Bank of Ceylon (UK) Ltd

Financial Statements

For the year ended 31 December 2012

Company registration no. 06736473

Contents

Directors and advisors

Directors

The directors who served throughout the year were as follows:

Dr Gamini Wickramasinghe	Non-Executive Chairman and Chairman of Bank of Ceylon (Resigned 8th January 2013)
Mr K B S Bandara	Chief Executive Officer (Resigned 4th January 2013)
Mr N Fernando	Chief Executive Officer (Appointed 4th January 2013)
Mr D S Muthukudaarachchi	Chief Operating Officer/ Secretary
Mr W D R Swanney	Independent Non-Executive Director
Mr R England	Independent Non-Executive Director

The directors who served during the year were as follows:

Ms W A Nalini	Non –Executive Director and General Manager of Bank of Ceylon (Resigned 4th June 2012)
Mr K Dharmasiri	Non-Executive Director and General Manager of Bank of Ceylon (Appointed 5th July 2012)

Registered office 1 Devonshire Square, London, EC2M 4WD

Solicitors Field Fisher Waterhouse
35 Vine Street, London, EC3N 2PX

Auditors KPMG Audit Plc
15 Canada Square, London, E14 5GL

Chairman's Statement

The bank entered into year 2012 as the second full year of its operation as an independent bank in the midst of a challenging economic environment. The year progressed with a lot of negative sentiments around the countries in mainland Europe which significantly held back the global economic recovery. The UK economy reported encouraging growth numbers in Q3 against the back drop of the successful completion of the London Olympics otherwise the opportunities for income generations for small banks like ours were very limited in the year 2012.

Consequent to these developments interest rates of major currencies remained at historically low levels. The fiscal stimulus efforts of central governments resulted in market rates falling further with negative returns at times for Euro deposits and near zero returns for US Dollar deposits affecting one of our key business areas of treasury operations. Returns offered on Sterling deposits also dropped significantly as the year unfolded.

The Sri Lankan government also made some significant policy changes during the early part of 2012 resulting in the Sri Lankan Rupee depreciating by around 10% against the US Dollar in Q2 and a reduction in vehicle imports to the country. These policy decisions directly impacted on our trade finance business volumes and thereby the fee based income.

At a time when the bank was on course to meet its strategic aims the aforementioned changes in the operating markets presented unexpected challenges. However the conditions were well managed focusing on other business lines developed in the latter part of 2011.

The bank continued this positive trend changing the bank's revenue structure with more emphasis on the wholesale and retail sectors for new avenues of revenue. However the potential opportunities for these areas were limited due to the bank's level of funding as well as capital constraints. Furthermore due to its size the bank could not tap the potential business avenues which adversely effected results towards midyear, but it gathered momentum with the injection of fresh capital of approximately £ 2.9 million by the parent company that provided headroom to augment the bank's operations. This resulted in the focus being transferred to retail lending and bill discounting for income generation from wholesale treasury operations. A strong cost discipline during the year under review also contributed to the overall performance of the bank reflecting an improved outcome over the previous year.

As a part of improving our systems capabilities and efficient operations the bank continued its project to upgrade its core banking operating systems. The legacy core banking application "Bank Master" was phased out and a new core banking system "BankFusion Universal Banking" (BFUB) was introduced in order to provide a more efficient and effective service for the customers. Furthermore another widely used supplementary operating system "TI Plus" was acquired to enable an efficient service in the Trade Finance operations, which is expected to be operational in 2013. In order to improve efficiency of the bank's payment systems an automated inward SWIFT payment processing interface will also be added to BFUB.

Overall the world economic picture looks bleak and it is seen that the USA is being pushed towards a second so called fiscal cliff predicting spending cuts and a possibly another recession. Even though the bank expects an uncertain 2013, plans are underway to build upon the strengths of 2012 in familiar markets whilst managing our internal operational risk management processes and planning for risk exposures, an important factor in such turbulent times.

I am happy that we have performed as well as we could in 2012 and I take this opportunity to thank our valued customers for their continued support and confidence placed in us during this difficult period.

The support extended by the Management of the Parent Bank has been of paramount importance in achieving our tasks. The external and internal auditors, our legal advisers, consultants, correspondents and all the other stake holders are remembered with gratitude and appreciation.

I appreciate the outstanding contributions made by my colleagues on the board, without whom the picture would have been different. I must greatly thank them for all the support extended to me. The Chief Executive Officer, Chief Operating Officer and the staff of Bank of Ceylon (UK) Ltd also receive my greatest appreciation for the difficult job done under difficult conditions.

In conclusion I wish to state that I am confident that the Bank of Ceylon (UK) Ltd will become a force to be reckoned with, within the Bank of Ceylon Group, playing a pivotal role in the International arena. We remain determined to penetrate the EU Market.

This is my final report for Bank of Ceylon (UK) Ltd as I stood down as Chairman on the 8th January 2013. Once again I would like to thank everyone for all their support and wish the incoming chairman every success in the future.

Dr Gamini Wickramasinghe

7th January 2013

Directors' Report

Principal Activities

Bank of Ceylon (UK) Ltd (the Bank) was incorporated in England and Wales in 2008 as a wholly owned subsidiary of Bank of Ceylon (BoC).

The Bank is authorised by the UK Financial Services Authority (FSA) pursuant to Part IV of the Financial Services and Markets Act 2000 (FSMA 2000) to carry on regulated financial services activities including deposit-taking and dealing in investments as principal. The Bank offers retail services, corporate and correspondent banking facilities in addition to trade finance services.

The directors are required by the Companies Act to set out in this report a fair review of the business of the Bank during the year ended 31 December 2012 and a description of the principal risks and uncertainties facing the Bank within their business review. The information that fulfils this requirement can be found within the Chairman's Report on page 4.

Going Concern Basis of Accounting

Having due regard to all aspects of the Bank's operations the directors are satisfied that the Bank has sufficient resources to continue in business for the foreseeable future.
Further details regarding adoption of the going concern basis can be found in the accounting policies of these financial statements.

Disclosure of information to the auditors

The directors who held office at the date of approval of this Directors' Report confirm that, as far as they are each aware, there is no relevant audit information of which the Bank's auditors are unaware; and each director has taken all the steps that they ought to have taken as a director to make themselves aware of any relevant audit information and to establish that the Bank's auditors are aware of that information.

