Shares

Arpico Finance Company Limited	**50,000**	**500**		50,000	500	
Total investments in unquoted preference shares - Bank		**750,500**			703,500	
Investments in unquoted preference shares by subsidiaries		**148,550**			84,050	
Total investments in unquoted preference shares - Group		**899,050**			787,550	

21.7.3 Investments in Unquoted Preference Shares by Subsidiaries

Ceyquartz MBI (Pvt) Limited	**2,500,000**	**25,000**	**16.8**	2,500,000	25,000	29.7
Coco Lands Limited	**1,875,000**	**18,750**	**12.6**	1,875,000	18,750	22.3
E Services Limited	**2,500,000**	**25,000**	**16.8**	1,250,000	12,500	14.9
Lanka Fastners (Pvt) Limited	**1,700,000**	**17,000**	**11.5**	1,700,000	17,000	20.2
Nividhu (Pvt) Limited	**3,280,000**	**32,800**	**22.1**	1,080,000	10,800	12.9
Royal Fernwood Porcelain Limited	**2,500,000**	**30,000**	**20.2**	0	0	0.0
		148,550	**100.0**		84,050	100.0

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

** *Par value of Rs100,000 each.*

21.8 Quoted Debentures

	31.03.2004 Cost* Rs 000	31.03.2004 % of total cost	31.03.2003 Cost* Rs 000	31.03.2003 % of total cost
Commercial Bank of Ceylon Limited - 13.5%	**0**	**0.0**	8,000	3.4
Eagle Insurance Company Limited - 15.35%	**0**	**0.0**	104,927	44.2
Hatton National Bank Limited - 13.5%	**0**	**0.0**	5,000	2.1
Mercantile Leasing Limited - 14%	**0**	**0.0**	6,000	2.5
Sampath Bank Limited - 13.5%	**10,000**	**8.8**	10,000	4.2
Seylan Bank Limited - 13.35%	**5,000**	**4.4**	5,000	2.1
Suntel Limited - 22%	**98,470**	**86.8**	98,483	41.5
Total quoted debentures - Bank	**113,470**	**100.0**	237,410	100.0

Market value of quoted debentures - Bank Rs125.6m

Investments in quoted debentures by subsidiaries	**36,781**	20,062
Total investments in quoted debentures - Group	**150,251**	257,472

Market value of quoted debentures - Group Rs167.0m

21.8.1 Investment in Quoted Debentures by Subsidiaries

Hatton National Bank Limited - 13.75%	**7,500**	**20.4**	7,500	37.4
Hatton National Bank Limited - 12% (2002/7)	**6,000**	**16.3**	6,000	29.9
Sri Lanka Telecom Limited - 14.5%	**3,281**	**8.9**	6,562	32.7
Commercial Bank of Ceylon Limited - 9.39%	**20,000**	**54.4**	0	0
	36,781	**100.0**	20,062	100.0

Market value Rs41.4m

21.9 Unquoted Debentures

Ocean View Limited	**2,260**	**99.7**	2,260	99.6
Riverina Hotels Limited	**6**	**0.3**	8	0.4
Total investments in unquoted debentures - Bank	**2,266**	**100.0**	2,268	100.0
Investments in unquoted debentures by subsidiaries	**216,396**		260,514	
Total investments in unquoted debentures - Group	**218,662**		262,782	

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

21.9.1 Investments in Unquoted Debentures by Subsidiaries

	31.03.2004		31.03.2003	
	Cost *	**% of total**	Cost *	% of total
	Rs 000	**cost**	Rs 000	cost
Alutec Extrusions (Pvt) Limited	**28,125**	**13.0**	30,000	11.5
Asia Soft (Pvt) Limited	**0**	**0.0**	11,750	4.5
Asiri Hospitals Limited	**50,000**	**23.1**	50,000	19.2
Cabland Lanka Limited	**2,000**	**0.9**	2,000	0.8
Ceylon Hospitals Limited	**8,821**	**4.1**	10,964	4.2
Coco Lands Limited	**20,000**	**9.2**	0	0.0
Gas Auto Lanka Limited	**14,450**	**6.7**	23,800	9.2
Hatton National Bank Limited	**10,000**	**4.6**	0	0.0
Koolair Ventures Power (Pvt) Limited	**30,000**	**13.9**	30,000	11.5
Lanka Transformers Limited	**18,000**	**8.3**	24,000	9.2
Link Natural Products (Pvt) Limited	**35,000**	**16.2**	35,000	13.4
Surakum Limited	**0**	**0.0**	43,000	16.5
	216,396	**100.0**	260,514	100.0

21.10 Investments in Unit Trusts

	31.03.2004				31.03.2003			
	Number of units	**Cost**	**% of total**	**Market value**	Number of units	Cost	% of total	Market value
		Rs 000	**cost**	**Rs 000**		Rs 000	cost	Rs 000
NAMAL Growth Fund	**6,193,050**	**61,500**	**22.9**	**102,990**	6,193,050	61,500	19.3	63,912
NAMAL Income Fund	**10,721,154**	**107,500**	**40.0**	**109,785**	10,721,154	107,500	33.8	110,857
National Equity Fund	**9,380,540**	**99,679**	**37.1**	**111,347**	14,027,381	149,057	46.9	132,278
Total investments in unit trusts by Bank		**268,679**	**100.0**	**324,122**		318,057	100.0	307,047
Investments in unit trusts by subsidiaries		**58,889**		**59,784**		8,889		8,272
Total investments in unit trusts by Group		**327,568**		**383,906**		326,946		315,319

21.10.1 Investments in Unit Trusts by Subsidiaries

NAMAL Income Fund	**4,873,740**	**50,000**	**84.9**	**49,371**	0	0	0.0	0
National Equity Fund	**877,250**	**8,889**	**15.1**	**10,413**	877,250	8,889	100.0	8,272
		58,889	**100.0**	**59,784**		8,889	100.0	8,272

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

22 Investment in Associate Company

	Bank		Group	
	31.03.2004	31.03.2003	**31.03.2004**	31.03.2003
	Rs 000	Rs 000	**Rs 000**	Rs 000
As previously stated	**1,810,356**	1,564,897	**1,810,356**	1,564,897
Post acquisition reserve	**0**	7,266	**0**	7,266
Restated	**1,810,356**	1,572,163	**1,810,356**	1,572,163
Share of profit after tax	**171,089**	250,389	**171,089**	250,389
Less: Goodwill written off in this financial year	**1,161**	11,873	**1,161**	11,873
Losses not recognised in the Income Statement	**(2,161)**	(323)	**(2,161)**	(323)
Subscription for rights issue*	**541,937**	0	**541,937**	0
Share of net assets and unamortised goodwill on 31 March 2004	**2,520,060**	1,810,356	**2,520,060**	1,810,356
Market value	**3,048,399**	2,226,578	**3,048,399**	2,226,578

** Includes goodwill of Rs.11,605,603.*

Bank owns approximately 28% of both voting and non-voting ordinary shares in Commercial Bank of Ceylon Limited. Percentage of voting shares owned by DFCC Bank is 29.8%.

23 Investments in Subsidiary Companies

	DFCC Stock Brokers (Pvt) Limited Ownership 100% subsidiary Rs 000	DFCC Vardhana Bank Limited Ownership 94% subsidiary Rs 000	Lanka Industrial Estates Limited Ownership 50% subsidiary Rs 000	Lanka Ventures Limited Ownership 59% subsidiary Rs 000	National Asset Management Limited Ownership 80% subsidiary Rs 000	Bank 31.03.2004 Rs 000	Bank 31.03.2003 Rs 000
Balance as at 31 March	29,280	0	317,544	427,705	77,893	**852,422**	779,023
Share of profit/(loss) after tax	23,558	(45,179)	9,260	54,629	(5,851)	**36,417**	24,992
Gains & losses not recognised in the income statement	0	0	0	0	0	**0**	32,371
Investment in rights issue	0	450,004	0	0	0	**450,004**	0
Net Assets on initial acquisition	0	(202,860)	0	0	0	**(202,860)**	0
Goodwill on initial acquisition	0	262,486	0	0	0	**262,486**	0
Net assets on additional acquisition	0	11,042	0	0	23,649	**34,691**	0
Goodwill on additional acquisition	0	20,195	0	0	351	**20,546**	0
Purchase of additional shares	0	0	0	0	0	0	15,000
Negative goodwill on acquisition	0	0	0	0	0	**0**	1,704
Less: Goodwill written off in this financial year	668	23,220	0	0	23	**23,911**	668
Share of net assets and unamortised goodwill on 31 March 2004	**52,170**	**472,468**	**326,804**	**482,334**	**96,019**	**1,429,795**	852,422
Market value of quoted investments				**305,757**			

On 1st August 2003 DFCC Bank acquired 90% holding in National Mercantile Bank Limited subsequently renamed as DFCC Vardhana Bank Limited. A further investment was made on 28 August 2003 to increase the holding to 94%.

Bank owns approximately 50% of the ordinary shares in Lanka Industrial Estates Limited, comprising 49% direct ownership and a 1% indirect ownership via Lanka Ventures limited.

Bank owns approximately 59% of the ordinary shares in Lanka Ventures Limited, comprising a 58% direct ownership and a 1% indirect ownership via National Asset Management Limited.

On 28 November 2003 DFCC Bank's ownership in ordinary shares of National Assest Management Limited was increased from 60% to 80%.

