

THE
SRI LANKA FUND

Annual Report 2005

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Fund Manager's Review

We, as the Managers to the Fund, have pleasure in reporting to unit holders on the Fund's results for the year ended 31st December 2005.

Stock Market

The Colombo Bourse continued its bull run in year 2005 for the third year running with the All Share Index (ASI) recording a 27% growth, closing the year at 1,922.2 points. The Milanka Price Index grew by 18% during the year, closing at 2,451.1 points.

	Dec 04	Mar 05	Jun 05	Sept 05	Oct 05	Nov 05	Dec 05
ASI	1,506.9	1,751.9	1,897.8	2,434.4	2,516.4	2,292.4	1,922.2
Milanka	2,073.7	2,392.2	2,682.0	3,208.9	3,320.5	2,944.3	2,451.1
Avg. Turnover Rs. Mn	201.5	629.2	224.0	606.0	678.0	609.0	248.0
Market Cap. Rs. Bn	382.1	448.9	489.1	734.8	761.5	696.3	584.0

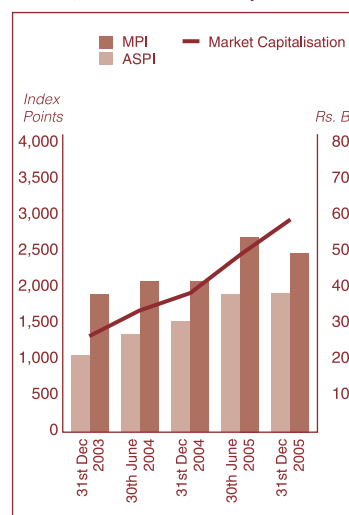
The largest IPO in the history of the Colombo Stock Exchange was witnessed with the listing of Dialog Telekom Limited, a subsidiary of Telekom Malaysia Berhad which raised Rs. 8.5 billion from the market. The Market Capitalisation of the Colombo Stock Exchange increased over 50% during the year from US\$ 3.8 billion end of December 2004 to US\$ 5.8 billion end of December 2005. This was mainly due to the listing of Dialog Telekom which enhanced the market capitalisation by US\$ 1.13 billion. Adding to the above was the spate of attractive IPO's which brought in enhanced levels of activity and liquidity into the market.

During the year 2005, domestic investors accounted for 78.4% of the annual turnover while foreigners accounted for only 21.6%. Net foreign inflow during the year amounted to Rs. 6,144 million. This was mainly due to listing of Dialog Telekom which attracted much foreign interest with the share being oversubscribed 11.6 times on the foreign component.

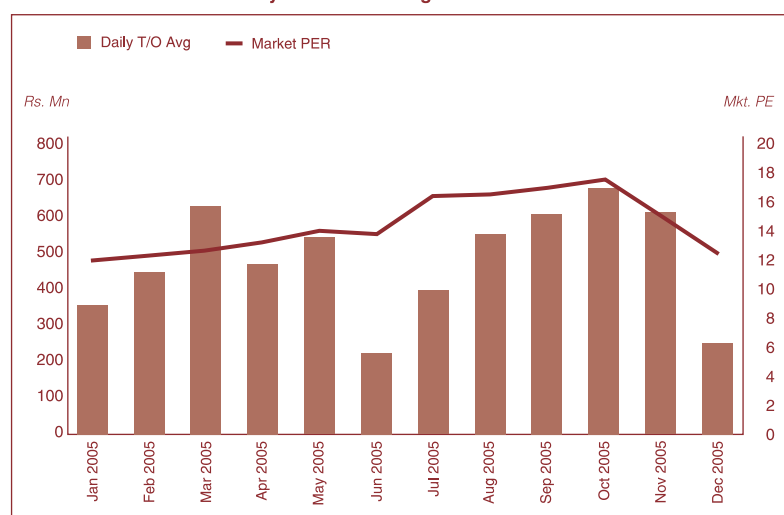
The market was very volatile during the year due to political and economic factors. The year started on a negative note given the devastation of the tsunami on Boxing Day in 2004 which

destroyed two-thirds of the coastal belt in Sri Lanka, killing over 40,000 people. The country is yet to recover from its impact; with the most affected sectors being tourism and fisheries. However, the Colombo Bourse bounced back with donor agencies pledging funds to rebuild the affected areas. This brought about much investor confidence and the country's economy proved its resilience.