Auditor

KPMG Audit Plc has indicated its willingness to continue in office and a resolution concerning their re-appointment will be proposed at the forthcoming Annual General Meeting.
The company did not make any political or charitable contributions in the year. (2011: Nil)

Corporate Governance

The Board of Directors of the Bank comprises two executive directors, two non-independent non-executive directors appointed by Bank of Ceylon, one of whom is the chairman of both the Board of the UK subsidiary and the Board of Directors of Bank of Ceylon Sri Lanka, and two independent non-executive directors. The Board meets at least quarterly and has defined responsibilities for the overall direction, supervision and control of the Bank. This includes assessment of the Bank's competitive position, approval of strategic and financial plans and review of the performance and financial status. It reviews and approves significant changes in the Bank's structure and organisation and establishes the risk framework, overall risk appetite and key policies in relation to credit, large exposures, impairment, liquidity and operational risk. The Board also approves and monitors the Bank's policies, procedures and processes in connection with the fight against financial crime.

Audit Committee

The Audit Committee comprises the two independent non-executive directors and is chaired by a financially qualified individual. Meetings are attended by the Bank's executive directors and occur three or four times each year. The primary function of the Audit Committee is to assist the Board in fulfilling its oversight responsibilities by monitoring and assessing the integrity of financial statements, the qualifications, independence and performance of internal and external auditors, compliance with legal and regulatory requirements and the adequacy of systems of internal accounting and financial controls.

Financial risk management

The Bank has exposure to the following risks:
- credit risk
- liquidity risk
- market risk
- operational risk

Risk management framework

The Board of Directors has overall responsibility for the establishment and oversight of the Bank's risk management framework. The Bank has appointed a Risk Manager who is responsible for developing and monitoring the Bank's risk management policies.

The Bank's risk management policies are established to identify and analyse the risks faced by the Bank, to set appropriate risk limits and controls and to report on the effectiveness of those controls to the Board of Directors.

The Bank's Audit Committee is responsible for ensuring that the Bank complies with its risk management policies through periodic assessment of key risk indicators and reviews of reports prepared by the Risk Manager, Internal and External Auditors.

Credit risk

Credit risk is the risk of financial loss to the Bank if a customer or counterparty to a financial instrument fails to meet its contractual obligations and arises principally from the Bank's loans and advances to customers and other banks and investment debt securities. For risk management reporting purposes the Bank considers and consolidates all elements of credit risk exposure (such as individual obligor default risk, country and sector risk).

The Board of Directors has delegated responsibility for the oversight of credit risk to the Bank's Credit Committee. The Credit Committee is responsible for the effective management of credit risk by agreeing and recommending to the Board, credit and concentration risk policies, underwriting guidelines and standard proposals within the Board's overall risk appetite and by approving individual credits and lending decisions in line with responsibility delegated by the Board. The credit process is reviewed on a regular basis by Internal Audit.

Liquidity risk

Liquidity risk is the risk that the Bank will encounter difficulty in meeting obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. The Bank's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Bank's reputation.

Liquidity is managed centrally by the Treasury function according to the liquidity policy approved by the Board. The Bank's liquidity risk appetite is documented in its Individual Liquidity Adequacy Assessment (ILAA). The Bank's ILAA is prepared annually and may be reviewed by the FSA as part its Supervisory Liquidity Review Process (SLRP) when setting the Bank's Individual Liquidity Guidance (ILG).

The Bank conducts regular stress tests on its liquidity position and the results of the tests are reviewed by the Bank's Asset and Liability Committee (ALCO) and presented to the Board.

Market risk

Market risk is the risk that changes in market prices, such as interest rates and credit spreads will affect the Bank's income or the value of the Bank's holdings of financial instruments. The Bank's exposure to market risk is primarily due to interest rate and foreign exchange exposure.

The Bank manages foreign exchange risk by means of currency exposure limits placed on intraday and overnight positions. Interest rate risk is actively managed by the Treasury area principally through monitoring interest rate gaps. The pricing of new products is considered by the Bank's Product Development Committee.

Operational risk

Operational risk is the risk of direct or indirect loss arising from a wide variety of causes associated with the Bank's processes, personnel, technology and infrastructure and from external factors other than credit, market and liquidity risks. These can include risks arising from legal and regulatory requirements and generally accepted standards of corporate behaviour.

The Bank's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to the Bank's reputation with overall cost effectiveness. Controls, limits and procedures are in place to provide business and operational resilience.

Capital management

The Bank's regulator (the FSA) sets and monitors capital requirements for the Bank. The Bank is required to comply with the provisions of the Capital Requirements Directive in respect of regulatory capital. The Bank's regulatory capital comprises ordinary share capital and retained earnings.

Management uses the regulatory capital ratios in monitoring the Bank's capital base. The regulator's approach to capital measurement is based upon the Capital Requirements Directive (CRD) and monitors the relationship of the Capital Resources Requirement (measured as 8 percent of risk-weighted assets) to available capital resources. The lead regulator provides individual capital guidance (ICG) to each bank that sets capital requirements in excess of the minimum Capital Resource Requirement. A key input to the ICG setting process is a bank's Internal Capital Adequacy Assessment Process (ICAAP). The Bank submitted its ICAAP to the regulator in 2010 and the ICG was agreed in April 2010. The agreed ICG remains confidential between each bank and the regulator in accordance with accepted practice.

By order of the Board:

Mr N Fernando, Chief Executive Officer

26th March 2013

Statement of Directors' responsibilities in respect of the Directors' Report and the financial statements

The directors are responsible for preparing the Directors' Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with International Financial Reporting Standards as adopted by the European Union.

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit and loss for that period. In preparing these financial statements, the directors are required to:

- Select suitable accounting policies and then apply them consistently;
- Make judgements and estimates that are reasonable and prudent;
- State whether they have been prepared in accordance with International Financial Reporting Standards as adopted by the EU; and
- Prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the company and to prevent and detect fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Independent Auditor's Report to the Members of Bank of Ceylon (UK) Limited

We have audited the financial statements of Bank of Ceylon (UK) Limited (the "Bank")for the year ended 31 December 2012 set out on pages 11 to 30. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU.