Bank owns 100% of the ordinary shares of DFCC Stock Brokers (Pvt) Limited.

Investment in associate and subsidiary companies are accounted under equity method. If equity method of accounting was not adopted the carrying value of the investment in associate company would be decreased by Rs971 million and the carrying value of the subsidiary companies would be decreased by Rs465 million with the corresponding reduction in reserves and retained profits.

Reconciliation		Associate Rs million	Subsidiaries Rs million
Increase in profit after tax	- current year	167	18
	- Prior year, Note 40.4	(106)	189
Increase in share premium	Note 40.2	0	52
Increase in revenue reserves	Note 40.3	990	200
Unamortised negative goodwill arising from acquisition - Note 38		0	6
Total increase matched by corresponding increase in investment in associate and subsidiary companies		1,051	465
Reversal of goodwill charged to DFCC Bank's retained profits		80	0
		971	465

	Bank		Group	
	31.03.2004 Rs 000	31.03.2003 Rs 000	**31.03.2004 Rs 000**	31.03.2003 Rs 000

24 Group Balances Receivable

DFCC Stock Brokers (Pvt) Limited	**1,366**	913	**0**	0
DFCC Vardhana Bank Limited	**2,001**	0	**0**	0
Lanka Industrial Estates Limited	**14,090**	14,269	**0**	0
National Asset Management Limited	**1,558**	784	**0**	0
	19,015	15,966	**0**	0

25 Other Receivable

Refundable deposits and advances	**12,079**	14,836	**30,080**	26,254
Dividend receivable	**19,818**	64,448	**21,457**	64,448
Exchange loss receivable from Government of Sri Lanka	**319,285**	255,388	**319,285**	314,768
Debtors	**188,619**	180,406	**267,917**	180,406
	539,801	515,078	**638,739**	585,876

26 Income Tax Refund due

Income tax overpayment	**0**	36,482	**4,188**	41,957

27 Investment Properties

27.1 Composition

Balance as at 31 March	**187,199**	187,199	**715,037**	638,846
Additions during the year	**0**	0	**17,406**	8,109
Transferred from fixed assets	**0**	0	**0**	3,597
Disposals during the year	**175,019**	0	**190,665**	0
	12,180	187,199	**541,778**	650,552
Surplus on revaluation	**0**	0	**0**	64,485
	12,180	187,199	**541,778**	715,037

28 Goodwill on Consolidation

Balance as at 31 March			**2,058**	2,726
Arising on consolidation			**283,032**	0
Less: Goodwill written off			**23,911**	668
			261,179	2,058

29 Property and Equipment

29.1 Composition: Bank

	Land & building 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 as at 31.03.2003	244,719	283,882	33,244	99,738	3,689	665,272
Additions for the year	*6,601	192,903	2,923	9,843	0	212,270
Less: Disposals during the year	0	0	531	12,341	0	12,872
Cost as at 31.03.2004	251,320	476,785	35,636	97,240	3,689	864,670
Accumulated depreciation as at 31.03.2003	67,387	131,826	27,002	59,174	1,476	286,865
Charge for the year	8,994	44,257	2,858	15,215	738	72,062
Less:accumulated depreciation on disposal	0	0	531	10,188	0	10,719
Accumulated depreciation as at 31.03.2004	76,381	176,083	29,329	64,201	2,214	348,208
Net book value as at 31.03.2004	**174,939**	**300,702**	**6,307**	**33,039**	**1,475**	**516,462**
Net book value as at 31.03.2003	177,332	152,056	6,242	40,564	2,213	378,407

** Includes improvement to building.*

*** Office equipment includes the cost of software.*

29.1.1 Operating lease

	Rs 000
Cost as at 31 March 2004	23,593
Less: Accumulated depreciation as at 31 March 2004	21,838
Net book value as at 31 March 2004	1,755

Includes motor vehicles under operating lease disclosed as owned motor vehicles.

29.1.2 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	53,052	39,317	13,735
5, Deva Veediya, Kandy	4,600	12.54	12,699	2,751	9,948
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	175,690	34,313	141,377
4A, 4th Cross Lane, Borupana, Ratmalana	0	20	2,600	0	2,600
			251,320	76,381	174,939

Market value of properties

	Rs million	Date of valuation
73/5, Galle Road, Colombo 3	280	24.10.2000
5, Deva Veediya, Kandy	23	31.12.2000

Valued by Mr P B Kalugalagedera - Chartered Valuer

29.2 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 as at 31.03.2003	299,519	42,951	323,822	43,005	112,379	3,689	825,365
Add: DFCC Vardhana Bank Limited	0	0	214,562	28,809	0	0	243,371
Additions for the year	*6,635	0	201,652	5,004	12,018	0	225,309
Less: Disposals during the year	0	0	43	925	12,626	0	13,594
Cost as at 31.03.2004	306,154	42,951	739,993	75,893	111,771	3,689	1,280,451
Accumulated depreciation as at 31.03.2003	81,842	34,196	163,336	34,931	68,688	1,476	384,469
Add: DFCC Vardhana Bank Limited	0	0	106,543	16,870	0	0	123,413
Charge for the year	9,176	4,741	70,421	5,808	16,036	738	106,920
Less: Accumulated depreciation on disposals	0	0	31	666	10,245	0	10,942
Accumulated depreciation as at 31.03.2004	91,018	38,937	340,269	56,943	74,479	2,214	603,860
Net book value as at 31.03.2004	**215,136**	**4,014**	**399,724**	**18,950**	**37,292**	**1,475**	**676,591**
Net book value as at 31.03.2003	217,677	8,755	160,486	8,074	43,691	2,213	440,896

** Includes improvement to building.*

*** Office equipment includes the cost of software.*

	Bank		Group	
	31.03.2004 Rs 000	31.03.2003 Rs 000	**31.03.2004 Rs 000**	31.03.2003 Rs 000

30 Deposits

Demand deposits	**0**	0	**218,206**	0
Savings deposits	**0**	0	**50,975**	0
Fixed deposits	**4,717,388**	2,617,740	**5,220,971**	2,617,740
Certificates of deposits	**226,273**	249,925	**231,836**	249,925
Others	**0**	0	**2,496**	0
	4,943,661	2,867,665	**5,724,484**	2,867,665
Analysis				
Deposits from Banks	**228,000**	0	**404,191**	0
Deposits from non-bank customers	**4,715,661**	2,867,665	**5,236,307**	2,867,665
Deposits from finance companies	**0**	0	**83,986**	0

31 Borrowing - Medium and Long-Term

31.1 Borrowing

Government of Sri Lanka loans under foreign credit lines:				
Government of Sri Lanka/IDA loans	**874,768**	1,079,627	**874,768**	1,079,627
Government of Sri Lanka/ADB loans	**3,099,224**	1,955,783	**3,099,224**	1,955,783
Government of Sri Lanka/KFW loans	**2,123,055**	2,489,299	**2,123,055**	2,489,299
Government of Sri Lanka/GOI loans	**16,689**	18,448	**16,689**	18,448
European Investment Bank (EIB)	**1,178,605**	0	**1,178,605**	0
Refinance borrowing:				
Central Bank of Sri Lanka refinance loans (secured)	**2,228,415**	2,219,340	**2,228,415**	2,219,340
Government of Sri Lanka/IDA and ADB refinance of SMI loans	**1,058,460**	1,126,652	**1,058,460**	1,126,652
Government of Sri Lanka/JBIC refinance	**1,212,462**	1,195,872	**1,212,462**	1,195,872
Government of Sri Lanka/KFW refinance	**17,770**	32,734	**17,770**	32,734
Direct foreign borrowings:				
Direct loans	**879,376**	1,164,085	**879,376**	1,164,085
Floating rate notes	**4,339,732**	4,339,732	**4,339,732**	4,339,732
Others	**2,541,252**	536,830	**2,541,252**	536,830
	19,569,808	16,158,402	**19,569,808**	16,158,402
Liabilities denominated in foreign currency:				
- US Dollars (US$)	**77,609**	72,949	**77,609**	72,949
- Euro Dollars (EUR)	**8,136**	11,249	**8,136**	11,249
- Japanese Yen (JPY)	**605,875**	605,875	**605,875**	605,875

31.2 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 2004.

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.

31.3 Assets pledged as security

Nature	Amount Rs 000
Assignment in terms of Section 88A of the Monetary Law of loans refinanced by Central Bank	2,228,415

Acronyms:

ADB	-	Asian Development Bank
GOI	-	Government of India
IDA	-	International Development Association
JBIC	-	Japan Bank for International Cooperation Fund
KFW	-	Kreditanstalt fur Wiederaufbau
SMI	-	Small and Medium Industries

	Bank		Group	
	31.03.2004 Rs 000	31.03.2003 Rs 000	**31.03.2004 Rs 000**	31.03.2003 Rs 000
32 Borrowing - Short-Term				
Borrowing under repurchase agreements	**95,016**	57,154	***532,882**	59,295
Bank overdrafts	**132,150**	415,557	**137,179**	417,612
Interbank borrowing	**350,000**	670,000	**402,235**	670,000
	577,166	1,142,711	**1,072,296**	1,146,907

** Includes Rs416 million borrowing by DFCC Vardhana Bank Limited from DFCC Bank.*

33 Debentures

Unsecured debentures have been issued to corporate institutions and provident funds. These debentures have been issued in the ordinary course of business of the Bank to supplement other financial resources. The debentures were fully redeemed during the financial year.