ASPI, MPI and Market Capitalisation



Daily Turnover Average and Market PE



Fund Manager's Review (Contd.)

Performance of Regional Markets

The CSE was recognised as one of the best performing stock markets in Asia and one of the best in the world for the first ten months of the year. However, the market corrected from its all time high recorded in November due to the weakening security situation and political uncertainty.

Performance of the Fund

The total value of The Sri Lanka Fund inclusive of cash and cash equivalents amounted to US\$ 975,245 as at 31st December 2005 up from US\$ 671,396 as at 31st December 2004, a growth of 45%. The net asset value per unit too saw an increase of 51% from US\$ 1.31 in end 2004 to US\$ 1.98 end of 2005.

Redemptions during the year under review totalled US\$ 28,596 whilst the figure recorded last year was mere US\$ 353.

The Fund reported a net profit of US\$ 332,445 for the year ended 31st December 2005 when compared to the profit of \$ 164,483 in the corresponding period last year.

Total participating shares in issue as at end of December 2005 was 492,554.

Key investments of the portfolio were John Keells Holdings Limited (19%), Distilleries Company of Sri Lanka (4%) and Tea Plantations Investment Trust Plc (84%). The three companies

mentioned above are a proxy to the Sri Lankan economy given diversification into tourism, real estate, infrastructure & ports, telecommunication, insurance, plantations etc. These stocks are likely to perform well in the medium term. At present the Fund has little exposure to telecommunication sector and the Managers will focus on more acquisitions within this sector in the current year.

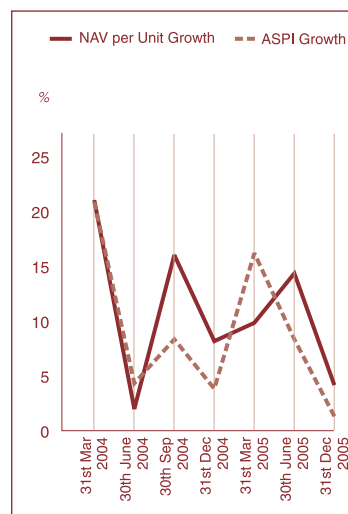
John Keells Holdings (JKH) is the second largest market capitalised company on the Colombo Stock Exchange. It has diversified interest into the most growth sectors of the economy having interest in leisure, transportation, food & beverages, financial services and information technology. Also they have exposure into prime property development projects through its investment in Asian Hotels and Properties Limited and the recent announcement of further investment in the sector with Associated Motorways, the agent for Nissan in Sri Lanka, who have a valuable land bank.

Distilleries Company of Sri Lanka (DCSL) is primarily into the sale of liquor in the country with a market share of 87%. Also it has investments in the Insurance sector and Telecommunication via its investments in Sri Lanka Insurance Company and Lanka Bell, both unquoted equity investments.

Performance of Regional Markets



Sri Lanka Fund NAV per Unit vs. ASPI



Tea Plantation Investment Trust plc is listed on the London Stock Exchange and has investment in plantation companies in Sri Lanka, both listed and unlisted. The increase in recent world rubber prices and tea prices is likely to pay dividends given its exposure to the main two commodities. Also the strengthening of the pound has given the Fund a hedge against the other world currencies.

Fund Manager's Review (Contd.)

Economy and Future Outlook

The Sri Lankan economy grew at 6% during the year 2005 demonstrating its resilience given the aftermath of the tsunami disaster end of 2004. The major contributor was the Service and Industrial sectors which grew by 6.4% and 8.3% respectively. The Agricultural sector grew marginally by 1.5% due to a slow recovery in the fishing sub-sector, even though both tea and paddy production reached record highs. The Industrial sector was driven by the textiles and garments despite the termination of the Multi Fibre Arrangement (MFA) in 2005. The Service sector growth was maintained by port services, telecommunication and financial services.

The country recorded a balance of payment surplus with large inflows to the Government with tsunami aid and increased private remittances. A marginal depreciation of the rupee was recorded for the year. The US Dollar which traded at Rs. 101.19 as at end of 2004 saw a decline to Rs. 100.50 as at end of 2005, an appreciation of 0.68%. Inflation has declined from a high of 13.8% from the beginning of the year to single digit levels of 8% as at end of the year.