This report is made solely to the Bank's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Bank's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Bank and the Bank's members, as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 9, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the APB's website at www.frc.org.uk/auditscopeukprivate

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the Bank's affairs as at 31 December 2012 and of its loss for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the EU; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Samer Hijazi (Senior Statutory Auditor)
for and on behalf of KPMG Audit Plc, Statutory Auditor
Chartered Accountants
15, Canada Square
London, E14 5GL

26th March 2013

Statement of Comprehensive Income

For the year ended 31 December 2012

	Note	Year ended 31 December 2012 GBP 000	Year ended 31 December 2011 GBP 000
Interest income		1,038	1,169
Interest expense	4	(196)	(382)
Net interest income		**842**	**787**
Fees and commissions	5	625	649
Dealing and exchange profit		205	7
Operating income		**1,672**	**1,443**
Administration expenses	6	(1,890)	(1,770)
Depreciation	10	(63)	(63)
Amortization	11	(21)	-
Loss from ordinary activities before tax		**(302)**	**(390)**
Tax credit /(charge) on loss from ordinary activities	12	81	(49)
Loss from ordinary activities after tax		**(221)**	**(439)**
Other comprehensive income			
Net change in the fair value of available for sale investments		15	-
Other comprehensive income for the year		**15**	**-**
Total comprehensive income for the year		**(206)**	**(439)**

The notes on pages 15 to 31 are an integral part of these financial statements.

Statement of Financial Position

As at 31 December 2012

	Note	31 December 2012 GBP 000	31 December 2011 GBP 000
Assets			
Cash at bank and in hand		2,820	1,320
Loans and advances to banks	13	70,664	63,031
Loans and advances to customers	14	6,726	3,640
Investments	15	2,215	3,994
Property and equipment	10	2,479	2,907
Intangible assets	11	344	-
Deferred tax	12	64	51
Other assets		182	172
Total assets		**85,494**	**75,115**
Liabilities			
Deposits by Banks	16	66,419	49,648
Customer accounts	17	4,538	13,573
Other liabilities	18	172	203
Total liabilities		71,129	63,424
Equity			
Share capital	19	15,000	12,120
Fair value reserve		15	-
Retained earnings		(650)	(429)
Equity shareholders' funds		14,365	11,691
Total liabilities and equity		**85,494**	**75,115**

These financial statements were approved by the Board of Directors on 26th March 2013 and were signed on its behalf by:

N Fernando, Chief Executive Officer

The notes on pages 15 to 31 are an integral part of these financial statements.

Statement of Changes in Equity

For the Year ended 31 December 2012

	Share Capital GBP 000	Fair value Reserve GBP 000	Retained earnings GBP 000	Total equity GBP 000
Equity shareholder's funds 1 January 2012	**12,120**	**-**	**(429)**	**11,691**
Loss for the year	-	-	(219)	**(219)**
Additional capital added during the year	2,880	-	-	**2,880**
Net change in the fair value of available for sale investments	-	15	-	**15**
Translation loss on conversion of reserves	-	-	(2)	**(2)**
Equity shareholder's funds 31 December 2012	**15,000**	**15**	**(650)**	**14,365**
Equity shareholder's funds 1 January 2011	**12,120**	**-**	**14**	**12,134**
Loss for the year	-	-	(439)	(439)
Transactions with owners, recorded directly in equity - Issue of ordinary shares	-	-	(4)	(4)
Equity shareholder's funds 31 December 2011	**12,120**	**-**	**(429)**	**11,691**

The notes on pages 15 to 31 are an integral part of these financial statements.

Statement of Cash Flows

For the year ended 31 December 2012

	Note	Year ended 31 December 2012 GBP 000	Year ended 31 December 2011 GBP 000
Cash flow from operating activities:			
Loss before tax		(302)	(390)
Adjusted for:			
Depreciation	10	63	63
Amortization	11	21	-
Other non-cash items included in loss before tax		83	(2)
		(135)	(329)
Changes in:			
Loans and advances to banks	13	(7,633)	49,872
Loans and advances to customers	14	(3,086)	(2,546)
Investments	15	1,779	(2,076)
Other assets		(10)	(22)
Deposits by banks	16	16,771	(56,695)
Customer accounts	17	(9,035)	(296)
Other liabilities	18	(31)	20
		(1,245)	(11,743)
Net cash flow used in operating activities		**(1,380)**	**(12,072)**
Cash flow for investing activities			
Acquisition of fixed assets		-	(59)
Pre subsidiarisation tax charges		-	(95)
Net cash flow used in investing activities		-	(154)
Cash flow from financing activities			
Proceeds from the issue of share capital		2,880	-
Net cash flow from financing activities		**2,880**	-
Net increase / (decrease) in cash and cash equivalent		1,500	(12,226)
Cash and cash equivalents at 1 January		**1,320**	**13,546**
Cash and cash equivalents at 31 December		**2,820**	**1,320**

The notes on pages 15 to 31 are an integral part of these financial statements.

Notes to the Financial Statements

1) Reporting entity

Bank of Ceylon (UK) Ltd (the "Bank") is a company incorporated in the United Kingdom under the Companies Act 2006.

The business of the London Branch of Bank of Ceylon was transferred to the Bank under a Part VII transfer of the Financial Services and Markets Act 2000 on 1 May 2010.

Information regarding the principal activities and operations of the Bank and its regulatory status is set out in the Report of the Directors and in the notes to the financial statements.

2) Basis of Preparation

a) Statement of compliance

The financial statements of the Bank have been prepared in accordance with International Financial Reporting Standards as endorsed by the European Union.

The International Accounting Standards Board (IASB) has issued a number of new standards, amendments to standards and interpretations that are not yet effective and have not been applied in the preparation of the financial statements for the year ended 31 December 2012. The impact is expected to be immaterial, except for IFRS9 (which is effective for annual periods beginning on or after 1 January 2015) which is expected to have pervasive impact on the Bank's Financial Statements.

b) Going Concern Basis of Accounting

The financial statements of the Bank have been prepared on a going concern basis as the directors continue to be of the opinion that the Bank has sufficient resources to continue in business for the foreseeable future.

