

AUDITORS' REPORT

**The Shareholders,
Bhutan National Bank Ltd.
Thimphu, Bhutan.**

We have audited the attached Balance Sheet of Bhutan National Bank Ltd. as at 31st December, 2006 and also the Profit & Loss Account and the Cash Flow Statement annexed thereto for the year ended on that date in which are incorporated 3 branches (Phuentsholing, Thimphu and Paro) audited by us and the returns of 2 branches (Mongar and Gelephu) and 2 extension offices (Samdrupjongkhar, Trashigang) which have not been audited by us. The returns received from these unaudited offices have been found to be adequate for the purpose of consolidation. These financial statements are the responsibility of the Bank's Management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our Audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion. As required by section 75 of the Companies Act of the Kingdom of Bhutan 2000 read with section II of the Schedule XIV thereto (the Minimum Audit examination and Audit Reporting Requirements issued by the Royal Audit Authority), we enclose in the Annexure A a statement on the matters specified therein to the extent applicable to the Bank.

Further to our comments in the Annexure referred to above, we report that :

1. We have obtained all the information and explanations, which to the best of our knowledge and belief, were necessary for the purpose of our audit and have found them to be satisfactory.
2. In our opinion, proper books of account have been kept by the Bank so far as it appears from our examinations of those books.
3. The Bank has complied with the various provisions of the Financial Institution Act 1992 and other applicable laws, rules & regulations, systems, procedures and practices except otherwise stated else where in this report.
4. The Balance Sheet and Profit & Loss account dealt with by this report have been prepared on the basis of generally accepted accounting principles and are in agreement with the books of account.
5. Adjustment of certain items in sundry receivable accounts Nu.10,972,348.62 (previous year Nu. 16,083,338.16), sundry payables account Nu.11,755,853.28 (previous year

Nu.23,932,308.14) as mentioned in Note 7 of Schedule 11 may have impact on profitability, which is not readily ascertainable.

- 6. In our opinion, as shown by the books of the Bank, and to the best of our information and according to the explanations given to us, the said Balance Sheet and Profit & Loss Account and the Cash Flow Statement read together with Schedule 1 to 11 and subject to para 5 of the above and our comments in the Annexure-A attached herewith give the information under The Companies Act of the Kingdom of Bhutan 2000 in the manner so required and exhibit a true and fair view:
 - a) In case of the Balance Sheet, of the state of affairs of the Bank as at 31st December, 2006;
 - b) In case of the Profit & Loss Account, of the profit of the Bank for the year ended on that date;

AND

- c) In the case of Cash Flow Statement, of the cash flows for the year ended on that date.

DATE: 07/4/2007

PLACE: KOLKATA

For S.N. Mukherji & Co.
CHARTERED ACCOUNTANTS



A handwritten signature in blue ink, appearing to read "Sudip K. Mukherji".

Sudip K. Mukherji
Partner

BALANCE SHEET AS AT 31st DECEMBER 2006

	SCHEDULE	31st DEC 2006		31st DEC 2005	
		Nu.	ch.	Nu.	ch.
<u>CAPITAL AND LIABILITIES</u>					
Share Capital	1	119,008,000.00		119,008,000.00	
Reserves	2	705,575,870.02		638,856,207.44	
Deposits	3	8,622,910,434.81		6,424,627,251.87	
Current Liabilities	4	131,666,916.19		188,681,092.89	
Provisions	5	472,672,824.70		428,239,744.67	
Total Liabilities		<u>10,051,834,045.72</u>		<u>7,799,412,296.87</u>	
<u>ASSETS</u>					
Cash and Bank Balances	6	4,265,336,688.38		3,014,739,244.44	
Investments	7	584,927,237.30		723,431,565.19	
Loans and Advances	8	5,094,539,649.59		3,961,993,988.49	
Fixed Assets (at cost, less depreciation)	9	79,807,282.77		71,782,119.15	
Other Assets	10	27,223,187.68		27,465,379.60	
Total Assets		<u>10,051,834,045.72</u>		<u>7,799,412,296.87</u>	
<u>SIGNIFICANT ACCOUNTING POLICIES</u>					
<u>&</u>					
<u>NOTES ON ACCOUNTS</u>	11		0.00		0.00

The Schedules referred to above form part of the Balance Sheet.