Sri Lanka has been rated as one of the best performing stock markets in the World in 2004 and the performance trend continued into 2005 as well.

Interest shown on specific stocks is evident by the bottom up approach of stock selection, particularly by foreign funds, in Dialog, JKH, Hemas Holdings to name a few. We are most bullish on the Telecommunication sector, which has recorded a growth of 53%. This growth is likely to filter to the quoted mobile companies Sri Lanka Telecom and Dialog Telekom Limited. Hence, the Fund will look to accumulate a position in the sector.

Update on 2006

The relative deterioration of the security situation during the second and third quarters of 2006 saw some lull in market activity. Nevertheless, the market recovered with a 24% growth in the All Share Price Index for the first 3 quarters of 2006, following strong corporate earnings and indications of commitment to the peace process. The net asset value per share of the Sri Lanka Fund increased by 14% during the same period, and some key acquisitions were made in the telecommunications and real estate stocks.

Despite the concerns raised among investors initially, the situation is now set to recover with the likelihood of the resumption of peace negotiations. Adding further confidence to the market is the alliance between the two key political parties of the South, with an agreement to work together on the key issues of

peace and economic development. General consensus among the political parties will create the much needed stability to progress on both fronts.

Real GDP growth averaged over 8% in the first half of 2006, stemming from the telecommunications, financial services, fishing, trade and export industry output. Nevertheless, the Sri Lankan economy has felt the repercussions of the global petroleum price hike and increased defence spending, by way of a weakening rupee, rising cost of living and upward pressure on interest rates. Looking towards the future, the commencement of the peace process will create an environment conducive for higher levels of economic activity and restoration of economic fundamentals to the previously healthy levels. The Central Bank forecasts average GDP growth rate for the year to be 7%.

The Managers of The Sri Lanka Fund are of the view that the Colombo Bourse still offers value and hence will look to aggressively accumulate the stocks mentioned. Also the Managers will look to mobilise fresh investment funds and thereby increase the fund size in the coming year. Appropriate intermediaries based in overseas markets will be sourced for this purpose.

Report of the Directors

The Directors hereby submit their annual report together with the audited financial statements of The Sri Lanka Fund (the Fund) for the year ended 31st December 2005.

The Company

The Company is an open-ended investment company, incorporated as an exempt company in the Cayman Islands with limited liability. The Sri Lanka Fund was launched via a prospectus and currently the Fund represents the class A shares of the Company. The articles of the Company permits the creation of new classes of shares to accommodate subordinated funds, though no such subordinated funds have been created as at 31st December 2005.

The Fund's investment objective is to achieve long-term capital growth by investing in a diversified portfolio of equity securities including convertible bonds and warrants listed on the Colombo Stock Exchange and those issued outside Sri Lanka by any Corporation organised in and under the laws of Sri Lanka and which has its shares listed on the Colombo Stock Exchange and equity securities issued by listed investment companies and funds, wherever established, which invest primarily in equity issued by Sri Lankan companies listed on the Colombo Stock Exchange.

Results and Dividends

The results of the Fund for the year ended 31st December 2005 are set out on pages 6 to 18 of the Annual Report. The Directors do not recommend the payment of a dividend for the year ended 31st December 2005.

Share Capital

The details of changes in the issued share capital including subscriptions and redemptions of shares for cash during the year are set out in the statement of changes in ownership equity and Note 3 to the financial statements.

Directors

The Directors during the year and up to the date of this report were:

Don Chandima Rajakaruna
Gunawardena
Palehenalage Chandana
Priyankara Tissera
Adrian John Reginald Collins
Gordon Haig Brough
(Resigned *w.e.f.* 1.8.2006)

Directors' and other Interests

Don Chandima Rajakaruna
Gunawardena and Palehenalage
Chandana Priyankara Tissera
are Directors of Guardian Fund
Management Limited, the
Investment Manager of the
Fund and Carsons Management
Services (Pvt) Limited the Fund's
Administrator.

Apart from the above, as at 31st December 2005, none of the Directors had any interest in the share capital of the Company or any interest in any material contracts or contracts for the provision of services during the year significant to the business of the Company.

All Directors are entitled to an annual fee. However, Don Chandima Rajakaruna Gunawardena and Palehenalage Chandana Priyankara Tissera have waived their Directors' fee for the year.