The directors' opinion that the financial statements should be prepared on an ongoing concern basis has been reached after reviewing the company's budget and cash flow forecast for the next three years.

In forming this opinion the directors have had due regard to the guidance issued by the Financial Reporting Council in October 2009 entitled 'Going Concern and Liquidity Risk: Guidance for Directors of UK Companies 2009'

c) Functional and presentational currency

The functional currency of the Bank is pounds Sterling, the currency of the country in which the bank is incorporated. These financial statements are presented in Sterling (GBP) and amounts are rounded to the nearest thousand pounds, except when otherwise indicated.

d) Basis of measurement

These financial statements have been prepared on the historical cost basis.

e) Critical accounting estimates

The preparation of the financial statements in accordance with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise judgement in the process of applying the accounting policies. In this regard, management has applied such judgement relating to loan impairments, taxation and credit risk.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

3) Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these financial statements.

a) Interest income and expense

Interest income and interest expense are recognised in the statement of comprehensive income for all interest bearing financial instruments classified as held to maturity or other loans and receivables using the effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial asset or liability (or group of assets and liabilities) and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts the expected future cash payments or receipts through the expected life of the financial instrument, or when appropriate, a shorter period, to the net carrying amount of the instrument. The application of the method has the effect of recognising income (and expense) receivable (or payable) on the instrument evenly in proportion to the amount outstanding over the period to maturity or repayment.

b) Foreign currency

Transactions in foreign currencies are translated to the functional currency, Sterling, at the exchange rate at the date of the transaction. Monetary assets and liabilities denominated in foreign currency are translated into Sterling at the closing exchange rate and resultant gains and losses on translation are included in the statement of comprehensive income.

c) Fees and commissions

Fees and commissions are recognised on an accruals basis as the service is provided.

d) Impairment of financial assets

At each reporting date the Bank assesses whether there is objective evidence that a financial asset (or group of financial assets), not carried at fair value through profit or loss, is impaired.

The Bank will regard a financial asset as impaired when, based on current information and events such as default, non-payment of principal and interest for a period of 90 days and/or bankruptcy and/or liquidation, it is considered that the creditworthiness of the borrower has undergone a deterioration such that it expects that the recoverable amount of the asset is below the then current carrying amount. For available for sale investments a significant or prolonged decline in it’s fair value below it’s cost is objective evidence of impairment in general, the bank considers a decline in 20% to be significant and a period of nine months to be prolonged.

The Bank considers evidence of impairment at both a specific asset and collective level. All individually significant financial assets are assessed for specific impairment. Assets that are not individually significant are collectively assessed for impairment by grouping together financial assets (carried at amortised cost) with similar credit risk characteristics, taking into account asset type, industry, geographic location, collateral type, past due status, historical loss experience and other relevant factors.

When a subsequent event causes the amount of impairment loss to decrease, the impairment loss (or proportion of the impairment loss) is reversed through the statement of comprehensive income.

e) Property and equipment

Items of property and equipment are measured at cost less accumulated depreciation and accumulated impairment losses.

Cost includes expenditures that are directly attributable to the acquisition of the asset. Purchased software that is integral to the functionality of the related equipment is capitalised as part of that equipment.

The estimated useful lives for the current year are as follows:

Freehold buildings	50 years
Fixtures fittings and furniture	10 years
IT equipment and software	5 years

Depreciation methods, useful lives and residual values are reassessed at each financial year end and adjusted if appropriate.

f) Capital work in progress

The Bank capitalises all costs relating to assets as capital work in progress, until the date of completion and commissioning of the assets. The costs are transferred from capital work in progress to the appropriate asset category upon completion and commissioning and amortised over their useful economic lives from the date of such completion and commissioning.

g) Intangible assets

Intangible assets comprise computer software which is not considered as an integral part of the related hardware. Intangible assets acquired by the Bank and which have finite useful lives are measured at cost less accumulated amortisation and impairment losses, if any. Other intangible assets acquired by the Group and which have infinite useful lives are measured at cost less accumulated impairment losses, if any.

Software is depreciated when the Bank is able to use the software in a manner that will generate future economic benefits, and can reliably measure the costs to complete development.

Amortisation

Amortisation is recognised in the consolidated income statement on a straight line basis over the estimated useful lives of the intangible assets from the date they are available for use. The estimated useful lives for the current and comparative periods are as follows:

Computer software	5 years

h) Financial assets and financial liabilities

i) Recognition

The Bank initially recognises loans, advances and deposits at fair value on the date at which they are originated.

ii) Derecognition

The Bank derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire, or when it transfers the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred.

The Bank derecognises a financial liability when its contractual obligations are discharged or cancelled or expire.

iii) Offsetting

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when and only when the Bank has a legal right to set off the recognised amounts and it intends either to settle on a net basis or to realise the asset and liability simultaneously.

Income and expenses are presented on a net basis only when permitted by IFRS, or for gains and losses arises from similar transactions such as the bank’s trading activity.

iv) Amortised cost measurement

The amortised cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus the principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initial amount recognised and the maturity amount minus any reduction for impairment.

v) Fair value measurement

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction on the measurement date.
When a market for a financial instrument is not active, the bank establishes fair value using valuation techniques. Valuation techniques include using recent arm's length transactions between knowledgeable, willing parties (if available), reference to the current fair value of other instruments that are substantially the same, net present value techniques and discounted cash flow methods. The chosen valuation technique makes maximum use of market inputs, relies as little as possible on estimates specific to the Bank, incorporates all factors that market participants would consider in setting a price, and is consistent with accepted economic methodologies for pricing financial instruments. Inputs to valuation techniques reasonably represent market expectations and measures of the risk-return factors inherent in the financial instrument.

Assets are measured at a bid price.

i) Cash and cash equivalents

Cash and cash equivalents include cash in hand and funds held with banks on current account with no contractual maturity.

j) Loans and advances

Loans and advances are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and that the Bank does not intend to sell immediately or in the near term.