34 Obligation under Finance Leases

	Bank 31.03.2004	Bank 31.03.2003	Group 31.03.2004	Group 31.03.2003
Total minimum lease payments outstanding	**3,718**	5,157	**3,718**	5,157
Less: Interest on lease payments	**951**	1,813	**951**	1,813
Present value	**2,767**	3,344	**2,767**	**3,344**

Maturity profile of total minimum lease payments

Up to 1 year	**1,439**
1 to 5 years	**2,279**
	3,718

Maturity profile of present value

Up to 1 year	**853**
1 to 5 years	**1,914**
	2,767

The monthly lease payments are fixed for 5 years, the duration of the contract. The contract does not have any restrictive covenant on dividend declaration, additional borrowing or leasing by the Bank and includes a purchase option in favour of the Bank.

35 Taxation

	Bank 31.03.2004	Bank 31.03.2003	Group 31.03.2004	Group 31.03.2003
Balance before set-off of notional credit	**113,883**	0	**131,933**	9,956
Less: Notional credit (Note 2)	**61,062**	0	**61,062**	0
Balance on 31 March	**52,821**	0	**70,871**	9,956
Payable within one year from balance sheet date				

Notional credit for withholding tax on treasury bills & bonds

The Inland Revenue (amendment) bill passed by the Parliament on January 21, 2004 (pending certification), provides that a company which derives interest income from the secondary market transactions in Government Securities (on or after April 1, 2002) would be entitled to a notional credit (being one ninth of the net interest income) provided such interest income forms part of statutory income of the Company.

	Bank		Group	
	31.03.2004	31.03.2003	**31.03.2004**	31.03.2003
	Rs 000	Rs 000	**Rs 000**	Rs 000
36 Deferred Taxation				
Balance on 31 March	**347,377**	291,887	**347,867**	292,495
Increase in provision	**122,947**	55,490	**123,207**	55,372
	470,324	347,377	**471,074**	347,867
37 Other Liabilities				
37.1 Accruals	**78,114**	38,538	**100,925**	44,488
Unclaimed dividends	**7,153**	6,057	**7,825**	6,314
Security deposit for leases	**21,181**	26,624	**54,582**	56,554
Provision	**76,611**	50,581	**85,325**	53,777
Account payables	**166,775**	149,696	**259,898**	197,202
	349,834	271,496	**508,555**	358,335
37.2 Movement in provision				
Balance on 31 March	**50,581**		**53,777**	
Add: Provision for the year	**76,611**		**82,129**	
Less: Payments	**48,581**		**48,581**	
Transferred to loan provision	**2,000**		**2,000**	
	76,611		***85,325**	

** Includes gratuity provision of Rs8.7m (Rs3.2m) of subsidiaries.*

38 Negative Goodwill				
Balance on 31 March	**10,870**	22,731	**10,870**	22,731
Profit on acquisition of subsidiary	**0**	1,704	**0**	1,704
	10,870	24,435	**10,870**	24,435
Less: Negative goodwill recognised as income	**5,053**	13,565	**5,053**	13,565
	5,817	10,870	**5,817**	10,870
39 Share Capital				
39.1 Authorised share capital				
500,000,000 ordinary shares of Rs10/- each	**5,000,000**	5,000,000	**5,000,000**	5,000,000
Issued share capital				
57,145,823 ordinary shares of Rs10/- each	**571,458**	423,111	**571,458**	423,111
Alloted and fully paid:				
Balance on 31 March 2003, 42,311,111 ordinary shares	**423,111**	423,111	**423,111**	423,111
Bonus share issue in February 2004, 1 for every 3 held, 14,286,456 ordinary shares	**142,865**	0	**142,865**	0
Issue under share option - 548,256 ordinary shares	**5,482**	0	**5,482**	0
	571,458	423,111	**571,458**	423,111

Ordinary shares held by associate on 31 March 2004
Commercial Bank of Ceylon Limited - 3,368,359

39.2 Employee Share Option Plan

39.2.1 Scope and excercise price

Shareholder approval date	-	28 June 2002		
Amendment to clarify adjustment for theoretical dilution in price from Bonus/Rights issue				
Shareholder approval date	-	12 February 2004		
Total options approved	-	4.5% of the ordinary shares in issue at any given time, over a period of 5 years commencing on 31 March 2002.		
Maximum allocation per year	-	1.5% of the ordinary shares in issue as at the end of that financial year excluding any fractional amount.		

	31.03.2004	31.03.2003	31.03.2002
Grant date	**31.03.2004**	31.03.2003	31.03.2002
Award date	*	1 July 2003	20 July 2002
Option exercise dates	**	1 July 2004 to 30 June 2008	20 July 2003 to 19 July 2007
Exercise price			
- Pre-bonus issue	–	Rs135.51	Rs155.60
- Post-bonus issue	**Rs211.55**	Rs101.63***	Rs116.70***

* *Not yet awarded. To be awarded on or before 28 July 2004.*

** *After one year and within 5 years from the date of award*

*** *Adjusted for the theoretical dilution arising from the bonus issue of shares to the shareholders approved by the shareholders on 12 February 2004.*

39.2.2 Movement in options granted

Grant date	**31.03.2004**	31.03.2003	31.03.2002
Options granted, number	**857,187** *	634,628	634,631
Options lapsed, number	**Nil**	(28,207)	Nil
Options exercised, number Pre-bonus share issue period (01.04.2003 to 12.02.2004)	–	Nil	(548,256)
Options outstanding, number on 12.02.2004	–	606,421	86,375
Adjustment for theoretical dilution in price arising from bonus share issue on 12.02.2004	**Nil**	202,119	28,787
Options exercised number Post-bonus share issue period (13.02.2004 to 31.03.2004)	**Nil**	Nil	Nil
Options outstanding on 31 March 2004, number	**857,187** *	808,540	115,162

* *The number of options granted in respect of the financial year ended 31 March 2004, shall not exceed 857,187 and could be below due to exclusion of fractional entitlements. Consequently the options outstanding on 31 March 2004 in respect of financial year ended 31 March 2004 would be reduced by the exclusion of fractional entitlements when the award is made.*

40 Reserve - Bank/Group

40.1 Reconciliation of movement in reserves

	Reserve fund Rs 000	Sinking fund Rs 000	Share premium Rs 000	Revenue reserve* Rs 000	Profit & Loss Account Rs 000
Balance as at 31.03.2002	140,000	940,789	955,332	3,233,648	966,178
Consolidation adjustment				581,328	(581,328)
Restated	140,000	940,789	955,332	3,814,976	384,850
Retained profit for the year					1,131,189
First & final dividend approved on 28.06.2002					(211,556)
Transfers	45,000	484,528	0	75,000	(604,528)
Consolidation adjustment				206,294	(206,294)
Gains not recognised in the income statement				48,645	
Balance as at 31.03.2003	185,000	1,425,317	955,332	4,144,915	493,661
Retained profit for the year					1,292,813
Transfers	60,000	361,141		157,721	(578,862)
First & final dividend approved on 30.06.2003					(232,711)
Capitalisation - Bonus issue			(142,865)		
Issues of shares under employee share option plan			79,826		
Gains & not recognised in the income statement				41,562	
Balance as at 31.03.2004	**245,000**	**1,786,458**	**892,293**	**4,344,198**	**974,901**

* *Includes revaluation surplus of property of subsidiary company amounting to Rs180m.*

Reserve fund is a statutory reserve created as per direction issued by the Central Bank of Sri Lanka under Section 79(j)(I) of the Banking Act No. 30 of 1988 as amended by Banking (Amendment) Act No. 33 of 1995.

Computation of transfer

	Rs 000
Profit after tax of the Bank - Note 10	1,085,307
Exclusion - goodwill amortisation (net)	20,019
	1,105,326
Minimum amount to be transferred @ 5%	55,266

The sinking fund is for the purpose of repaying the principal amount of floating rate notes and loan of US$ 5m from Asian Development Bank. The amount in the fund is in accordance with the respective loan covenants.