Auditors

KPMG, retire and being eligible, offer themselves for reappointment. A resolution for the reappointment of KPMG as Auditors of the Company is to be proposed at the forthcoming Annual General Meeting.

By order of the Board

Director

22nd September 2006

Report of the Independent Auditors



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AUDITORS' REPORT TO THE SHAREHOLDERS OF THE SRI LANKA FUND

We have audited the accompanying balance sheet of The Sri Lanka Fund (the "Fund") as of 31 December 2005 and the related statements of income, changes in net assets attributable to holders of redeemable shares and cash flows for the year then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements give a true and fair view of the financial position of the Fund as of 31 December 2005, and of the result of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

A stylized, handwritten signature of the KPMG firm, written in dark ink. The letters are bold and slightly slanted, with a horizontal line extending from the end of the 'G'.

Chartered Accountants

22 September 2006

Income Statement*For the year ended 31st December*

	Note	2005 US\$	2004 US\$
Income			
Bank interest income		–	136
Dividend income		5,530	16,567
Realised gain/(loss) on sale of investments		16,482	(19,815)
Movement in unrealised (diminution)/appreciation in value of investments		381,617	348,829
Foreign exchange losses on investment		(389)	(108,759)
Net Investment Income		403,240	236,958
Expenses			
Investment Manager's fee	6	(12,719)	(8,526)
Custodian's fee	7	(20,000)	(20,055)
Administrator's fee	6	(1,525)	(1,137)
Legal & professional fees		(5,585)	(7,601)
Auditors' remuneration		(8,500)	(7,250)
Directors' remuneration		(10,000)	(10,027)
Sundry expenses		(12,466)	(17,879)
Operating expenses		(70,795)	(72,475)
Changes in net asset attributable to holders of redeemable shares		332,445	164,483

See accompanying notes to the financial statements.

Balance Sheet

<i>As at 31st December</i>		2005	2004
	Note	US\$	US\$
Assets			
Cash & cash equivalents		189	21,902
Equity investments	2, 8	1,045,720	698,734
Prepayments		1,501	3,583
Total assets		1,047,410	724,219
Liabilities			
Accruals & other payables		72,165	52,823
Total liabilities (excluding net assets attributable to holders of redeemable shares)		72,165	52,823
Net assets attributable to holders of redeemable shares		975,245	671,396
Represented by:			
Net assets attributable to holders of redeemable shares based on 492,554 (2004 - 512,554) redeemable shares outstanding	4	975,245	671,396
		975,245	671,396
Net asset value per share	3, 4	1.98	1.31

See accompanying notes to the financial statements.

The financial statements were approved and authorised for issue by the Board of Directors and are signed on their behalf.



D. C. R. Gunawardena
Director



P. C. P. Tissera
Director

22 September 2006

Cash Flow Statement*For the year ended 31st December*

	2005 US\$	2004 US\$
Operating Activities		
Dividend income	5,530	16,567
Interest income	–	136
Operating expenses paid	(49,371)	(56,011)
Cash flows from operating activities	(43,841)	(39,308)
Investing Activities		
Proceeds on sale of investments	50,724	209,572
Payments for purchase of investments	–	(197,516)
Cash Flows from investing activities	50,724	12,056
Financing Activities		
Payment for redemption of redeemable shares	(28,596)	(354)
Cash flows from financing activities	(28,596)	(354)
Net decrease in cash and cash equivalents	(21,713)	(27,606)
Cash and cash equivalents as at 1st January	21,902	49,508
Cash and cash equivalents as at 31st December	189	21,902

See accompanying notes to the financial statements.

Statement of Changes in Net Assets Attributable to Holders of Redeemable Shares

<i>For the year ended 31st December</i>	2005 US\$	2004 US\$ (Restated)
Balance as at 31st December	671,396	507,267
Changes in net assets attributable to		
holders of redeemable shares for the year	332,445	164,483
Redemption of redeemable shares during the year	(28,596)	(354)
Balance as at 31st December	<u>975,245</u>	<u>671,396</u>

See accompanying notes to the financial statements.

Notes to the Financial Statements

1. Significant Accounting Policies

The Sri Lanka Fund (the "Fund") is an open-ended investment company incorporated as an exempt company with limited liability on 21st October 1993 under the Companies Law (Revised) of the Cayman Islands and registered under the Mutual Funds Law on the 26th July 1994.