This is the Balance Sheet referred to in our report of even date.

for S.N. Mukherji & Co.
Chartered Accountants

Sudip K. Mukherji
Partner

Date : 07/4/2007
Place: Kolkata



CHAIRPERSON

CHIEF EXECUTIVE
OFFICER

PROFIT & LOSS ACCOUNT

for the year-ended 31st DECEMBER 2006

PARTICULARS

	<u>31st DEC 2006</u>		<u>31st DEC 2005</u>	
	Nu.	ch.	Nu.	ch.
Interest on loans	502,958,274.13		421,292,160.54	
Interest on bills & cheques	612,431.10		473,411.30	
Interest on deposits with other banks	54,854,621.95		26,695,418.09	
Interest on RGOB & RMA bills and CRR	56,693,298.00		60,801,934.23	
Interest Income	615,118,625.18		509,262,924.16	
Interest on savings deposits	23,758,620.61		21,098,129.14	
Interest on fixed deposits(including FTU)	211,518,113.45		176,728,052.58	
Interest on recurring deposits	22,093.31		39,563.45	
Interest on miscellaneous accomodations	764,101.53		798,030.37	
Interest Expenses	236,062,928.90		198,663,775.54	
Interest Differential	379,055,696.28		310,599,148.62	
Exchange, commissions, & recoveries	48,920,447.63		39,427,936.68	
Dividends (Gross)	2,759,180.00		3,183,822.00	
Forex gains	0.00		32,197,549.93	
Fees Income	11,833,855.47		10,317,849.27	
Rents & other receipts	42,900.50		141,000.60	
Other Income	63,556,383.60		85,268,158.48	
Gross Operating Income	442,612,079.88		395,867,307.10	
Employment costs	76,464,298.83		41,597,874.54	
Establishment overheads	8,518,766.26		8,312,038.55	
Communication costs	8,750,000.45		7,246,682.70	
Travelling expenses	7,856,959.39		6,359,510.50	
Vehicles expenses	610,616.22		571,079.67	
Computer running & maintenances	4,821,903.69		3,077,170.63	
Advertisements & publicity	823,358.90		1,160,869.67	
Entertainments	734,873.19		389,453.97	
Gifts	87,837.50		83,561.00	
Donations	400,000.00		100,000.00	
HRD costs	13,295,416.00		11,280,298.56	
Audit fees	150,000.00		150,000.00	
Legal & Regulatory expenses	484,120.00		361,084.15	
Board meetings expenses	766,536.00		551,958.00	
Other banks charges, fees etc	1,618,720.71		1,323,295.51	
Stores	790,197.25		633,164.13	

Miscellaneous expenses	1,265,507.09	1,228,044.92
Depreciation	13,078,485.32	11,728,212.68
Operating Expenses	140,517,596.80	96,154,299.18
Net Operating Income (carried forward)	302,094,483.08	299,713,007.92
Net Operating Income		
Net Operating Income (brought forward)	302,094,483.08	299,713,007.92
Write-offs & losses	20,116,891.37	2,012,352.01
Charge for / (write-back of) provisions (net)	7,143,398.84	81,074,415.52
Profit Before Tax	274,834,192.87	216,626,240.39
Provision for taxation	82,450,257.86	64,987,872.12
Tax paid for earlier period	622,364.81	0.00
Profit After Tax	191,761,570.20	151,638,368.27
Balance in Profit & Loss Account (brought forward)	16,058,215.49	1,266,344.70
Transfer of Balance in Staff Training Fund	0.00	0.00
Profit Available for Appropriation	207,819,785.69	152,904,712.97
Proposed Dividend	119,008,000.00	83,305,600.00
Transfer to Foreign Exchange Fluctuation Reserve	0.00	8,049,387.00
Transfer To General Reserve	57,528,471.06	45,491,510.48
Balance in Profit & Loss Account (carried forward)	31,283,314.63	16,058,215.49

SIGNIFICANT ACCOUNTING POLICIES & NOTES ON ACCOUNTS (Schedule 11)