	Bank		Group	
	31.03.2004 Rs 000	31.03.2003 Rs 000	**31.03.2004 Rs 000**	31.03.2003 Rs 000
40.2 Composition of share premium				
Bank	**840,100**	903,139	**840,100**	903,139
Share of the share premium of subsidiary companies				
Lanka Ventures Limited	**48,693**	48,693	**48,693**	48,693
National Asset Management Limited	**3,500**	3,500	**3,500**	3,500
	892,293	955,332	**892,293**	955,332
40.3 Composition of revenue reserves				
Bank	**3,153,278**	3,110,723	**3,153,278**	3,110,723
Commercial Bank of Ceylon Limited	**990,395**	833,667	**990,395**	833,667
Lanka Industrial Estates Limited	**200,320**	200,320	**200,320**	200,320
Lanka Ventures Limited	**205**	205	**205**	205
Associate/subsidiary companies	**1,190,920**	1,034,192	**1,190,920**	1,034,192
Total	**4,344,198**	4,144,915	**4,344,198**	4,144,915
40.4 Composition of retained profit				
First and final dividend proposed (Note 40.5)	**314,302**	232,711	**314,302**	232,711
Retained profit	**370,209**	23,546	**370,209**	23,546
Bank	**684,511**	256,257	**684,511**	256,257
Commercial Bank of Ceylon Limited	**60,555**	48,354	**60,555**	48,354
DFCC Stock Brokers (Pvt) Limited	**37,150**	14,261	**37,150**	14,261
DFCC Vardhana Bank Limited	**(45,179)**	–	**(45,179)**	–
Lanka Industrial Estates Limited	**48,205**	38,945	**48,205**	38,945
Lanka Ventures Limited	**191,270**	131,992	**191,270**	131,992
National Asset Management Limited	**(1,611)**	3,852	**(1,611)**	3,852
Associate/subsidiary companies	**290,390**	237,404	**290,390**	237,404
	974,901	493,661	**974,901**	493,661

	Bank		Group	
	31.03.2004	31.03.2003	**31.03.2004**	31.03.2003
	Rs 000	Rs 000	**Rs 000**	Rs 000
40.5 Dividend proposed				
Net dividend	**314,302**	232,711	**314,302**	232,711
Tax deducted at source*	**0**	0	**0**	0
Gross dividend - 55%	**314,302**	232,711	**314,302**	232,711
Dividend per share, Rs	**5.50**	5.50	**5.50**	5.50

** Nil as dividend proposed would be distributed utilising dividend recieved.*

41 Contingent Liabilities and Commitments

41.1 Contingent liabilities

	Bank 31.03.2004	Bank 31.03.2003	Group 31.03.2004	Group 31.03.2003
Guarantees issued to:				
DFCC Vardhana Bank Limited, in respect of the indebtedness of customers	**308,150**	–	**203,150**	–
Other banks in respect of indebtedness of customers of the Bank	**80,900**	107,950	**80,900**	107,950
Companies in respect of indebtedness of customers of the Bank	**136,270**	107,249	**136,270**	107,249
Principal collector of customs (duty guarantees)	**833**	481	**9,380**	481
Third parties as security for commercial paper issued by customers of the Bank	**751,152**	749,657	**815,093**	749,657
Unit holders in Namal Optima Fund*	**0**	0	**0**	0
Documentary credits	**0**	0	**586,993**	0
Bills for collection	**0**	0	**83,531**	0
41.2 Commitments in ordinary course of business				
Commitments for unutilised credit facilities	**5,633,379**	3,990,620	**5,926,779**	4,062,070
Capital expenditure approved by the Board of Directors:				
not contracted	**0**	12,663	**9,976**	12,663
Contracted	**0**	107,570	**0**	113,042
	6,910,684	5,076,190	**7,852,072**	5,153,112

** Redemption price of a unit on maturity with a minimum yield of 13% per annum.*

41.3 Consolidation Adjustments

Guarantees issued to DFCC Vardhana Bank Limited	**308,150**
Less : Customer loans outstanding on 31 December 2003 in DFCC Vardhana Bank Limited	**105,000**
	203,150

41.4 Litigation

41.4.1 Litigation against the Bank

Bank has appealed to the High Court to set aside the award made in favour of an ex-employee by the Labour Tribunal. No material losses are anticipated as a result of the above transactions.

42 Maturity Profile of Assets and Liabilities

42.1 Definition of maturity

42.1.1 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.

42.1.2 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.

42.2 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.

42.3 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	%
42.3.1 Bank											
Assets with contractual maturity											
(interest bearing assets)											
Treasury bills & other securities	2,266,605	1,111,628	49	863,269	38	291,708	13	–		–	
Securities purchased under resale agreements	26,006	26,006	100	–		–		–		–	
Placements with and loans to other banks and financial institutions	500,000	41,666	8	124,999	25	333,335	67	–		–	
Dealing securities	1,314	1,314		–		–		–		–	
Loans	21,502,234	2,662,657	12	3,757,527	17	8,030,267	37	4,582,891	21	2,468,892	13
Leases	3,567,320	359,458	10	927,559	26	1,992,063	56	288,240	8	–	
	27,863,479	4,202,729	15	5,673,354	20	10,647,373	38	4,871,131	17	2,468,892	10
Other assets											
(Non interest-bearing assets)											
Cash and short-term funds	408,137	408,137	100	–		–		–		–	
Interest receivable	204,137	204,137	100	–		–		–		–	
Investment securities											
Ordinary shares/Units	739,823	–		–		–		–		739,823	100
Preference shares	850,500	125,667	14	38,083	4	358,250	42	278,000	33	50,500	7
Debentures	113,476	–		–		113,476	100	–		–	
Investment in associate company	2,520,060	–		–		–		–		2,520,060	100
Investment in subsidiary	1,429,795	–		–		–		–		1,429,795	10
Group balances receivable	19,015	19,015	100	–		–		–		–	
Prepayments	145,474	7,250	5	21,750	15	58,000	40	58,000	40	474	
Other receivables	539,801	527,722	98	–		–		–		12,079	2
Investment property	12,180	–		–		–		–		12,180	100
Property and equipment	516,462	–		–		–		–		516,462	100
	7,498,861	1,291,928	17	59,833	2	529,726	7	336,000	4	5,281,373	70
Total Assets	35,362,339	5,494,657	15	5,733,187	16	11,177,099	32	5,207,131	15	7,750,266	22
Liabilities with contractual maturity											
(Interest bearing liabilities)											
Deposits from customers	4,943,661	1,784,131	36	2,479,800	50	423,762	8	255,968	6	–	
Medium and long-term	19,569,808	802,654	4	3,066,614	16	3,473,958	18	8,258,203	42	3,968,379	20
Short-term	577,166	577,166	100	–		–		–		–	
Obligation under finance leases	2,767	187	6	666	24	1,914	70	–		–	
	25,093,402	3,164,138	13	5,547,080	22	3,899,634	16	8,514,171	34	3,968,379	15
Other liabilities											
(Non-interest bearing liabilities)											
Interest accrued	575,833	575,833	100	–		–		–		–	
Taxation	52,821	52,821	100	–		–		–		–	
Deferred taxation	470,324	–		–		–		470,324	100	–	
Other liabilities	349,834	342,064	98	350		5,920	2	1,500		–	
	1,448,812	970,718	67	350	0	5,920	0	471,824	33	–	
Total Liabilities	26,542,214	4,134,856	16	5,547,430	21	3,895,554	15	8,985,995	33	3,968,379	15

	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	%
42.3.2 Group											
Assets with contractual maturity											
(interest bearing assets)											
Treasury bills & other securities	2,439,120	1,253,290	51	894,122	37	291,708	12	–		–	
Securities purchased											
under resale agreements	852,684	852,684	100	–		–		–		–	
Placement with and loans to other banks											
and Financial institutions	606,607	41,666	7	231,606	38	333,335	55	–		–	
Dealing securities	1,314	1,314	100	–		–		–		–	
Bills of exchange discounted	16,320	7,436	46	8,884	54	–		–		–	
Loans	22,138,006	3,143,582	14	3,797,956	17	8,094,602	37	4,607,596	21	2,494,270	11
Leases	3,567,320	359,458	10	927,559	26	1,992,063	56	288,240	8	–	
	29,621,371	5,659,430	19	5,860,127	20	10,711,708	36	4,895,836	17	2,494,270	8
Other assets											
(non-interest bearing assets)											
Cash and short-term funds	675,915	675,915	100	–		–		–		–	
Balances with Central Bank of Sri Lanka	50,309	50,309	100	–		–		–		–	
Interest receivable	184,977	184,977	100	–		–		–		–	
Investment securities											
Ordinary shares/units	903,823	3,281	0	–		–		–		900,542	100
Preference shares	981,450	125,667	13	38,083	4	358,250	36	408,950	42	50,500	5
Debentures	334,653	–	–	–		334,653	100	–		–	
Investment in associate company	2,520,060	–	–	–		–		–		2,520,060	100
Prepayments	145,474	7,250	5	21,750	15	58,000	40	58,000	40	474	0
Income tax refund due	4,188	1,062	25	3,126	75	–		–		–	
Other receivables	638,739	614,185	96	5,592	1	4,012	1	886	0	14,064	2
Investment property	541,778	–	–	–		–		–		541,778	100
Goodwill on consolidation	261,179	13,058	5	39,176	15	104,468	40	104,477	40		
Property and equipment	676,591		–	42		359		507		675,683	100
	7,919,136	1,675,704	21	107,769	1	859,742	11	572,820	7	4,703,101	60
Total Assets	37,540,507	7,335,134	20	5,967,896	16	11,571,450	30	5,468,656	14	7,197,371	20
Liabilities with contractual maturity											
(Interest bearing liabilities)											
Deposits from customers	5,724,484	2,136,530	37	2,905,102	50	426,884	7	255,968	6	–	
Medium and long-term	19,569,808	854,890	4	3,066,614	16	3,473,958	18	8,258,203	42	3,916,143	20
Short-term	1,072,296	1,072,296	100	–		–		–		–	
Obligation under finance leases	2,767	188	7	665	24	1,914	69	–		–	
	26,369,355	4,063,904	15	5,972,381	23	3,902,756	15	8,514,171	32	3,916,143	15
Other liabilities											
(Non-interest bearing liabilities)											
Interest accrued	587,085	587,085	100	–		–		–		–	
Taxation	70,871	70,871	100	–		–		–		–	
Deferred taxation	471,074	–		–				471,074	100	–	
Other liabilities	508,555	447,535	88	10,177	2	7,615	2	4,620	1	38,608	7
	1,637,585	1,105,491	68	10,177	1	7,615		475,694	29	38,608	2
Total Liabilities	28,006,940	5,169,395	18	5,982,558	22	391,371	14	8,989,865	32	3,954,751	14