The objective of the Fund is to provide shareholders with above average returns over the medium to long term through both capital growth and income. The Fund aims to deliver this objective mainly by investing in highly diversified portfolios of equity securities including convertible bonds and warrants listed on the Colombo Stock Exchange and those issued outside Sri Lanka by any corporation organised in and under the laws of Sri Lanka which have their shares listed on the Colombo Stock Exchange, and equity securities issued by listed investment companies and funds, wherever established, which invest primarily in equity issued by Sri Lankan companies listed on the Colombo Stock Exchange. In doing so, it applies techniques more fully defined in the Fund's Offering Memorandum.

The investment activities of the Fund are managed by Guardian Fund Management Limited ("the Investment Manager") and the administration of the Company is delegated to Carsons Management Services (Pvt) Limited. The Registered Office of the Company is located at P.O. Box 309GT, Uglan House, Grand Cayman, Cayman Islands. During the year ended 31st December, 2005, the Fund had no employees.

(a) Statement of Compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) and interpretations adopted by the international Accounting Standards Board (IASB).

(b) Basis of Preparation

The financial statements are presented in United States Dollars. They are prepared on a fair value basis for the financial assets and financial liabilities at fair value through profit or loss. Other financial assets and financial liabilities are stated at amortised cost or redemption amount (redeemable shares).

The preparation of the financial statements in conformity with IFRSs requires management to make judgments, estimates and assumptions that effect the applications of policies and the reported amounts of the assets and liabilities, income and expense. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgments about carrying values of assets and liabilities that are not really apparent from other sources. Actual results may differ from these estimates.

The 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 if the revisions affect only that period, or in the period of the revision and the future period if the revisions affect both current and future periods.

Notes to the Financial Statements (Contd.)

The accounting policies have been applied consistently by the Fund and are consistent with those used in the previous years, except for changes resulting from the amendments to IFRSs. The comparative figures for 2004 have been adjusted or extended to conform to the changes in the presentation in the 2005 financial statements as required by the amended IFRSs.

The Fund adopted the revised version of IFRSs that were effective at 1st January 2005. The changes to the Fund's accounting policies and their effect on the financial statements are in Note 1 (l).

(c) Foreign Currency Translation

Transaction in foreign currencies are translated at the foreign currency exchange rate ruling at the date of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated to United State Dollars at the foreign currency closing exchange rate ruling at the balance sheet date. Foreign currency exchange differences arising on translation and realised gains and losses on disposal or settlements of monetary assets and liabilities are recognised in the income statement. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are translated to United States Dollars at the foreign currency exchange rates ruling at the dates that the values were determined. Foreign currency exchange differences relating to investments at fair value through profit and loss are included in gains or losses on investments. All other foreign currency exchange differences relating to monetary items, including cash and cash equivalents are presented separately in the income statement.

(d) Financial Instruments

(i) Classification

At 1st January 2005, the Fund adopted the amended IAS 32 and IAS 39 and designated all its debt and equity investments into the financial assets at the fair value through profit and loss category. The changes to the Fund's accounting policies as a result of amendments to IAS 32 and IAS 39 and their effect on the financial statements are disclosed in Note 1 (l).

The financial instruments designated at fair value through profit and loss upon initial recognition include equity securities including convertible bonds and warrants. Financial assets and liabilities that are not at fair value through profit or loss include prepayments and accruals and other payables, and financial liabilities arising on redeemable shares.

(ii) Recognition

The Fund recognises financial assets and financial liabilities on the date it becomes a party to the contractual provisions of the instrument.

A regular way purchase of financial assets is recognised using trade accounting. From this date any gains and losses arising from changes in fair value of the financial assets or financial liabilities are recorded.

Financial liabilities are not recognised unless one of the parties has performed or the contract is a derivative contract not exempted from the scope of IAS 39.

Notes to the Financial Statements (Contd.)

(iii) *Measurement*

Financial instruments are measured initially at fair value (transaction price) plus, in case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability.

Transaction costs on financial assets and financial liabilities at the fair value through profit and losses expended immediately, while on other financial instruments they are amortised.

Subsequent to the initial recognition the instruments classified at fair value through profit or loss are measured at the fair value with changes in their fair value recognised in the income statement.