Loans and advances are initially measured at fair value and subsequently measured at their amortised cost using the effective interest method, except when the Bank chooses to carry the loans and advances at fair value through profit or loss.

k) Available for sale investments

The Bank's debt securities are classified as available for sale investments.
Available-for-sale investments are non-derivative financial assets that are designated as available-for-sale and that are not classified as held-to-maturity investments, or at fair value through profit or loss, or loans and receivables. Subsequent to initial recognition, they are measured at fair value and changes therein, other than impairment losses and foreign currency differences on available-for-sale equity instruments, are recognised in other comprehensive income and presented within equity in the fair value reserve. When an investment is derecognised, the cumulative gain or loss in other comprehensive income is transferred to the statement of comprehensive income.
Available for sale investments are those intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchanges rates or equity prices.
Available for sale investments are initially recognised on trade date (the date on which the Bank commits to purchase the asset). These investments are subsequently carried at fair value.

Gains and losses arising from changes in fair value of the available for sale financial assets other than foreign exchange gains and losses from monetary items are recognised directly in equity, until the financial asset is derecognised or impaired at which time the cumulative gains or losses previously recognised in equity is recognised in profit or loss.

Interest income on available for sale equity instruments are recognised in the income statement when the entity's right to receive payment is established.

The fair values of quoted investments in active markets are based on current bid prices. If the market for a financial assets is not active (and for unlisted securities), the Bank establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants.

l) Pension Liabilities

The Bank operates a defined contribution pension scheme and the amount charged to the Statement of Comprehensive Income in respect of pension costs is the contribution payable in the period.

m) Taxation

Current tax is the expected tax payable on the taxable income for the year using tax rates enacted at the date of the statement of financial position.

Deferred tax is provided on temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

n) VAT

Expenses are recognised gross of any amounts of value added tax. Where value added tax is recoverable in part from the taxation authorities it is reflected as income within the Statement of Comprehensive Income.

o) Segmental Reporting

No segmental analyses have been prepared as all the Bank's income derives from the single activity of commercial banking in the United Kingdom.

p) Dealing and Exchange Profit

Dealing and exchange profit relates to foreign exchange income derived from currency transactions and the revaluation of assets and liabilities denominated in currencies other than Sterling.

q) Identity of related parties

Related parties comprise the shareholder and its related entities, directors and key management of the Bank. The Bank, in the ordinary course of business, enters into transactions, at agreed terms and conditions, with other business enterprises or individuals that fall within the definition of related party contained in International Accounting Standard 24.

4) Interest expense

	Year ended 31 December 2012 GBP 000	Year ended 31 December 2011 GBP 000
Interest paid to related entities	153	317
Other interest paid on deposits	43	65
	196	**382**

5) Fees and commissions

	Year ended 31 December 2012 GBP 000	Year ended 31 December 2011 GBP 000
International commission	380	478
Domestic commission	201	89
Other income	44	82
	625	**649**

6) Administration expenses

	Note	Year ended 31 December 2012 GBP 000	Year ended 31 December 2011 GBP 000
Wages and salaries including directors		1,024	990
Social security costs		142	138
Other pension costs		31	29
Total staff costs	7	1,197	1,157
Fees payable to the Bank's auditors for the audit of the Bank's financial statements		25	36
Fees payable to the Bank's auditors for taxation compliance advice		16	23
Other administration expenses		652	554
Total administration expenses		**1,890**	**1,770**

7) Staff Costs

	Year ended 31 December 2012 GBP 000	Year ended 31 December 2011 GBP 000
Staff		
Salary and allowances	799	717
Social security costs	103	93
Pension costs	31	29
	933	839
Directors		
Salary and allowances	225	273
Social security costs	39	45
	264	318
Total staff costs	**1,197**	**1,157**

The average number of persons employed by the Bank during the period was made up as follows:	Year ended 31 December 2012	Year ended 31 December 2011
Executive directors	2	2
Non-executive directors	2	4
Executive management	4	3
Clerical and other grades	19	18
	27	**27**

8) Pension costs

The Bank makes defined contributions to the personal pension funds of employees under Group Personal Pension arrangements. Contributions are recognised in the Statement of Comprehensive Income as they are payable.

9) Directors' Emoluments

The total emoluments of the directors were £225,000 (2011 - £273,000). The highest paid director received emoluments of £93,000 in 2012. The highest paid director in 2011 received £63,000.

10) Property and Equipment

	Freehold Property GBP 000	Computer Equipment GBP 000	Furniture & Equipment GBP 000	Work in Progress GBP 000	Total GBP 000
Cost					
Cost at 1 January 2012	2,560	37	43	365	3,005
Additions in the year	-	-	-	-	-
Transfers	-	-	-	(365)	(365)
Cost at 31 December 2012	2,560	37	43	-	2,640
Accumulated depreciation					
Depreciation at 1 January 2012	(85)	(8)	(5)	-	(98)
Depreciation charged for the year	(51)	(8)	(4)	-	(63)
Depreciation at 31 December 2012	(136)	(16)	(9)	-	(161)
Net book value at 31 December 2012	**2,424**	**21**	**34**	**-**	**2,479**

10) Property and Equipment (continued)

	Freehold Property GBP 000	Computer Equipment GBP 000	Furniture & Equipment GBP 000	Work in Progress GBP 000	Total GBP 000
Cost					
Cost at 1 January 2011	**2,560**	**37**	**42**	**307**	**2,946**
Additions in the period	**0**	**0**	**1**	**58**	**59**
Cost at 31 December 2011	**2,560**	**37**	**43**	**365**	**3,005**
Accumulated depreciation					
Balance at 1 January 2011	**(34)**	**(1)**	**-**	**-**	**(35)**
Depreciation charged for the year	**(51)**	**(7)**	**(5)**	**-**	**(63)**
At 31 December 2011	**(85)**	**(8)**	**(5)**	**0**	**(98)**
Net book value at 31 December 2011	**2,475**	**29**	**38**	**365**	**2,907**

Work in Progress

The Bank has contracted to implement a replacement core banking system. Implementation remains ongoing at the reporting date. The project will bring economic benefits in terms of enhanced product development facilities and cost savings through increased automation. The Board of Directors have approved total project costs of GBP 781,000.