43 Concentration of Assets and Liabilities

43.1 Concentration in the distribution of assets

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

43.1.2 Industrywise distribution of main assets are given below:

Industry sector	%
Agriculture, forestry and fishing	11.6
Mining and quarrying	0.7
Manufacture of food, beverages and tobacco	13.0
Manufacture of textiles	1.3
Manufacture of wearing apparel excluding footwear	4.0
Manufacture of leather and leather products including footwear	0.3
Wood and manufacture of wood products	1.1
Manufacture of paper products, printing, publishing and packaging	2.4
Manufacture of chemical and chemical products	1.0
Manufacture of rubber products	1.7
Manufacture of plastic products	2.6
Manufacture of non-metallic mineral products including pottery, china & glass	2.1
Basic metal production	0.8
Manufacture of fabricated metal products, machinery and equipment including electrical items, transport equipment & instruments	6.0
Electricity, gas and water industries	5.9
Construction industries	6.0
Trade	16.9
Hotels and restaurants	3.1
Transport, storage and communications	5.4
Financing, insurance, real estate and business services	9.8
Community, social and personal services	4.3
	100.0

Composition of assets	Rsm
Loans*	21,412
Lease	3,567
Investment securities	1,704
	27,183

* *Excluding staff loans*

43.2 Composition of liabilities is given in Note 31

44 Non-Performing Loans, Leases and Bills

	Loans Rs 000	Lease Capital Rs 000	Bills Capital Rs 000	31.03.2004 Total Rs 000	31.03.2003 Total Rs 000
Gross	2,323,179	297,660	17,582	2,638,421	2,935,525
Net of tangible securities and specific provisions	44,013	33,810	0	77,823	124,424

45 Directors' Interest in Contracts with the Bank and Related Party Transactions

45.1 Directors' interest in contracts

45.1.1 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.

M J C Amarasuriya	Commercial Bank of Ceylon Limited
	Serendib Flour Mills (Pvt) Limited
	Orient Motor Company Limited
A N Fonseka	Commercial Bank of Ceylon Limited*
	Associated Battery Manufacturers (Ceylon) Limited*
	National Asset Management Limited*
	Ceylon Hospitals Limited **
	Hemas Holdings Limited**
	Caltex Lubricants Lanka Limited**
T N Jinasena	DFCC Vardhana Bank Limited*
	Handrookanda (Pvt) Limited
	Loadstar (Pvt) Limited
M L Mack	Commercial Bank of Ceylon Limited*
	Acme Printing and Packaging Limited
M R Prelis	Nations Trust Bank Limited**

** Representing the Bank*
*** Only a shareholder*

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

45.1.2 Other contracts

The Bank has leased premises owned by the spouse of the Director/Chief Executive, Mr A N Fonseka. This is in discharge of a contractual obligation by the Bank to provide suitable accommodation for the Chief Executive and family. The annual lease contract was renewed on 1 April 2003 for a further period of one year at a rental of Rs80,000 per month.

The Bank paid Rs1,235,494 to Credit Information Bureau of Sri Lanka for services obtained in which Mr A N Fonseka and Mr S N P Palihena are Directors.

The Bank has entered into an agreement with Commercial Bank of Ceylon Limited to assist Bank's customers to open letters of credit, through Commercial Bank of Ceylon Limited. The Bank received an income of Rs1,470,000. Bank has provided indemnities to Commercial Bank of Ceylon Limited in respect of such letters of credit; the indemnity is however limited to the amount of facilities approved to Bank's customers net of partial disbursements against approved facilities.

In addition, the Bank has obtained an overdraft facility of Rs500m. The Bank paid Rs674,412 as interest. Mr M J C Amarasuriya, Mr A N Fonseka and Mr M L Mack are Directors of Commercial Bank of Ceylon Limited.

The Bank paid Rs1,426,535 as payments for consultancy services to Ernst & Young in which Mr G A E Gunatilleke is a Director.

The Bank paid Rs712,239 during the year to BOC Travels (Pvt) Limited in which Mr S N P Palihena is a Director.

The Bank paid Rs136,250 as annual listing fees to Colombo Stock Exchange in which Mr A N Fonseka and Mr R T Wijetilleke are Directors.

The Bank paid Rs100,000 as annual subscription fees to The Financial Ombudsman of Sri Lanka (Guarantee) Limited.

The Bank has obtained an overdraft facility of Rs 405m from DFCC Vardhana Bank Limited on which Rs2,730 has been paid as interest.

45.2 Related party transactions

45.2.1 The Bank carries out transactions in the ordinary course of business on an arm's length basis with companies in which a Director of the Bank singly or with the spouse, has substantial shareholding of 10% or more of the paid-up capital.

These companies, names of Directors and the nature of transactions entered into are listed below:

Party accommodated	Name of Director/position	Aggregate amount of accommodation Approved Rs m	Outstanding as at 31.03.2004 Rs m	Nature of transaction	Security
Jinasena Limited	T N Jinasena	50.00	20.83	Term loan	Immovable property
	Managing Director	3.00	1.79	Finance Lease	Lease assets
		53.00	22.62		
Handrookanda (Pvt) Limited	T N Jinasena Chairman	3.43	2.85	Finance Lease	Lease assets
		3.43	2.85		

45.2.2 The Bank carries out transactions in the ordinary course of its business on an arm's length basis with companies in which a Director of the Bank has a significant influence by representation on the Board of Directors without a substantial shareholding. These companies, names of Directors and nature of transactions are listed below:

Party accommodated	Name of Director/position	Aggregate amount of accommodation Approved Rs m	Outstanding as at 31.03.2004 Rs m	Nature of transaction	Security
Acme Printing and Packaging Limited	M L Mack	134.50	89.88	Term Loan	Immovable property
	Director	48.00	30.86	Term Loan	* Immovable property
		5.00	2.83	Term Loan	Movable property
		70.00	52.51	Revolving credit	Immovable property
		257.50	176.08		
Associated Battery Manufacturers (Ceylon) Limited	A N Fonseka Director	160.00	129.64	Term loan	Immovable property
		160.00	129.64		
Ceylon Glass Company Limited	M R Prelis Director	250.00	218.75	Debenture	Immovable property
		250.00	218.75		
Lanka Aluminum Industries Limited	M L Mack Director	3.69	0.86	Term loan	Immovable property
		3.69	0.86		
Loadstar (Pvt) Limited	T N Jinasena Chairman	300.00	175.00	Term Loan	Immovable property
		300.00	175.00		
Orient Motor Company Limited	M J C Amarasuriya Chairman	61.10	61.10	Trust certificate guaranteed by the parent Company	
		61.10	61.10		
Serendib Floor Mills (Pvt) Limited	M J C Amarasuriya Chairman	500.00	Not disbursed	Term Loan	Immovable property
		500.00			

Party accommodated	Name of Director/position	Aggregate amount of accommodation		Nature of transaction	Security
		Approved	Outstanding as at 31.03.2004		
		Rs m	Rs m		
Sri Lanka Institute of Information Technology	M A R C Cooray Government Director	20.00	5.22	Term Loan	
		20.00	5.22		
The Lanka Hospital Corporation Limited	S N P Palihena Director	668.40	268.40	Guarantee**	Immovable & movable property
		668.40	268.40		

** Agreement to mortgage*

*** Only indirect accommodation.*

45.2.3 Intra-group transactions - Financial accommodation

The Bank provides financial accommodation to its subsidiary DFCC Vardhana Bank Limited, in the ordinary couse of business on an arm's length basis. Such transactions, if eliminated when the financial statements of DFCC Vardhana Bank are consolidated with the Bank requires no disclosure as provided in paragraph 4(a) and (b) of Sri Lanka Accounting Standard No. 30 - Related party disclosure.

Details of transactions which have not been eliminated on consolidation due to the differences in the financial year between the subsidiary and Bank are given below:

Nature of transaction	Aggregate amount of accommodation			Security
	Approved	Outstanding as at 31.12.2003	31.03.2004	
	Rs m	Rs m	Rs m	
Composite facility comprising a term loan and/or guarantee facility - Note 15	600	0	**500**	
Short term borrowing - Note 32	416	416	**0**	Treasury bills under repurchase agreements.

45.2.4 Intra-group transactions - others

DFCC Vardhana Bank Limited has opened branches at DFCC Bank premises at Matara, Kurunegala, Kandy and at DFCC Bank Head Office premises at No. 73/5, Galle Road, Colombo 3. No rent was charged on above premises.

Chief operating officer of DFCC Vardhana Bank Limited is an employee of the Bank seconded for service for which no fee has been charged.

DFCC Bank maintains a time deposit account with DFCC Vardhana Bank Limited (DVB) and the amount outstanding as at 31 March 2004 was Rs232 million. The interest rate is comparable to the rate DVB would charge to a non-affliated customer.