Financial assets and liabilities other than those at fair value through profit or loss, are measured at amortised cost. Financial liabilities arising from the redeemable shares are carried at redemption amount representing the investors' right to a residual interest in the Fund's assets.

(iv) *Fair Value Measurement Principles*

The fair value of financial instruments is based on their quoted market prices at the balance sheet date without any deduction for estimate future selling cost. Financial assets are priced at the current bid prices.

If a quoted market prices are not available on a recognised stock exchange or from a broker/dealer for non-exchange traded financial instruments, the fair value of the instrument is estimated using valuation techniques, including use of recent arm's length market transaction, reference to the current fair value of another instrument which is substantially the same, or discounted cash flow techniques that provides a reliable estimate of prices obtained in actual market transactions.

Where discounted cash flow techniques are used, estimated future cash flows are based on management's best estimates and the discount rate used is a market rate at the balance sheet date applicable for an instrument with similar terms and conditions. Where other pricing models are used, inputs are based on market data at the balance sheet date. Fair values for unquoted equity investments are estimated, if possible, using applicable price/earnings ratio for similar listed companies adjusted to reflect the specific circumstances of the issuer.

(v) *Impairment*

Financial assets that are stated at cost or amortised cost are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. If any such indication exists, an impairment loss is recognised in the income statement as the difference between the assets carrying amount and present value of estimated future cash flows discounted at the financial asset's original effective interest rate.

Notes to the Financial Statements (Contd.)

If in a subsequent period the amount of impairment loss recognised on a financial asset carried at amortised cost decreases and the decrease can be linked objectively to an event occurring after the written-down, the write-down is reverse through the income statement.

(vi) *Derecognition*

The Fund derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire or it transfers the financial asset and the transfer qualifies for derecognition in accordance with IAS 39.

The Fund used weighted average method to determine realised gains and losses on derecognition.

(vii) *Specific Instruments*

Cash and Cash Equivalents

Cash comprised current deposits with banks. Cash equivalents are short-term highly liquid investments that are readily convertible to known amounts of cash, are subject to an insignificant risk of changes in value, and are held for the purpose of meeting short-term cash commitments rather than for investments for other purposes.

(e) *Interest income*

Interest income and expenses are recognised in the income statement as it accrues, using the original effective interest rate of the instruments calculated at the acquisition or origination date. Interest income includes the amortisation of any discount or premium, transaction costs or other differences between the initial carrying amount of an interest-bearing instrument and its amount at maturity calculated on an effective interest rate basis.

(f) *Dividend Income*

Dividend income relating to exchange-traded equity investments is recognised in the income statement on the ex-dividend date.

In some cases, the Fund may receive or choose to receive dividends in the form of additional shares rather than cash. In such cases the Fund recognises the dividend income for the amount of the cash dividend alternative with the corresponding debit treated as an additional investment.

Income distribution from private equity investments and other investment funds are recognised in the income statements as dividend income when declared.

(g) *Expenses*

All expenses, including management fee and custodian fees, are recognised in the income statement on an accrual basis.

Included in sundry expenses are registers fees paid by the Fund, safe custody and bank charges and printing and advertising.

Notes to the Financial Statements (Contd.)

(h) Foreign Exchange Gains and Losses

Foreign exchange gains and losses on financial assets and financial liabilities at fair value through profit or loss are recognised together with other changes in the fair value.

(i) Taxation

Under the current system of taxation in Cayman Islands the Fund is exempt from paying taxes on income, profits or capital gains. The Fund has received an undertaking from Cayman Islands authorities exempting it from income tax for a period of 20 years.

Dividend and interest income received by the Fund may be subject to withholding tax imposed in the country of origin. Investment income is recognised gross of such taxes and the withholding tax is recognised as a finance cost.

(j) Redeemable Shares

All redeemable shares issued by the Fund provide the investors with the right to require redemption for cash at the value proportionate to the investor's share in the Fund's net assets at the redemption date. In accordance with IAS 32 such instruments gave rise to a financial liability for a present value of redemption amount.

(k) Finance Costs (Dividends Payable)

Dividends payable on redeemable shares are recognised in the income statement as finance costs.

(l) Changes in Accounting Policies

In December 2003 and March 2004, the IASB approved amendments to a number of existing standards as a result of the improvements project and issued several new standards. The objectives of the improvements project were to reduce or eliminate alternatives, redundancies and conflicts within the standards, to deal with some convergence issues and to make other improvements.