Work in Progress expenditure at 31 December comprised**:**

	2012 GBP 000	2011 GBP 000
Purchase of application licences	-	187
External consultancy	-	123
Equipment	-	55
	-	365

Work in progress assets were transferred in full on 31 December 2012 to Intangible assets and amortised for the period from 1st July 2012.

11) Intangible assets

	Computer software GBP 000	**Total GBP 000**
Cost		
Balance at 1 January 2012	-	-
Transfer from Capital work in progress	365	365
Balance at 31 December 2012	365	365
Accumulated amortization		
Balance at 1 January 2012	-	-
Amortization for the year	(21)	(21)
Balance at 31 December 2012	(21)	(21)
Net book value at 31 December 2012	344	344

12) Taxation

Analysis of tax charge

	Year ended 31 December 2012 GBP 000	Year ended 31 December 2011 GBP 000
Current tax being United Kingdom Corporation Tax for the period at 24.50% (2011 26.5%)	26	(2)
Deferred tax arising from timing differences in recognition	(107)	51
(Credit)/ Charge for year	**(81)**	**49**

Reconciliation of total tax charge

	Year ended 31 December 2012 GBP 000	Year ended 31 December 2011 GBP 000
Tax on profit from ordinary activities – being UK Corporation Tax at 24.50% (2011 – 26.5%)	(74)	(103)
(Loss)/profit from ordinary activities before tax	(302)	(390)
Tax at 24.50% (2011 – 26.5%)	(74)	(103)
Tax paid on pre subsidiarisation activities	-	95
Tax in relation to prior year	26	22
Effect of expenses not deductible for tax purposes	74	(16)
Tax values in excess of asset values	(107)	51
(Credit) / Charge for the year	**(81)**	**49**

Analysis of deferred tax asset

	Year ended 31 December 2012 GBP 000	Year ended 31 December 2011 GBP 000
Asset values in excess of the tax values of those assets	64	51

On 21 March 2012 the Chancellor announced the reduction in the main rate of UK corporation tax from 25 per cent to 23 per cent with effect from 1 April 2013. This change became substantively enacted on 3 July 2012 and therefore the effect of the rate reduction creates a reduction in the deferred tax asset which has been included in the figures above.

The Chancellor also proposed changes to further reduce the main rate of corporation tax by two per cent to 21 per cent by 1 April 2014, but these changes have not yet been substantively enacted and therefore are not included in the figures above. The overall effect of the further reductions from 23 per cent to 21 per cent, if these applied to the deferred tax balance at 31 December 2012, would be to further reduce the deferred tax asset by approximately £6k.

13) Loans and advances to banks

	As at 31 December 2012 GBP 000	As at 31 December 2011 GBP 000
Repayable within one month	65,971	41,604
Repayable within three months	4,693	20,124
Repayable with agreed maturity within 1 year or less but greater than 3 months	-	1,303
	70,664	**63,031**

Loans and advances to banks include GBP 436,000 (2011 GBP 571,000) advanced to a Group company.

14) Loans and advances to customers

	As at 31 December 2012		
	Gross amount GBP 000	Impairment allowance GBP 000	Carrying amount GBP 000
Personal loans and advances	2,658	-	2,658
Commercial loans and advances	4,111	43	4,068
	6,769	**43**	**6,726**

	As at 31 December 2011		
	Gross amount GBP 000	Impairment allowance GBP 000	Carrying amount GBP 000
Personal loans and advances	1,173	-	1,173
Commercial loans and advances	2,492	25	2,467
	3,665	**25**	**3,640**

Full provision has been made against loans assessed to be impaired. The carrying value of impaired loans is GBP nil (2011 GBP nil).

15) Investments

	As at 31 December 2012 GBP 000	As at 31 December 2011 GBP 000
Held to Maturity	-	3,994
Available for sale	2,215	-
	2,215	**3,994**

Investments are debt securities issued by the UK and Sri Lankan governments and supra nationals are held for liquidity asset buffer purposes in accordance with BIPRU 12 and as investments. These securities were classified as held to maturity, but during July 2012 the Bank reclassified these debt securities and classified them as available for sale.

16) Deposits by banks

	As at 31 December 2012 GBP 000	As at 31 December 2011 GBP 000
Repayable on demand or at short notice	3,996	27,451
Repayable with agreed maturity within three months	46,775	6,289
Repayable with agreed maturity within 1 year or less but greater than 3 months	15,648	15,908
	66,419	49,648
Amounts include the following Group deposits:		
Repayable on demand or at short notice	2,348	19,814
Repayable with agreed maturity within three months	26,800	6,289
Repayable with agreed maturity within 1 year or less but greater than 3 months	15,648	15,908
	44,796	42,011

17) Deposits by customers

	As at 31 December 2012 GBP 000	As at 31 December 2011 GBP 000
Repayable on demand or at short notice	3,917	3,688
Repayable with agreed maturity within three months	399	9,692
1 year or less but greater than 3 months	222	193
	4,538	13,573

Deposits repayable on demand include GBP 7,000 (2011 - GBP 125,000) held as collateral against guarantees issued by the Bank.

18) Other Liabilities

	As at 31 December 2012 GBP 000	As at 31 December 2011 GBP 000
Accrued expenses	68	81
Trade payables	104	122
	172	203

19) Share Capital

	As at 31 December 2012 GBP 000	As at 31 December 2011 GBP 000
15,000,000 (2011: 12,119,611) Authorised, issued and fully paid shares of GBP 1 each	15,000	12,120

20) Related Parties

The Bank of Ceylon (UK) Limited is a wholly owned subsidiary of Bank of Ceylon, a licensed commercial bank established in Sri Lanka under the Banking Act No. 30 of 1988 and owned by the Government of Sri Lanka. The registered office of the Parent is situated at No. 04, Bank of Ceylon Mawatha, Colombo 01, Sri Lanka. Copies of the Parent consolidated accounts can be obtained from this address or accessed through the internet at http://www.boc.lk/bochome/aboutus/stat.jsp .

20) Related Parties (continued)

The Bank has a related party relationship with it's Parent, associates, directors and executive officers including business entities over which they can exercise control or significant influence or which can exercise significant influence over the Banks. The Bank's management is of the opinion that the terms of such transactions are not significantly different from those that could have been obtained from third parties.