45.2.5 Investment in companies where a Director of the Bank is a Director

Company	Name of Director/Position	Ordinary Shares Quoted Rs 000	Ordinary Shares Unquoted Rs 000	Preference Shares Quoted Rs 000	Preference Shares Unquoted Rs 000	Debentures Quoted Rs 000
		As at 31.03.2004				
Associated Battery Manufacturers (Ceylon) Limited	A N Fonseka - Director		100			
Credit Information Bureau of Sri Lanka	S N P Palihena, A N Fonseka - Directors		888			
Lanka Aluminium Industries Limited	M L Mack - Director	11,060				
Commercial Bank of Ceylon Limited	M J C Amarasuriya - Chairman M L Mack, A N Fonseka - Directors			100,000		
Hatton National Bank Limited Non voting	R T Wijetilleke - Managing Director	10,500				
People's Merchant Bank Limited	R T Wijetilleke - Director	12,500				
Nations Trust Bank Limited	M R Prelis - Director	4,937				
Sri Lanka Telecom Limited	M A R C Cooray - Government Director	47,084				1,314

45.2.6 Key Management personnel of the Bank

The Chief Executive, Executive Vice Presidents and the Secretary to the Board of Directors constitute the key management personnel of the Bank for purposes 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 appointment 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.

46 Business Segment Information

	Lending	Financial leasing	Investing in equity	Venture capital	Commercial Banking	Other	Unallocated	Elimina- tions	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 2004									
Revenue									
Interest income	2,924,581	536,843	–	53,773	26,048	22,322	–	(416)	3,563,151
Amortisation of negative goodwill							5,053		5,053
Other income	369,378	–	414,726	33,817	9,076	199,831	198,049	(106,469)	1,118,408
Income from external customers	3,293,959	536,843	414,726	87,590	35,124	222,153	203,102	(106,885)	4,686,613
Inter segment income				–	–		717	(717)	–
Total income	**3,293,959**	**536,843**	**414,726**	**87,590**	**35,124**	**222,153**	**203,819**	**(107,602)**	**4,686,613**
Percentage*	**70**	**11**	**9**	**2**	**1**	**5**	**7**	**–**	**100**
Expense									
Segment losses	265,509	34,734	8,367	(6,070)	(5,804)	(1,323)			295,414
Depreciation	–	–	–	949	22,727	11,178			34,854
Other operating & interest expenses	1,948,190	275,989	–	16,476	66,598	74,825		(416)	2,381,662
Inter segment expense				–		717		(717)	–
	2,213,699	**310,723**	**8,367**	**11,355**	**83,521**	**85,397**		**(1,133)**	**2,711,930**
Result	**1,080,260**	**226,120**	**406,359**	**76,235**	**(48,397)**	**136,756**			**1,974,684**
Unallocated expenses									264,864
Value Added Tax									182,895
									1,526,924
Associate company profit before tax									417,327
Profit on ordinary activities before tax									**1,944,251**
Income tax on profit on ordinary activities									542,716
Profit on ordinary activities after tax									**1,401,535**
Minority interest									108,722
Profit for the year									**1,292,813**
Assets	**22,232,377**	**3,567,320**	**1,703,798**	**825,974**	**1,572,292**	**967,235**	**4,170,466**	**(19,015)**	**35,020,447**
Percentage	**63**	**10**	**5**	**2**	**4**	**3**	**12**	**–**	**100**
Investment in associate company									2,520,060
									37,540,507
Liabilities	**19,290,583**	**3,210,588**	**–**	**8,263**	**1,346**	**144,998**	**5,370,177**	**(19,015)**	**28,006,940**
Capital expenditure - additions				**2,403**	**7,393**	**3,242**			

	Lending	Financial leasing	Investing in equity	Venture capital	Commercial Banking	Other	Unallocated	Elimina- tions	Total
For the year ended 31 March 2003									
Revenue									
Interest income	3,046,860	381,020	–	66,525	–	23,439	–		3,517,844
Amortisation of negative goodwill							13,565		13,565
Other income	274,627	–	238,884	34,859	–	157,753	166,104	(51,816)	820,411
Income from external customers	3,321,487	381,020	238,884	101,384	–	181,192	179,669	(51,816)	4,351,820
Inter segment income				624	–		4,637	(5,261)	–
Total income	**3,321,487**	**381,020**	**238,884**	**102,008**	**–**	**181,192**	**184,306**	**(57,077)**	**4,351,820**
Percentage*	**76**	**8**	**5**	**2**	**–**	**4**	**5**	**–**	**100**
Expense									
Segment losses	343,449	23,287	7,260	28,118	–	(1,505)			**400,609**
Depreciation	–	–	–	1,224	–	11,156			**12,380**
Other operating & interest expenses	2,134,177	234,878	–	13,006	–	72,056			**2,454,118**
Inter segment expense				624	–	4,637		(5,261)	**–**
	2,477,626	**258,165**	**7,260**	**42,972**	**–**	**86,344**		**(5,261)**	**2,867,107**
Result	**843,861**	**122,855**	**231,624**	**59,036**	**–**	**94,848**			**1,484,713**
Unallocated expenses									317,540
Value Added Tax									28,961
									1,138,212
Associate company profit before tax									384,973
Profit on ordinary activities before tax									**1,523,185**
Income tax on profit on ordinary activities									336,259
Profit on ordinary activities after tax									**1,186,926**
Minority interest									55,737
Profit for the year									**1,131,189**
Assets	**18,969,322**	**2,283,666**	**1,802,216**	**660,849**	**–**	**917,153**	**3,780,112**	**(15,996)**	**28,397,352**
Percentage	**67**	**8**	**7**	**2**	**–**	**3**	**13**	**–**	**100**
Investment in associate company									1,810,356
									30,207,708
Liabilities	**16,824,386**	**2,055,299**	**–**	**5,800**	**–**	**119,592**	**2,900,693**	**(15,966)**	**21,889,804**
Capital expenditure - additions				**163**	**–**	**6,666**			

** Net of eliminations.*

46.1 Revenue and expenses attributable to the incorporated business segments of industrial estate management unit trust management and DFCC Stock Brokers (Pvt) Limited are included in the column for Other.

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

46.3 Dealing securities losses and goodwill written off of associate and subsidiary companies are included in unallocated expenses.

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

47 Events after Balance Sheet date

47.1 Board of Directors on 26 May 2004 approved the abolition of non-contributary defined benefit pension scheme to all recruits to the permanent cadre who joined the Bank on or after 1 May 2004. The necessary amendments to the pension scheme approved by the Commissioner General of Inland Revenue will require the concurrence of Commissioner General of Inland Revenue.

The new recruits will qualify for gratuity payment under the Payment of Gratuity Act No. 12 of 1983.

47.2 DFCC Vardhana Bank Limited, subsidiary of the Bank incurred a loss of Rs.3.8million for the month of April 2004 as per the non audited interim financial statements.

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

48 Restatement of Comparative Figures

Comparative figures have been restated to conform to the year ended 31 March 2004 classification.

49 Employee population - Bank

As at 31 March 2004	**305**
As at 31 March 2003	305

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. 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. The aim is to ensure minimum capital, commensurate with risks assumed by the Bank, is maintained as a buffer to absorb credit 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. Consolidated financial statements are used for this computation.

Capital to Risk Weighted Assets Ratio

		Actual	
	Minimum Requirement	**31.03.2004**	31.03.2003
Tier 1 (%)	5.0	**26.9**	29.2
Tier 2 (%)		**0.1**	0.2
Tier 1 and Tier 2 (%)		**27.0**	29.4
Deductions (%)		**8.1**	6.9
Capital base (%)	10.0	**18.9**	22.5

Investments in the regulatory capital of other banks are deducted from the capital base. Consequently the ratio of capital base to risk weighted assets is lower than Tier 1 capital ratio.

Details of Computation

Capital Base	**31.03.2004**	31.03.2003
	Rs 000	Rs 000
Tier 1 : Core Capital		
Paid-up ordinary shares	**571,458**	423,111
Share premium	**892,293**	955,332
Statutory reserve fund	**245,000**	185,000
Published retained profits	**974,901**	493,661
General & other reserves	**5,950,563**	5,390,140
Minority interest	**713,442**	679,698
	9,347,657	8,126,942
Less: Deductions		
Goodwill	**261,179**	2,058
Total Tier 1 capital	**9,086,478**	8,124,884
Tier 2 : Supplementary Capital		
General provision	**40,874**	70,453
Tier 1 and Tier 2	**9,127,352**	8,195,337
Less: Deductions		
Investments in capital of other banks		
Commercial Bank - Bank	**2,620,060**	1,860,356
Other banks	**54,028**	33,674
Debenture investments - Banks	**58,500**	28,000
Capital base	**6,394,764**	6,273,307

Risk Weighted Assets and Off Balance Sheet Exposure

Balance Sheet Assets	31.03.2004 Rs 000	31.03.2003 Rs 000	Risk Weights %	Risk Weighted Balance 31.03.2004 Rs 000	Risk Weighted Balance 31.03.2003 Rs 000
Cash, treasury bills & other securities eligible for rediscounting with Central Bank	**2,487,286**	2,380,706	0	**–**	–
Securities purchased under resale agreements	**852,684**	415,152	0	**–**	–
Textile debt restructure fund	**197,331**	249,246	0	**–**	–
Balances due from Central Bank	**50,309**	0	0	**–**	–
Loans against cash deposits	**151,384**	0	0	**–**	–
Bank balances	**204,927**	210,485	20	**40,985**	42,097
Due from banks abroad	**45,934**	0	20	**9,187**	–
Placements with and loans to other banks and financial institutions	**983,495**	69,503	20	**196,699**	13,901
Loans guaranteed by SLECIC	**1,088**	0	50	**544**	–
Dealing securities	**1,314**	2,629	100	**1,314**	2,629
Other loans, bills of exchange, finance lease and interest receivable	**25,597,694**	21,033,584	100	**25,597,694**	21,033,584
Other investments (excluding items deducted from total capital)	**2,369,083**	2,569,377	100	**2,369,083**	2,569,377
Property and equipment	**676,591**	440,896	100	**676,591**	440,896
Prepayments and other receivables	**788,402**	802,403	100	**788,402**	802,403
Total assets	**34,407,522**	28,173,981		**29,680,499**	24,904,887