As part of the improvements project IAS 32 and IAS 39 were significantly amended. As a result, the Fund changed some of its accounting as described below. The amendments became effective on 1st January 2005. No significant changes to the 2004 accounts resulted from these amendments.

Notes to the Financial Statements (Contd.)

2. Equity Investments

As at 31st December

	2005 US\$	2004 US\$
Cost		
Balance at the beginning of the year	1,748,615	1,889,245
Additions during the year	–	197,516
Disposals during the year	(34,631)	(338,146)
Balance at the end of the year	1,713,984	1,748,615
Unrealised diminution in value	(668,264)	(1,049,881)
Fair value (Note 8)	1,045,720	698,734

3. Called up Share Capital

	2005		2004	
	Number of Shares	Amount US\$	Number of Shares	Amount US\$
Authorised				
Founders shares of US\$ 1 each	100	100	100	100
Participating Shares of US\$ 0.01 each	89,990,000	899,900	89,990,000	899,900
	<u>89,990,100</u>	<u>900,000</u>	<u>89,990,100</u>	<u>900,000</u>
Issued and Fully Paid				
Founders shares of US\$ 1 each	100	100	100	100
	<u>100</u>	<u>100</u>	<u>100</u>	<u>100</u>
Participating Shares of US\$ 0.01 each				
At the beginning of the year	512,554	5,125	512,904	5,129
Redeemed during the year	(20,000)	(200)	(350)	(4)
Balance at the end of the year	492,554	4,925	512,554	5,125
Total	<u>492,554</u>	<u>5,025</u>	<u>512,554</u>	<u>5,225</u>

Founder Shares

Founder shares confer upon the holders thereof rights in a winding up or repayment of capital in accordance with Article 129 (2) (b) of the Articles of Association of the Fund but confer no other rights to participate in the profits or assets of the Fund. The holder of a founder share has no right to receive notice of or to attend and vote as a shareholder of the Fund at any General Meeting of the Fund. The issued founder shares are held by Guardian Fund Management Limited, the Investment Manager.

Participating Shares

Participating shares may be redeemed on the first and third Tuesday of the month or such other dates as the Board of Directors shall from time to time determine (Valuation Day) at the net asset value per share. The shareholder must request such redemption at least 14 days prior to the last business day of each month or such other day as the Directors may determine.

Participating shares have the right to receive notice of or to attend and vote as a shareholder of the Fund at any General Meeting of the Fund. Participating shares confer upon the holders of their right of a winding up or repayment of capital in accordance with Articles 129(2)(a),(c),(e),(d) of the Articles of Association of the Fund. They also have the right to share in all profits or assets of the Fund in excess of the value of the issued share capital of the founder shares.

Notes to the Financial Statements (Contd.)

4. Net Asset Value per Redeemable Share

The calculation of Net Asset Value per redeemable share is based on the net asset value attributable to redeemable shareholders of US\$ 975,245 (2004 - US\$ 671,396) and on the total number of 492,554 (2004 - 512,554) redeemable shares in issue at the balance sheet date.

5. Financial Instruments and Associated Risks

Financial assets of the Fund include cash, equity investments and prepayments. Financial liabilities include accruals and other payables.

(a) Market Risk

The Fund's investment activities expose it to various types of market risk, which are associated with the markets in which it invests, to the extent of the amount invested in equity securities. The Fund invests in securities listed on the Colombo Stock Exchange and those issued outside Sri Lanka by any corporation organised in and under the laws of Sri Lanka, and equity securities issued by listed investment companies and funds, wherever established, which invest primarily in equity issued by Sri Lankan companies listed on the Colombo Stock Exchange, which may experience greater volatility than those of Western companies.

(b) Foreign Exchange Risk

The Fund is exposed to foreign exchange risk from its investments and receivables and payables denominated in currencies other than United States Dollars, to the extent of the amount invested for investments, receivables and payables.

(c) Interest Rate Risk

The Fund is exposed to interest rate risk to the extent that changes in interest rates will affect the borrowing costs payable on bank overdrafts and interest income on bank deposits.