The Bank of Ceylon (UK) Limited transacts with its parent group on a commercial basis. No charges were levied during the year (2011 GBP nil) but GBP 153,000 (2011 GBP317,000) was paid in interest on deposits held. At 31 December 2012 Bank of Ceylon (UK) Limited held GBP 44,796,000 (2011 GBP 42,011,000) of deposits from Bank of Ceylon.

21) Contingent Liabilities

	As at 31 December 2012	As at 31 December 2011
	GBP 000	GBP 000
Guarantees Issued	211	1,078
Documentary credits and short term trade related transactions	1,732	566
	1,943	1,644

22) Interest rate risk

31 December 2012	Total	0-3 Months	3-12 Months	Over 1 Year	Non Interest Bearing
	GBP 000	GBP 000	GBP 000	GBP 000	GBP 000
Assets					
Cash at bank and in hand	2,820	-	-	-	2,820
Loans and advances to banks	70,664	65,971	4,693	-	-
Loans and advances to customers	6,726	850	1,969	3,907	-
Debt securities	2,215	1,209	1,006	-	-
Property and equipment	2,479	-	-	-	2,479
Intangible assets	344	-	-	-	344
Deferred tax and other assets	246	-	-	-	246
Total assets	**85,494**	**68,030**	**7,668**	**3,907**	**5,889**
Liabilities					
Deposits by Banks	66,419	50,771	15,648	-	-
Customer accounts	4,538	4,316	222	-	-
Other liabilities	172	-	-	-	172
	71,129	55,087	15,870	-	172
Share capital	15,000	-	-	-	15,000
Fair value reserve	15	-	-	-	15
Retained earnings	(650)	-	-	-	(650)
Total liabilities and equity	**85,494**	**55,087**	**15,870**	**-**	**14,537**
Net interest gap		12,943	(8,202)	3,907	(8,648)
Cumulative interest gap		12,943	4,741	8,648	-

22) Interest rate risk (continued)

31 December 2011	Total	0-3 Months	3-12 Months	Over 1 Year	Non Interest Bearing
Assets	**GBP 000**	**GBP 000**	**GBP 000**	**GBP 000**	**GBP 000**
Cash at bank and in hand	1,320	-	-	-	1,320
Loans and advances to banks	63,031	61,728	1,303	-	-
Loans and advances to customers	3,640	1,344	-	2,296	-
Debt securities	3,994	2,994	-	1,000	-
Property and equipment	2,907	-	-	-	2,907
Deferred tax and other assets	223	-	-	-	223
Total assets	**75,115**	**66,066**	**1,303**	**3,296**	**4,450**
Liabilities					
Deposits by Banks	49,648	33,740	15,908	-	-
Customer accounts	13,573	13,380	193	-	-
Other liabilities	203	-	-	-	203
	63,424	47,120	16,101	-	203
Share capital	12,120	-	-	-	12,120
Retained earnings	(429)	-	-	-	(429)
Total liabilities and equity	**75,115**	**47,120**	**16,101**	**-**	**11,894**
Net interest gap		18,946	(14,798)	3,296	(7,444)
Cumulative interest gap		18,946	4,148	7,444	-

A parallel shift increase of 2% in interest rates would bring additional income of GBP 174,000 (2011 - GBP 305,000). A 2% reduction in rates would have a similar but opposite effect.

23) Maturity Analysis

31 December 2012	**Total**	**0-3 Months**	**3-12 Months**	**Over 1 Year**	**Undated**
	GBP 000	**GBP 000**	**GBP 000**	**GBP 000**	**GBP 000**
Assets					
Cash at bank and in hand	2,820	2,820	-	-	-
Loans and advances to banks	70,664	65,971	4,693	-	-
Loans and advances to customers	6,726	850	1,969	3,907	-
Debt securities	2,215	1,209	1,006	-	-
Property and equipment	2,479	-	-	-	2,479
Intangible assets	344	-	-	-	344
Deferred tax and other assets	246	246	-	-	-
Total assets	**85,494**	**71,096**	**7,668**	**3,907**	**2,823**
Liabilities					
Deposits by Banks	66,419	50,771	15,648	-	-
Customer accounts	4,538	4,316	222	-	-
Other liabilities	172	-	-	-	172
	71,129	55,087	15,870	-	172
Share capital	15,000	-	-	-	15,000
Fair value reserve	15	-	-	-	15
Retained earnings	(650)	-	-	-	(650)
Total liabilities and equity	**85,494**	**55,087**	**15,870**	**-**	**14,537**
Net maturity gap		16,009	(8,202)	3,907	(11,714)
Cumulative maturity gap		16,009	7,807	11,714	-

23) Maturity Analysis (continued)

31 December 2011	Total	0-3 Months	3-12 Months	Over 1 Year	Undated
	GBP 000	GBP 000	GBP 000	GBP 000	GBP 000
Assets					
Cash at bank and in hand	1,320	1,320	-	-	-
Loans and advances to banks	63,031	61,728	1,303	-	-
Loans and advances to customers	3,640	2,018	58	1,564	-
Debt securities	3,994	2,994	-	1,000	-
Property and equipment	2,907	-	-	-	2,907
Deferred tax and other assets	223	223	-	-	-
Total assets	**75,115**	**68,283**	**1,361**	**2,564**	**2,907**
Liabilities					
Deposits by Banks	49,648	33,740	15,908	-	-
Customer accounts	13,573	13,380	193	-	-
Other liabilities	203	-	-	-	203
	63,424	47,120	16,101	-	203
Share capital	12,120	-	-	-	12,120
Retained earnings	(429)	-	-	-	(429)
Total liabilities and equity	**75,115**	**47,120**	**16,101**	**-**	**11,894**
Net maturity gap		21,163	(14,740)	2,564	(8,987)
Cumulative maturity gap		21,163	6,423	8,987	0

24) Foreign exchange exposure

The Bank's exposure to foreign currency risk, based on notional amounts, was as follows:

31 December 2012	Total	GBP	Euro	JPY	USD
Assets	GBP 000	GBP 000	GBP 000	GBP 000	GBP 000
Cash at bank and in hand	2,820	478	1,495	1	846
Loans and advances to banks	70,664	64,500	-	-	6,164
Loans and advances to customers	6,726	5,226	-	-	1,500
Debt securities	2,215	2,215	-	-	-
Property and equipment	2,479	2,479	-	-	-
Intangible assets	344	344	-	-	-
Deferred tax and other assets	246	190	-	-	56
Total assets	**85,494**	**75,432**	**1,495**	**1**	**8,566**
Liabilities					
Deposits by Banks	66,419	59,427	1,445	-	5,547
Customer accounts	4,538	4,141	41	-	356
Other liabilities	172	161	-	-	11
	71,129	63,729	1,486	-	5,914
Share capital	15,000	15,000	-	-	-
Fair value reserve	15	15	-	-	-
Retained earnings	(650)	(650)	-	-	-
Total liabilities and equity	**85,494**	**78,094**	**1,486**	**-**	**5,914**
Gross exposure (liability)		(2,662)	9	1	2,652
Foreign exchange contracts		2,500	-	-	(2,500)
Net exposure (liability)		**(162)**	**9**	**1**	**152**

24) Foreign exchange exposure (continued)

31 December 2011	Total GBP 000	GBP GBP 000	Euro GBP 000	LKR GBP 000	USD GBP 000
Assets					
Cash at bank and in hand	1,320	282	93	29	916
Loans and advances to banks	63,031	41,216	16,544	-	5,271
Loans and advances to customers	3,640	2,006	-	-	1,634
Debt securities	3,994	2,000	-	1,994	-
Property and equipment	2,907	2,907	-	-	-
Deferred tax and other assets	223	203	-	20	
Total assets	**75,115**	**48,614**	**16,637**	**2,043**	**7,821**
Liabilities					
Deposits by Banks	49,648	34,146	6,786	-	8,716
Customer accounts	13,573	3,522	9,615	-	436
Other liabilities	203	151	43	5	4
	63,424	37,819	16,444	5	9,156
Share capital	12,120	12,120	-	-	-
Retained earnings	(429)	(429)	-	-	-
Total liabilities and equity	**75,115**	**49,510)**	**16,444**	**5**	**9,156**
Gross exposure (liability)		(896)	193	2,038	(1,335)
Foreign exchange contracts		-	-	(1,298)	1,298
Net exposure (liability)		**(896)**	**193**	**740**	**(37)**

At 31 December 2012 a 5% strengthening of Sterling against the Euro would have reduced profits by GBP 0 (2011 - reduced profits by GBP 10,000) whilst a 5% strengthening of Sterling against the Sri Lankan Rupee would have reduced profits by GBP Nil (2011: Nil). In each case a weakening of Sterling would have had an equal but opposite effect.

25) Risk management

The Bank has exposure to the following risks:

- credit risk
- liquidity risk
- market risk
- operational risk

The management of these risks is set out in the Directors' Report.

25) Risk management (continued)

As a financial institution, the Bank's maximum exposure to Credit Risk comprises all assets other than cash on hand, property and equipment and certain sundry debtors.

	As at 31 December 2012 GBP 000	As at 31 December 2011 GBP 000
Cash at bank	2,683	1,182
Loans and advances to banks	70,664	63,031
Loans and advances to customers	6,726	3,640
Investments	2,215	3,994
Other assets	84	107
Maximum credit risk exposure	82,372	71,954
Investment grade assets	65,498	51,266
Other assets	16,874	20,688
	82,372	71,954

Exposure to Liquidity Risk arises from the difficulty in meeting obligations settled by delivering cash or another financial asset. The maturity of all assets and liabilities are shown in note 22 above. The Bank did not have any derivative exposures at the year end and hence no further liquidity exposure.

Market risk is considered to comprise three elements, Interest Rate Risk (assessed in Note 21 above), Foreign Exchange Risk (assessed in Note 23 above) and Price Risk. The Bank's holdings of debt securities comprise UK Government Gilts and International Bank for Reconstruction and Development Bonds held for liquidity asset buffer purposes in accordance with BIPRU 12 together with Sri Lankan Treasury Bills. These assets were valued at GBP 2,200,000 at 31 December 2012 (investments at 31 December 2011 were GBP 3,994,000). A 5% movement in the value of investments would impact reserves by GBP 110,000 (2011 GBP 200,000).

26) Fair Value

The term "financial instrument" includes both financial assets and financial liabilities. The fair value of a financial instrument is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.
The Bank analyses financial instruments held at fair value into the three categories as outlined below.

- Level 1 financial instruments are those that are valued using unadjusted quoted prices in active markets for identical financial instruments. These financial instruments consist primarily of liquid listed equity shares and certain exchange-traded derivatives.

- Level 2 financial instruments are those valued using techniques based primarily on observable market data. Instruments in this category are valued using quoted prices for similar instruments or identical instruments in markets which are not considered to be active; or valuation techniques where all the inputs that have a significant effect on the valuation are directly or indirectly based on observable market data. Financial instruments included are other government agency securities, investment-grade corporate bonds, less liquid listed equities, state and municipal obligations, certain money market securities and most OTC derivatives.

26) Fair Value (continued)

- Level 3 financial instruments are those valued using techniques that incorporate information other than observable market data. Instruments in this category have been valued using a valuation technique where at least one input, which could have a significant effect on the instrument's valuation, is not based on observable market data. Financial instruments included are primarily unlisted equity shares.

2012

	Level 1 GBP 000	Level 2 GBP 000	Level 3 GBP 000	Total GBP 000
Financial instrument assets				
Debt Securities	2,215	-	-	2,215
Loans and advances to customers	-	6,726	-	6,726
Total	**2,215**	**6,726**	**-**	**8,941**

2011

	Level 1 GBP 000	Level 2 GBP 000	Level 3 GBP 000	Total GBP 000
Financial instrument assets				
Debt securities	2,000	1,994	-	3,994
Loans and advances to customers	-	3,640	-	3,640
Total	**2,000**	**5,634**	**-**	**7,634**

27) Capital Management

The Bank's approach to capital management is as set out in the Directors' Report. The regulatory capital base of the Bank was GBP 14,416,000 at 31 December 2012 (GBP 11,691,000 at 31 December 2011). The Bank complied with all regulatory capital requirements throughout the year.

28) Subsequent events

There were no subsequent events.