Off Balance Sheet Exposure	Credit Conversion Factor %	31.03.2004 Rs 000	31.03.2003 Rs 000	Risk Weights %	Risk Weighted Credit Equivalent 31.03.2004 Rs 000	Risk Weighted Credit Equivalent 31.03.2003 Rs 000
General guarantee of indebtness	100	**1,024,153**	849,198	100	**1,024,153**	849,198
Performance bonds, bid bonds and warranties	50	**181,912**	116,138	100	**90,956**	58,069
Shipping guarantees	20	**8,547**	0	100	**1,709**	–
Documentary letters of credit	20	**586,993**	0	100	**117,399**	–
Trade related acceptances	20	**30,184**	0	100	**6,037**	–
Others - Bills on collection	20	**83,531**	0	100	**16,706**	–
Undrawn term loans	50	**5,482,515**	3,895,012	100	**2,741,258**	1,947,506
Others - undrawn lease facilities	50	**152,065**	167,059	100	**76,033**	83,530
Undrawn overdraft facilities	0	**162,550**	0	100	**–**	–
Formal standby facilities and credit lines	0	**129,646**	0	100	**–**	–
Total off balance sheet exposure		**7,842,096**	5,027,407		**4,074,251**	2,938,303
Total risk weighted assets and off balance sheet exposure					**33,754,750**	27,843,189

Reconciliation with Balance Sheet

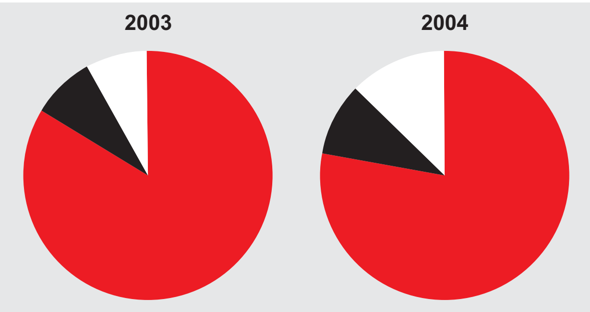
Capital excludes revaluation reserve of Rs180m and negative goodwill, a deferred income.

STATEMENT OF VALUE ADDED - BANK

For the year ended 31 March		**2004** **Rs million**	**%**		2003 Rs million	%
Value Added						
Gross income		**4,444**			4,181	
Cost of borrowing and support services		**(2,018)**			(2,283)	
Provision for bad debts and investments		**(308)**			(374)	
		2,118			1,524	
Value Allocated						
To employees						
Salaries, wages and other benefits		**394**	**19**		313	21
To providers of capital						
Dividends to shareholders		**314**	**15**		233	15
To government						
Income tax on profit	**385**			181		
Turnover tax	–			1		
National security levy	–			67		
Value Added Tax	**182**	**567**	**27**	28	277	18
To expansion and growth						
Retained income	**771**			623		
Depreciation	**72**	**843**	**39**	78	701	46
		2,118	**100**		1,524	100

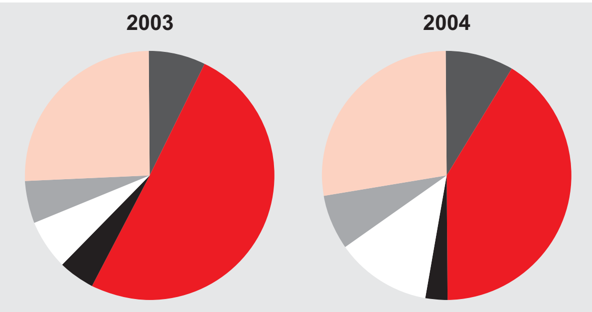
For the year ended 31 March	2000	2001	2002	2003	**2004**
			Rupees million		
Sources of Income					
Interest income	3,037	3,177	3,844	3,495	3,461
Income from investments	368	313	280	354	414
Other	201	178	187	332	569
	3,606	3,668	4,311	4,181	4,444
Distribution of Income					
To employees as emoluments	196	215	257	313	394
To lenders as interest	1,977	1,935	2,200	2,091	1,819
To providers of supplies and services	131	129	132	192	118
To government as taxation	293	348	526	277	567
To shareholders as dividends	141	159	212	233	314
Retained in the business:					
Depreciation set aside	42	51	48	78	72
Provision for losses	624	618	516	374	309
Reserves	202	213	420	623	851
	3,606	3,668	4,311	4,181	4,444

SOURCES OF INCOME



	2003	2004
Interest Income	84%	78%
Income from Investments	8%	9%
Other	8%	13%

DISTRIBUTION OF INCOME

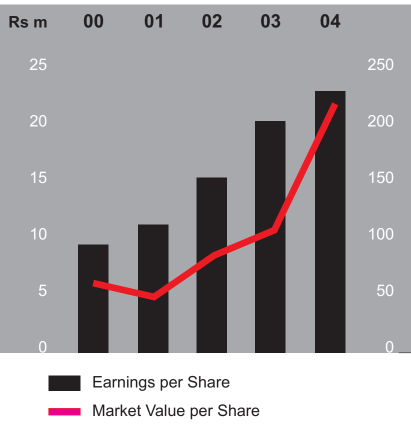


	2003	*2004*
Employees	*7%*	*9%*
Lenders	*49%*	*40%*
Supplies and Services	*5%*	*3%*
Government	*7%*	*13%*
Shareholders	*6%*	*7%*
Retained	*26%*	*28%*

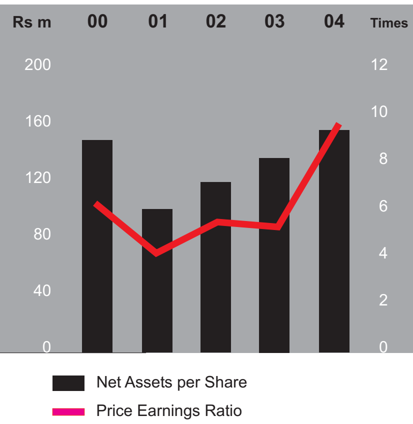
Year ended 31 March	1995	1996	1997	1998	1999	2000	2001	2002	2003	**2004**
					Rupees million					
OPERATING RESULTS										
Total income (net of TT & NSL)	1,919	2,265	2,411	2,762	2,949	3,446	3,452	4,037	4,113	**4,444**
Profit before tax	901	818	622	942	913	733	818	1,259	1,459	**1,874**
Income tax	270	334	206	350	241	203	190	401	327	**581**
Profit after tax	631	484	416	592	672	530	627	857	1,131	**1,293**
BALANCE SHEET										
Assets										
Cash, short-term funds & securities	215	1,975	2,352	1,164	2,877	1,631	1,394	2,359	2,398	**2,675**
Dealing securities	0	0	0	0	0	0	3	4	3	**1**
Receivables	277	197	194	286	601	508	533	666	914	**909**
Placements with and loans to Banks and financial institutions	0	0	0	0	1,175	651	325	0	0	**500**
Securities purchased under resale agreement	0	0	0	0	0	23	288	569	48	**26**
Bills of exchange discounted	543	477	231	138	38	22	21	21	10	**0**
Loans	7,419	9,091	10,446	11,807	14,734	15,722	17,406	17,364	18,740	**21,502**
Finance leases	1,338	1,782	1,933	1,971	1,984	1,903	1,773	1,722	2,284	**3,567**
	9,300	11,350	12,610	13,916	17,931	18,321	19,813	19,676	21,082	**25,595**
Investment securities	1,063	1,383	1,446	2,004	1,865	1,474	1,784	2,102	1,802	**1,704**
Investment in associate/subsidiary companies	405	396	344	1,525	1,695	1,851	2,104	2,351	2,663	**3,950**
Investment property	0	0	0	0	0	0	0	187	187	**12**
Property and equipment	61	64	75	100	265	285	277	265	378	**516**
	11,321	15,365	17,021	18,995	25,234	24,070	25,908	27,610	29,427	**35,362**
Negative goodwill	0	0	0	0	52	40	27	23	11	**6**
Liabilities										
Shareholders' funds	3,339	3,717	4,028	4,665	4,991	5,413	5,745	6,659	7,627	**8,814**
Medium/long-term borrowing and debentures	6,855	10,958	11,746	12,750	17,424	17,279	17,841	17,892	16,775	**19,570**
Customer deposits	0	0	0	0	555	314	558	1,562	2,868	**4,944**
Short-term borrowing	385	0	0	0	1,140	0	796	398	1,143	**577**
	7,240	10,958	11,746	12,750	19,119	17,593	19,195	19,852	20,786	**25,091**
Other liabilities	742	690	1,247	1,580	1,072	1,024	941	1,076	1,003	**1,451**
	11,321	15,365	17,021	18,995	25,234	24,070	25,908	27,610	29,427	**35,362**
Return on shareholders' funds, %	20.9	13.7	10.7	13.6	13.9	10.2	11.2	13.8	15.8	**15.7**
Return on total assets, %	6.1	3.6	2.6	3.3	3.0	2.1	2.5	3.2	4.0	**4.0**
Earnings per share, Rs	11.19	8.58	7.37	10.51	11.91	9.39	11.12	15.20	20.05	**22.70**
Market value per share, Rs	184.82	184.82	133.79	135.53	66.88	59.38	46.88	84.00	106.50	**219.50**
Price earnings ratio	16.5	21.5	18.2	12.9	5.6	6.3	4.2	5.5	5.3	**9.7**
Rate of dividend, %	35.0	35.0	35.0	35.0	40.0	40.0	45.0	50.0	55.0	**55.0**
Dividend cover, times	4.3	3.3	2.8	4.0	4.0	3.1	3.3	3.0	3.7	**3.5**
Gross dividend, Rsm	105.8	105.8	105.8	123.4	141.0	141.0	159.0	212.0	233.0	**314.3**

Basic earnings per share and market value per share of prior years have been restated for the effect of bonus share issues.