(d) Credit Risk

Financial assets which potentially expose the Fund to credit risk consist principally of equity investments and cash balances. Investments in Sri Lanka expose to the risk of illiquidity and volatility. The extent of the Fund's exposure to risk in respect of these financial assets approximates to their carrying value as recorded in the Fund's balance sheet.

The Fund limits its exposure to credit risk by transacting the majority of its securities and contractual commitment activity with broker-dealers, banks and regulated exchanges with high credit ratings that the Fund considers to be well established.

(e) Fair Values of Financial Instruments

Investment securities are carried at market values unless the Directors have determined that a discount is required to arrive at fair value. The Fund's other assets and liabilities include cash and cash equivalents and amounts due on open transactions which normally settle within a few days. The carrying values of these other assets and liabilities approximate their fair values.

Notes to the Financial Statements (Contd.)

6. Related Parties

Investment Manager

The Fund appointed Guardian Fund Management Limited ("GFML"), an investment management company incorporated in Sri Lanka, to implement the investment strategy and to provide administrative services. Under the Investment Management Agreement, the Investment Manager receives a management fee equivalent to 1.5% per annum of the net asset value of the Fund, a fee of 0.5% of the redemption price of each share redeemed, and a performance fee of 20% of any increase in net asset value per share of the Fund in excess of the increase in the US Dollar value performance of the Colombo Stock Exchange's All Share Price Index during the year. No performance fee was payable for the year ended 31st December 2005 (2004 - US\$ Nil). Total management fees for the period ended 31st December 2005 was US\$ 12,719 (2004 - US\$ 8,526).

Administrator

Carsons Management Services (Pvt) Limited ("CMSL"), the present administrator, and a fellow affiliate of GFML, receives an administrative fee of 0.2% of the average weekly net asset value of the Fund until the termination of its administration agreement with the Fund with effect from 1st June 2001. The total administrator's fees paid to CMSL during the year was US\$ 1,525 (2004 - US\$ 1,137).

Directors' Fees

The Directors' fees are disclosed in the income statement.

Messrs. Don Chandima Rajakaruna Gunawardena and Palehenalage Chandana Tissera, Directors of the Fund are Directors of the GFML and CMSL.

7. Custodian

The Custodian is HSBC International Trustee Limited, which receives a fee of 0.15% per annum of the net asset value of the Fund, subject to a minimum annual fee of US\$ 6,000 (2004 - US\$ 6,000). In addition, the Custodian was entitled to an annual administration fee of US\$ 14,000 (2004 - US\$ 14,000).

Investment Portfolio

<i>As at 31st December</i>	2005			2004		
	Holdings	Fair Value US\$	% of Net Assets	Holdings	Fair Value US\$	% of Net Assets
Listed Investments						
Blue Diamonds Jewellery						
Worldwide Limited	135	3	–	90	4	0.00
Aitken Spence Hotel Holdings Limited	8,100	5,395	0.55	8,100	7,100	1.06
Distilleries Company of Sri Lanka	101,100	34,657	3.55	131,000	35,695	5.32
Eden Hotel Lanka Limited	3,000	338	0.04	5,000	836	0.12
John Keells Holdings Limited	150,000	189,887	19.47	150,700	158,366	23.59
Tea Smallholders Factories Limited	–	–	–	900	477	0.07
Tea Plantations Investment Trust Plc	603,569	815,440	83.61	603,569	496,256	73.91
		<u>1,045,720</u>	<u>107.22</u>		<u>698,734</u>	<u>104.07</u>
Unlisted Investments						
Ceyexxe Limited	1,000,000	–	–	1,000,000	–	–
Ceyexxe Plantations Limited	263,500	–	–	263,500	–	–
		<u>1,045,720</u>	<u>107.22</u>		<u>698,734</u>	<u>104.07</u>

MANAGEMENT AND ADMINISTRATION

Registered Office

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Cayman Islands
British West Indies

Investment Manager

Guardian Fund Management Limited
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Colombo 1
Sri Lanka
Corporate Website:
www.carsoncumberbatch.com

Administrator

Carsons Management Services (Pvt) Limited
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Directors

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Gordon Haig Brough
(Resigned w.e.f. 1.8.2006)
19, Victoria Square, London
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Auditors

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Century Yard
Grand Cayman
Cayman Islands

Custodian

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Tortola
British Virgin Islands

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The Landmark
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Hong Kong

Share Registrar

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