This is the Profit & Loss Account referred to in our report of even date

for S.N. Mukherji & Co.
Chartered Accountants

Sudip K. Mukherji
Partner

Date : 07/4/2007
Place: Kolkata



CHAIRPERSON

CHIEF EXECUTIVE
OFFICER

1. Provision against Loan amounting to Nu. 4,988,032.50 has been made during the year 2006 (Nu. 71,562,053.31 in 2005) as per the prudential guidelines issued by Royal Monetary Authority of Bhutan. Similarly interest earned but not collected amounting to Nu. 2,268,522.09 has not been recognised in 2006 (Nu. 4,399,376.39 in 2005) and kept under Interest-in-Suspense Account.
2. Guarantees given and Letters of Credit issued are outstanding at the year-end amounting to Nu. 633,945,968.49 and Nu. 119,802,651.80 respectively (Previous year Nu. 416,420,824.27 and Nu. 228,795,932.38 respectively). The total Margin Money collected against Guarantees amounts to Nu. 1,462,089.00 and against Letters of Credit Nu. 29,684,308.42 (Previous year Nu. 392,978.00 and Nu. 31,505,594.73 respectively).
3. Confirmation, being not available, book balances of loans, advances and other receivables are reflected in this account.
4. a) The bank has provided Nu.101,395,058.83 (Nu.79,040,000.00 in 2005) as required to be provided based on the figures of non – performing assets of this year under the Transitional Stipulation of the Prudential Guidelines, 2002 issued by Royal Monetary Authority of Bhutan and the same is included in the amount of provision as stated above.
 b) Misappropriation of loan under “Government Employee Loan” amounting to Nu. 20,244,713.37 (Principal & Interest) was detected by the Management in 2005 and necessary legal action has been taken to recover the amount. An amount of Nu. 799,930.72 was recovered and the balance amount of Nu. 19,444,782.65 has been written off from the books of account in 2006.
5. Provision for taxation includes :-

Tax on current year's profit	: Nu. 82,450,257.86
Less : Advance Tax Paid	: Nu. 45,452,584.30
(net of TDS)	-----
Payable	: Nu. 36,997,673.56
	=====
6. Capital work - in progress amounting to Nu.5,949,076.52 (previous year Nu. 288,000.00) represents the expenditure in connection with the payments against the purchase and installation of ATMs and HR Tools pending as on 31-12-2006.
7. Other assets (advance, claims, pre-payments, deferrals etc.) include balances in Sundry Receivables accounts aggregating to Nu. 10,972,348.62 (previous year Nu 16,083,338.16) pertaining to Banking Division pending settlement of claims by various parties. Similarly, Other Liabilities include an unadjusted balance in Sundry Payables Account of International Banking Division amounting to Nu. 11,755,853.28 (previous year Nu 23,932,308.14) representing

receipt from foreign sources pending identification of the payees.

8. Market value of Quoted Equity Investments at the end of the year is Nu. 49,429,400.00 (previous year Nu. 48,621,360.00).
9. Aggregate recoveries amounting to Nu.9,796,032.12 from old bad loan accounts (which were liquidated by Ministry of Finance, Royal Government of Bhutan at the time of incorporation of the Bank) have been paid to the Ministry of Finance during the year. Further recoveries made amounting to Nu. 163,500.00 against the same are included in Other Liabilities pending payment to Ministry of Finance, Royal Government of Bhutan..
10. Remuneration and expenditure paid, reimbursed or accrued to the Managing Director:

	Current year	Previous Year
Salary & other benefits	Nu. 1,357,410.00	Nu. 801,491.98
Vehicle Expenses	Nu. 225,937.04	Nu. 220,267.88
Travel-local/foreign	Nu. 326,569.00	Nu. 566,208.00
Medical reimbursement	Nu. -	Nu. 13,248.54
Training & Seminars	: Nu. 609,090.00	Nu. 423,924.00
Total	Nu. 2,519,006.04	Nu. 2,025,140.40

11. Tax assessment of the bank has been completed upto 31st December, 2005. The tax authorities demanded additional tax for Nu. 6,838,450.48 for the Income Year 2003-2005. The bank has appealed to the Revenue authorities against such demand. Pending appeal, the bank has made an adhoc payment of Nu.622,364.81 against the said additional tax demand. The matter is subjudice and the actual tax liability is not ascertainable.
12. During the year 2006 gain out of foreign exchange trading amounted to Nu. 3,752,126.66 (Nu. 24,318,756.72 in 2005) and loss on account conversion of foreign currency assets/liabilities at prevailing rates as on 31-12-2006 amounted to Nu.9,786,034.28 (gain of Nu.7,878,793.21 in 2005). The net loss of Nu. 6,033,907.62 has been adjusted with the Foreign Exchange Fluctuation Reserve as per RMA Prudential Regulations.
13. BNB Employees Gratuity Fund is a separate fund created under the aegis of BNB Employees Gratuity Trust. During the year a sum of Nu 8,474,427.97 (Nu. 949,137.20 in 2005) has been provided towards gratuity liability.
14. Previous Year's figures have been re-arranged & regrouped, wherever necessary.