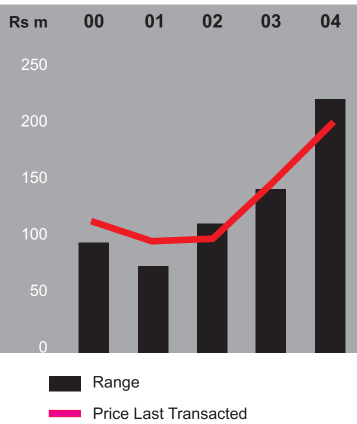
EARNINGS AND MARKET VALUE



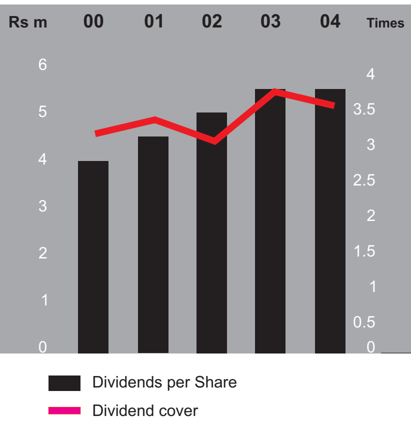
SHARE VALUE



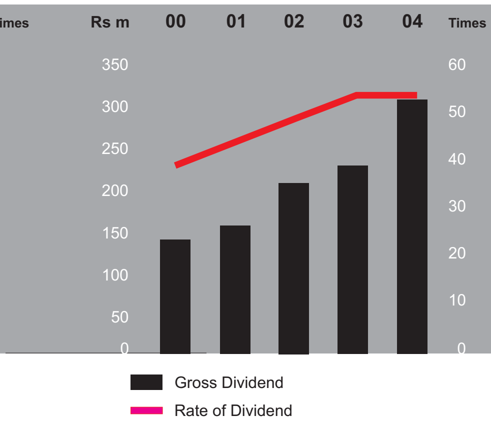
SHARE PRICE



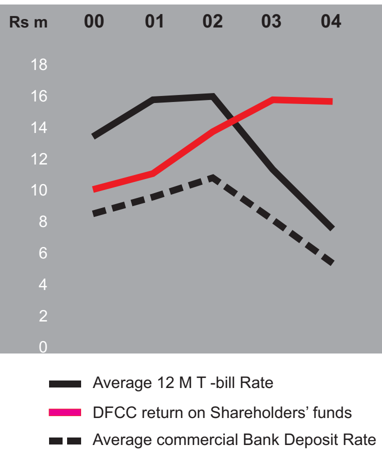
DIVIDENDS



DIVIDEND PAID



RETURN ON EQUITY AND MONEY MARKET RATES



Year ended 31 March	**2004**	2003
Earnings		
Earnings per share, Rs	**22.70**	20.05
Price earnings ratio, times	**9.7**	5.3
Dividends		
First and final dividend, Rs m	**314.00**	233.00
Rate of dividend, %	**55.00**	55.0
Dividend per share, Rs	**5.50**	5.50
Book Value - Bank		
Net assets per share on 31 March, Rs	**154.35**	134.96
Share Prices		
Lowest, Rs	**140.00 (01.04.03)**	105.50 (04.04.02)
Highest, Rs	**385.50 (13.10.03)**	189.00 (25.09.02)
Last transaction, Rs	**219.50 (31.03.04)**	142.00 (31.03.03)
Volume of Shares Traded		
Number of shares traded	**14,048,508**	9,008,600
Rank	**38**	28
Market Capitalisation		
Value, Rs m	**12,544**	6,008
% of market	**3.9**	3.2
Rank	**4**	5
Price Indices		
CSE All Share Price Index	**1,284.2**	739.0
Milanka Price Index	**2,021.0**	1,259.6
Frequency of Shares Traded		
Number of transactions	**5,856**	3,729
% of total frequency	**1.07**	1.44
Rank	**24**	20
Days Traded		
Number of days traded	**240**	228
Total number of market days	**241**	240
% of market days traded	**99.59**	95.00
Value of Shares Traded		
Value, Rs m	**3,977**	1,458
% of total trading	**4.86**	5.06
Rank	**5**	5

Size-wise Distribution of Shareholding

Number of Shares			As at 31 March 2004			As at 31 March 2003		
			No. of Holders	**Total Holding**	**%**	No. of Holders	Total Holding	%
01	-	1,000	**6,201**	**1,651,907**	**2.89**	**6,470**	1,540,376	3.64
1,001	-	5,000	**578**	**1,175,553**	**2.06**	576	1,221,915	2.89
5,001	-	10,000	**82**	**574,229**	**1.0**	87	611,666	1.45
10,001	-	50,000	**61**	**1,220,224**	**2.14**	62	1,309,797	3.10
50,001	-	100,000	**11**	**759,516**	**1.33**	21	1,574,767	3.72
100,001	-	500,000	**13**	**3,333,612**	**5.83**	17	3,474,141	8.21
500,001	-	1,000,000	**2**	**1,579,066**	**2.76**	3	2,231,006	5.27
Greater than		1,000,000	**8**	**46,851,716**	**81.99**	8	30,347,443	71.72
Total			**6,956**	**57,145,823**	**100.0**	7,244	42,311,111	100.0

Ownership

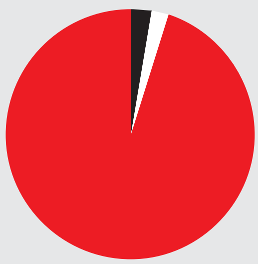
Shareholding %	As at 31 March 2004			As at 31 March 2003		
	Foreign	**Sri Lankan**	**Total**	Foreign	Sri Lankan	Total
Individuals	**0.07**	**6.81**	**6.88**	0.15	8.89	9.04
Institutions	**17.07**	**76.05**	**93.12**	18.02	72.94	90.96
Total	**17.14**	**82.86**	**100.0**	18.17	81.83	100.0

As per the Rule No. 8.7 (h) of the Colombo Stock Exchange, percentage of public holding as at 31.03.2004 was 86.15% (91.94% as at 31.03.2003).

SHAREHOLDERS

1,000 shares or less	89%
1,000 - 5,000 shares	8%
Greater than 5,000 shares	3%

SHAREHOLDING



1,000 shares or less	3%
1,000 - 5,000 shares	2%
Greater than 5,000 shares	95%

OWNERSHIP

Foreign Individuals	0%
Foreign Institutions	17%
Sri Lankan Individuals	7%
Sri Lankan Institutions	76%

The Annual General Meeting will be held at
The Colombo Plaza, Galle Road, Colombo 3, on 30 June 2004.
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 statute
(Development Finance Corporation of Ceylon Act No. 35 of 1955).

BOARD SECRETARY
T Wijemanna

LAWYERS
F J & G De Saram
Attorneys-at-Law

AUDITORS
KPMG Ford, Rhodes, Thornton & Co.
Chartered Accountants

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

VAT REGISTRATION NO.
409000088 7000

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

DFCC BANK'S OTHER OFFICES

Anuradhapura
279, Maithripala Senanayake Road
Anuradhapura.
Telephone: 025-2223417
Fax: 025-2223418

Badulla
Modern Complex
8, Cocowatte Road
Badulla.
Telephone: 055-2230160
Fax: 055-2230163

Colombo
73, W A D Ramanayake Mawatha
Colombo 2.
Telephone: 2305560
Fax: 2305579

Gampaha
17, Yakkala Road
Gampaha.
Telephone: 033-2226104
Fax: 033-2226104

Kaduruwela
624/1, Main Street
Kaduruwela
Telephone: 027-2225858
Fax: 027-2225858

Kalutara
270/1/1, Main Street
Kalutara South
Telephone: 034-2236363
Fax: 034-2236364

Kandy
5, Deva Veediya
Kandy.
Telephone: 081-2234411
Fax: 081-2228460

Kurunegala
67, Colombo Road
Kurunegala.
Telephone: 037-2224142, 037-2224461/2
Fax: 037-2224142

Matara
26 1/1, Anagarika Dharmapala Mawatha
Matara.
Telephone: 041-2225500/1
Fax: 041-2222585

Ratnapura
Ratnaloka Building,
25, Bandaranaike Mawatha
Ratnapura.
Telephone: 045-2223667/9
Fax: 045-2223670

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